



Banco Cooperativo Español, S.A.

Annual Accounts
31 December 2018

Directors' Report
2018

(With Independent 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.
Pº de la Castellana, 259 C
28046 Madrid

Independent Auditor's Report on the 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 ANNUAL ACCOUNTS

Opinion

We have audited the annual accounts of Banco Cooperativo Español, S.A. (the "Company"), which comprise the balance sheet at 31 December 2018, the income statement, the statement of recognised income and expense, the statement of changes in equity and the cash flow statement for the year then ended, and notes.

In our opinion, the accompanying annual accounts give a true and fair view, in all material respects, of the equity and financial position of the Company at 31 December 2018, and of its financial performance and its cash flows for the year then ended in accordance with the applicable financial reporting framework (specified in note 1 to the accompanying annual accounts) and, in particular, with the accounting principles and criteria set forth therein.

Basis for Opinion

We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Annual Accounts* section of our report.

We are independent of the Company in accordance with the ethical requirements, including those regarding independence, that are relevant to our audit of the annual accounts in Spain pursuant to the legislation regulating the audit of accounts. We have not provided any non-audit services, nor have any situations or circumstances arisen which, under the aforementioned regulations, have affected the required independence such that this has been compromised.

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

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in the audit of the annual accounts of the current period. These matters were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



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

Impairment of the loans and advances portfolio
See notes 7 and 10 to the annual accounts

<i>Key audit matter</i>	<i>How the matter was addressed in our audit</i>
<p>To estimate the impairment of financial assets, as of 1 January 2018 the Bank has applied Banco de España Circular 4/2017, which includes relevant amendments in this respect. Consequently, at that date, the Bank estimated the effects of the first-time application of this legislation.</p> <p>The process of estimating the impairment of the loans and advances to customers portfolio due to credit risk entails a significant and complex estimate, especially with regard to the identification and classification of exposures through loans that are under special monitoring or impaired, portfolio segmentation, and the use of significant assumptions such as the realisable value of the collateral associated with credit transactions.</p>	<p>In relation to the Bank’s implementation of Circular 4/2017 with regard to the impairment of financial assets, we performed procedures to assess the concepts, criteria and methodologies defined, and carried out control tests and tests of detail on the Bank’s analysis regarding the credit risk classification of financial instruments and on the estimated provisions for impairment.</p> <p>Our audit approach included assessing the relevant controls linked to the processes of estimating impairment of the loans and advances to customers portfolio and performing different tests of detail on that estimate.</p> <p>Our procedures relating to the control environment were focused on the following key areas: governance, accounting policies, refinancing and restructuring, monitoring of loans outstanding, the process of estimating provisions and assessment of the integrity, accuracy, quality and recency of the data and of the control and management process in place.</p> <p>Our tests of detail on the estimates of impairment of the loans and advances to customers portfolio basically encompassed the following:</p> <ul style="list-style-type: none"> - Impairment of individually significant transactions: we selected a sample from the population of significant risks for which there was objective evidence of impairment and assessed the adequacy of the provisions recognised. - With respect to the impairment provisions estimated collectively, we evaluated the methodology used by the Bank, analysing the integrity of the input balances for the process and validating the correct calculation. <p>Lastly, we evaluated whether the information disclosed in the notes to the annual accounts is appropriate, in accordance with the criteria set out in the financial reporting framework applicable to the Bank.</p>



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Classification and measurement of financial instruments
 See notes 6, 7, 8, 9, 10 and 14 to the annual accounts

<i>Key audit matter</i>	<i>How the matter was addressed in our audit</i>
<p>As of 1 January 2018 the Bank has applied Banco de España Circular 4/2017, which includes relevant amendments in relation to the classification and measurement of financial instruments.</p> <p>Consequently, at that date, the Bank estimated the effects of the first-time application of this legislation.</p> <p>For the purposes of measuring financial instruments, in the absence of a quoted price in an active market (level 2 and 3 financial instruments), determining the fair value of financial instruments requires a complex estimate using valuation techniques that may take into consideration market data that are neither directly nor indirectly observable, or complex pricing models which demand a high degree of subjectivity.</p> <p>Due to the significance of the financial instruments, we consider there to be an inherent risk associated with determining the classification and measurement of these instruments.</p>	<p>In relation to the Bank’s implementation of Circular 4/2017 with regard to the classification of financial instruments, we performed procedures to assess the concepts, criteria and methodologies defined, and carried out control tests and tests of detail on the Bank’s analysis.</p> <p>Our procedures related to the control environment were focused on the following key areas and involved our market risk specialists:</p> <ul style="list-style-type: none"> - Governance: identification of the market risk management framework and controls. - Transaction origination process: assessment of transaction settlement processes and custody at the depository. - Measurement estimation process: assessment of the relevant valuation controls. - Databases: evaluation of the integrity, accuracy, quality and recency of the data and of the control and management process in place. <p>With regard to the tests of detail on the measurement and classification of financial instruments, we selected a sample of the Bank’s financial assets and assessed the appropriateness of their measurement and classification, as well as any impairment recognised at 31 December 2018.</p> <p>Lastly, we evaluated whether the information disclosed in the notes to the annual accounts is appropriate, in accordance with the criteria set out in the financial reporting framework applicable to the Bank.</p>



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Risks associated with information technology	
<i>Key audit matter</i>	<i>How the matter was addressed in our audit</i>
<p>The Bank has a complex technological operating environment. In light of the business's heavy reliance on IT systems, it is critical to evaluate the controls over the main technological risks.</p> <p>The continuity of the Bank's business processes is highly dependent on its technological infrastructure and the controls in place.</p> <p>Employees are granted rights of access to the different systems to enable them to execute their remit and responsibilities. These access rights are relevant, inasmuch as they are designed to ensure that any changes made to the applications are duly authorised and appropriately monitored and implemented, as such, they are key controls aimed at mitigating the potential risk of fraud or error resulting from changes made to applications.</p>	<p>In accordance with our audit methodology, our assessment of the information technology systems encompassed two areas: IT general controls and automated controls over key processes. We were assisted in this task by our IT specialists.</p> <p>Our assessment of IT general controls encompassed the evaluation of general controls in place over technological platforms, notably computer applications. During the audit we performed control tests on the relevant applications associated with the critical areas of our work.</p> <p>In this phase of our evaluation of the general controls we assessed, among others, controls related to the following activities: access to programs and data; management of program changes; management of program development; and management of operations in the production environment.</p> <p>With respect to the automated controls over key processes, during our audit we determined the main business processes, and for those processes we identified the principal applications and automated controls in place for information flows. We analysed the threats and vulnerabilities associated with the integrity, accuracy and availability of information in those processes, and identified and tested the operating effectiveness of the controls implemented to mitigate these risks.</p>

Other Information: Directors' Report

Other information solely comprises the 2018 directors' report, the preparation of which is the responsibility of the Company's Directors and which does not form an integral part of the annual accounts.

Our audit opinion on the annual accounts does not encompass the directors' report. Our responsibility for the directors' report, in accordance with the requirements of prevailing legislation regulating the audit of accounts, consists of assessing and reporting on the consistency of the directors' report with the annual accounts, based on knowledge of the entity obtained during the audit of the aforementioned accounts and without including any information other than that obtained as evidence during the audit. It is also our responsibility to assess and report on whether the content and presentation of the directors' report are in accordance with applicable legislation. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report them.



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Based on the work carried out, as described in the preceding paragraph, the information contained in the directors' report is consistent with that disclosed in the annual accounts for 2018 and the content and presentation of the report are in accordance with applicable legislation.

Directors' and Audit Committee's Responsibility for the Annual Accounts _____

The Directors are responsible for the preparation of the accompanying annual accounts in such a way that they give a true and fair view of the equity, financial position and financial performance of the Company in accordance with the financial reporting framework applicable to the entity in Spain, and for such internal control as they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The audit committee is responsible for overseeing the preparation and presentation of the annual accounts.

Auditor's Responsibilities for the Audit of the Annual Accounts _____

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with prevailing legislation regulating the audit of accounts in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence economic decisions of users taken on the basis of these annual accounts.

As part of an audit in accordance with prevailing legislation regulating the audit of accounts in Spain, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit 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 entity's internal control.



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- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.
- Conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves a true and fair view.

We communicate with the audit committee of Banco Cooperativo Español, S.A. regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the entity's audit committee with a statement that we have complied with the applicable ethical requirements, including those regarding independence, and to communicate with them all matters that may reasonably be thought to bear on our independence and, where applicable, related safeguards.

From the matters communicated to the audit committee of the entity, we determine those that were of most significance in the audit of the annual accounts of the current period and which are therefore the key audit matters.

We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Additional Report to the Audit Committee _____

The opinion expressed in this report is consistent with our additional report to the Company's audit committee dated 29 April 2019.



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Contract Period

We were appointed as auditor by the Shareholders at the Ordinary and Extraordinary General Meeting on 20 June 2018 for a period of one year, from the year commenced 1 January 2018.

Previously, we were appointed for a period of three years, by consensus of the Shareholders at their General Meeting, and have been auditing the annual accounts since the year commenced 1 January 2002.

KPMG Auditores, S.L.

On the Spanish Official Register of Auditors ("ROAC") with No. S0702

(Signed on original in Spanish)

Pedro González Millán

On the Spanish Official Register of Auditors ("ROAC") with No. 20,175

29 April 2019

Banco Cooperativo Español, S.A.
Balance Sheets at 31 December 2018 and 2017

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

ASSETS	NOTE	In thousands of Euros	
		2018 Circular 4/2017	2017 Circular 4/2004 (*)
Cash, cash balances with central banks and other demand deposits	5	1,471,851	742,858
Financial assets held for trading	6	832,370	654,070
Derivatives		804,826	507,121
Equity instruments		1,071	-
Debt securities		26,473	146,949
<i>Memorandum item: loaned or pledged as collateral with the right to sell or pledge</i>		-	31,420
Non-trading financial assets mandatorily at fair value through profit or loss	7	18,491	-
Equity instruments		35	-
Debt securities		4,066	-
Loans and advances		14,390	-
Other debtors		14,390	-
<i>Memorandum item: loaned or pledged as collateral with the right to sell or pledge</i>		-	-
Financial assets designated at fair value through profit or loss	8	197,904	-
Debt securities		197,904	-
<i>Memorandum item: loaned or pledged as collateral with the right to sell or pledge</i>		10,221	-
Financial assets at fair value through other comprehensive income	9	2,286,350	2,293,619
Equity instruments		27,785	23,423
Debt securities		2,258,565	2,270,196
<i>Memorandum item: loaned or pledged as collateral with the right to sell or pledge</i>		764,798	1,632,878
Financial assets at amortised cost	10	3,657,443	3,569,558
Debt securities		1,050,113	77,368
Loans and advances		2,607,330	3,492,190
Credit institutions		1,996,088	1,553,716
Other debtors		611,242	1,938,474
<i>Memorandum item: loaned or pledged as collateral with the right to sell or pledge</i>		341,749	20,829
Derivatives - hedge accounting	16	4	1,907
Investments in subsidiaries, joint ventures and associates	11	7,037	11,256
Subsidiaries		7,037	11,256
Tangible assets	12	1,728	2,013
Fixed assets		1,728	2,013
For own use		1,728	2,013
Intangible assets	13	3,041	2,273
Other intangible assets		3,041	2,273
Tax assets	21	38,332	24,440
Current tax assets		4,051	2,780
Deferred tax assets		34,281	21,660
Other assets	15	15,941	4,095
Other assets		15,941	4,095
TOTAL ASSETS		8,530,492	7,306,089

(*) Figures from the annual accounts prepared under Circular 4/2004 and subsequent amendments, are presented for comparison purposes only

Banco Cooperativo Español, S.A.
Balance Sheets at 31 December 2018 and 2017

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

LIABILITIES	NOTE	In thousands of Euros	
		2018	2017
		Circular 4/2017	Circular 4/2004 (*)
Financial liabilities held for trading	6	853,832	600,586
Derivatives		853,832	568,934
Short positions		-	31,652
Financial liabilities designated at fair value through profit or loss	8	4,731	4,731
Deposits		4,731	4,731
Credit institutions		4,731	4,731
<i>Memorandum item: subordinated liabilities</i>		-	-
Financial liabilities at amortised cost	14	6,920,635	5,983,174
Deposits		6,870,335	5,888,565
Central banks		367,598	370,800
Credit institutions		5,398,425	4,670,359
Other debtors		1,104,312	847,406
Other financial liabilities		50,300	94,609
<i>Memorandum item: subordinated liabilities</i>		-	-
Derivatives - hedge accounting	16	200,147	157,290
Provisions	17	463	196
Commitments and guarantees given		463	196
Tax liabilities	21	11,055	15,607
Current tax liabilities		413	537
Deferred tax liabilities		10,642	15,070
Other liabilities	15	33,680	41,285
TOTAL LIABILITIES		8,024,543	6,802,869

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Banco Cooperativo Español, S.A.
Balance Sheets at 31 December 2018 and 2017

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

EQUITY	NOTE	In thousands of Euros	
		2018 Circular 4/2017	2017 Circular 4/2004 (*)
Shareholders' equity	19	512,279	471,399
Share capital	19.1	115,811	115,811
Paid-in capital		115,811	115,811
Share premium	19.2	85,972	85,972
Retained earnings	20	260,616	233,225
Revaluation reserves	20	157	157
Other reserves	20	(4,260)	(157)
Profit for the year	3	63,983	36,391
(-) Interim dividends	3	(10,000)	-
Accumulated other comprehensive income	18	(6,330)	31,821
Items that will not be reclassified to profit or loss		(2,249)	-
Fair value changes of equity instruments measured at fair value through other comprehensive income		(2,249)	-
Items that may be reclassified to profit or loss		(4,081)	31,821
Hedging derivatives - cash flow hedging reserves [effective portion]		(1,145)	(834)
Fair value changes of debt instruments measured at fair value through other comprehensive income		(2,936)	32,655
TOTAL EQUITY		505,949	503,220
TOTAL LIABILITIES AND EQUITY		8,530,492	7,306,089
 MEMORANDUM ITEM: Off-balance sheet exposures			
Loan commitments given	22	70,420	359,243
Financial guarantees given	22	17,059	32,891
Other commitments given	22	151,462	75,007

(*) Figures from the annual accounts prepared under Circular 4/2004 and subsequent amendments, are presented for comparison purposes only

BANCO COOPERATIVO ESPAÑOL, S.A.

Income Statement for the years ended

31 December 2018 and 2017

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

	NOTE	In thousands of Euros	
		2018	2017
		Circular 4/2017	Circular 4/2004 (*)
Interest income	25.a)	88,045	84,311
Financial assets at fair value through other comprehensive income		6,967	8,523
Financial assets at amortised cost		39,416	33,272
Other interest income		41,662	42,516
(Interest expenses)	25.b)	(33,943)	(29,130)
INTEREST MARGIN		54,102	55,181
Dividend income	26	29,603	3,391
Fee and commission income	27	28,737	20,325
(Fee and commission expenses)	27	(16,703)	(11,377)
Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	28	4,282	7,301
Other financial assets and liabilities		4,282	7,301
Gains or (-) losses on financial assets and liabilities held for trading, net	28	7,917	5,802
Other gains or (-) losses		7,917	5,802
Gains or (-) losses on non-trading financial assets mandatorily at fair value through profit or loss, net	28	(2,474)	-
Other gains or (-) losses		(2,474)	-
Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net	28	47	(31)
Gains or (-) losses from hedge accounting, net	28	(53)	(4)
Exchange differences [gain or (-) loss], net	28	917	943
Other operating income	29	4,090	2,698
(Other operating expenses)	29	(9,554)	(10,368)
GROSS MARGIN		100,911	73,861
(Administrative expenses)	30	(24,706)	(23,280)
(Personnel expenses)		(15,566)	(14,749)
(Other administrative expenses)		(9,140)	(8,531)
(Depreciation and amortisation)	12 and 13	(1,775)	(1,388)
(Provisions) or reversal of provisions	31	(274)	731
(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss and net losses or (-) gains due to modification)	32	3,583	(856)
(Financial assets at fair value through other comprehensive income)		(56)	196
(Financial assets at amortised cost)		3,639	(1,052)
Gains or (-) losses on derecognition of non-financial assets, net		24	-
PROFIT OR (-) LOSS BEFORE TAX FROM CONTINUING OPERATIONS		77,763	49,068
(Tax expense or (-) income related to profit or loss from continuing operations)	21	(13,780)	(12,677)
PROFIT FOR THE YEAR	3	63,983	36,391
EARNINGS PER SHARE (in Euros)			
Basic	3	33.20	18.89
Diluted	3	33.20	18.89

(*) Figures from the annual accounts prepared under Circular 4/2004 and subsequent amendments, are presented for comparison purposes only

Banco Cooperativo Español, S.A.
Statement of Recognised Income and Expense for the years
ended 31 December 2018 and 2017

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

	NOTE	In thousands of Euros	
		2018	2017
		Circular 4/2017	Circular 4/2004 (*)
Profit for the year		63,983	36,391
Other comprehensive income		(17,741)	18,244
Items that will be reclassified to profit or loss		(2,249)	-
Actuarial gains or (-) losses on defined benefit pension plans		-	-
Non-current assets and disposal groups held for sale		-	-
Fair value changes of equity instruments measured at fair value through other comprehensive income		(3,213)	-
Gains or (-) losses from hedge accounting of equity instruments measured at fair value through other comprehensive income, net		-	-
Fair value changes of financial liabilities measured at fair value through profit or loss attributable to changes in credit risk		-	-
Income tax on items that will not be reclassified		964	-
Items that may be reclassified to profit or loss		(15,492)	18,244
Hedge of net investments in foreign operations [effective portion]		-	-
Valuation gains or (-) losses taken to equity		-	-
Transferred to profit or loss		-	-
Other reclassifications		-	-
Foreign currency translation		-	-
Translation gains or (-) losses taken to equity		-	-
Transferred to profit or loss		-	-
Other reclassifications		-	-
Cash flow hedges [effective portion]		(444)	(152)
Valuation gains or (-) losses taken to equity		(444)	(152)
Transferred to profit or loss		-	-
Transferred to the initial carrying amount of hedged items		-	-
Other reclassifications		-	-
Hedging instruments [items not designated]		-	-
Valuation gains or (-) losses taken to equity		-	-
Transferred to profit or loss		-	-
Other reclassifications		-	-
Debt instruments at fair value through other comprehensive income		(21,688)	26,215
Valuation gains or (-) losses taken to equity		(17,411)	33,579
Transferred to profit or loss		(4,277)	(7,364)
Other reclassifications		-	-
Non-current assets and disposal groups held for sale		-	-
Valuation gains or (-) losses taken to equity		-	-
Transferred to profit or loss		-	-
Other reclassifications		-	-
Income tax relating to items that may be reclassified to profit or (-) loss		6,640	(7,819)
Total comprehensive income for the year		46,242	54,635

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Banco Cooperativo Español, S.A.
Cash Flow Statement for the years ended
31 December 2018 and 2017

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

	NOTE	In thousands of Euros	
		2018	2017
		Circular 4/2017	Circular 4/2004 (*)
CASH FLOWS FROM OPERATING ACTIVITIES		1,376,240	18,613
Profit for the year		63,983	36,391
Adjustments to obtain cash flows from operating activities		11,972	14,922
Depreciation and amortisation		1,775	1,388
Other adjustments		10,197	13,524
Net increase in operating assets		80,441	6,768,419
Financial assets held for trading		(178,300)	1,991,665
Non-trading financial assets mandatorily at fair value through profit or loss		(18,491)	-
Financial assets designated at fair value through profit or loss		(197,904)	-
Financial assets at fair value through other comprehensive income		(30,883)	1,432,308
Financial assets at amortised cost		504,115	3,345,514
Other operating assets		1,904	(1,068)
Net increase/(decrease) in operating liabilities		1,233,565	(6,798,001)
Financial liabilities held for trading		253,246	(216,469)
Financial liabilities designated at fair value through profit or loss		-	-
Financial liabilities at amortised cost		937,462	(6,676,252)
Other operating liabilities		42,857	94,720
Income tax paid		(13,721)	(3,118)
CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES		(23,777)	34,067
Payments		(27,996)	(1,970)
Tangible assets		(181)	(453)
Intangible assets		(2,077)	(1,517)
Investments in subsidiaries, joint ventures and associates		-	-
Other business units		-	-
Non-current assets and liabilities classified as held for sale		-	-
Other payments relating to investing activities		(25,738)	-
Collections		4,219	36,037
Tangible assets		-	-
Intangible assets		-	-
Investments in subsidiaries, joint ventures and associates		4,219	-
Other business units		-	-
Non-current assets and liabilities classified as held for sale		-	-
Other collections relating to investing activities		-	36,037
CASH FLOWS FROM (USED) IN FINANCING ACTIVITIES		(35,053)	(5,035)
Payments		(35,053)	(5,035)
Dividends		(23,103)	(127)
Subordinated liabilities		-	-
Redemption of own equity instruments		-	-
Acquisition of own equity instruments		-	-
Other payments relating to financing activities		(11,950)	(4,908)
Collections		-	-
Subordinated liabilities		-	-
Issuance of own equity instruments		-	-
Disposal of own equity instruments		-	-
Other receipts relating to financing activities		-	-
EFFECT OF EXCHANGE RATE FLUCTUATIONS		-	-
NET INCREASE IN CASH AND CASH EQUIVALENTS		1,317,410	47,645
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		154,441	106,796
CASH AND CASH EQUIVALENTS AT PERIOD END		1,471,851	154,441
COMPOSITION OF CASH AND CASH EQUIVALENTS AT YEAR END			
Cash		864	916
Cash equivalents in central banks		425,253	153,525
Other financial assets		1,045,734	-
Less: Bank overdrafts repayable on demand		-	-

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Banco Cooperativo Español, S.A.
Statement of Changes in Equity
for the years ended 31 December 2018 and 2017

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

	(Thousands of Euros)										
	Share capital	Share premium	Equity instruments issued other than capital	Retained earnings	Revaluation reserves	Other reserves	(-) Own shares	Profit for the year	(-) Interim dividends	Accumulated other comprehensive income	Total
Balance at 31 December 2017	115,811	85,972	-	233,225	157	(157)	-	36,391	-	31,821	503,220
Effects of correction of errors	-	-	-	-	-	-	-	-	-	-	-
Effects of changes in accounting policies (see note 1.c)	-	-	-	-	-	(4,199)	-	-	-	(20,410)	(24,609)
Opening balance 1/1/2018	115,811	85,972	-	233,225	157	(4,356)	-	36,391	-	11,411	478,611
Total comprehensive income for the year	-	-	-	-	-	-	-	63,983	-	(17,741)	46,242
Other changes in equity	-	-	-	27,391	-	96	-	(36,391)	(10,000)	-	(18,904)
Issue of other equity instruments	-	-	-	-	-	-	-	-	-	-	-
Purchase of own shares	-	-	-	-	-	-	-	-	-	-	-
Share-based payments	-	-	-	-	-	-	-	-	-	-	-
Dividends (or shareholder remuneration)	-	-	-	-	-	-	-	(9,000)	(10,000)	-	(19,000)
Transfers between equity components	-	-	-	27,391	-	-	-	(27,391)	-	-	-
Other increases or (-) decreases in equity	-	-	-	-	-	96	-	-	-	-	96
Balance at 31 December 2018	115,811	85,972	-	260,616	157	(4,260)	-	63,983	(10,000)	(6,330)	505,949

(*) Figures from the annual accounts prepared under Circular 4/2004 and subsequent amendments, are presented for comparison purposes only. See note 1.c

Banco Cooperativo Español, S.A.
Statement of Changes in Equity
for the years ended 31 December 2018 and 2017

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

(Thousands of Euros)

	Share capital	Share premium	Equity instruments issued other than capital	Retained earnings	Revaluation reserves	Other reserves	(-) Own shares	Profit for the year	(-) Interim dividends	Accumulated other comprehensive income	Total
Balance at 31 December 2016	106,957	85,972	-	201,884	158	(158)	-	40,322	-	13,577	448,712
Effects of correction of errors	-	-	-	-	-	-	-	-	-	-	-
Effects of changes in accounting policies	-	-	-	-	-	-	-	-	-	-	-
Opening balance 1/1/2017	106,957	85,972	-	201,884	158	(158)	-	40,322	-	13,577	448,712
Total comprehensive income for the year	-	-	-	-	-	-	-	36,391	-	18,244	54,635
Other changes in equity	8,854	-	-	31,341	(1)	1	-	(40,322)	-	-	(127)
Issue of other equity instruments	8,854	-	-	(8,854)	-	-	-	-	-	-	-
Purchase of own shares	-	-	-	-	-	-	-	-	-	-	-
Share-based payments	-	-	-	-	-	-	-	-	-	-	-
Dividends (or shareholder remuneration)	-	-	-	(127)	-	-	-	-	-	-	(127)
Transfers between equity components	-	-	-	40,322	(1)	1	-	(40,322)	-	-	-
Other increases or (-) decreases in equity	-	-	-	-	-	-	-	-	-	-	-
Balance at 31 December 2017	115,811	85,972	-	233,225	157	(157)	-	36,391	-	31,821	503,220

(*) Figures from the annual accounts prepared under Circular 4/2004 and subsequent amendments, are presented for comparison purposes only. See note 1.

Banco Cooperativo Español, S.A.

Notes to the annual accounts for the year ended 31 December 2018

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

1. Introduction, basis of presentation 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 and operates from its office located at Calle Virgen de los Peligros No. 4, in Madrid.

At 31 December 2018, the Bank forms part of the Grucajrrural Group (hereinafter the Group), the parent of which is Grucajrrural Inversiones, S.L. Until 31 December 2017, the Bank was the parent of a group of financial institutions whose activity it controlled directly or indirectly, and together with which it formed the Banco Cooperativo Español Group, which is currently a financial sub-group of the Grucajrrural Group.

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

b) Basis of Presentation of the Annual Accounts

The accompanying annual accounts for 2018 have been prepared in accordance with Banco de España Circular 4/2017 of 27 November 2017 and other provisions of the financial reporting framework applicable to the Bank, to give a true and fair view of the equity and financial position of the Bank at 31 December 2018 and the results of its operations and its cash flows for the year then ended.

Banco de España Circular 4/2017 to credit institutions on public and confidential financial reporting rules and formats came into force on 1 January 2018. The publication of Circular 4/2017 brought Circular 4/2004 and subsequent amendments thereto up to date. The purpose of this Circular is to adapt the accounting regime of Spanish credit institutions to the changes in European accounting legislation derived from the adoption of two new International Financial Reporting Standards (IFRS), namely IFRS 15 Revenue from Contracts with Customers and IFRS 9 Financial Instruments.

The Bank has opted to present separate statements, one reflecting the components of profit or loss, entitled the "income statement", and another reflecting the components of other comprehensive income for the year, based on profit or loss for the year, entitled the "statement of recognised income and expense", using the name given by Banco de España Circular 4/2017.

The Bank's annual accounts have been prepared by the Entity's Board of Directors to give a true and fair view of the equity and financial position at 31 December 2018 and the results of its operations and its cash flows for the year then ended.

The annual accounts have been prepared on the basis of the individual accounting records of the Entity. The Board of Directors considers that the annual accounts for 2018 will be approved by the Shareholders at the annual General Meeting without significant changes.

The annual accounts for 2017 were approved by the Shareholders at the annual General Meeting held on 20 June 2018.

c) First-time application of Circular 4/2017 and opening balance sheet at 1 January 2018

As mentioned in section b) of this note, Circular 4/2017 came into force on 1 January 2018 and replaces Circular 4/2004 as regards the classification and measurement of financial assets and liabilities, impairment of financial assets and hedge accounting.

The entry into force of this legislation has had a significant impact on the financial statements of the Bank at that date. The effects of first-time application of Circular 4/2017 are detailed below:

ASSETS	Thousands of Euros			
	31.12.2017	Classification of		Opening balance
	Circular 4/2014	financial instruments	Impairment	sheet 01.01.2018 Circular 4/2017
Cash, cash balances with central banks and other demand deposits	742,858	-	-	742,858
Financial assets held for trading	654,070	(123,706)	-	530,364
Non-trading financial assets mandatorily at fair value through profit or loss	-	27,588	1,278	28,866
Financial assets at fair value through profit or loss	-	123,706	-	123,706
Financial assets at fair value through other comprehensive income	-	1,652,350	(29,589)	1,622,761
Available-for-sale financial assets	2,293,619	(2,293,619)	-	-
Financial assets at amortised cost	3,505,709	671,064	(314)	4,176,459
Held-to-maturity investments	63,849	(63,849)	-	-
Derivatives - hedge accounting	1,907	-	-	1,907
Investments in joint ventures and associates	11,256	-	-	11,256
Tangible assets	2,013	-	-	2,013
Intangible assets	2,273	-	-	2,273
Tax assets	24,440	1,940	(139)	26,241
Other assets	4,095	-	-	4,095
TOTAL ASSETS	7,306,089	(4,526)	(28,764)	7,272,799

The differences recognised in “Available-for-sale financial assets” are primarily due to classification under “Financial assets at fair value through other comprehensive income” and “Financial assets at amortised cost”.

Thousands of Euros				
LIABILITIES AND EQUITY	31.12.2017 Circular 4/2014	Classification of financial instruments	Impairment	Opening balance sheet 01.01.2018 Circular 4/2017
Financial liabilities held for trading	600,586	-	-	600,586
Financial liabilities designated at fair value through profit or loss	4,731	-	-	4,731
Financial liabilities at amortised cost	5,983,174	-	-	5,983,174
Derivatives - hedge accounting	157,290	-	-	157,290
Provisions	196	-	66	262
Tax liabilities	15,607	-	(8,747)	6,860
Other liabilities	41,285	-	-	41,285
TOTAL LIABILITIES	6,802,869	-	(8,681)	6,794,188
SHAREHOLDERS' EQUITY				
Capital	115,811	-	-	115,811
Share premium	85,972	-	-	85,972
Retained earnings	233,225	-	-	233,225
Revaluation reserves	157	-	-	157
Other reserves	(157)	(4,526)	327	(4,356)
Profit for the year	36,391	-	-	36,391
ACCUMULATED OTHER COMPREHENSIVE INCOME	31,821	-	(20,410)	11,411
TOTAL EQUITY	503,220	(4,526)	(20,083)	478,611
TOTAL LIABILITIES AND EQUITY	7,306,089	(4,526)	(28,764)	7,272,799

d) Significant accounting principles

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

However, the operations of the Entity and the rest of the Grucajrural Inversiones, S.L. Group in 2018 (the Banco Cooperativo Español, S.A. Group in 2017) are managed on a consolidated basis, irrespective of the individual allocation of the corresponding assets and liabilities. Consequently, the individual annual accounts of Banco Cooperativo Español, S.A. at 31 December 2018 and 2017 do not reflect changes in equity resulting from the application of consolidation or equity accounting criteria, as applicable, to financial investments corresponding to subsidiaries, or transactions carried out within the Group, which are reflected in the consolidated annual accounts.

At 31 December 2018 the effect of consolidation with respect to these individual annual accounts is an increase of Euros 3,134,158 thousand in assets and Euros 341,511 thousand in Shareholders' equity (Euros 35,829 thousand and Euros 31,961 thousand, respectively, at 31 December 2017), and a decrease of Euros 14,375 thousand in consolidated profit for 2018 (an increase of Euros 953 thousand in consolidated profit at 31 December 2017), with consolidated profit for the year attributable to the Group amounting to Euros 49,608 thousand (Euros 37,344 thousand at 31 December 2017).

e) Responsibility for information and estimates

The information contained in the annual accounts of Banco Cooperativo Español, S.A. is the responsibility of the Directors of the Entity.

The Bank's annual accounts for 2018 and 2017 include estimates made by Senior Management, which were later ratified by the Directors, to quantify certain assets, liabilities, income, expenses and commitments reported herein. These estimates basically refer to the following:

- Impairment losses on certain assets (see notes 9 and 10).
- The assumptions used in the actuarial calculation of post-employment benefit liabilities and commitments (see note 2 (r)).
- The useful lives of tangible and intangible assets (see notes 12 and 13).
- The fair value of certain financial assets not quoted on organised markets (see notes 6, 7, 8 and 9).
- Estimates used in the calculation of other provisions (see note 17).
- The calculation of income tax and deferred tax assets and liabilities (see note 21).

The above-mentioned estimates are based on the best information available at 31 December 2018 regarding the events analysed. However, future events may require these estimates to be significantly increased or decreased in subsequent years. Any such changes would be applied prospectively in accordance with the provisions of Banco de España Circular 4/2017, recognising the effects of the change in estimates in the related income statement.

f) Comparative information

The information at 31 December 2017 contained in these annual accounts is presented solely for the purpose of comparison with the information at 31 December 2018, and therefore does not constitute the Bank's annual accounts for 2017.

Circular 4/2017 came into force as of 1 January 2018 and includes amendments to the requirements for the classification and measurement of financial assets and liabilities, hedge accounting and impairment of financial assets (see notes 2.c), d) and e)). The effects of first-time application are presented in note 1.c).

Therefore, certain changes have been made to the comparative information for 2017 disclosed in these annual accounts to present it in a manner consistent with that for 2018. Presentation of the financial statements in these new formats does not have a significant impact with respect to the format applied in the financial statements included in the annual accounts for the year ended 31 December 2017.

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, and 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, came into force on 1 January 2014. These two sets of legislation constitute the transposition to European regulations of the new Basel III (BIS III) solvency framework, and regulate solvency levels and the composition of eligible capital with which credit institutions must operate.

On 5 February 2014, the Official State Gazette (“BOE”) published Banco de España 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 aimed to establish which of the EU 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 the same year, Law 10/2014 of 26 June 2014 on the organisation, supervision and solvency of credit institutions was published, 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.

The next step in this legislative process was the publication of Royal Decree 84/2015 of 13 February 2015, developing Law 10/2014. The purpose of this Royal Decree is 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 duly adapted content 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, were combined in a single text.

Furthermore, 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. In addition, 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.

Finally, on 2 November 2017, the Official State Gazette (“BOE”) published Banco de España Circular 3/2017 of 24 October 2017, which amends Circular 2/2014, bringing the content thereof into line with the guidelines issued by the European Central Bank under the framework of prudential supervision of credit institutions and availing of the permanent and transitional options attributed to the pertinent authorities by Regulation (EU) No 575/2013.

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

The minimum solvency ratio under the current regulations is calculated as the eligible capital held by the Banco Cooperativo Español, S.A. Group divided by its risk-weighted assets. The highest quality capital is known as CET1 (Common Equity Tier 1 capital) and essentially comprises capital and reserves, from which several items are deducted, mainly intangible assets and a certain amount of investments in financial sector entities, as well as deferred tax assets that rely on future profitability.

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

Lastly, T2 (Tier 2 capital) comprises loss-absorbing instruments, only ranking behind Tier 1 capital but subordinate to ordinary creditors, as well as provision surpluses eligible as Tier 2 capital under Regulation (EU) No. 575/2013.

Further details of the characteristics of these instruments with regard to their ability to absorb losses, availability, term and order of priority in the event of liquidation are set out in the Report on Information Relevant to the Principle of Prudence, which is available on the Bank's corporate website. This report also contains a reconciliation of own funds as per the accounts and eligible capital.

Risk-weighted assets are determined according to the Banco Cooperativo Español, S.A. 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 risk, position and settlement risk relating to items held for trading, currency risk and gold position risk (based on the global net position in foreign currency and the net position in gold), operational risk, and so-called credit valuation adjustment (CVA) risk.

This legislation imposes more stringent capital requirements on institutions, including the following:

- It sets minimum requirements (Pillar 1), establishing three levels of capital: Common Equity Tier 1 capital, Tier 1 capital and total capital, for which minimum ratios of 4.5%, 6% and 8%, respectively, are demanded.
- A capital conservation buffer and a countercyclical capital buffer. Following on from the Basel III regulatory framework, and with a view to mitigating the procyclical effects of financial regulations, it includes the obligation to maintain a capital conservation buffer of 2.5% of Common Equity Tier 1 capital for all financial institutions and a countercyclical capital buffer specific to each institution based on Common Equity Tier 1 capital.

- A systemic risk buffer and a systemically important institutions buffer, the latter being applicable to institutions that are systemically important on a worldwide scale as well as other systemically important institutions, for the purpose of mitigating existing systemic or macroprudential risks, in order to protect the financial system from shocks that could have serious adverse consequences within the system and in the real economy of a Member State.
- In addition, specific tasks are conferred upon the European Central Bank with respect to the policies on prudential supervision of credit institutions. The regulation allows the pertinent authorities to impose capital requirements in addition to the minimum capital requirements under Pillar 1, so as to mitigate risks not covered by the latter. These are known as Pillar 2 capital requirements.
- The requirement for financial institutions to calculate a leverage ratio, defined as an institution's Tier 1 capital divided by its total non-risk-adjusted exposure, which aims to prevent institutions from holding assets in a proportion that is excessive with respect to their level of capital. Until this takes effect, presumably enforcing a minimum requirement of 3%, since 2015 this information has been made available to the public.

To prevent an excessive impact on the real economy due to solvency bolstering, certain aspects of the regulations are being phased in over a period of several years. This transitional implementation phase, which is now close to completion, 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.

Within this context, and pursuant to article 68.2.a) of Law 10/2014, following the Supervisory Review and Evaluation Process (SREP) carried out by the pertinent authority, Banco de España has announced its decision regarding the prudential capital requirements applicable to the Banco Cooperativo Español Group. This decision requires the Group to maintain a total phase-in capital ratio of no less than 9.39% of the amount of its total risk exposure from 1 January 2019 onwards (9.41% in 2018), to which the capital buffers – which in 2019 stood at 2.50% of total risk exposure (1.875% in 2018) – should be added. In addition to this quantitative minimum capital ratio requirement, a qualitative requirement (composition of capital) demands that the Group maintain a CET 1 capital ratio of no less than 5.89% and a Tier 1 capital ratio of 7.39% or more. The buffers should also be covered by CET 1 capital.

The principle established by the Directors of the Banco Cooperativo Español, S.A. Group's Parent for managing capital consists of operating at a level of solvency above that stipulated in the applicable regulations, and which is appropriate for 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 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 Entity 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 the Group's decisions on its eligible capital and the risk-return ratio is 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 and liquidity self-assessment process in place. This process comprises a set of solid, comprehensive strategies and procedures that, inter alia, 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 exposed, 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 additional capital, should this prove necessary. To that end, once the Group has calculated its minimum capital 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 of the risks while maintaining an adequate buffer with respect to the regulatory minimum capital 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 the composition and distribution among the various legally separate entities, and is formally recorded in the following documents (subject to review at least once a year), which have been approved by the boards of Directors of the Bank and of the Group's Parent:

- Risk Appetite Framework, which defines the Group's appetite vis-à-vis the risks it is prepared to assume in conducting its activity. Besides the capital and leverage targets, this document determines the risk tolerance, i.e. the maximum deviation from the targets defined that the Group considers acceptable.
- Capital Contingency Plan, which outlines the plan of action with respect to potential adverse effects in the event of a capital shortfall, when capital falls below the threshold stipulated in the Risk Appetite Framework. The Capital Contingency Plan aims to facilitate the return to a robust capital position within the Group in the event of a potential moderate crisis wherein the threshold is surpassed. In this respect, the Board of Directors of the Bank and/or of the Group's Parent considers the application of extraordinary measures that would enable the desired levels to be recovered.
- Recovery Plan, which sets the solvency and leverage indicator levels below the Group's risk tolerance before the occurrence of any possible regulatory non-compliance, which would entail the implementation of corrective measures for crisis situations. The plan also defines the range of measures and the enforceability of each one.

The Bank's capital at 31 December 2018 and 2017 and the related capital ratios are shown in the following table:

	Thousands of Euros	
	2018	2017
Capital	115,811	115,811
Reserves and other	385,018	381,888
Deductions	(3,040)	(2,290)
Common Equity Tier 1 (CET 1) capital	497,789	495,409
Additional Tier 1 items	-	-
Tier 1 capital	497,789	495,409
Collective provision	-	10,761
Tier 2 capital	-	10,761
Total eligible capital	497,789	506,170
Credit, counterparty, dilution and delivery risk	97,792	106,152
Price, currency and commodity position risk	13,165	15,987
Operational and other risks	19,844	35,442
Total capital requirement	130,801	157,581
Surplus	366,988	348,588
Capital ratio (%)	30.5	25.7
Tier 1 capital (%)	30.5	25.2

At 31 December 2018 and 2017, and during both years, the Bank's eligible capital exceeded the requirements of the regulations and of the pertinent authority availing of its powers of supervision of credit institutions.

A reconciliation of the Group's regulatory capital and its book equity is as follows:

	Thousands of Euros			
	2018		2017	
	Regulatory capital	Book equity	Regulatory capital	Book equity
Capital	201,783	201,783	115,811	115,811
Reserves	256,513	256,513	350,198	350,198
Profit for the year	48,159	53,983	28,344	37,344
Valuation adjustments	(5,185)	(6,330)	32,663	31,828
Deductions	(3,481)	-	(2,290)	-
Temporary adjustments	-	-	(29,317)	-
Common Equity Tier 1 (CET 1) capital	497,789	505,949	495,409	535,181

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 DGFICI). In 2018 and 2017 the expense incurred for ordinary, additional and extraordinary contributions to this fund amounted to Euros 94 thousand and Euros 72 thousand, respectively, and was recognised under “Other operating expenses” in the accompanying 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 service 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 DGFICI, 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 DGFICI.

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.

Commission Delegated Regulation (EU) 2015/63 developed a standard methodology for calculating contributions to the SRF. The contributions are made annually and the amount payable by each institution is 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 was 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).

The expense recognised by the Bank in 2015 in respect of contributions amounted to Euros 8,826 thousand.

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 rejected the Bank's requests, thereby requiring it to include the liabilities between the Bank and the rural savings banks, which were reported for the purposes of calculating contributions to the NRF.

On 29 January 2016 the Bank filed an appeal for judicial review with the Spanish High Court 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. The Spanish High Court rejected the appeal in a judgment handed down on 10 May 2017. A cassation appeal was lodged with the Supreme Court in respect of this judgment. This was upheld in a writ dated 12 December 2017, and the cassation appeal was formally filed on 1 February 2018. At the date of these annual accounts the Supreme Court has confirmed, by means of a writ issued on 7 March 2019, its decision adopted in an interlocutory order dated 28 January 2019 to suspend resolution of the cassation appeal until the preliminary proceedings taken to the Court of Justice of the European Union (CJEU), set forth in case ICCREA Banca C-414/18, are resolved.

Single Resolution Fund

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 2018, the Bank's contribution amounted to Euros 6,198 thousand, of which Euros 5,291 thousand was recognised under "Other operating expenses" in the accompanying income statement and Euros 907 thousand took the form of an irrevocable commitment. In 2017, the Bank's contribution amounted to Euros 7,705 thousand and was recognised in "Other operating expenses" in the accompanying income statement.

On 11 December 2015, the FROB notified the Bank in writing that in view of the Single Resolution Fund (SRF) coming into operation 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 Bank informed the SRB in writing of the items and balances vis-à-vis its shareholder rural savings banks which the Bank 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 Bank received notice, through the FROB, of the SRB's decision in relation to the Bank's ex ante contribution to the SRF for 2016, which amounted to Euros 8,857 thousand.

As balances whose elimination was requested in the Bank's written request of 1 February 2016 were not taken into account in calculating this contribution, the Bank, on 29 June 2016, 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. The hearing before the General Court took place on 27 February 2019, and at the date of these annual accounts that Court has yet to hand down its resolution on the appeal.

Likewise, the Bank 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 Bank in 2015 and 2016. At the date of these annual accounts, a resolution is also pending on these appeals for judicial review.

i) Minimum reserve ratio

At 31 December 2018, and throughout 2018 period, the Bank complied with the minimum reserve ratio stipulated in applicable Spanish legislation, based on Regulation (EC) No 1745/2003 of 12 September 2003.

j) Environmental impact

In light of its activity, the Entity does not have any liabilities, expenses, assets, provisions or contingencies of an environmental nature that could be significant with respect to its equity, financial position or financial performance. Therefore, no specific disclosures relating to environmental issues are included in the notes to the accompanying annual accounts.

k) Institutional protection scheme

On 29 December 2017 the rural savings banks affiliated with the Spanish Association of Rural Savings Banks (hereinafter the Savings Banks) entered into a Framework Agreement with the aforementioned Association, the Bank's Parent (Grucajrural Inversiones, S.L.) and the Bank, the purpose of which was to set up a "cooperative institutional protection scheme" (hereinafter IPS) within the Caja Rural Group, as well as certain other arrangements. These agreements envisaged, among others, the following milestones:

- Promote the advancement of the statutory and conventional framework of the Association, so as to modernise and reinforce it, replacing the support mechanisms currently in place with an institutional protection scheme (IPS) as envisaged in article 113.7 of Regulation (EU) No 575/2013 (CRR). The IPS shall be formed by the 29 Savings Banks affiliated with the Association at the date of the Framework Agreement, Grucajrural Inversiones, S.L. and Banco Cooperativo Español, S.A. (hereinafter the IPS members).
- Constitute a fund to provide any financial support that may be addressed through the IPS, which shall be sustained by contributions from the IPS members. This fund shall be administered and controlled by the Association, directly or indirectly, through one or more vehicles.

On 1 March 2018 the Spanish Association of Rural Savings Banks ("AECR") held its general assembly, during which all of the affiliated Savings Banks approved the creation of the IPS. To this end, they also approved the AECR's new statutes, the IPS regulation, the IPS disciplinary regime, certain technical notes relating to measurement of the solvency and liquidity of the IPS members, the general risk policy, and a new agreement regulating economic relations within the Caja Rural Group.

For the purposes envisaged in (i) article 113.7 of the CRR and (ii) in the legislation regulating contributions to the Deposit Guarantee Fund, Banco de España acknowledged the IPS as an institutional protection scheme meeting the definition provided in article 113.7 of the CRR on 23 March 2018.

Creation of the aforementioned IPS required recognition of the commitment undertaken to constitute the fund created to provide any financial support that may be addressed through the IPS. This entailed an expense of Euros 4,000 thousand for 2018 (Euros 2,400 thousand in 2017), which has been recorded in “Other operating expenses” in the accompanying income statement.

l) Late payments to suppliers. “Reporting requirement”, additional provision three of Law 15/2010 of 5 July 2010

Pursuant to Law 15/2010 of 5 July 2010, which amends Law 3/2004 of 29 December 2004 containing measures to combat late payments in commercial transactions, as developed by the Spanish Accounting and Auditing Institute (ICAC) resolution of 29 January 2016 on disclosures in the notes to the annual accounts on the average supplier payment period in commercial transactions.

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

	<u>2018</u>	<u>2017</u>
	<u>Days</u>	
Average supplier payment period	29.8	30.7
Transactions paid ratio	28.5	30.7
Transactions payable ratio	31.6	29.6
	<u>Thousands of Euros</u>	
Total payments made	44,613	37,160
Total payments outstanding	2,634	2,091

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

The “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.

m) Seasonal nature of income and expenses

The most significant operations conducted by the Bank are fundamentally the activities typically befitting financial institutions. Therefore, its operations are not significantly affected by seasonal factors within the year.

n) Events after the reporting period

Irrespective of the matters mentioned in these notes to the annual accounts, no significant events occurred between 31 December 2018 and the date on which the Board of Directors of the Bank draw-up the annual accounts, which need to be included in the annual accounts in order to give a true and fair view of the equity, financial position and financial performance of the Bank.

2. Significant Accounting Policies

The following accounting policies and measurement criteria have been applied in the preparation of the annual accounts:

a) Going concern

The Bank has prepared these annual accounts for 2018 on a going concern basis.

b) Accruals principle

The accompanying annual accounts, except for the cash flow statement, have been prepared on an accruals basis, irrespective of collections and payments.

c) Financial instruments

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

I. Initial recognition of financial instruments

Financial instruments are initially recognised in the balance sheet when the Bank becomes party to the contract that generates them, in accordance with the terms therein. Specifically, debt instruments such as loans and cash deposits are recognised from the date that a legal right to receive or a legal obligation to pay cash arises, respectively. Derivatives are generally recognised from the trade date.

A regular way purchase or sale of financial assets, defined as one in which the parties' reciprocal obligations must be discharged within a time frame established by regulation or convention in the marketplace and that may not be settled net, such as stock market contracts or forward currency sale and purchase contracts, are recognised on the date from which the rewards, risks, rights and duties attaching to all owners are for the purchaser, which, depending on the type of financial asset purchased or sold, may be the trade date or the settlement or delivery date. In particular, cash transactions in currency markets are recognised at the settlement date; equity instruments traded on Spanish secondary securities markets are recognised at the trade date, and debt securities traded on Spanish secondary securities markets are recognised at the settlement date.

II. Derecognition of financial instruments

A financial asset is derecognised from the balance sheet when any of the following circumstances arise:

- The contractual rights over the cash flows have expired; or
- The financial asset and substantially all the risks and rewards associated therewith are transferred, or although these are neither substantially transferred nor retained, control over the financial asset is transferred.

A financial liability is derecognised from the balance sheet when the obligations arising therefrom have expired or when it is redeemed by the Bank with the intention either to resell it or to cancel it.

III. Fair value and amortised cost of financial instruments

The fair value of a financial instrument on a given date is taken to be the amount for which it could be bought or sold on that date by 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 risks associated with it.

In particular, the fair value of derivatives traded on an organised, transparent and deep market included in the trading portfolios is equivalent to their daily quotation price and if, for exceptional reasons, the quotation price on a given date cannot 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, or others.

Amortised cost is understood to be the acquisition cost of a financial asset or liability plus or minus, as appropriate, the principal and interest repayments, and plus or minus, as appropriate, the cumulative amortisation (as reflected in the income statement), using the effective interest method, of the difference between the initial cost and the maturity amount of these financial instruments. The amortised cost of financial assets also includes any impairment losses.

The effective interest rate is the discount rate that exactly matches the initial value of a financial instrument to all of its estimated cash flows for all items over its remaining life. For fixed rate financial instruments, the effective interest rate is the same as the contractual interest rate established on the acquisition date, adjusted, where applicable, to reflect the fees and transaction costs that should be included in the calculation of the effective interest rate in accordance with Banco de España Circular 4/2017. For variable interest financial instruments, the effective interest rate is calculated in a manner similar to that for fixed interest financial instruments, and is recalculated at each date of review of the contractual rate, taking into account any changes in future cash flows from the transaction.

A summary of the different valuation techniques used by the Bank to measure financial instruments categorised as "Financial assets held for trading", "Non-trading financial assets mandatorily at fair value through profit or loss", "Financial assets designated at fair value through profit or loss", "Financial assets at fair value through other comprehensive income" and "Derivatives – Hedge accounting" under balance sheet assets, and "Financial liabilities held for trading", "Financial liabilities designated at fair value through profit or loss" and "Derivatives – Hedge accounting", under balance sheet liabilities, at 31 December 2018 and 2017 is as follows:

	%			
	2018		2017	
	Assets	Liabilities	Assets	Liabilities
Quoted price in active markets	75.0	-	79.0	5.3
Internal valuation models	25.0	100.0	21.0	94.7
	100.0	100.0	100.0	100.0

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

- The present value method is used to measure financial instruments that 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 an entity's own credit 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 the financial assets and financial liabilities in the balance sheet and gains and losses on these financial instruments are reasonable and reflect their market value (see note 24).

IV. Classification and measurement of financial assets and financial liabilities

Circular 4/2017 includes three main categories for the classification of financial assets: measured at amortised cost, at fair value through other comprehensive income and at fair value through profit or loss.

- A financial asset shall be measured at amortised cost if both of the following conditions are met:
 - The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows; and
 - The contractual terms of the financial asset give rise to cash flows that are solely payments of principal and interest, the latter basically being consideration for the time value of money and the credit risk associated with the borrower.
- A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:
 - The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
 - The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
- A financial asset shall be classified as mandatorily at fair value through profit or loss when it is not held in either of the two preceding portfolios, in view of the business model under which it is managed or the characteristics of its contractual cash flows.

Within the portfolio of financial assets mandatorily at fair value through profit or loss, financial assets held for trading shall include all assets that meet any of the following characteristics:

- They are originated or acquired with the purpose of selling them in the near term.
- They are part of a group of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit taking.
- They are derivatives that do not meet the definition of a financial guarantee contract and have not been designated as hedging instruments.

However, an entity may make an irrevocable election at initial recognition to include investments in equity instruments that should not be classified as held for trading and which would be classified as financial assets mandatorily at fair value through profit or loss in the portfolio of financial assets at fair value through other comprehensive income. This election shall be made on an instrument-by-instrument basis.

Similarly, an entity may, at initial recognition, irrevocably designate a financial asset as measured at fair value through profit or loss if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

Business model for managing financial assets

In relation to the foregoing, 'business model' refers to how an entity manages its financial assets in order to generate cash flows. In particular, the business model may entail holding the financial assets with the objective of collecting contractual cash flows therefrom, selling the assets, or both.

The business model is determined considering how groups of financial assets are managed together to achieve a particular business objective. In other words, the business model does not depend on the Entity's intentions for an individual instrument, but rather should be determined for a group of instruments.

Characteristics of contractual cash flows of the financial assets

Similarly, a financial asset should be classified at initial recognition in one of the following categories, depending on the characteristics of its contractual cash flows:

- a) Financial assets whose contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.
- b) Other financial assets.

All financial assets are initially recognised at fair value plus, in the case of financial instruments not classified at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset.

Except in the case of trading derivatives that are not financial hedges or hedge accounting, all changes in value of financial assets due to the accrual of interest and similar items are recognised as "Interest income" in the income statement for the period in which such amounts were accrued. Dividends received from companies other than subsidiaries, joint ventures or associates are recognised as "Dividend income" in the income statement for the period in which the right to receive them is established.

Changes in value subsequent to initial recognition due to reasons other than those mentioned in the preceding paragraph are treated as described below, based on the category in which the financial assets have been classified.

- Financial assets included in the financial assets at amortised cost category are measured at amortised cost. Amortised cost is the amount at which the financial instrument was initially measured, minus principal repayments, plus or minus the cumulative amortisation (as reflected in the income statement by the effective interest method) of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.
- Financial assets recorded in the financial assets at fair value through other comprehensive income category are measured at fair value. Subsequent gains or losses on this measurement are temporarily recognised (net of any tax effect) under "Accumulated other comprehensive income" on the balance sheet. The amounts recognised in this line item remain in the Entity's equity until the asset giving rise to them is derecognised, or until the financial instrument is considered to be impaired.

When a debt instrument at fair value through other comprehensive income is derecognised, the cumulative gain or loss in equity is reclassified to profit or loss for the period, under “Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net” in the income statement. However, when an equity instrument at fair value through other comprehensive income is derecognised, the gain or loss recognised in accumulated other comprehensive income is not reclassified to profit or loss, but instead to reserves.

Financial assets that are equity instruments whose fair value cannot be reliably measured and derivatives that have those instruments as their underlying and are settled by delivery of those instruments, are measured at cost, net of any impairment, calculated using the criteria described.

- Subsequent to their acquisition, financial assets categorised at fair value through profit or loss are measured at fair value. Changes in fair value are recognised directly in the income statement, distinguishing, for non-derivative instruments, between the part attributed to accrued returns of the instrument, which is recorded as interest or as dividends depending on its nature, and the rest, which is recognised as gains or losses on financial transactions. Interest accrued on debt instruments is calculated using the effective interest method.
- Liabilities through profit or loss. This financial liability portfolio is divided into two parts:
 - Financial liabilities held for trading: financial liabilities issued with the intention of repurchasing them in the near term, short positions and derivatives not designated as hedging instruments.
 - Financial liabilities designated at fair value through profit or loss: hybrid financial liabilities not held for trading that must be measured entirely at fair value.
- Financial liabilities at amortised cost: this financial instrument category comprises financial liabilities not included in any of the above categories.

Liabilities issued by the Bank which, having the legal nature of capital, do not qualify as equity, are classified as financial liabilities at amortised cost, except those designated by the Bank as financial liabilities at fair value through profit or loss, if the pertinent conditions are met.

Financial liabilities included in this category are initially measured at fair value, adjusted to reflect transaction costs directly attributable to the issue of the financial liability, which are taken to the income statement until maturity using the effective interest method, as defined in Banco de España Circular 4/2017. These liabilities are subsequently measured at amortised cost, calculated using the effective interest method defined in the aforementioned Circular.

Interest accrued on these securities, calculated using the effective interest method, is recognised under “Interest expense” in the income statement. Exchange differences on securities denominated in currencies other than the Euro that are included in this portfolio are recognised following the criteria described in note 2.n. Financial liabilities included in this category subject to fair value hedges are recognised following the criteria described in note 2.d.

Nevertheless, financial instruments which should be considered as non-current assets and disposal groups classified as held for sale in accordance with Rule 34 of Banco de España Circular 4/2017 are recognised in the annual accounts applying the criteria described in note 2.e.

d) Derivatives and hedge accounting

Derivatives are instruments that allow all or part of the credit and/or market risks associated with balances and transactions to be transferred to third parties, using interest rates, certain indices, prices of certain securities, different currency cross rates or other similar references as underlying items.

All derivatives are recognised in the balance sheet at fair value from the trade date. If the fair value is positive they are recognised as an asset, and if the fair value is negative they are recognised as a liability. Unless there is evidence to the contrary, the fair value on the trade date is deemed to be the transaction price. Changes in the fair value of derivatives after the trade date are recognised under “Gains or losses on hedge accounting, net” in the income statement. In particular, the fair value of standard derivatives included in the trading portfolios is equivalent to their daily quotation price and if, for exceptional reasons, the quotation price on a given date cannot be established, methods similar to those used to measure over-the-counter (OTC) derivatives are applied. The fair value of OTC derivatives 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, or others.

Derivatives that have equity instruments as their underlying whose fair value cannot be determined in a sufficiently objective manner and which are settled by delivery of those instruments are measured at cost of acquisition.

I. Hedge accounting

Hedge accounting may only be applied to a derivative if the following three conditions are met:

- One of the following three types of risks is hedged:
 - Changes in the value of assets and liabilities due to fluctuations in the interest rate and/or exchange rate applicable to the position or balance to be hedged (“fair value hedge”).
 - Variability in the estimated cash flows deriving from financial assets and liabilities and highly probable transactions forecast to be carried out by an entity (“cash flow hedge”).
 - The net investment in a foreign operation (“hedges of a net investment in a foreign operation”), which in practice equates to a cash flow hedge.
- A significant part of the risk inherent in the hedged item or position during the entire term of the hedge is effectively eliminated, which means that:
 - Upon arrangement the hedge is expected, under normal conditions, to be highly effective (“prospective effectiveness”).
 - There is sufficient evidence that the hedge was actually effective throughout the life of the hedged item or position (“retrospective effectiveness”).

- And lastly, there must be adequate documentation of the derivative having been arranged for the specific purpose of hedging certain balances or transactions, and the manner in which the hedge was to be achieved, which must be consistent with the Bank's management of its own risks.

The Bank designates operations as hedges on inception of the hedge or the hedged instruments, and duly documents the hedging transaction. Documentation on these hedging transactions should adequately identify the hedged instrument or instruments and the hedging instrument or instruments, in addition to the nature of the risk to be hedged; as well as the criteria or methods followed by the Bank to evaluate the effectiveness of the hedge throughout its duration, taking into account the risk it intends to hedge.

The Bank only considers operations that are deemed highly effective throughout their duration as hedging transactions. A hedge is considered highly effective if during the expected term of the hedge changes in fair value or cash flows attributable to the hedged risk are virtually fully offset by changes in the fair value or cash flows, as applicable, of the hedging instrument or instruments.

To measure the effectiveness of hedging transactions defined as such, the Bank analyses whether from inception to expiration of the hedge it can expect, prospectively, that the changes in fair value or cash flows of the hedged item that are attributable to the hedged risk will be almost completely offset by changes in the fair value or cash flows, as applicable, of the hedging instrument or instruments and, retrospectively, whether gains or losses on the hedging transaction are within a range of 80% to 125% of the results of the hedged item.

The Bank has arranged fair value hedges, that is, hedges of exposure to changes in the fair value of financial assets and liabilities or unrecognised firm commitments, or an identified portion of these assets, liabilities or firm commitments, attributable to a particular risk and provided that these changes could affect the income statement; and cash flow hedges, that is, hedges of variability in the estimated cash flows deriving from financial assets and liabilities and highly probable transactions forecast to be carried out by an entity.

With respect to financial instruments designated as hedged items and that qualify for hedge accounting, changes in value of both the hedging instruments and the hedged items – as regards the type of hedged risk – are recognised in profit or loss.

The Bank discontinues hedge accounting when the hedging instrument expires or is sold, the hedge no longer meets the criteria for hedge accounting or the Bank revokes the designation of a hedge.

When, in accordance with the preceding paragraph, fair value hedging is discontinued, adjustments to the value of hedged items measured at amortised cost resulting from the aforementioned hedge accounting are taken to the income statement until the hedged items expire, using the effective interest rate recalculated on the date the hedging transaction is discontinued.

The Bank holds certain derivatives for the purpose of mitigating certain risks inherent in its activity, and which do not qualify for hedge accounting. In particular, the Bank has arranged swaps to hedge the interest rate risk on the associated transactions. The Bank accounts for these instruments as trading derivatives.

On the basis of its analysis, the Bank continues to apply Circular 4/2004 for its hedge accounting, as permitted by the regulations.

e) Impairment of financial assets

The carrying amounts of financial assets are generally adjusted with a charge to the income statement when there is objective evidence that an impairment loss has occurred, i.e.:

1. In the case of debt instruments, understood as loans, advances other than loans and debt securities, when, after their initial recognition, a single event or the combined effect of several events causes a negative impact on their future cash flows.
2. In the case of equity instruments, when, as a result of an event or the combined effect of several events after initial recognition, their carrying amount will not be able to be recovered.

The potential situations the Bank considers as objective evidence that a financial instrument could be impaired, and which give rise to a specific analysis of the financial instrument in question to determine the amount of any possible impairment, include those enumerated in Rule 29 of Banco de España Circular 4/2017. The situations which for the Bank constitute objective evidence of possible impairment of a financial instrument include the following:

- a) Significant financial difficulty of the issuer or the borrower.
- b) The disappearance of an active market for that instrument because of financial difficulties of the issuer.
- c) Significant changes in the performance of the issuer compared with budgets, business plans or milestones.
- d) Significant changes in expectations that the issuer's technical product milestones will be achieved.
- e) Significant changes in the market for the issuer's equity instruments or its products or potential products.
- f) Significant changes in the global economy or the economic environment in which the issuer operates.
- g) Significant changes in the technological or legal environment in which the issuer operates.
- h) Significant changes in the performance of comparable entities, or in the valuations implied by the overall market.
- i) Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.

The mere decline in the fair value of the instrument below its carrying amount may indicate impairment, but is not necessarily objective evidence of an impairment loss. Objective evidence of impairment shall be deemed to exist when there is a significant or prolonged decline in the fair value of the instrument below its carrying amount.

Objective evidence of impairment shall also be deemed to exist when the issuer has been declared or will probably be declared bankrupt.

In the case of debt instruments measured at amortised cost, as well as other exposures entailing credit risk, such as loan commitments, financial guarantees, and other commitments given, the amount of the impairment loss is equal to the negative difference between the carrying amount and the present value of estimated future cash flows. For quoted debt instruments, market value may be used instead of the present value of future cash flows, provided that it is sufficiently deep to be considered as representative of the amount that would be recovered by the Bank.

Impairment losses on debt instruments at amortised cost are recognised in an allowance account that reduces the carrying amount of the asset, while impairment losses on debt instruments at fair value through other comprehensive income are recognised in equity of the Entity. Impairment losses on exposures entailing credit risk other than debt instruments are recognised as a provision under liabilities on the balance sheet. Impairment losses for the period are recognised as an expense in the income statement.

Subsequent reversals of previously recognised allowances and provisions for impairment are recognised immediately as income in the income statement for the period in which the amount is recovered.

Objective evidence of impairment is determined individually for all doubtful debt instruments that are individually significant, and collectively for groups of debt instruments that are not individually significant. When a specific instrument cannot be included in any group of assets with similar credit risk characteristics, it is analysed solely on an individual basis to determine whether it is impaired and, if so, to estimate the impairment loss. Impairment is therefore broken down as follows, depending on how it is calculated:

- Specific impairment allowances for financial assets, determined individually: the cumulative amount of allowances recorded to cover doubtful assets, estimated individually.
- Specific impairment allowances for financial assets, determined collectively: the cumulative amount of collective impairment calculated for debt instruments of immaterial amounts classified as doubtful, for which impairment has been determined individually, and for which the Entity uses the specific allowance applying percentages for collective allowances based on the age of the past-due amounts, in accordance with Annex IX of Banco de España Circular 4/2017 and subsequent amendments.
- Collective impairment allowances for losses incurred but not reported: the generic allowance or provision estimated collectively for debt instruments classified as standard exposures or standard exposures under special monitoring.

Collective assessment of a group of financial assets to estimate impairment losses is carried out as follows:

Debt instruments are included in groups with similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due, both principal and interest, according to the contractual terms. The credit risk characteristics to be taken into account for grouping assets are, among others: instrument type, the debtor's industry, geographical location, type of guarantee or collateral, age of past-due amounts and any other factor relevant to the estimation of future cash flows.

The future cash flows from each group of debt instruments are estimated for instruments with credit risk characteristics similar to those in the respective group.

The impairment loss of each group is the difference between the carrying amount of all the debt instruments in the group and the present value of the estimated future cash flows.

Debt instruments not included in financial assets held for trading and off-balance sheet exposures are classified, based on the insolvency risk attributable to the customer and the transaction, in the following categories: standard exposures, standard exposures under special monitoring, doubtful as a result of borrower arrears, doubtful for reasons other than borrower arrears, and write-off. For individually significant debt instruments that are not classified as standard exposures or standard exposures under special monitoring, based on the past experience of the Entity and the sector, specific allowances or provisions for impairment estimated individually are determined taking into account the age of the past-due amounts, the guarantees or collateral provided and the economic situation of the customer and, if applicable, the guarantors. For the remaining debt instruments, the specific or generic allowances and provisions estimated collectively are determined using the parameters defined by Banco de España in Circular 4/2017.

The Entity classifies transactions whose credit risk has not increased significantly since their initial recognition as standard exposures. The allowance or provision for impairment shall be equal to the 12-month expected credit losses. Interest income shall be calculated applying the effective interest rate to the gross carrying amount of the transaction.

The Entity classifies transactions whose credit risk has increased significantly since their initial recognition, but for which there is no related default event, as standard exposures under special monitoring. The allowance or provision for impairment shall be equal to the lifetime expected credit losses. Interest income shall be calculated applying the effective interest rate to the gross carrying amount of the transaction. All borrowers declared subject to bankruptcy proceedings which do not qualify for classification as doubtful exposures, insofar as they have paid at least 25% of the credit that is affected by the bankruptcy proceedings or because two years have elapsed since the creditors' agreement was approved, provided that this agreement is being faithfully performed and there are no doubts regarding full repayment of all debts, are also classified as standard exposures under special monitoring.

The Entity uses the indicators in Annex IX of Banco de España Circular 4/2017 to determine a significant increase in credit risk for transactions classified as standard exposures under special monitoring.

The classification of refinanced or restructured transactions takes into account the payment history over a long period of time, any grace periods granted, any new effective guarantees or collateral provided and the ability to generate resources, amongst other factors, which determine their classification as doubtful exposures or standard exposures under special monitoring.

The refinancing or restructuring of transactions in arrears does not interrupt their classification as doubtful, unless there is reasonable certainty that the customer can make payment on schedule, or unless new effective guarantees or collateral are provided and, in both cases, unless at least the current interest receivable is paid.

The amount of financial assets that would have been impaired had their terms not been renegotiated is not significant with respect to the annual accounts taken as a whole. The purpose of the transactions identified by the Bank as refinancing or restructuring transactions is essentially to improve the allowance or provision for such operations by providing additional guarantees or collateral. With respect to these transactions, for 2018 and 2017 there are no significant differences between the carrying amount of the derecognised assets and the fair value of the new assets. Furthermore, the aforementioned transactions do not delay or reduce the allowance or provision that would have been required had they not been modified, inasmuch as at the modification date, impairment had already been recognised thereon where necessary and before arranging this type of transaction the Bank recognises the pertinent allowances and provisions for insolvency.

Similarly, debt instruments not measured at fair value through profit or loss and off-balance-sheet exposures, whose customer, are analysed to determine the associated credit risk attributable to country risk. Country risk is understood as the risk associated with customers resident in a specific country due to circumstances other than normal commercial risk.

In addition to the previously mentioned specific allowances or provisions for impairment estimated individually or collectively, the Entity recognises a general allowance or provision estimated collectively for losses incurred but not reported, in respect of the losses inherent in other debt instruments not measured at fair value through profit or loss and in off-balance-sheet exposures classified as standard exposures or standard exposures under special monitoring. These allowances and provisions are estimated using the parameters defined by Banco de España in Circular 4/2017.

Impairment of the carrying amount of debt instruments at amortised cost is recognised with a charge to the income statement for the period in which the impairment becomes evident, and any reversals of previously recognised impairment losses are recognised in the income statement for the period in which the impairment is reversed or reduced. Balances are derecognised from the balance sheet when the possibility of their recovery is considered remote, without prejudice to any initiatives of the Entity to recover such amounts before the collection right expires by becoming time-barred, through debt forgiveness or for other reasons. The remaining amount of transactions with amounts derecognised (partial derecognition) is classified in full in the category corresponding to it on the basis of the credit risk attributable to the borrower.

The amount of the impairment losses incurred on debt securities and equity instruments included under “Financial assets at fair value through other comprehensive income” is the positive difference between their cost of acquisition, net of any principal repayment, and their fair value.

When there is objective evidence that the decline in fair value is due to impairment, the unrealised losses recognised directly as “Accumulated other comprehensive income” in equity are recorded immediately in the income statement. If all or part of the impairment losses are subsequently recovered, the amount is recognised in the income statement for the period in which the recovery occurred in the case of debt securities, and as “Accumulated other comprehensive income” in equity in the case of equity instruments.

In the case of debt instruments and equity instruments classified as “Non-current assets and disposal groups classified as held for sale”, losses previously recorded in equity are considered to be realised, and are therefore recognised in the income statement on the date they are so classified.

In the case of investments in subsidiaries, jointly controlled entities and associates, the Entity estimates impairment by comparing their recoverable amount with their carrying amount. Impairment losses are recognised in the income statement for the period in which they occur and subsequent reversals are recognised in the income statement for the period in which they are recovered.

f) Acquisition and sale of assets with a resale or repurchase agreement

Purchases (sales) of financial instruments with an obligatory resale (repurchase) commitment at a determined price are recognised as financing granted (received) under “Loans and receivables” (“Financial liabilities at amortised cost”), in line with the nature of the borrower (lender).

The difference between the purchase and sale prices is recognised as interest over the life of the contract.

g) Investments in subsidiaries, joint ventures and associates

I. Group companies

Group companies 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, all of 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.

Investments in Banco Cooperativo Español, S.A. Group companies are presented in these annual accounts under "Investments in subsidiaries, joint ventures and associates" in the balance sheet and are measured at cost of acquisition, net of any possible impairment losses.

Dividends accrued in the year on these investments are recognised under "Dividend income" in the income statement.

At 31 December 2018 and 2017 there are no significant restrictions on the ability of the Banco Cooperativo Español, S.A. Group companies to transfer funds to the parent in the form of dividends or repayments of loans or advances.

II. 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.

Investments in associates are presented in these annual accounts under "Investments in subsidiaries, joint ventures and associates" in the balance sheet and are measured at cost of acquisition, net of any possible impairment losses.

Dividends accrued in the year on these investments are recognised under "Dividend income" in the income statement.

Relevant information on Banco Cooperativo Español, S.A. Group companies is provided in Appendix I.

III. Calculation of impairment

The Bank estimates and recognises impairment losses on the equity instruments that constitute investments in Group companies and associates, which for the purposes of preparing these annual accounts are not considered financial instruments, as follows: when, in accordance with Circular 4/2017, there is evidence of impairment of these investments, the amount of this impairment is estimated as the negative difference between their recoverable amount (calculated as the higher of the fair value of the investment, less costs to sell, and its value in use, which is defined as the present value of the cash flows expected to be received from the investment as dividends and proceeds from its sale or other disposal) and their carrying amount.

Impairment losses on these investments and possible reversals thereof are recognised as a charge or credit, respectively, in “Impairment or (-) reversal of impairment of investments in subsidiaries, joint ventures and associates” in the income statement.

h) Tangible assets

Tangible assets for own use are measured at cost of acquisition, 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.

The annual depreciation charge is recognised in the income statement and is calculated using the following rates, based on the average years of estimated useful life of the different groups of assets:

	<u>% annual</u>	<u>Estimated useful life (years)</u>
Buildings	2	50
Furniture and fixtures	6-10	16.7-10
IT equipment	16-33	6.3-3

The Bank reviews the depreciation method and useful life of each tangible asset at least at each year end.

Repair and maintenance costs which do not improve the related assets or extend their useful life are expensed when incurred.

i) 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 Bank. Intangible assets are only recognised when their cost can be reasonably and objectively estimated and when the Bank considers it probable that future economic benefits will be obtained.

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

j) 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 Bank acts as the lessor of an asset, the sum of the present values 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 receivables” in the balance sheet.

When the Bank acts as the lessee, it recognises the cost of the leased assets in the balance sheet according to the nature of the asset that is the subject matter of the contract, and simultaneously recognises a liability for the same amount (which is the lower of the fair value of the leased asset and the sum of the present values 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 cost arising from these contracts is credited or debited, respectively, to the 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 thereto remain with the lessor.

When the Bank acts as the lessor, it recognises the acquisition cost of the leased assets under “Tangible assets” in the 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 income statement on a straight-line basis.

When the Bank acts as the lessee, lease expenses, including any incentives granted by the lessor, are charged to the income statement on a straight-line basis.

Banco de España Circular 2/2018 came into force on 1 January 2019, with the main purpose of bringing Circular 4/2017 of 27 November 2017, to credit institutions on public and confidential financial reporting rules and formats, into line with International Financial Reporting Standard (IFRS) 16 Leases, as adopted by the European Union. The new standard introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities on its balance sheet for all leases. The only exemptions permitted as regards recognition are for short-term leases and leases of low-value assets. A lessee is required to recognise a right-of-use asset representing its right to use the leased asset and a lease liability representing its obligation to make lease payments.

The new standard substantially carries forward the lessor accounting requirements from the previous standard. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

k) Exchanges of assets

An “exchange of assets” is understood to be the acquisition of tangible and intangible assets in exchange for the conveyance of other non-monetary assets or a combination of monetary and non-monetary assets. For the purpose of the accompanying annual accounts, foreclosures of assets in settlement of amounts due to the companies from third parties do not constitute an exchange of assets.

Items received in an exchange of assets are measured at fair value, provided that this exchange operation could be understood to have commercial substance, as defined in applicable regulations, and when the fair value of the asset received, or the asset given up, can be estimated reliably. The fair value of the instrument received is determined as the fair value of the asset given up, plus, where applicable, the fair value of any monetary consideration given, except when there is much clearer evidence of the fair value of the asset received.

In exchanges of assets that do not meet the requirements described above, the asset received is recognised at the carrying amount of the asset given up, plus any monetary consideration paid or committed on acquisition.

l) Offsetting of balances

Receivables and payables may only be used to offset each other (and are therefore presented in the balance sheet at the net amount) if they derive from transactions in which this possibility is specified in the contract or in compliance with a legal obligation, and provided that the balances will be settled on a net basis or the asset realised and the liability settled simultaneously.

m) 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: security deposit, bank guarantee, irrevocable documentary credit issued or confirmed by the entity, etc.

In accordance with Banco de España Circular 4/2017 and as a general rule, the Bank considers financial guarantee contracts extended to third parties as financial instruments.

On initial recognition, the Bank records financial guarantees extended under liabilities 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 similar income to be received throughout the term of these contracts, with a balancing entry under assets in the amount of fees and commissions and similar income collected at the outset of the transactions 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 Circular 4/2017. In this respect, 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 by 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 is charged to the income statement on a straight-line basis over the term of these contracts.

Provisions made for these instruments, are recorded as “Provisions – Commitments and guarantees given” under liabilities in the balance sheet. Allowances for and reversals of these provisions are recognised with a balancing entry under “Provisions or (-) reversal of provisions” in the income statement.

In the event that, pursuant to the foregoing, a provision were required for these financial guarantees, unaccrued fees and commissions on these transactions, which are recognised under “Financial liabilities at amortised cost – Other financial liabilities”, are reclassified to the corresponding provision.

n) Foreign currency transactions

I. Functional currency

The Bank’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 in force 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 income statement (see notes 28 and 35.5).

o) Own equity instruments

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

- They do not include any contractual obligation for the issuer:
 - to deliver cash or another financial asset to a third party; or
 - to exchange financial assets or financial liabilities with third parties under conditions that are potentially unfavourable for the Entity.
- They will or may be settled in the issuer's own equity instruments and are:
 - a non-derivative that includes no obligation for the issuer to deliver a variable number of its own equity instruments; or
 - a derivative that will be settled by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

A financial instrument that does not meet the conditions stipulated in the two preceding paragraphs, even if it is a derivative financial instrument that may or must be settled by the future delivery or receipt of the issuer’s own equity instruments, is not an equity instrument.

Transactions involving own equity instruments, including their issuance and redemption, are recognised directly in equity of the Entity, and no profit or loss thereon may be recognised. The costs of any transaction involving own equity instruments are deducted directly from equity, net of any related tax effect.

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

p) Recognition of income and expenses

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

I. Interest income and expenses and similar items

As a general rule, interest income, interest expenses and similar items are recognised on an accruals basis using the effective interest method. Dividends received from other companies are recognised as income when the Bank's right to receive them is established.

II. Commissions, fees and similar items

Fee and commission income and expenses are recognised in the income statement using criteria that vary according to their nature. The main criteria are as follows:

- Those relating to financial assets and financial liabilities at fair value through profit or loss are recognised upon collection.
- Those originating from transactions or services carried out over an extended period are deferred over the term of the transactions or services.
- Those relating to the provision of a service in a single act are recognised when the single act is carried out.

III. Non-finance income and expenses

These items are recognised on an accruals basis.

q) Assets under management

Assets owned by third parties and managed by Banco Cooperativo Español, S.A. Group companies are not disclosed in the balance sheet. Details of the third-party assets managed by the Banco Cooperativo Español, S.A. Group at 31 December 2018 and 2017 are disclosed in note 23.

r) Post-employment benefits

The Bank recognises the present value of defined benefit pension commitments, net of the fair value of the plan assets and the past service cost, the recognition of which is deferred as explained below, in "Provisions - Pensions and other post-employment defined benefit obligations" under liabilities, or in "Other assets - Insurance contracts linked to pensions" under assets, depending on whether the difference is negative or positive, and provided that the recognition criteria set out in Banco de España Circular 5/2013 are met.

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 Bank, but rather by a legally separate third party not related to the Bank; they are only available to settle or finance post-employment benefits payable to employees; they can only be returned to the Bank when the remaining plan assets are sufficient to meet all obligations of the plan or of the Entity relating to current or former employee benefits or to reimburse employee benefits already settled by the Bank.

If the Bank 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 qualify as a plan asset, the Bank 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.

Actuarial gains and losses are deemed to be those arising from differences between previous actuarial assumptions and what has actually occurred in the plan and from changes in the actuarial assumptions used.

The Bank 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 credit or debit to the income statement.

The past service cost, 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:

- The current service cost, defined as the increase in the present value of the obligations resulting from employee service in the current period, is recognised under “Administrative expenses - Personnel expenses”.
- The interest cost, defined as the increase during the year in the present value of the obligations as a result of the passage of time, is recognised under “Interest expense”. When obligations are presented under liabilities net of plan assets, the cost of the liabilities recognised in the income statement is only that relating to the obligations recorded 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 Bank's post-employment benefit obligations at the 2018 and 2017 reporting dates are as follows:

	Thousands of Euros	
	2018	2017
Present value of obligations	(1,265)	(1,408)
Fair value of plan assets	1,310	1,462
Positive difference	45	54

The amount of the obligations was determined by independent actuaries applying, inter alia, the following criteria:

1. *Calculation 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:

	2018	2017
Annual technical interest rate	1.50%	1.50%
Mortality tables	PERM/F 2000P	PERM/F 2000P
Expected rate of return on plan assets	1.50%	1.50%
Annual salary increase rate	2.50%	2.50%
Annual Social Security pension increase rate	1.50%	1.50%

In 2014 the Bank implemented a defined contribution supplementary benefit 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 450, with profit-sharing rights in favour of the employee should he or she leave the Bank for reasons other than retirement.

s) Termination benefits

In accordance with current legislation, the Bank pays compensation to those employees whose services are discontinued without just cause. Termination benefits 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.

t) Income tax

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

The income tax expense is determined by the tax payable on the taxable profit for the year after taking account of any changes in that year due to temporary and permanent differences, tax credits for tax deductions and benefits, and tax loss carryforwards.

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

Deferred tax assets, credits and deductions and loss carryforwards are only recognised when it is considered likely that the Bank will generate sufficient future taxable profit against which they can be utilised.

Deferred tax assets and liabilities are measured by applying to the relevant temporary difference or credit the tax rate at which they are expected to be realised or settled.

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 to determine whether they still exist, and the appropriate adjustments are made based on the findings of the analyses performed.

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

u) Cash flow statement

The Bank reports its cash flows applying 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 equity and liabilities and that are not operating activities.

When preparing the cash flow statement, “Cash and cash equivalents in central banks” have been considered as cash and cash equivalents.

v) Statement of recognised income and expense

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

Accordingly, this statement presents:

- a) Profit or loss for the year.

- b) Net income and expenses recognised temporarily as valuation adjustments in equity.
- c) Net income and expenses recognised permanently in equity.
- d) Accrued income tax payable or recoverable in respect of the items listed in points b) and c) above.
- e) Total recognised income and expenses, calculated as the sum of the preceding points.

The changes in income and expenses recognised in equity as valuation adjustments are as follows:

- a) Valuation gains (losses): income, net of expenses incurred during the year, recognised directly in equity. Amounts recognised in this line item during the year continue to be carried in this line item at the initial value of other assets or liabilities, even when they are transferred to the income statement in the same year, or they are reclassified to another line item.
- b) Amounts transferred to the income statement: valuation gains or losses previously recognised in equity, even in the same period, which are accounted for in the income statement.
- c) Amounts transferred to the initial value of hedged items: valuation gains or losses previously recognised in equity, even in the same period, which are accounted for in the initial value of assets or liabilities as a result of cash flow hedges.
- d) Other reclassifications: transfers between valuation adjustments during the year in accordance with criteria established under current legislation.

The amounts disclosed in these items are presented gross, and the related tax effect is recognised under “Income tax”.

w) *Statement of total changes in equity*

This statement presents all changes in equity, including those arising from changes in accounting criteria and the correction of errors. This statement therefore shows a reconciliation of the opening and closing carrying amounts of all items that make up equity, grouping movements according to their nature, as follows:

- a) Adjustments for changes in accounting criteria and correction of errors: changes in equity due to the retrospective restatement of balances in the financial statements as a result of changes in accounting criteria or the correction of errors.
- b) Income and expenses recognised during the year: the aggregate amount of all of the aforementioned items recorded in the statement of recognised income and expense.
- c) Other changes in equity: the remaining items recognised in 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 equity components and any other increases or decreases in 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 2018 be distributed as follows:

	<u>Thousands of Euros</u>
Net profit for 2018	63,983
Distribution:	
Interim dividend	10,000
Reserves:	<u>53,983</u>
Legal	-
Voluntary	53,983

The distribution of the Bank's net profit for 2017, approved by the Shareholders at their annual General Meeting held on 20 June 2018, was as follows:

	<u>Thousands of Euros</u>
Net profit for 2017	36,391
Distribution:	
Dividends	9,000
Reserves:	<u>27,391</u>
Legal	1,771
Voluntary	25,620

According to the minutes of the Board of Directors' meeting on 19 December 2018, an interim dividend of Euros 10,000 thousand was distributed to the Shareholders.

The amounts allocated for distribution did not exceed the profits reported by the Company since the end of the previous reporting period, after deducting the estimated income tax payable on these profits, as required by article 277 of the Revised Spanish Companies Act.

The provisional accounting statement at 30 November 2018 prepared in accordance with statutory requirements demonstrating that sufficient cash was available for distribution of the aforementioned dividend is as follows:

	<u>Thousands of Euros</u>
Profit before income tax at 30 November 2018	48,040
Income tax (30%)	14,448
Provisional net profit for the year	33,592
Legal reserve (*)	-
Liquidity	2,093,809
Interim dividend	10,000

(*) At 30 November 2018 the legal reserve was fully appropriated in accordance with article 274 of Royal Legislative Decree 1/2010 of 2 July 2010 approving the Revised Spanish Companies Act.

Earnings per share

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

	<u>2018</u>	<u>2017</u>
Net profit (thousands of Euros)	63,983	36,391
Number of ordinary shares outstanding (note 19)	1,926,970	1,926,970
Earnings per share (Euros)	33.20	18.89

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 2018 and 2017 are as follows:

Directors	Thousands of Euros		
	2018	2017	
Mr. José Luis García Palacios	-	18	Chairman until 22/06/2017
Mr. Ignacio Arrieta del Valle (Chairman)	12	12	Chairman since 22/06/2017
Mr. José Luis García-Lomas Hernández (First Vice-chairman)	10	10	
Mr. Pedro García Romera (Second Vice-chairman)	10	10	
Mr. Luis Esteban Chalmovsky	8	9	
Mr. Carlos Martínez Izquierdo	10	10	
Mr. Carlos de la Sierra Torrijos	12	10	
Mr. Dimas Rodríguez Rute (1)	-	7	Director until 18/07/2017
Mr. Cipriano García Rodríguez (2)	11	12	
Ms. Dagmar Werner	10	10	
Mr. José María Quirós Rodríguez	12	10	
Mr. Fernando Berge Royo	11	10	
Mr. Jesús Méndez Álvarez-Cedrón (3)	12	12	
Mr. Manuel Ruíz Escudero	11	4	Director since 22/06/2017
Mr. Ernesto Moronta Vicente	11	4	Director since 22/06/2017
Total	140	148	

(1) Allowances received by Caja Rural de Granada, SCC

(2) Allowances received by Caja Rural de Zamora, SCC

(3) Allowances received by Caixa Rural Galega, SCC

Public liability insurance

The Directors and Executives of the Bank have a public liability insurance policy, for which the premium is borne by the Spanish Association of Rural Savings Banks. In 2018 and 2017, this item had no impact on the Bank's income statement.

Loans

The Group has extended no loans to the Bank's Directors at 31 December 2018 or 2017.

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 annual accounts, Senior Management comprises the 13 members of the Bank's steering committee in 2018 (12 members in 2017), considered to be key management personnel within the Bank.

The following table details the remuneration received by Senior Management personnel in 2018 and 2017:

	Thousands of Euros					
	Remuneration received		Deferred remuneration during the year (*)		Total	
	2018	2017	2018	2017	2018	2017
Senior Management personnel	2,115	2,010	304	343	2,419	2,353

(*) This remuneration accrued during 2018 and 2017 is payable at 31 December 2018 and 2017.

Accrued variable remuneration is calculated on a best estimate basis using information available at the date these annual accounts were drawn up, and is settled in accordance with the Remuneration Policy approved by the Board of Directors. Settlements of variable remuneration take into account all remuneration requirements approved by the remuneration committee and applicable to the employees in question. These requirements are governed by the mandatory standards imposed on credit institutions by the regulatory framework in force.

The characteristics of the variable remuneration model approved by the Board of Directors are as follows:

40% of the variable remuneration is deferred over a period of three years, the payment schedule being as follows:

- One third is payable one year after the scheduled date for employees and management of the Bank in general. 50% cash and 50% share-based.
- One third is payable two years after the general payment date. 50% cash and 50% share-based.
- One third is payable three years after the general payment date. 50% cash and 50% share-based.

The remaining 60% of variable remuneration shall be paid as follows:

- 50% in cash at the general payment date.
- 50% as share-based payment with a one-year retention period, i.e. it shall not be effective earlier than one year after the general payment date.

Gender distribution of the Board of Directors

At 31 December 2018 and 2017 the Board of Directors was formed by 12 male and one female members.

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

Details at 31 December 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Cash	864	916
Cash balances with central banks		
Banco de España		
Current account	425,253	153,525
Other demand deposits	1,045,734	588,417
	1,471,851	742,858

Details of residual maturity and the interest rate repricing matrix for the items comprising the balances in this balance sheet caption are provided under Risk Management (see note 35).

6. Financial assets and liabilities held for trading

Information on credit, liquidity and market risks assumed by the Bank in relation to financial assets included in this category, as well as details of the distribution of the carrying amount of the most significant financial assets disclosed according to geographical areas and activity segment, are provided under Risk Management in note 35, and certain information on the fair value of these assets is provided in note 24.

Details of these balance sheet items, by type of instrument, at 31 December 2018 and 2017, are as follows:

	Thousands of Euros	
	2018	2017
Assets		
Derivatives	804,826	507,121
Equity instruments	1,071	-
Debt securities	26,473	146,949
Total assets	832,370	654,070
Liabilities		
Derivatives	853,832	568,934
Short positions	-	31,652
Total liabilities	853,832	600,586

Financial assets and financial liabilities held for trading. Trading derivatives

The derivatives portfolio arises from the Bank's need to manage the risks to which it is exposed in the ordinary course of business, and the need to market these products to customers. At 31 December 2018 and 2017, derivatives were mainly arranged on OTC markets, the counterparties were credit institutions and other non-financial corporations, and they were associated with currency, interest rate and share risk.

Details, by type of risk and type of product or market, of the fair value as well as notional amounts relating to financial derivatives recognised on the balance sheets, differentiating between official and OTC market arrangements, at 31 December 2018 and 2017, are as follows:

	Thousands of Euros					
	31.12.2018			31.12.2017		
	Assets	Liabilities	Notional amount	Assets	Liabilities	Notional amount
Interest rate	763,770	813,811	24,723,031	468,151	530,806	26,033,129
OTC options	19,210	19,210	330,335	24,128	24,128	875,485
OTC other	744,560	794,601	24,374,196	444,023	506,678	25,143,968
Organised market options	-	-	-	-	-	-
Organised market other	-	-	18,500	-	-	13,676
Equity instruments	37,363	37,319	479,344	27,913	27,362	1,943,212
OTC options	600	245	28,974	1,542	764	26,330
OTC other	36,763	37,074	450,370	26,371	26,598	1,916,882
Organised market options	-	-	-	-	-	-
Organised market other	-	-	-	-	-	-
Foreign exchange and gold	3,693	2,372	18,914	11,057	9,988	388,723
OTC options	135	135	18,914	1,859	1,859	56,360
OTC other	3,558	2,237	-	9,198	8,129	332,363
Organised market options	-	-	-	-	-	-
Organised market other	-	-	-	-	-	-
Credit	-	-	-	-	-	-
Credit default swaps	-	-	-	-	-	-
Credit spread options	-	-	-	-	-	-
Total return swaps	-	-	-	-	-	-
Other	-	-	-	-	-	-
Commodities	-	-	-	-	-	-
Other	-	330	7,930	-	778	8,160
Derivatives	804,826	853,832	25,229,219	507,121	568,934	28,373,224
<i>Of which: OTC - Credit institutions</i>	660,440	465,560	13,501,617	367,634	243,699	13,516,635
<i>Of which: OTC - Other financial corporations</i>	141,798	386,771	11,602,358	136,883	325,188	14,747,366
<i>Of which: OTC - Other</i>	2,588	1,501	125,244	2,604	47	109,223

Financial assets held for trading. Equity instruments

Details at 31 December 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Other financial corporations	1,071	-
Total	1,071	-

Financial assets held for trading. Debt securities

Details of balances of debt securities by counterparty are as follows:

	Thousands of Euros	
	2018	2017
General governments	23,576	24,752
Credit institutions	-	120,131
Other financial corporations	1,458	-
Non-financial corporations	1,439	2,066
Total	26,473	146,949

At 31 December 2018 the Bank did not have any loaned or pledged securities (Euros 31,420 thousand at 31 December 2017).

Financial liabilities held for trading. Short positions

Details at 31 December 2018 and 2017 by type of counterparty are as follows:

	Thousands of Euros	
	2018	2017
Credit institutions	-	31,652
Total	-	31,652

7. Non-trading financial assets mandatorily at fair value through profit or loss

A breakdown of this item by type of instrument at 31 December 2018 and 2017 is as follows:

Instrument	Thousands of Euros	
	2018	2017
Equity instruments	35	-
Debt securities	4,066	-
Loans and advances	14,390	-
Total	18,491	-

A breakdown of this item by geographical area and category of counterparty at 31 December 2018 and 2017 is as follows:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2017</u>
Geographical area		
Spain	25,186	-
Rest of European Union	-	-
Other	-	-
(Impairment losses)	<u>(6.695)</u>	<u>-</u>
	<u>18,491</u>	<u>-</u>
Counterparty		
Other financial corporations	3,709	-
Non-financial corporations	21,477	-
(Impairment losses)	<u>(6.695)</u>	<u>-</u>
Total	<u>18,491</u>	<u>-</u>

8. Financial assets and liabilities designated at fair value through profit or loss

A breakdown of financial assets designated at fair value through profit or loss, by type of instrument and counterparty, at 31 December 2018 and 2017, is as follows:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2018</u>
Debt securities	<u>197,904</u>	<u>-</u>
General governments	159,727	-
Credit institutions	<u>38,177</u>	<u>-</u>
Total	<u>197,904</u>	<u>-</u>

A breakdown of financial liabilities designated at fair value through profit or loss at 31 December 2018 and 2017 is as follows:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2017</u>
Deposits	<u>4,731</u>	<u>4,731</u>
Credit institutions	4,731	4,731
Debt securities issued	<u>-</u>	<u>-</u>
Total	<u>4,731</u>	<u>4,731</u>

At 31 December 2018 the Bank has loaned or pledged securities amounting to Euros 10,221 thousand. The Bank had no loaned or pledged securities at 31 December 2017.

Note 35 includes details of the distribution of the carrying amount of the most significant financial assets disclosed according to geographical area and activity segment.

9. Financial assets designated at fair value through other comprehensive income

Details of this item, by instrument and counterparty, are as follows:

	Thousands of Euros	
	2018	2017
Equity instruments	27,785	23,423
Shares in Spanish companies	27,785	23,423
Credit institutions	2,540	2,885
Other financial corporations	9,955	9,813
Non-financial corporations	15,290	10,725
Shares in foreign companies	-	-
Debt securities	2,258,565	2,270,196
Central banks	-	-
General governments	2,061,083	2,073,653
Credit institutions	21,171	17,765
Other financial corporations	82,724	88,478
Non-financial corporations	94,383	90,606
Impairment losses	(796)	(306)
Loans and advances	-	-
	2,286,350	2,293,619

Loaned or pledged securities amount to Euros 764,798 thousand at 31 December 2018 (Euros 1,632,878 thousand in 2017).

Information on credit, liquidity and market risks assumed by the Bank in relation to financial assets included in this category, as well as details of the distribution of the carrying amount of the most significant financial assets disclosed according to geographical areas and activity segment, are provided under Risk Management in note 35, and certain information on the fair value of these assets is provided in note 24.

Past-due impaired assets

In 2018 equity instruments are not considered to be impaired.

In 2017, impairment of Euros 101 thousand was recognised on equity instruments in the accompanying income statements with a direct charge to the acquisition cost of these instruments. At 31 December 2017 these assets were impaired in an amount of Euros 4,019 thousand (see note 35.1.6).

Details of movement in changes in the value of financial assets classified in this category are provided in note 18 Accumulated other comprehensive income.

10. Financial assets at amortised cost

Details of the balances of this item at 31 December 2018 and 2017, based on the nature of the financial instrument giving rise to them, are as follows:

	Thousands of Euros	
	2018	2017
Debt securities	1,050,113	77,368
<i>Of which: Impairment losses</i>	-	(860)
Loans and advances to credit institutions	1,996,088	1,553,716
<i>Of which: Impairment losses</i>	(162)	(53)
Loans and advances to customers	611,242	1,938,474
General governments	19,518	659,627
Other financial corporations	165,010	211,124
Non-financial corporations	320,869	971,053
Households	105,845	96,670
<i>Of which: Impairment losses</i>	(28,228)	(36,122)
Total	3,657,443	3,569,558

Information on credit, liquidity and market risks assumed by the Bank in relation to financial assets included in this category, as well as details of the distribution of the carrying amount of the most significant financial assets disclosed, based on geographical area and activity segment is provided under Risk Management in note 35, and certain information on the fair value of these assets is provided in note 24.

Financial liabilities at amortised cost. Debt securities

Details at 31 December 2018 and 2017, by instrument, are as follows:

	Thousands of Euros	
	2018	2017
General governments	1,050,113	73,701
Other financial corporations	-	4,527
	1,050,113	78,288
Impairment losses	-	(860)
Total	1,050,113	77,368

Securities recognised in this portfolio and totalling Euros 36,638 thousand matured in 2018 (Euros 26,165 thousand in 2017).

Loaned or pledged securities amount to Euros 341,749 thousand at 31 December 2018 (Euros 20,829 thousand at 31 December 2017).

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 35, whereas certain information on the fair value of these assets is provided in note 24.

Financial liabilities at amortised cost. Loans and advances to credit institutions

Details by instrument are as follows:

	Thousands of Euros	
	2018	2017
Credit card debt	17	-
Reverse repurchase loans	1,740,233	1,152,523
Other term loans	228,501	375,782
Advances that are not loans	27,337	25,411
Total	1,996,088	1,553,716
<i>Of which:</i>		
<i>Impairment losses</i>	<i>(162)</i>	<i>(53)</i>

Financial assets at amortised cost. Loans and advances to customers

Details by instrument and transaction status are as follows:

	Thousands of Euros	
	2018	2017
On demand, short notice (current account)	129	7
Credit card debt	649	638
Commercial loan portfolio	56,674	53,852
Finance leases	1,150	1,464
Reverse repurchase loans	-	-
Other term loans	427,709	1,698,688
Advances that are not loans	124,931	183,825
Total	611,242	1,938,474
<i>Of which:</i>		
<i>Impaired assets</i>	<i>2,101</i>	<i>5,906</i>
<i>Impairment losses</i>	<i>(28,228)</i>	<i>(36,122)</i>

11. Investments in subsidiaries, joint ventures and associates

Details at 31 December 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Rural Informática, S.A.	2,603	6,822
Rural Inmobiliario, S.L.	3,486	3,486
BCE Formación, S.A.	60	60
Espiga Capital Gestión, S.A.	288	288
Rural Renting, S.A.	600	600
Total	7,037	11,256

On 27 June 2017 Rural Informática, S.A. agreed to share between the Shareholders, based on their share in capital, an amount of Euros 4,226 thousand corresponding to the share premium.

All the securities included in this item at 31 December 2018 and 2017 are not quoted on official markets.

Appendix I includes certain relevant information on the Bank's investees.

12. Tangible assets

Movement in 2018 and 2017 is as follows:

	Thousands of Euros			
	Buildings	Furniture and fixtures	IT equipment	Total
Cost				
Balances at 31 December 2016	582	3,437	3,158	7,177
Additions	-	152	301	453
Disposals	-	-	-	-
Balances at 31 December 2017	582	3,589	3,459	7,630
Additions	-	490	292	782
Disposals	(582)	(299)	-	(881)
Balances at 31 December 2018	-	3,780	3,751	7,531
Accumulated depreciation				
Balances at 31 December 2016	(133)	(2,465)	(2,617)	(5,215)
Charges	(5)	(177)	(220)	(402)
Disposals	-	-	-	-
Balances at 31 December 2017	(138)	(2,642)	(2,837)	(5,617)
Charges	(1)	(192)	(273)	(466)
Disposals	139	141	-	280
Balances at 31 December 2018	-	(2,693)	(3,110)	(5,803)
Net tangible assets				
Balances at 31 December 2017	444	947	622	2,013
Balances at 31 December 2018	-	1,087	641	1,728

At 31 December 2018 and 2017 the cost of fully depreciated tangible assets for own use amounts to Euros 3,787 thousand and Euros 3,926 thousand, respectively.

At 31 December 2018 and 2017, 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.

13. Intangible assets

Movement in 2018 and 2017 is as follows:

	Thousands of Euros
	<u>Other intangible assets</u>
Cost	
Balances at 31 December 2016	12,318
Additions	1,517
Disposals	-
Balances at 31 December 2017	<u>13,835</u>
Additions	2,077
Disposals	-
Balances at 31 December 2018	<u>15,912</u>
Accumulated depreciation	
Balances at 31 December 2016	(10,576)
Charges	(986)
Disposals	-
Balances at 31 December 2017	<u>(11,562)</u>
Charges	(1,309)
Disposals	-
Balances at 31 December 2018	<u>(12,871)</u>
Net intangible assets	
Balances at 31 December 2017	<u>2,273</u>
Balances at 31 December 2018	<u>3,041</u>

At 31 December 2018 and 2017 the cost of fully depreciated intangible assets for own use in service amounts to Euros 9,316 thousand and Euros 9,293 thousand, respectively.

14. Financial liabilities at amortised cost

Details at 31 December 2018 and 2017 are as follows:

	Thousands of Euros	
	<u>2018</u>	<u>2017</u>
Deposits		
Deposits from central banks	367,598	370,800
Deposits from credit institutions	5,398,425	4,670,359
Deposits from other creditors	1,104,312	847,406
Other financial liabilities	<u>50,300</u>	<u>94,609</u>
Total	<u>6,920,635</u>	<u>5,983,174</u>

Details of residual maturity and the interest rate repricing matrix for the items comprising the balances in this balance sheet caption are provided under Risk Management (see note 35).

Note 24 includes information on the fair value of financial instruments included in this caption.

Deposits from central banks and from credit institutions

Details at 31 December 2018 and 2017, by nature, are as follows:

	Thousands of Euros					
	Deposits from central banks		Deposits from credit institutions		Total	
	2018	2017	2018	2017	2018	2017
Current accounts / overnight deposits	-	-	3,928,622	2,911,233	3,928,622	2,911,233
Deposits redeemable at notice	367,598	370,800	738,381	688,314	1,105,979	1,059,114
Repurchase agreements	-	-	731,422	1,070,812	731,422	1,070,812
Total	367,598	370,800	5,398,425	4,670,359	5,766,023	5,041,159

Deposits from customers

Details at 31 December 2018 and 2017, by nature, are as follows:

	Thousands of Euros	
	2018	2017
Current accounts / overnight deposits	780,675	655,448
Deposits redeemable at notice	7,334	9,004
Repurchase agreements	316,303	182,954
Total	1,104,312	847,406

Likewise, details by type of counterparty are as follows:

	Thousands of Euros	
	2018	2017
General governments	364,455	276,250
Other financial corporations	600,250	430,052
Non-financial corporations	72,102	89,874
Households	67,505	51,230
Total	1,104,312	847,406

Other financial liabilities

Details are as follows:

	Thousands of Euros	
	2018	2017
Obligations payable	748	2,876
Collateral received	3,060	6,180
Tax collection accounts	2,811	1,008
Special accounts	43,257	84,300
Financial guarantees	159	41
Other items	265	204
Total	50,300	94,609

At 31 December 2018, “Special accounts” reflect unsettled balances of Euros 37,362 thousand pertaining to securities sales, which were settled at the start of 2019 (an amount of Euros 79,960 thousand at 31 December 2017, settled at the start of 2018).

15. Other assets and liabilities

Details at 31 December 2018 and 2017 are as follows:

	Thousands of Euros	
	Other assets	
	2018	2017
Accruals	6,594	3,635
Operations in transit	1	-
Other assets	9,346	460
Total assets	15,941	4,095
	Other liabilities	
	2018	2017
Accruals	24,104	25,166
Operations in transit	1	-
Other liabilities	9,575	16,119
Total liabilities	33,680	41,285

Other assets at 31 December 2018 mainly include transitory balances relating to the offset of credit and debit cards to be settled, which were settled at the start of 2019.

Other liabilities mainly include balances payable to suppliers at 31 December 2018 and 2017.

16. Hedging derivatives

At 31 December 2018 and 2017, the Bank's main hedged positions and the derivatives designated to hedge those positions were as follows:

- Fair value hedges: Fixed-interest debt securities recognised in the available-for-sale assets portfolio. The risk is hedged with interest rate derivatives (fixed-for-floating swap).
- Cash flow hedges: The hedged assets are inflation-linked assets recognised in the available-for-sale assets portfolio. This risk is hedged with inflation swaps and interest rate swaps.

Details, by product and market type, of the fair value and notional amount of the hedging derivatives recognised on the accompanying balance sheets are as follows:

	Thousands of Euros					
	2018		2017		Notional amount	
	Assets	Liabilities	Assets	Liabilities	2018	2017
Interest rate	4	151,791	1,907	113,597	3,511,383	3,020,898
OTC options	-	-	-	-	-	-
OTC other	4	151,791	1,907	113,597	3,511,383	3,020,898
Organised market options	-	-	-	-	-	-
Organised market other	-	-	-	-	-	-
Equity instruments	-	-	-	-	-	-
Foreign exchange and gold	-	-	-	-	-	-
Credit	-	-	-	-	-	-
Commodities	-	-	-	-	-	-
Other	-	37,242	-	36,970	385,000	385,000
Fair value hedges	4	189,033	1,907	150,567	3,896,383	3,405,898
Interest rate	-	-	-	-	-	-
Equity instruments	-	-	-	-	-	-
Foreign exchange and gold	-	5,029	-	-	20,967	-
Commodities	-	-	-	-	-	-
Other	-	6,085	-	6,723	20,000	20,000
Cash flow hedges	-	11,114	-	6,723	40,967	20,000
Derivatives - hedge accounting	4	200,147	1,907	157,290	3,937,350	3,425,898
<i>Of which: OTC - Credit institutions</i>	4	114,830	1,575	86,206	1,271,583	1,354,898
<i>Of which: OTC - Other financial corporations</i>	-	85,317	332	71,084	2,665,767	2,071,000

Gains or losses on hedging instruments and the hedged item attributable to the hedged risk are not significant in 2018 and 2017 and are recognised under “Gains or losses on hedge accounting, net” (see note 28).

17. Provisions

This item comprises provisions for contingent exposures and commitments. Movement during 2018 and 2017 is as follows:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2017</u>
<i>Opening balance</i>	196	951
Additions (note 31)	396	-
(-) Amounts used	-	(24)
(-) Unused amounts reversed during the period (note 31)	(135)	(731)
Other movements	<u>6</u>	<u>-</u>
<i>Closing balance</i>	<u>463</u>	<u>196</u>

18. Accumulated Other Comprehensive Income. (Net equity)

Accumulated other comprehensive income in the balance sheets includes the amounts, net of the related tax effect, of adjustments to the assets and liabilities recognised temporarily in equity through the statement of total changes in equity until they are realised or extinguished, whereupon they are recognised definitively in equity through the income statement.

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 2018 and 2017 is as follows:

	Financial assets at fair value through other comprehensive income - equity instruments	Financial assets at fair value through other comprehensive income - debt instruments	Cash flow hedges	Total
2017 opening balance	-	14,305	(728)	13,577
Net valuation gains/(losses)	-	33,579	(152)	33,427
Amounts transferred to the income statement	-	(7,364)	-	(7,364)
Income tax	-	(7,865)	46	(7,819)
2018 opening balance	-	32,655	(834)	31,821
Effects of changes in accounting policies (see Note 1.c)	-	(20,410)	-	(20,410)
Fair value changes of equity instruments measured at fair value through other comprehensive income	(3,213)			(3,213)
Net valuation gains/(losses)	-	(17,411)	(444)	(17,855)
Amounts transferred to the income statement	-	(4,277)	-	(4,277)
Income tax	964	6,507	133	7,604
2018 closing balance	(2,249)	(2,936)	(1,145)	(6,330)

19. Share Capital and Share Premium

19.1 Share Capital

At 31 December 2016 the share capital of the Bank was represented by 1,779,645 registered shares of Euros 60.10 par value each, subscribed and fully paid.

At their Ordinary General Meeting held on 22 June 2017 the Bank's Shareholders agreed to increase capital with a charge to voluntary reserves, with an option for the Bank to acquire the free assignment rights (scrip dividend), with the Board of Directors being delegated to take all the necessary measures for its implementation and formalisation.

On 27 September 2017 capital was increased by 147,325 shares of Euros 60.10 par value. This increase was executed in a public deed and charged to voluntary reserves. Consequently, at 31 December 2017 share capital represented 1,926,970 shares, fully subscribed and paid.

Shareholders holding more than 10% of share capital at 31 December 2018 and 2017 are as follows:

Entity	% ownership	
	2018	2017
Gucajrural Inversiones, S.L.	84.700	84.700
DZ Bank AG	12.024	12.024

On 29 December 2017, the member Savings Banks of the Spanish Association of Rural Savings Banks, and which are Shareholders of the Bank, entered into a Framework Agreement encompassing the following agreements (see Note 1. k)):

- The shares held by the Savings Banks in Banco Cooperativo and Rural Servicios Generales (hereinafter RGA) were to be grouped in Grucajrrural Inversiones, S.L. (hereinafter Grucajrrural), a vehicle set up by the Association, as the founding partner, on 1 December 2017. This grouping was to follow the 29 Savings Banks' acquisition of the equity investments in Grucajrrural held by the Association as founding partner, and the subsequent transfer to this company, as a non-monetary contribution, of the shares held by the 29 Savings Banks in BCE and RGA, thereby increasing its capital, with newly issued equity investments in Grucajrrural being delivered to the contributing Savings Banks.

At their General Meeting held on 29 December 2017, the Shareholders of Grucajrrural agreed to the aforementioned capital increase through a non-monetary contribution.

On 23 February 2018 the European Central Bank and the Spanish National Securities Market Commission notified of its decision not to oppose the transfer of the shares to Grupcajrrural in the capital increase, which was executed in a public deed on 9 March 2018.

The Bank held no own shares at 31 December 2018 and 31 December 2017.

19.2 Share Premium

This item reflects the amount disbursed by the Shareholders over the par value of the shares when subscribing the share capital. At 31 December 2018 and 2017 the share premium amounts to Euros 85,972 thousand.

20. Retained Earnings, revaluation and other reserves

Details of these items at 31 December 2018 and 2017 are as follows:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2017</u>
Legal reserve	23,162	21,391
Capitalisation and revaluation reserve	14,513	11,794
Other reserves	218,838	200,040
	<u>256,513</u>	<u>233,225</u>

Movement

Details of changes in this item in 2018 and 2017 are shown in the Bank's statement of total changes in equity for those years.

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.

At 31 December 2018 and 2017, the Bank has appropriated to this reserve the minimum amount required by law.

21. Taxation

Tax Assets and Liabilities

Details at 31 December 2018 and 2017 are as follows:

	Thousands of Euros			
	Current		Deferred	
	2018	2017	2018	2017
Tax assets				
Temporary differences	-	-	34,281	21,660
Value added tax	330	226	-	-
Other items	3,721	2,554	-	-
Total	4,051	2,780	34,281	21,660
Tax liabilities				
Temporary differences	-	-	10,642	15,070
Income tax	-	-	-	-
Value added tax	413	537	-	-
Total	413	537	10,642	15,070

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 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 8,168 thousand and Euros 9,343 thousand at 31 December 2018 and 2017, 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 2018 and 2017 are as follows:

	Thousands of Euros			
	Assets		Liabilities	
	2018	2017	2018	2017
Temporary differences				
Pension obligations	413	420	-	-
Impairment losses on bad debts	7,755	8,923	-	-
Other items	12,799	10,925	40	40
Temporary differences recognised under Equity - Financial instruments	13,314	1,392	10,602	15,030
Unused tax deductions	-	-	-	-
Tax loss carryforwards	-	-	-	-
Total tax assets/liabilities	34,281	21,660	10,642	15,070

Movement in deferred tax assets and liabilities in 2018 and 2017 is as follows:

	Thousands of Euros	
	Assets	Liabilities
Balance at 31 December 2016	24,652	7,571
Additions	503	7,545
Disposals	(3,495)	(46)
Balance at 31 December 2017	21,660	15,070
Additions	15,192	7,499
Disposals	(2,571)	(11,927)
Balance at 31 December 2018	34,281	10,642

Additions of deferred tax assets mainly include non-deductible charges to cover pension obligations, portfolio impairment, asset valuation adjustments, the tax effect due to the fall in value of the portfolio at fair value against equity and other non-deductible provisions.

Due to the first-time adoption of Circular 4/2017 and regarding the need to adjust the credit and investment portfolio to the requirements thereof, on 1 January 2018 the Bank recognised tax assets and liabilities, giving rise to a credit or reversal charged to reserves for a net amount of Euros 1,799 thousand. A portion of these assets and liabilities has been subject to reversal, adjusting the taxable income for 2018 by a net amount of Euros 32 thousand, with the balance of these assets amounting to Euros 1,767 thousand at 31 December 2018.

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 impairment, 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.

Additions to deferred tax liabilities mainly reflect the tax effect of increases in the value of liabilities at fair value through equity. Disposals are essentially the tax effect of decreases in the value of liabilities at fair value through equity.

As indicated in note 2, the Bank 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 which may be reduced by certain credits.

A reconciliation of accounting profit for 2018 and 2017 with the taxable income that the Bank expects to declare after approval of the annual accounts is as follows:

	Thousands of Euros	
	2018	2017
Accounting profit for the year before tax	77,763	49,068
Permanent differences		
Donations and non-deductible expenses	35	64
Exemption for double taxation on dividends	(28,884)	(2,995)
Capitalisation reserve	(3,023)	(3,990)
Taxable accounting income	<u>45,891</u>	<u>42,147</u>
Temporary differences		
Provision for bad debts and pension obligations	(4,217)	(1,933)
Reversal of adjustments, first-time adoption Circular 4/2017	(106)	-
Portfolio impairment, amortisation/depreciation and other	3,906	328
Valuation adjustments	(3,250)	(7,500)
Other adjustments to the tax base with no effect on the income tax expense	<u>3,486</u>	<u>674</u>
Taxable income	45,710	33,716
Tax at 30%	13,713	10,115
Withholdings and payments on account	(13,721)	(12,199)
Deductions and credits with effect on the income tax expense	(45)	(37)
Other deductions with no effect on the income tax expense	<u>(86)</u>	<u>(433)</u>
Recoverable income tax	<u>(139)</u>	<u>(2,554)</u>

Permanent differences in taxable income reflect expenses for:

- Donations to non-profit entities and non-deductible penalties.
- Exemption for double taxation on dividends of entities in which the share in their capital is higher than 5%, under the terms of article 31 of Income Tax Law 27/2014.
- 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 Shareholders' equity in 2018 due to the distribution of 2017 profit approved by the Shareholders at their General Meeting on 20 June 2018. Equity increased by Euros 25,620 thousand in 2018, whereby within the limit of the 10% increase in equity, taxable income would be reduced by an amount of up to Euros 2,562 thousand. At 31 December 2018 the Bank has an unused reduction of Euros 461 thousand in taxable income for 2017, with a reduction of Euros 3,023 thousand having been made in 2018.

Temporary differences primarily include the reversal of tax adjustments to the provision for standard-risk loans and loans that are under special monitoring, deriving from application of Banco de España Circular 4/2017, the reversal of the accrual of fees and commissions on first-time adoption of Circular 4/2004, the net effect of including deferred assets and liabilities deriving from first-time adoption of Circular 4/2017 in 2018, those deriving from pension obligations, adjustments and reversals of portfolio impairment adjustments, 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 2018 of the asset valuation adjustment resulting from the tax assessment issued on 4 November 2015, and other non-tax deductible provisions.

Other adjustments to the tax base and deductions with no effect on the income tax expense reflect the recognition of tax profit and losses for a net amount of Euros 3,350 thousand at 31 December 2018 (Euros 674 thousand at 31 December 2017) and deductions totalling Euros 86 thousand (Euros 433 thousand at 31 December 2017) derived from investments in two economic interest groupings (EIG), in accordance with the terms of article 36 of Income Tax Law 27/2014. The Bank forms part of various 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. This also includes an amount of Euros 136 thousand for the inclusion in taxable income of the amount charged to reserves, deriving from the transfer of available-for-sale assets under the terms of article 17.1 of Income Tax Law 27/2014.

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 2018 and 2017 is calculated as follows:

	Thousands of Euros	
	2018	2017
Income tax expense for the year:		
Taxable accounting income at 30%	13,767	12,644
Credits and deductions	(45)	(37)
Prior years' tax adjustments	25	58
Income tax expense	13,747	12,665
Foreign tax expense	33	12
Total	13,780	12,677

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 by the taxation authorities or before the inspection period of four years has elapsed. At 31 December 2018 the Bank has open to inspection by the taxation authorities all the main applicable taxes since 2014, inclusive.

Due to the various possible interpretations of the tax regulations applicable to the operations performed by the Bank, 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 annual accounts.

The different tax benefits applied in the calculation of income tax payable of Banco Cooperativo Español, S.A. for 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Tax relief		
Deductions for international double taxation	33	12
Deduction for donations	12	25
Total	45	37

Independently of income tax recognised in the income statement, the Bank has recognised taxes relating to valuation adjustments to available-for-sale financial assets directly in equity, until these assets are sold. Tax assets in this respect amount to Euros 13,314 thousand and Euros 1,393 thousand at the 2018 and 2017 reporting dates, respectively. Tax liabilities in the same respect amount to Euros 10,602 thousand and Euros 15,030 thousand at the 2018 and 2017 reporting dates, respectively.

As a result of the first-time adoption of Banco de España Circular 4/2017, on the basis of transitional provision 39 of Income Tax Law 27/2014, the Bank must include in 2018, 2019 and 2020 the following amounts corresponding to credit and charges to reserves with the consideration of expense or income for tax purposes:

	Thousands of Euros		
	2018	2019	2020
Charges to reserves	865	865	865
Credits to reserves	(384)	(384)	(384)

22. Commitments and guarantees given

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 needed to reflect all transactions entered into by the Bank although they may not impinge on their net assets.

Details at 31 December 2018 and 2017 are as follows:

	<i>Thousands of Euros</i>	
	2018	2017
Contingent commitments given	70,420	359,243
Central banks	-	-
General governments	-	1,329
Credit institutions	114	276,405
Other financial corporations	4,892	3,883
Non-financial corporations	59,091	71,477
Households	6,323	6,149
Financial guarantees given	17,059	32,891
Central banks	-	-
General governments	-	-
Credit institutions	6,881	26,600
Other financial corporations	-	-
Non-financial corporations	10,155	6,203
Households	23	88
Other commitments given	151,462	75,007
Central banks	-	-
General governments	2,236	-
Credit institutions	82,936	43,926
Other financial corporations	10,161	8,828
Non-financial corporations	51,531	21,298
Households	4,598	955

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

This item includes transactions under which the Bank guarantees the obligations of a third party and which result from financial guarantees granted by the Bank or from other types of contract. This item also includes amounts payable by the Bank on behalf of third parties as a result of the commitments undertaken in the ordinary course of business, if the parties that are originally liable to pay fail to do so.

Income from guarantee instruments is recognised under Fee and commission income in the income statements and is calculated by applying the rate established in the related contract to the nominal amount of the guarantee (see note 27).

23. Off-Balance sheet funds under management

Details of off-balance sheet funds managed by the Banco Cooperativo Español, S.A. Group at 31 December 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Investment companies and mutual funds	4,823,338	4,698,652
Customer portfolios managed on a discretionary basis	1,268,971	1,384,462
Total	6,092,309	6,083,114

24. Assets and Liabilities (financial and non-financial): Fair Value

a) Fair value of financial assets and financial liabilities

At 31 December 2018 and 2017 the fair value of the Bank's financial instruments measured at fair value, 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.

2018						
Financial assets	Financial assets held for trading	Non-trading financial assets mandatorily at fair value through profit or loss	Financial assets designated at fair value through profit or loss	Financial assets at fair value through other comprehensive income	Derivatives - hedge accounting	Total
Level 1:						
Equity instruments	1,071	-	-	20,026	-	21,097
Debt securities	26,074	-	197,904	2,253,492	-	2,477,470
Level 2:						
Derivatives	767,325	-	-	-	4	767,329
Equity instruments	-	-	-	63	-	63
Debt securities	399	-	-	5,073	-	5,472
Level 3:						
Derivatives	37,501	-	-	-	-	37,501
Equity instruments	-	35	-	7,696	-	7,731
Debt securities	-	4,066	-	-	-	4,066
Loans and advances	-	14,390	-	-	-	14,390
	832,370	18,491	197,904	2,286,350	4	3,335,119

2017						
Financial assets	Financial assets held for trading	Non-trading financial assets mandatorily at fair value through profit or loss	Financial assets designated at fair value through profit or loss	Financial assets at fair value through other comprehensive income	Derivatives - hedge accounting	Total
Level 1:						
Equity instruments	-	-	-	11,612	-	11,612
Debt securities	66,148	-	-	2,250,292	-	2,316,440
Level 2:						
Derivatives	477,342	-	-	-	1,907	479,249
Equity instruments	-	-	-	52	-	52
Debt securities	80,801	-	-	19,904	-	100,705
Level 3:						
Derivatives	29,779	-	-	-	-	29,779
Equity instruments	-	-	-	11,759	-	11,759
Debt securities	-	-	-	-	-	-
Loans and advances	-	-	-	-	-	-
	654,070	-	-	2,293,619	1,907	2,949,596

The fair value and carrying amounts of financial assets carried at amortised cost at 31 December 2018 and 2017 are as follows:

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial assets at amortised cost				
Debt securities	1,050,113	1,088,053	77,368	83,994
Loans and advances				
Credit institutions	1,996,088	1,996,312	1,553,716	1,554,635
Other customers	611,242	668,876	1,938,474	2,014,605
Total	3,657,443	3,753,241	3,569,558	3,653,234

Financial liabilities	2018			Total
	Financial liabilities held for trading	Financial liabilities designated at fair value through profit or loss	Derivatives - hedge accounting	
Level 2:				
Derivatives	816,362	-	200,147	1,016,509
Deposits	-	4,731	-	4,731
Level 3:				
Derivatives	37,470	-	-	37,470
	853,832	4,731	200,147	1,058,710

Financial liabilities	2017			Total
	Financial liabilities held for trading	Financial liabilities designated at fair value through profit or loss	Derivatives - hedge accounting	
Level 1:				
Short positions	31,652	-	-	31,652
Level 2:				
Derivatives	539,148	-	157,290	696,438
Deposits	-	4,731	-	4,731
Level 3:				
Derivatives	29,786	-	-	29,786
	600,586	4,731	157,290	762,607

The fair value and carrying amounts of financial liabilities carried at amortised cost at 31 December 2018 and 2017 are as follows:

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Financial liabilities at amortised cost				
Deposits				
Central banks and credit institutions	5,766,023	5,767,511	5,041,159	5,038,864
Other customers	1,104,312	1,109,809	847,406	847,606
Total	6,870,335	6,877,320	5,888,565	5,886,470

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, it is a market-based measurement, not an entity-specific measurement.

All financial instruments, whether assets or liabilities, are initially recognised at fair value which, at that point, is the same as the transaction price, unless there is evidence to the contrary in an active market. Depending on the nature of the financial instrument, it may subsequently continue to be recognised at amortised cost or fair value through profit or loss or equity.

Insofar as possible, the fair value is determined as the market price of the financial instrument. However, for certain financial assets and liabilities, particularly derivatives, no market price is available. In such cases, the fair value must be estimated based on recent transactions involving similar instruments or, in the absence thereof, using proven mathematical valuation models in the international financial community. These models take into consideration the specific features of the asset or liability to be measured and, particularly, the various types of associated risk. However, the inherent limitations of the valuation techniques used and possible inaccuracies in the assumptions and parameters required by these models may result in a fair value of a financial asset or liability that does not exactly match the price at which the asset could be delivered or the liability settled at the measurement date.

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 Bank'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 2018 and 2017 the Bank 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 Bank'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 3,520 thousand (Euros 7,523 thousand in 2017), 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, or using the prices obtained from information service providers, primarily Bloomberg, Reuters and Iberclear, 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 advances - Loans to customers

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.

25. Interest Margin

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

a) Interest and other similar income

Details of the source of interest income recognised in the accompanying income statements during 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Loans and advances to general governments	19,352	20,399
Loans and advances to credit institutions	2,744	3,023
Loans and advances to other financial corporations	584	233
Loans and advances to non-financial corporations	4,647	4,465
Loans and advances to households	1,581	1,308
Debt securities	18,935	13,133
Rectification of income originating from hedge accounting	11,424	6,273
Other interest	28,778	35,477
	88,045	84,311
<i>Of which:</i>		
<i>Financial assets at fair value through other comprehensive income</i>	6,967	8,523
<i>Financial assets at amortised cost</i>	39,416	33,272
<i>Derivatives - hedge accounting</i>	11,424	6,273
<i>Other assets</i>	30,238	36,243

Other interest during 2018 and 2017 mainly includes interest from simultaneous transactions.

b) Interest expenses

Details in 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Deposits from central banks	-	1
Deposits from general governments	4	14
Deposits from credit institutions	7,386	7,696
Deposits from other financial corporations	21	23
Deposits from non-financial corporations	8	11
Deposits from households	22	36
Rectification of costs originating from hedge accounting	(857)	(2,320)
Other interest	27,359	23,669
	33,943	29,130

Other interest during 2018 and 2017 mainly includes interest from simultaneous transactions.

26. Dividends Income

This item reflects the dividends and remuneration from equity instruments deriving from profits generated by investees after the acquisition of the equity interest.

Details in 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Financial assets held for trading	197	-
Financial assets designated at fair value through profit or loss	523	396
Investments in subsidiaries, joint ventures and associates consolidated using methods other than the equity method	28,883	2,995
	29,603	3,391

27. Fee and Commission Income and Expenses

This item comprises the amount of all fees and commissions accrued in the year, except those forming an integral part of the effective interest rate on financial instruments.

Details of Fee and Commission Income in 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Securities	648	273
Asset management	12,064	5,250
Custody	7,402	6,076
Payment services	2,385	2,355
Customer resources distributed but not managed	1,347	2,326
Loan commitments given	115	120
Financial guarantees given	73	485
Other	4,703	3,440
	28,737	20,325

Details of Fee and Commission Expenses in 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Other	16,703	11,377
	16,703	11,377

28. Gains (losses) on financial assets and liabilities and exchange gains (losses)

This item includes 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 recognised in the income statement, as well as gains or losses on the sale and purchase of financial instruments.

Details of this item for 2018 and 2017 by type of instrument are as follows:

	Thousands of Euros	
	2018	2017
Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	4,282	7,301
Gains or losses on financial assets and liabilities held for trading, net	7,917	5,802
Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss, net	(2,474)	-
Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net	47	(31)
Gains or losses on hedge accounting, net	(53)	(4)
	9,719	13,068
Exchange gains	917	943
	10,636	14,011

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

Details for 2018 and 2017, based on the nature of the financial instruments giving rise to these balances, excluding exchange gains/losses, are as follows:

	Thousands of Euros	
	2018	2017
Debt securities	7,105	13,750
Equity instruments	(29)	2
Loans and advances to other debtors	(3,322)	-
Trading derivatives and hedge accounting	5,931	(582)
Other	34	(102)
	9,719	13,068

The amount recognised under gains or losses on hedge accounting, net, reflects fair value hedges, distinguishing between hedging instruments and the hedged item. Gains and losses recognised in 2018 and 2017 are as follows:

	<i>Thousands of Euros</i>	
	2018	2017
Fair value changes of the hedging instrument including discontinued operations	(34,059)	(14,829)
Fair value changes of the hedged item attributable to the hedged risk	34,006	14,825
	(53)	(4)

29. Other Operating Income and Expenses

Details of other operating income in the accompanying income statements for 2018 and 2017 are as follows:

	<i>Thousands of Euros</i>	
	2018	2017
Sales and income from the provision of non-financial services	3,889	2,596
Other non-recurring income	79	2
Other items	122	100
	4,090	2,698

Details of other operating expenses in the accompanying income statements for 2018 and 2017 are as follows:

	<i>Thousands of Euros</i>	
	2018	2017
Contribution to the Deposit Guarantee Fund and SRF	5,385	7,885
Contribution to the Institutional Protection Mechanism	4,000	2,400
Other items	169	83
	9,554	10,368

30. Administrative expenses

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 for 2018 and 2017 are as follows:

	Thousands of Euros	
	2018	2017
Salaries and wages	12,536	11,819
Social Security	2,674	2,656
Transfers to defined benefit plans	25	25
Transfers to defined contribution plans	86	74
Termination benefits	81	-
Other personnel expenses	164	175
	15,566	14,749

The Group's average headcount, distributed by professional category and type of contract, during 2018 and 2017, as well as that existing at the related reporting dates, is as follows:

	2018			2017		
	Male	Female	Average	Male	Female	Average
Management team	12	1	13	11	1	12
Directors	16	8	23	15	7	23
Department managers	13	12	23	10	7	16
Technicians	43	56	97	45	58	102
Administrative staff	25	39	63	21	38	58
	109	116	219	102	111	211
By type of contract						
Indefinite	107	113	215	100	110	208
Temporary	2	3	4	2	1	3
	109	116	219	102	111	211

At 31 December 2018 and 2017, four Bank employees had a disability.

Other administrative expenses

Details for 2018 and 2017 are as follows:

	<i>Thousands of Euros</i>	
	2018	2017
Property, fixtures and materials	1,241	1,194
Information technology	1,939	1,638
Communications	1,496	1,322
Advertising and publicity	11	52
Legal and lawyer expenses	205	391
Technical reports	985	808
Security and armoured cash transport services	237	237
Insurance premiums	273	215
Governing and control bodies	195	200
Entertainment and staff travel expenses	294	248
Association membership fees	285	306
Outsourced administrative services	1,226	1,194
Contributions and taxes	569	462
Other	184	264
	9,140	8,531

KPMG Auditores S.L., the auditors of the Bank's individual annual accounts, have invoiced fees and expenses for professional services during the years ended 31 December 2018 and 2017, as follows:

	Thousands of Euros	
	2018	2017
Audit services	32	25
Other assurance services	28	20
Other services	-	-
	60	45

The amounts detailed in the above table include the total fees for the 2018 and 2017 audits, irrespective of the invoice date.

Furthermore, during 2017 KPMG Auditores, S.L. invoiced the Bank an amount of Euros 24 thousand for the audit of the consolidated annual accounts of the Banco Cooperativo Español, S.A. Group.

Other assurance services provided to the Bank by KPMG Auditores, S.L. during the year ended 31 December 2018 comprise the following:

- Agreed-upon procedures report on certain information included in the reporting form relating to the ex ante contributions to the Single Resolution Fund.
- Agreed-upon procedures report on certain information relating to the forms for the second series of targeted longer-term refinancing operations (TLTRO II).
- Report on the protection of customer assets.

Other companies forming part of the KPMG Group invoiced the Bank the following fees and expenses for professional services during the years ended 31 December 2018 and 2017:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2017</u>
Other services	161	-

31. Provisions or reversals of provisions

In 2018 and 2017 net charges to this item of the income statements were:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2017</u>
Commitments and guarantees given (note 17)	261	(750)
Other provisions	13	19
	<u>274</u>	<u>(731)</u>

32. Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss

Impairment of financial assets, disclosed by nature, for 2018 and 2017, recognised in the accompanying income statements is as follows:

	<u>Thousands of Euros</u>	
	<u>2018</u>	<u>2017</u>
Financial assets designated at fair value through other comprehensive income	(56)	196
Financial assets at amortised cost	3,639	(1,052)
	<u>3,583</u>	<u>(856)</u>

33. Related party transactions

In addition to the information provided in note 4 on remuneration received, details of balances in the balance sheet at 31 December 2018 and 2017 and in the income statements for 2018 and 2017, originating from transactions with related parties are as follows:

	Thousands of Euros					
	Subsidiaries		Senior Management personnel		Other related parties	
	2018	2017	2018	2017	2018	2017
Assets						
Loans and advances to customers	88,395	705,467	1,050	577	90,405	675
Derivatives	-	-	-	-	10,416	-
Other assets	-	-	-	-	-	-
Liabilities						
Deposits from customers	4,209	3,633	1,257	1,299	168,133	4,308
Derivatives	-	-	-	-	17,951	-
Other						
Guarantees given	86	126	-	-	-	-
Contingent commitments given	3,253	3,291	299	265	975	240
Profit and loss						
Interest income	261	752	1	5	781	4
Interest expenses	1	1	-	-	-	-
Dividends Income	28,883	2,995	-	-	2	2
Fee and commission income	2,238	1,728	-	-	149	-
Administrative Expenses	994	689	-	-	-	-

34. 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 2018 Annual Report presented by the head of the service to the Board of Directors at their meeting held on 30 January 2019 is summarised below:

During 2018 the Customer Service Department received 42 complaints, 24 of which were admitted. From the total number of complaints admitted, 22 were resolved in 2018 (of which two were resolved in favour of the customer and 20 in favour of the Bank) and two have been resolved in 2019. Only one of the complaints received has been lodged by a legal entity.

Details of complaints received are as follows:

	Number	
	2018	2017
Loans	40	53
Deposits	-	1
Other banking products	-	4
Investment services	2	-
Collection and payment services	-	1
Other	-	1
	42	60

The number of complaints resolved during 2018, by autonomous region, is as follows:

	Number	
	2018	2017
Andalusia	1	-
Castilla La Mancha	2	3
Catalonia	-	-
Madrid	19	52
Basque Country	-	2
Extremadura	-	-
Galicia	-	-
Navarre	-	3

35. Risk management

The Bank has a strategic risk framework, the purpose of which is to ensure the control and proactive management of all risks to which the Group is exposed. This framework is partly instrumented through a Risk Appetite Framework (RAF), which stipulates the quantity and diversity of risks sought and tolerated by the Bank to achieve its business objectives, while preserving a balance between risk and return.

The RAF is composed of quantitative metrics, which enable objective monitoring of risk management, and complementary qualitative aspects. Risk management and control is configured as a far-reaching set of principles, policies, procedures and advanced valuation methodologies, integrated to form an efficient decision-making structure under a risk governance framework that is compliant with the legislation in force.

For each relevant risk to which the Group is exposed, the RAF details the main parties involved, their functions, policies, methods and procedures, as well as the monitoring and control mechanisms. It also specifies the organisation of the risk function, indicating the roles and responsibilities of the different risk departments and committees and their control systems, which are tailored to the activities of the business units, including the function of granting loans and credit.

The main financial risks to which the Bank is exposed are capital risk, excessive leverage, liquidity risk, profitability risk, operational risk, interest rate risk, credit risk, concentration risk and market risk. The most relevant of these is credit risk.

The main non-financial risks to which the Group is exposed are operational risk, tax risk and regulatory compliance risk.

35.1 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 given, 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 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.

35.1.1 Maximum credit risk exposure level

The following table shows the maximum credit risk exposure level assumed by the Bank at 31 December 2018 and 2017 for each type of financial instrument, without deducting collateral or any other guarantees received to ensure repayment by borrowers:

Type of instruments	Thousands of Euros						Total
	Cash, cash balances with central banks and other demand deposits	Financial assets held for trading	Non-trading financial assets mandatorily at fair value through profit or loss	Financial assets designated at fair value through profit or loss	Financial assets at fair value through other comprehensive income	Financial assets at amortised cost	
Debt instruments							
Loans and advances to central banks	425,253	-	-	-	-	-	425,253
Loans and advances to credit institutions	1,045,734	-	-	-	-	1,996,250	3,041,984
Loans and advances to customers	-	-	14,390	-	-	639,470	653,860
Debt securities	-	26,473	4,066	197,904	2,259,361	1,050,113	3,537,917
Total debt instruments	1,470,987	26,473	18,456	197,904	2,259,361	3,685,833	7,659,014
Equity instruments	-	1,071	35	-	27,785	-	28,891
Guarantees and commitments given							
Financial guarantees given	-	-	-	-	-	17,059	17,059
Other commitments given	-	-	-	-	-	151,462	151,462
Total guarantees and commitments given	-	-	-	-	-	168,521	168,521
Other exposures							
Derivatives	-	804,826	-	-	-	-	804,826
Contingent commitments given	-	-	-	-	-	70,420	70,420
Total other exposures	-	804,826	-	-	-	70,420	875,246
Maximum credit risk exposure level	1,470,987	832,370	18,491	197,904	2,287,146	3,924,774	8,731,672

Thousands of Euros							
Type of instruments	2017						Total
	Cash, cash balances with central banks and other demand deposits	Financial assets held for trading	Non-trading financial assets mandatorily at fair value through profit or loss	Financial assets designated at fair value through profit or loss	Financial assets at fair value through other comprehensive income	Financial assets at amortised cost	
Debt instruments							
Loans and advances to central banks	-	-	-	-	-	-	-
Loans and advances to credit institutions	742,858	-	-	-	-	1,553,769	2,296,627
Loans and advances to customers	-	-	-	-	-	1,974,596	1,974,596
Debt securities	-	146,949	-	-	2,270,502	78,238	2,495,679
Total debt instruments	742,858	146,949	-	-	2,270,502	3,606,603	6,766,902
Equity instruments	-	-	-	-	23,423	-	23,423
Guarantees and commitments given							
Financial guarantees given	-	-	-	-	-	32,891	32,891
Other commitments given	-	-	-	-	-	75,007	75,007
Total guarantees and commitments given	-	-	-	-	-	107,898	107,898
Other exposures							
Derivatives	-	507,121	-	-	-	-	507,121
Contingent commitments given	-	-	-	-	-	359,243	359,243
Total other exposures	-	507,121	-	-	-	359,243	866,364
Maximum credit risk exposure level	742,858	654,070	-	-	2,293,925	4,073,734	7,764,587

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

- Debt instruments recognised under assets in the 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 given comprise available balances bearing no conditions for debtors.
- Guarantees given are recognised at the maximum amount guaranteed by the Bank. In general, most of these balances are estimated to reach maturity without requiring any actual financing by the Entity (see note 22).
- Information on other credit risk exposures, such as counterparty risk related to the contracting of derivative financial instruments, is stated at the carrying amount.

The shareholder Rural Savings Banks and the Bank have a “Cash Treasury Agreement” in force whereby the former transfer funds to the Bank for investment in the interbank market and financial assets. The Rural Savings Banks provide a joint guarantee for any potential losses incurred by the Bank as a result of investing the funds received.

Details of the assets related to the investment of funds received from the shareholder Rural Savings Banks, and thus secured by the latter, which amounted to Euros 867,897 thousand and Euros 630,452 thousand at 31 December 2018 and 2017, respectively, are as follows:

	Thousands of Euros	
	2018	2017
Cash, cash balances with central banks and other demand deposits	195,875	46,745
Financial assets held for trading - Debt securities	-	123,706
Financial assets designated at fair value through profit or loss - Debt securities	197,904	-
Financial assets at fair value through other comprehensive income - Debt securities	463,118	293,001
Financial assets at amortised cost - Loans and advances to credit institutions	11,000	167,000
	867,897	630,452

Details of loans and advances, by counterparty and product, and net of impairment losses, classified in the different asset categories at 31 December 2018 and 2017 are as follows:

	31 December 2018					
	Central banks	General governments	Credit institutions	Other financial corporations	Non-financial corporations	Households
On demand, short notice (current account)	425,253	-	1,045,734	119	8	2
Credit card debt	-	-	17	5	73	571
Trade receivables	-	175	-	-	56,499	-
Finance leases	-	-	-	-	976	174
Reverse repurchase loans	-	-	1,740,233	-	-	-
Other term loans	-	19,078	228,501	43,940	274,149	104,932
Advances that are not loans	-	265	27,337	120,946	3,554	166
Loans and advances	425,253	19,518	3,041,822	165,010	335,259	105,845
<i>Of which: loans secured by real estate collateral</i>	-	-	-	83	12,278	70,047
<i>Of which: other secured loans</i>	-	-	11	2,809	21,176	16,267
<i>Of which: consumer credit</i>	-	-	-	-	-	18,279
<i>Of which: home purchase loans</i>	-	-	-	-	-	67,348
<i>Of which: project finance loans</i>	-	-	-	-	-	-

31 December 2017

	Central banks	General governments	Credit institutions	Other financial corporations	Non-financial corporations	Households
On demand, short notice (current account)	153,525	-	588,417	5	-	2
Credit card debt	-	-	16	8	85	545
Trade receivables	-	732	-	-	53,121	-
Finance leases	-	-	-	-	1,380	84
Reverse repurchase loans	-	-	1,152,523	-	-	-
Other term loans	-	658,895	375,782	28,743	915,039	96,009
Advances that are not loans	-	-	25,396	182,368	1,428	30
Loans and advances	153,525	659,627	2,142,134	211,124	971,053	96,670
<i>Of which: loans secured by real estate collateral</i>	-	-	-	96	14,461	68,578
<i>Of which: other secured loans</i>	-	-	4	-	24,636	13,158
<i>Of which: consumer credit</i>	-	-	-	-	-	11,966
<i>Of which: home purchase loans</i>	-	-	-	-	-	65,003
<i>Of which: project finance loans</i>	-	-	-	-	-	-

35.1.2 Credit rating of credit risk exposures

The Bank 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 2018 and 2017, based on ratings (external or internal, in line with the credit rating models developed by the Entity) is as follows:

Credit rating	2018		2017	
	Thousands of Euros	%	Thousands of Euros	%
AAA	124,296	1.7	133	0.0
AA+	20,768	0.3	39,094	0.6
AA	536	0.0	10,695	0.2
AA-	40,464	0.6	19,719	0.3
A+	304,040	4.1	29,049	0.5
A.	5,007,847	68.0	83,579	1.4
A-	54,751	0.7	4,716,911	77.8
BBB+	545,829	7.4	280,044	4.6
BBB	598,869	8.1	341,143	5.6
BBB-	101,186	1.4	115,920	1.9
BB+	28,283	0.4	14,860	0.3
BB	45,238	0.6	58,597	1.0
Below BB	162,004	2.2	85,795	1.4
Not rated	329,123	4.5	265,986	4.4
Total	7,363,234	100.0	6,061,525	100.0

35.1.3 Loans and advances to customers Details by counterparty and collateral received

Details of loans and advances to other debtors by activity and type of collateral, excluding advances that are not loans, at 31 December 2018 and 2017 are as follows:

		2018						
		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%
General governments	19,253	-	-	-	-	-	-	-
Other financial institutions	44,087	85	2,820	-	2,490	-	-	415
Non-financial corporations and sole proprietorships	333,551	12,517	28,027	14,178	8,756	7,366	1,798	8,446
Real estate construction and property development	43,172	-	-	-	-	-	-	-
Construction of civil works	-	-	-	-	-	-	-	-
Other purposes	290,379	12,517	28,027	14,178	8,756	7,366	1,798	8,446
Large corporations	117,050	3,783	10,620	9,234	-	-	664	4,505
SMEs and sole proprietorships	173,329	8,734	17,407	4,944	8,756	7,366	1,134	3,941
Other household loans	103,810	70,086	15,828	17,425	24,340	30,080	9,295	4,774
Housing	67,348	65,292	1,802	14,154	17,670	22,291	8,205	4,774
Consumer	18,427	-	784	234	-	550	-	-
Other purposes	18,035	4,794	13,242	3,037	6,670	7,239	1,090	-
TOTAL	500,701	82,688	46,675	31,603	35,586	37,446	11,093	13,635
MEMORANDUM ITEM								
<i>Refinancing, refinanced and restructured operations (net of specific provisions)</i>	7,698	601	4,597	3,479	101	-	-	1,618

2017

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%	
General governments	659,627	-	-	-	-	-	-	-
Other financial institutions	28,783	96	-	-	-	96	-	-
Non-financial corporations and sole proprietorships	971,234	15,197	28,097	20,274	5,152	13,368	960	3,541
Real estate construction and property development	52,899	-	-	-	-	-	-	-
Construction of civil works	-	-	-	-	-	-	-	-
Other purposes	918,335	15,197	28,097	20,274	5,152	13,368	960	3,541
Large corporations	158,563	11,717	8,742	17,373	-	-	694	2,391
SMEs and sole proprietorships	759,772	3,481	19,355	2,901	5,152	13,368	266	1,150
Other household loans and non-profit institutions serving households	95,005	67,923	12,311	17,422	19,507	27,598	8,927	6,781
Housing	65,005	63,332	1,439	13,642	13,963	22,549	7,949	6,668
Consumer	12,526	-	324	81	-	244	-	-
Other purposes	17,474	4,592	10,548	3,699	5,544	4,806	978	113
TOTAL	1,754,648	83,217	40,408	37,696	24,659	41,062	9,887	10,321
MEMORANDUM ITEM <i>Refinancing, refinanced and restructured operations (net of specific provisions)</i>	8,272	1,063	5,338	4,471	108	-	-	1,823

Refinancing and restructuring policy

The Bank's refinancing and restructuring policy is defined in accordance with the specifications laid down in the Banco de España regulation.

Its objective is to recover all amounts owed and it reflects the need to immediately recognise amounts deemed 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.

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

- Refinancing transaction: a transaction which, irrespective of the borrower or collateral/guarantees, is granted or used for economic or legal reasons relating to the borrower's/s' current or foreseeable financial difficulties, either to settle one or several transactions granted by the entity itself or by others in its group to the borrower/s or to one or more other companies in its/their economic group, or to bring these transactions wholly or partially up to date in payment, in order to facilitate debt payments by borrowers whose transactions are terminated or refinanced (principal and interest) because they are, or will foreseeably become, unable to comply with the terms and conditions on time and in due form.
- Refinanced transaction: a transaction which is brought wholly or partially up to date in payment as a result of a refinancing transaction carried out by the entity itself or by another entity in its economic group.
- Restructured transaction: a transaction in which, for economic or legal reasons relating to the borrower's/s' current or foreseeable financial difficulties, the financial terms and conditions are changed in order to facilitate payment of the debt (principal and interest) because the borrower is or will foreseeably become unable to comply with those terms and conditions on time and in due form, even if that change was envisaged in the contract. In any event, transactions are considered to be restructured when a debt reduction takes place, assets are received to reduce the debt or their terms and conditions are changed to extend their maturity, change the repayment table to reduce instalments in the short term or reduce their frequency, or establish or extend the principal repayment and/or interest grace period, except when it can be demonstrated that the terms and conditions were changed for reasons other than the borrowers' financial difficulties and are similar to those applying in the market on the date of change on transactions with borrowers of a similar risk profile.
- Novation transaction: a transaction entered into to replace another transaction previously granted by the entity 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:

- Permorfing exposure. Refinancing, refinanced or restructured transactions that do not meet the requirements to be classified in other categories.
- Watchlist exposure. 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 also includes 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 due to being irrecoverable that exceed the allowances and provisions resulting from applying the percentages established for the corresponding risk segment in the alternative solutions included in the new Annex IX of Circular 4/2017.
- 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 2018 the Bank's outstanding refinanced balance totals Euros 9,645 thousand (Euros 14,482 thousand at 31 December 2017). This figure includes loans classified as performing exposures and watchlist, and as non-performing exposures, representing 1.6% of total loans and advances to customers (0.8% in 2017).

2018

Thousands of Euros

	Credit institutions	General governments	Other financial corporations and sole proprietorships (financial business)	Non-financial corporations and sole proprietorships (non-financial business)	<i>Of which: financing of real estate construction and property development (including land)</i>	Other household loans	Total	Additional information: financing classified as non-current assets and disposal groups held for sale
Unsecured								
Number of transactions	-	-	-	10	-	4	14	-
Gross carrying amount	-	-	-	4,985	-	81	5,066	-
Secured								
Number of transactions	-	-	-	6	-	1	7	-
Gross carrying amount	-	-	-	4,478	-	101	4,579	-
Impairment allowances	-	-	-	(1,932)	-	(15)	(1,947)	-
<i>Of which: doubtful exposures</i>								
<i>Unsecured</i>								
<i>Number of transactions</i>	-	-	-	2	-	2	4	-
<i>Gross carrying amount</i>	-	-	-	1,001	-	13	1,014	-
<i>Secured</i>								
<i>Number of transactions</i>	-	-	-	-	-	-	-	-
<i>Gross carrying amount</i>	-	-	-	-	-	-	-	-
<i>Specific allowance or provision</i>	-	-	-	-	-	-	-	-
TOTAL								
Number of transactions	-	-	-	16	-	5	21	-
Gross carrying amount	-	-	-	9,463	-	182	9,645	-
Impairment allowances	-	-	-	(1,932)	-	(15)	(1,947)	-

2017

Thousands of Euros

	Credit institutions	General governments	Other financial corporations and sole proprietorships (financial business)	Non-financial corporations and sole proprietorships (non-financial business)	<i>Of which: financing of real estate construction and property development (including land)</i>	Other household loans	Total	Additional information: financing classified as non-current assets and disposal groups held for sale
TOTAL								
Unsecured								
Number of transactions	-	-	-	12	-	5	17	-
Gross carrying amount	-	-	-	3,261	-	238	3,499	-
Secured								
Number of transactions	-	-	-	9	1	1	10	-
Gross carrying amount	-	-	-	10,875	3,086	108	10,983	-
Impairment allowances	-	-	-	(6,143)	(3,086)	(67)	(6,210)	-
<i>Of which: doubtful exposures</i>	-	-	-					
Unsecured								
Number of transactions	-	-	-	1	-	-	1	-
Gross carrying amount	-	-	-	361	-	-	361	-
Secured								
Number of transactions	-	-	-	1	1	-	1	-
Gross carrying amount	-	-	-	3,086	3,086	-	3,086	-
Specific allowance or provision	-	-	-	3,195	3,086	-	3,195	-
TOTAL								
Number of transactions	-	-	-	21	1	6	27	-
Gross carrying amount	-	-	-	14,136	3,086	346	14,482	-
Impairment allowances	-	-	-	(6,143)	(3,086)	(67)	(6,210)	-

35.1.4 Credit risk on real estate construction and property development

Details of financing earmarked for real estate construction and property development by category of asset at 31 December 2018 and 2017 are as follows:

	<u>31.12.2017</u>	Reclassification first-time adoption Circular 4/2017	<u>01.01.2018</u>	<u>Derecognitions during the year</u>	<u>Depreciation</u>	<u>Impairment</u>	<u>31.12.2018</u>
Non-trading financial assets mandatorily at fair value through profit or loss	-	17,711	17,711	-	-	(3,321)	14,390
Financial assets at amortised cost	53,209	(17,711)	35,498	(3,086)	(3,181)	-	29,231
	53,209	-	53,209	(3,086)	(3,181)	(3,321)	43,621
<i>Of which: doubtful</i>	3,086	-	3,086	(3,086)	-	-	-

Details of provisions for and/or impairment of loans and advances earmarked for real estate construction and property development at 31 December 2018 and 2017 are as follows:

	<u>31.12.2017</u>	Charges to (reversal of) provisions for the year	<u>31.12.2018</u>
Financial assets at amortised cost	(4,001)	3,444	557
	(4,001)	3,444	557
<i>Of which: doubtful</i>	(3,086)	3,086	-

The figures above reflect financing extended for real estate construction and property development. Consequently, following Banco de España 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) assigned to the debtor. As a result, if the debtor is: (a) a real estate company but uses the financing for a purpose other than real estate construction or property development, the loan will not be included in these tables, and (b) if the company's principal activity is not real estate construction or development but it uses the loan to finance property development, it will be included in these tables.

Details of loans and advances to customers excluding general governments at 31 December 2018 and 2017 are as follows

	Thousands of Euros	
	2018	2017
Total loans and advances to customers excluding general governments	606,114	1,278,847
Total assets	8,530,492	7,306,089
Impairment and provisions for exposures classified as performing and watchlist	(26,294)	(32,379)

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

	Thousands of Euros	
	Gross amount	
	2018	2017
1. Unsecured	43,621	50,123
2. With mortgage guarantee	-	3,086
2.1. Finished buildings	-	3,086
2.1.1 Housing	-	-
2.1.2 Other	-	3,086
2.2. Buildings under construction	-	-
2.2.1 Housing	-	-
2.2.2 Other	-	-
2.3. Land	-	-
2.3.1 Developed land	-	-
2.3.2 Other land	-	-
Total	43,621	53,209

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

	Thousands of Euros			
	2018		2017	
	Gross amount	Of which: doubtful	Gross amount	Of which: doubtful
Home purchase loans	66,563	1	64,400	5
Unsecured	1,861	-	1,424	-
With mortgage guarantee	64,702	1	62,976	5

The following table shows a breakdown of mortgage loans extended to acquire homes at 31 December 2018 and 2017 by percentage of total risk on the latest available appraisal value (LTV):

Thousands of Euros						
2018						
LTV bracket						
	LTV < 40%	40% < LTV < 60%	60% < LTV < 80%	80% < LTV < 100%	LTV > 100%	Total
Gross amount	13,115	17,195	21,530	8,215	4,647	64,702
Of which: doubtful	1	-	-	-	-	1

Thousands of Euros						
2017						
LTV bracket						
	LTV < 40%	40% < LTV < 60%	60% < LTV < 80%	80% < LTV < 100%	LTV > 100%	Total
Gross amount	12,733	13,821	21,946	7,956	6,520	62,976
Of which: doubtful	5	--	--	--	--	5

The Bank has not recognised any foreclosed assets at 31 December 2018 and 2017.

35.1.5 Past-due unimpaired financial assets

Details of past-due unimpaired financial assets at 31 December 2018 and 2017, classified on the basis of the time elapsed since maturity, by nature of the financial instrument and by counterparty, are as follows:

31.12.2018				
Thousands of Euros				
	≤ 30 days	> 30 days ≤ 60 days	> 60 days ≤ 90 days	Total
Debt securities	-	-	-	-
Loans and advances				
General governments	-	-	-	-
Other financial corporations	-	-	-	-
Non-financial corporations	-	-	84	84
Households	153	177	220	550
Total	153	177	304	634

31.12.2017				
Thousands of Euros				
	≤ 30 days	> 30 days ≤ 60 days	> 60 days ≤ 90 days	Total
Debt securities	-	-	-	-
Loans and advances				
General governments	-	-	-	-
Other financial corporations	-	-	-	-
Non-financial corporations	-	-	-	-
Households	261	174	43	478
Total	261	174	43	478

35.1.6 Doubtful financial assets and impairment allowances

Details of financial assets at amortised cost, by nature of the financial instrument and by counterparty, and of impairment allowances, indicating whether these have been calculated on an individual or collective basis, are as follows:

Thousands of Euros						
2018						
	Gross carrying amount	Of which: doubtful	Specific impairment allowances for financial assets, estimated individually	Specific impairment allowances for financial assets, estimated collectively	Collective impairment allowances for incurred but not reported losses	Total
Debt securities	1,050,113	-	-	-	-	1,050,113
Loans and advances	2,635,720	2,101	-	(1,201)	(27,189)	2,607,330
Central banks	-	-	-	-	-	-
General governments	19,518	-	-	-	-	19,518
Credit institutions	1,996,250	-	-	-	(162)	1,996,088
Other financial corporations	165,832	1,186	-	-	(823)	165,009
Non-financial corporations	345,190	-	-	(531)	(23,790)	320,869
Households	108,930	915	-	(670)	(2,414)	105,846
Total	3,685,833	2,101	-	(1,201)	(27,189)	3,657,443

Thousands of Euros						
2017						
	Gross carrying amount	<i>Of which: doubtful</i>	Specific impairment allowances for financial assets, estimated individually	Specific impairment allowances for financial assets, estimated collectively	Collective impairment allowances for incurred but not reported losses	Total
Debt securities	78,228	-	-	-	(860)	77,368
Loans and advances	3,528,365	5,906	(3,086)	(1,876)	(31,213)	3,492,190
Central banks	-	-	-	-	-	-
General governments	659,627	-	-	-	-	659,627
Credit institutions	1,553,769	-	-	-	(53)	1,553,716
Other financial corporations	211,590	-	-	-	(466)	211,124
Non-financial corporations	1,005,185	5,428	(3,086)	(1,494)	(29,552)	971,053
Households	98,194	478	-	(382)	(1,142)	96,670
Total	3,606,593	5,906	(3,086)	(1,876)	(32,073)	3,569,558

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

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

35.1.7 Movement in impairment losses

Movement in impairment losses recognised by the Bank in 2018 and 2017 by type of financial asset is as follows:

	Thousands of Euros						
	2018						
	Balance at 31 December 2017	IFRS 9 first-time adoption adjustments	Balance at 1 January 2018	Increases (decreases) during the year due to charges for expected credit losses	Decreases for amounts applied, charged to valuation adjustments	Transfers between valuation adjustments and other adjustments	Balance at 31 December 2018
Specific impairment allowances for financial assets measured individually	3,086	-	3,086	-	(3,086)	-	-
Loans and advances	3,086	-	3,086	-	(3,086)	-	-
Specific impairment allowances for financial assets, estimated collectively	1,876	37	1,913	240	(1,057)	105	1,201
Debt securities	-	37	37	-	-	-	37
Loans and advances	1,876	-	1,876	240	(1,057)	105	1,164
Collective impairment allowances for incurred but not reported losses on financial assets	32,379	639	33,018	4,435	(9,354)	(114)	27,985
Debt securities	1,166	405	1,571	(812)	-	-	759
Loans and advances	31,213	234	31,447	5,247	(9,354)	(114)	27,226
Total	37,341	676	38,017	4,675	(13,497)	(9)	29,186

	Thousands of Euros				
	2017				
	Balance at 31 December 2016	Increases (decreases) during the year due to charges for expected credit losses	Decreases for amounts applied, charged to valuation adjustments	Transfers between valuation adjustments and other adjustments	Balance at 31 December 2017
Specific impairment allowances for financial assets measured individually	3,941	-	-	(855)	3,086
Loans and advances	3,941	-	-	(855)	3,086
Specific impairment allowances for financial assets, estimated collectively	367	478	(114)	1,145	1,876
Loans and advances	367	478	(114)	1,145	1,876
Collective impairment allowances for incurred but not reported losses on financial assets	33,321	(662)	(44)	(236)	32,379
Debt securities	1,419	(209)	-	-	1,166
Loans and advances	31,902	(453)	(44)	(236)	31,213
Total	37,629	(184)	(158)	54	37,341

35.1.8 Impaired and derecognised financial assets

Movement in 2018 and 2017 in the Bank's impaired financial assets, which have not been recognised as the probability of their recovery is considered remote, although the Bank continues its efforts to collect the amounts receivable, is as follows:

	Thousands of Euros	
	2018	2017
Opening balance	7,224	7,537
Charges	4,154	676
Application of accumulated impairment losses	4,138	115
Direct write-down in the income statement	7	534
Contractually payable interest	10	27
Derecognitions	(1,101)	(989)
Collection of principal from counterparties in cash	(15)	(171)
Collection of interest from counterparties in cash	(1)	(2)
Pardoning of debt	(1,085)	(816)
Closing balance	10,277	7,224

35.2 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 Bank'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 Entity 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 2018 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 2018 and 2017 was as follows:

	2018							Total
	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	
Assets								
Cash, cash balances with central banks and other demand deposits (note 5)	1,471,851	-	-	-	-	-	-	1,471,851
Loans to credit institutions (note 10)	-	895,951	96,158	21,915	980,408	1,656	-	1,996,088
Loans and advances to customers (notes 7 and 10)	16,250	2,921	21,829	199,774	197,364	187,494	-	625,632
Fixed income portfolio (notes 6, 7, 8, 9 and 10)	-	47,416	8,827	1,098,317	1,069,868	1,312,693	-	3,537,121
Other assets	-	80,483	120,724	185,110	418,510	-	94,973	899,800
Total assets	1,488,101	1,026,771	247,538	1,505,116	2,666,150	1,501,843	94,973	8,530,492
Liabilities								
Deposits from central banks and credit institutions (note 14)	2,295,134	1,523,656	142,315	376,362	1,426,900	1,656	-	5,766,023
Deposits from customers (note 14)	314,912	513,911	24,759	232,708	18,020	2	-	1,104,312
Other liabilities	50,300	105,398	158,097	242,415	548,069	-	555,878	1,660,157
Total Liabilities	2,660,346	2,142,965	325,171	851,485	1,992,989	1,658	555,878	8,530,492
Simple gap	(1,172,246)	(1,116,194)	(77,633)	653,631	673,162	1,500,184	(460,904)	-
Accumulated gap	(1,172,246)	(2,288,440)	(2,366,073)	(1,712,442)	(1,039,280)	460,904	-	-

2017

	Thousands of Euros							Total
	Demand	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Undetermined maturity	
Assets								
Cash, cash balances with central banks and other demand deposits (note 5)	742,858	-	-	-	-	-	-	742,858
Loans to credit institutions (note 10)	469,070	200,411	26,255	27,033	828,408	2,539	-	1,553,716
Loans and advances to customers (notes 7 and 10)	47,539	104,173	129,596	1,273,974	199,182	184,010	-	1,938,474
Fixed income portfolio (notes 6, 7, 8, 9 and 10)	-	43,027	85,441	64,718	1,241,358	1,059,969	-	2,494,513
Other assets	50,712	76,068	116,638	263,703	-	-	69,407	576,528
Total assets	1,310,179	423,679	357,930	1,629,428	2,268,948	1,246,518	69,407	7,306,089
Liabilities								
Deposits from central banks and credit institutions (note 14)	1,296,408	2,272,794	93,577	109,859	1,265,982	2,539	-	5,041,159
Deposits from customers (note 14)	238,559	403,652	20,155	167,821	17,217	2	-	847,406
Other liabilities	104,274	101,671	174,294	377,636	-	-	659,649	1,417,524
Total Liabilities	1,639,241	2,778,117	288,026	655,316	1,283,199	2,541	659,649	7,306,089
Simple gap	(329,062)	(2,354,438)	69,904	974,112	985,749	1,243,977	(590,241)	-
Accumulated gap	(329,062)	(2,683,501)	(2,613,597)	(1,639,485)	(653,737)	590,241	-	-

As part of its liquidity management, the Bank 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 Bank.

- *Short-term liquidity coverage ratio (LCR)*: under the stress scenario defined in Basel III, the 30-day liquidity ratio at 31 December 2018 stood at 281.9% (648.3% at 31 December 2017), both levels far above minimum regulatory requirements.

- *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 2018, the net stable funding ratio was 307.1% (172.3% at 31 December 2017), both 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.

35.3 Interest rate risk

To support management of interest rate risk, the 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 2018 and 2017 are as follows:

	2018						Total
	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	
Assets							
Cash, cash balances with central banks and other demand deposits (note 5)	1,471,851	-	-	-	-	-	1,471,851
Loans to credit institutions (note 10)	961,295	94,141	24,689	915,627	336	-	1,996,088
Loans and advances to customers (notes 7 and 10)	89,984	105,752	273,058	88,909	67,929	-	625,632
Fixed income portfolio (notes 6, 7, 8, 9 and 10)	47,416	8,827	1,098,317	1,069,868	1,312,693	-	3,537,121
Other assets	80,483	120,724	185,110	418,510	-	94,973	899,800
Total assets	2,651,029	329,444	1,581,174	2,492,914	1,380,958	94,973	8,530,492
Liabilities							
Deposits from central banks and credit institutions (note 13)	5,154,632	139,468	104,118	367,469	336	-	5,766,023
Deposits from customers (note 13)	828,745	190,307	67,258	18,002	-	-	1,104,312
Other Liabilities	85,383	119,536	204,920	443,993	-	806,325	1,660,157
Total liabilities	6,068,760	449,311	376,296	829,464	336	806,325	8,530,492
Off-balance sheet operations	1,093,149	42,112	(461,257)	(487,610)	(186,394)	-	-
Simple gap	(2,324,583)	(77,757)	743,621	1,175,840	1,194,228	(711,351)	-
Accumulated gap	(2,324,583)	(2,402,339)	(1,658,718)	(482,878)	711,351	-	-

2017

	Thousands of Euros						Total
	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	Over 5 years	Undetermined maturity	
Assets							
Cash, cash balances with central banks and other demand deposits (note 5)	742,858	-	-	-	-	-	742,858
Loans to credit institutions (note 10)	1,212,838	32,011	31,344	277,027	496	-	1,553,716
Loans and advances to customers (notes 7 and 10)	218,747	223,239	1,345,204	79,172	72,112	-	1,938,474
Fixed income portfolio (notes 6, 7, 8, 9 and 10)	305,973	302,914	739,582	951,580	194,464	-	2,494,513
Other assets	50,712	76,068	116,638	263,703	-	69,407	576,528
Total assets	2,531,128	634,232	2,232,768	1,571,482	267,072	69,407	7,306,089
Liabilities							
Deposits from central banks and credit institutions (note 13)	4,668,106	99,297	113,060	160,199	496	-	5,041,159
Deposits from customers (note 13)	642,088	131,323	56,795	17,200	-	-	847,406
Other liabilities	104,274	101,671	174,294	377,636	-	659,649	1,417,524
Total Liabilities	5,414,469	332,291	344,149	555,035	496	659,649	7,306,089
Off-balance sheet operations	1,534,953	35,290	(456,494)	(1,019,099)	(94,651)	-	-
Simple gap	(1,348,388)	337,231	1,432,125	(2,652)	171,925	(590,242)	-
Accumulated gap	(1,348,388)	(1,011,156)	420,970	418,317	590,241	-	-

The average interest rates of financial instruments in 2018 and 2017 were as follows:

	Percentage (%)	
	2018	2017
Cash, cash balances with central banks and other demand deposits	0.00	0.01
Financial assets held for trading	0.90	(0.04)
Non-trading financial assets mandatorily at fair value through profit or loss	0.02	0.00
Financial assets designated at fair value through profit or loss	0.01	0.00
Financial assets designated at fair value through other comprehensive income	(0.33)	0.13
Financial assets at amortised cost		
Credit institutions	(0.25)	(0.35)
Other debtors	2.18	1.52
Financial liabilities at amortised cost		
Credit institutions	(0.34)	(0.34)
Other debtors	0.01	0.00

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 2018 and 2017, 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:

	%	
	2018	2017
Sensitivity of the financial margin		
+ 100 b.p.	(3.75)	5.52
- 100 b.p.	1.85	(3.38)

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 hypothetical positive 200-basis point parallel displacement of the interest rate curve at 31 December 2018 and 2017 is as follows:

	%	
	2018	2017
Sensitivity of equity	(8.76)	(6.66)

35.4 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	
	2018	2017
Average VaR	1,023	1,210
Maximum VaR	1,591	2,043

Interest rate variations are the Bank's primary risk factor. The distribution by risk factor at 31 December 2018 and 2017 is as follows:

	Distribution (%)	
	2018	2017
Interest rate	55.8	82.9
Variable income	42.2	17.1

35.5 Currency risk

Details of the assets and liabilities recognised in the Bank's balance sheet in the most significant currencies at 31 December 2018 and 2017 are as follows:

	Thousands of Euros			
	2018		2017	
	Assets	Liabilities	Assets	Liabilities
US Dollar	108,617	101,794	90,389	118,639
Pound Sterling	41,874	19,946	6,755	20,157
Swiss Franc	666	598	576	539
Norwegian Krone	445	840	1,173	1,170
Swedish Krona	59	57	73	66
Canadian Dollar	1,126	965	1,423	1,422
Danish Krone	210	64	68	57
Japanese Yen	754	558	487	387
Other	2,686	822	5,467	2,175
Total	156,437	125,644	106,411	144,612

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

	Thousands of Euros	
	2018	2017
Assets		
Loans and advances to credit institutions	112,457	97,533
Loans and advances to customers	3,862	7,008
Debt securities	25,520	-
Other assets	14,598	1,870
Total	156,437	106,411
Liabilities		
Deposits from credit institutions	115,604	131,975
Deposits from customers	2,875	10,850
Other liabilities	7,165	1,787
Total	125,644	144,612

35.6 Risk concentration

Risk concentration is defined as a risk that could affect the Bank's income statement and its 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 Bank has established policies to limit the Bank'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 Bank is exposed, taking into account the nature and rating of the different financial instruments of the Bank, analysed at different levels (entity, bank, sector, country, etc.).

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

The distribution of the carrying amount of the Bank's most significant financial assets (cash balances at central banks and other demand deposits, loans and advances, debt securities, equity instruments, trading and hedging derivatives, investments in subsidiaries, joint ventures and associates, guarantees given and commitments given) at 31 December 2018 and 2017, broken down by geographical area, segment of activity, counterparty and purpose of the financing extended, is as follows:

	2018				
	Thousands of Euros				
	Total	Spain	Rest of EU	Americas	Rest of the world
Central banks and credit institutions	4,264,121	3,583,488	647,033	12,382	21,218
General governments	3,320,259	2,767,114	553,145	-	-
Central government	3,247,712	2,694,567	553,145	-	-
Other general governments	72,547	72,547	-	-	-
Other financial corporations	321,260	158,444	160,033	1,988	795
Non-financial corporations and sole proprietorships	624,823	455,627	157,922	5,298	5,976
Real estate construction and development	43,171	43,171	-	-	-
Construction of civil works	967	967	-	-	-
Other purposes	580,685	411,489	157,922	5,298	5,976
Large corporations	238,941	172,550	58,993	5,298	2,100
SMEs and sole proprietorships	341,744	238,939	98,929	-	3,876
Other household loans	108,644	107,897	629	118	-
Housing	67,348	66,720	628	-	-
Consumer	18,427	18,427	-	-	-
Other purposes	22,869	22,750	1	118	-
TOTAL	8,639,107	7,072,570	1,518,762	19,786	27,989

2017

Thousands of Euros

	Total	Spain	Rest of EU	Americas	Rest of the world
Central banks and credit institutions	2,653,070	2,059,482	565,994	8,382	19,212
General governments	3,017,511	2,650,662	366,849	-	-
Central government	2,960,422	2,593,573	366,849	-	-
Other general governments	57,089	57,089	-	-	-
Other financial corporations	304,182	198,732	105,186	264	-
Non-financial corporations and sole proprietorships	1,307,071	1,130,679	172,607	2,264	1,521
Real estate construction and development	52,898	52,898	-	-	-
Construction of civil works	27,582	27,582	-	-	-
Other purposes	1,226,591	1,050,199	172,607	2,264	1,521
Large corporations	274,972	225,432	45,755	2,264	1,521
SMEs and sole proprietorships	951,619	824,767	126,852	-	-
Other household loans	98,415	98,283	99	-	33
Housing	65,005	64,908	97	-	-
Consumer	12,526	12,526	-	-	-
Other purposes	20,884	20,849	2	-	33
TOTAL	7,380,249	6,137,838	1,210,735	10,910	20,766

The classification by geographical area and business segment in Spain at 31 December 2018 and 2017 is presented below:

RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2018

	Thousands of Euros									
	Total	Andalusia	Aragon	Asturias	Balearic Islands	Canary Islands	Cantabria	Castilla-La Mancha	Castile and León	Catalonia
Credit institutions	3,583,488	1,036,751	52,720	164,022	-	2,665	-	628,902	17,325	-
General governments	2,767,114	10,487	3,002	-	612	1,429	-	16,434	4,048	-
Central government (*)	2,694,567	-	-	-	-	-	-	-	-	-
Other	72,547	10,487	3,002	-	612	1,429	-	16,434	4,048	-
Other financial institutions	158,444	-	-	-	-	-	-	-	415	-
Non-financial corporations and sole proprietorships	455,627	11,445	48,743	659	5,991	-	2,255	10,276	5,828	9,036
Real estate construction and property development	43,171	-	43,171	-	-	-	-	-	-	-
Construction of civil works	967	-	-	-	-	-	-	-	-	-
Other purposes	411,489	11,445	5,572	659	5,991	-	2,255	10,276	5,828	9,036
Large corporations	172,550	5,288	596	659	5,991	-	-	3,254	3,104	4,127
SMEs and sole proprietorships	238,939	6,157	4,976	-	-	-	2,255	7,022	2,724	4,909
Other household loans and non-profit institutions serving households	107,897	1,409	173	173	51	405	34	1,101	708	2,902
Housing	66,720	326	97	103	-	79	26	503	453	187
Consumer	18,427	425	73	58	51	326	8	593	245	1,412
Other purposes	22,750	658	3	12	-	-	-	5	10	1,303
TOTAL	7,072,570	1,060,092	104,638	164,854	6,654	4,499	2,289	656,713	28,324	11,938

(*) Balance not attributable to any specific Autonomous Region

RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2018

	Thousands of Euros								
	Extremadura	Galicia	Madrid	Murcia	Navarre	Valencia	Basque Country	La Rioja	Ceuta and Melilla
Credit institutions	164,908	6,301	1,097,064	4	2,052	388,050	22,724	-	-
General governments	1,035	4,349	6,676	5,491	3,335	15,597	52	-	-
Central government	-	-	-	-	-	-	-	-	-
Other	1,035	4,349	6,676	5,491	3,335	15,597	52	-	-
Other financial institutions	-	-	158,029	-	-	-	-	-	-
Non-financial corporations and sole proprietorships	-	9,287	328,040	10,727	385	7,620	5,251	84	-
Real estate construction and property development	-	-	-	-	-	-	-	-	-
Construction of civil works	-	-	967	-	-	-	-	-	-
Other purposes	-	9,287	327,073	10,727	385	7,620	5,251	84	-
Large corporations	-	8,020	129,520	7,266	-	2,092	2,633	-	-
SMEs and sole proprietorships	-	1,267	197,553	3,461	385	5,528	2,618	84	-
Other household loans and non-profit institutions serving households	198	244	96,013	48	16	2,506	1,739	175	2
Housing	-	53	64,388	-	-	188	179	138	-
Consumer	197	74	14,487	48	16	360	16	36	2
Other purposes	1	117	17,138	-	-	1,958	1,544	1	-
TOTAL	166,141	20,181	1,685,822	16,270	5,788	413,773	29,766	259	2

RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2017

	Thousands of Euros									
	Total	Andalusia	Aragon	Asturias	Balearic Islands	Canary Islands	Cantabria	Castilla-La Mancha	Castile and León	Catalonia
Credit institutions	2,059,482	790,363	53,481	248,167	-	20,891	-	234,570	22,435	80,077
General governments	2,650,663	10,675	1,855	-	636	1,714	-	11,361	4,582	-
Central government (*)	2,593,573	-	-	-	-	-	-	-	-	-
Other	57,090	10,675	1,855	-	636	1,714	-	11,361	4,582	-
Other financial institutions	198,732	-	-	-	-	-	-	-	-	3
Non-financial corporations and sole proprietorships	1,130,679	9,137	56,270	721	8,004	-	1,360	3,396	4,358	21,570
Real estate construction and property development	52,898	-	52,898	-	-	-	-	-	-	-
Construction of civil works	27,582	2,200	-	-	-	-	-	-	-	-
Other purposes	1,050,199	6,937	3,372	721	8,004	-	1,360	3,396	4,358	21,570
Large corporations	225,432	2,402	592	714	8,003	-	1,360	3,178	1,569	16,536
SMEs and sole proprietorships	824,767	4,535	2,780	7	1	-	-	218	2,789	5,034
Other household loans and non-profit institutions serving households	98,283	1,385	230	249	41	149	41	1,141	775	1,851
Housing	64,908	314	103	113	-	81	31	657	482	203
Consumer	12,526	650	127	58	41	68	10	478	288	947
Other purposes	20,849	421	-	78	-	-	-	6	5	701
TOTAL	6,137,839	811,560	111,836	249,137	8,681	22,754	1,402	250,468	32,150	103,501

(*) Balance not attributable to any specific Autonomous Region

RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2017

Thousands of Euros

	Extremadura	Galicia	Madrid	Murcia	Navarre	Valencia	Basque Country	La Rioja	Ceuta and Melilla
Credit institutions	169,241	7,913	319,640	72	1	79,088	13,832	19,711	-
General governments	1,071	4,419	452	6,806	3,419	9,942	158	-	-
Central government	-	-	-	-	-	-	-	-	-
Other	1,071	4,419	452	6,806	3,419	9,942	158	-	-
Other financial institutions	-	-	198,729	-	-	-	-	-	-
Non-financial corporations and sole proprietorships	-	7,621	996,619	9,627	410	6,963	1,049	3,574	-
Real estate construction and property development	-	-	-	-	-	-	-	-	-
Construction of civil works	-	-	25,382	-	-	-	-	-	-
Other purposes	-	7,621	971,237	9,627	410	6,963	1,049	3,574	-
Large corporations	-	6,644	172,455	5,167	-	4,833	898	1,081	-
SMEs and sole proprietorships	-	979	798,782	4,462	410	2,130	151	2,493	-
Other household loans and non-profit institutions serving households	142	309	89,225	20	40	1,772	177	729	7
Housing	-	120	62,255	-	-	196	144	209	-
Consumer	142	66	9,349	20	40	32	32	171	7
Other purposes	-	123	17,621	-	-	1,544	1	349	-
TOTAL	170,454	20,262	1,604,665	16,525	3,870	97,765	15,216	24,014	7

35.7 Sovereign debt risk

As a rule, the Bank considers sovereign risk to be exposure through transactions with the central bank, issuer risk of the Treasury or Republic, and exposure through transactions with general government entities having the following characteristics: their funds derive solely from State budgets, they are legally acknowledged as entities that directly form part of the “State” sector, and they conduct activities of a non-trade nature.

Details of sovereign risk by country at 31 December 2018 and 2017 are as follows:

Thousands of Euros					
2018					
	Held for trading	At fair value through profit or loss	At fair value through other comprehensive income	At amortised cost	Total
Spain	20,216	159,727	1,511,298	1,050,113	2,741,354
Italy	3,360	-	549,785	-	553,145
Total	23,576	159,727	2,061,083	1,050,113	3,294,499
Thousands of Euros					
2017					
	Held for trading	At fair value through profit or loss	At fair value through other comprehensive income	At amortised cost	Total
Spain	16,897	-	1,714,106	63,849	1,794,852
Italy	-	-	334,158	-	334,158
Portugal	-	-	24,835	-	24,835
Total	16,897	-	2,073,099	63,849	2,153,845

36. 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

Subsidiaries

31.12.2018			% ownership		Thousands of Euros						
Company	Registered office	Activity	Direct	Indirect	Amount of interest	Capital and reserves	Total assets	Profit/(loss)	Other dividends	Interim dividend	Revenues
Rural Informática, S.A.	Madrid	IT services Manager of collective investment undertakings	99.8	0.2	2,603	4,178	65,180	13,444	(11,000)	(13,200)	13,974
Gescooperativo, S.A., S.G.I.I.C.	Madrid	Real-estate holding	-	100	1,893	3,054	9,932	3,932	(10,000)	(3,500)	7,509
Rural Inmobiliario, S.L.	Madrid	Training services	100	-	3,486	8,155	33,546	309	(2,500)	(250)	1,052
BCE Formación, S.A.	Madrid	Venture capital management	100	-	60	200	307	302	(1,180)	(300)	1,475
Espiga Capital Gestión, SA.	Madrid		80	-	288	345	340	(5)	-	-	-
Rural Renting, S.A.	Madrid	Financial	100	-	600	713	2,905	13	(500)	-	65

31.12.2017			% ownership		Thousands of Euros					
Company	Registered office	Activity	Direct	Indirect	Amount of interest	Capital and reserves	Total assets	Profit/(loss)	Revenues	
Rural Informática, S.A.	Madrid	IT services Manager of collective investment undertakings	99.8	0.2	6,822	13,860	559,456	7,633	655	
Gescooperativo, S.A., S.G.I.I.C.	Madrid	Real-estate holding	-	100	1,893	12,800	19,347	3,754	6,894	
Rural Inmobiliario, S.L.	Madrid	Training services	100	-	3,486	10,330	173,961	325	779	
BCE Formación, S.A.	Madrid	Venture capital management	100	-	60	1,034	1,368	275	1,090	
Espiga Capital Gestión, SA.	Madrid		80	-	288	348	344	(4)	-	
Rural Renting, S.A.	Madrid	Financial	100	-	600	1,190	3,830	22	82	

Appendix I forms an integral part of note 11 to the annual accounts for 2018, in conjunction with which it should be read.

Banco Cooperativo Español, S.A.

Directors' Report

2018

(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 Banco Cooperativo Español from 1 January to 31 December 2018, the Bank's twenty-eighth 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, a segmented structure has been adopted 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 2018 the Bank had assets totalling Euros 8,530 million, Shareholders' equity of Euros 512 million and 225 employees.

Within the Bank's organisational structure, the Board of Directors has the greatest decision-making power and the most extensive authority in managing the Entity, 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 Bank 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, online banking, telephone banking, mobile banking, ATMs, etc.). As these products and financial services are the cornerstone of our savings banks' relationships 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:** comprises 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 Bank 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 Banco Cooperativo 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 final customers, professional and swift 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 34.

2. Business performance

	Thousands of Euros	
	2018	2017
Balance sheet		
Total assets	8,530,492	7,306,089
On-balance sheet customer funds	1,104,312	847,406
Other funds managed (*)	6,092,309	6,083,114
Loans and advances to other debtors	625,632	1,938,474
Shareholders' equity	512,279	471,399
Profits		
Gross margin	100,911	73,861
Profit before income tax	77,763	49,068
Profit for the year	63,983	36,391
Significant ratios (%). Consolidated data		
Administrative expenses/gross margin	24.48	31.52
Net profit/average equity (ROE)	13.24	7.68
Net profit/average total assets (ROA)	0.58	0.26
Solvency ratio	30.5	25.7

(*) Off-balance sheet figures managed by the Banco Cooperativo Español, S.A. Group

2.1 Economic environment

Global expansion has slowed down. The International Monetary Fund (IMF) estimates that global growth amounted to 3.7% in 2018, in line with the forecast in the October 2018 edition of the Worldwide Economic Outlook (WEO) report, despite the weaker performance of some economies, particularly in Europe and Asia. The global economy is projected to grow by 3.5% in 2019 and 3.6% in 2020, i.e. 0.2 p.p. and 0.1 p.p. less than projected last October.

Worldwide growth forecasts for 2019 and 2020 were already downgraded in the last WEO report, partly due to the negative impact of higher tariffs introduced in the US and China earlier in the year. The further reduction since October reflects the consequences of the slower momentum seen in the second half of 2018 - for example in Germany following the adoption of new regulations on combustion vehicle emissions, and in Italy where concerns regarding sovereign and financial risks have hindered internal demand - but it also stems from the weaker attitude of financial markets and a downturn in Turkey which is now projected to be starker than expected.

Risks to global growth are trending downwards. Increased trade tensions, beyond those contemplated in the forecasts, still represent a significant source of risk for the outlook. Financial conditions have already become more restrictive since October. Various factors, apart from the increased trade tensions, could further debilitate the attitude to risk, which would negatively impact growth, particularly in view of the high levels of public and private debt. Such factors include the UK leaving the EU without a deal and a worse-than-expected slowdown in China.

The main common policy priority is for countries to cooperate and swiftly resolve their trade feuds and the resulting uncertainty surrounding policies, instead of putting up further harmful barriers and destabilising a worldwide economy which is already slowing down. In all economies it is fundamental to adopt measures that stimulate potential product growth, enable greater inclusion and strengthen tax and financial defences, in a scenario featuring considerable debt burdens and more restrictive financial conditions.

2.2 Balance sheet

- Total assets increased by 16.76% to Euros 8,530,492 thousand.
- Loans and advances to customers amounted to Euros 625,632 thousand at 31 December 2018, down 67.73% compared to the 2017 year end.
- Deposits from customers grew by 30.32% to Euros 1,104,312 thousand.
- Deposits from credit institutions and central banks rose by 14.37% to Euros 5,770,754 thousand.
- Shareholders' equity increased by 8.67% to Euros 512,279 thousand.

2.3 Income statement

- The interest margin was Euros 54,102 thousand, representing a decline of 1.96% on 2017.
- The gross margin improved by 36.62% to Euros 100,911 thousand.

- Administrative and personnel expenses grew by 6.13% to Euros 24,706 thousand. Depreciation totalled Euros 1,775 thousand (up 27.88%). In 2018 the sum of provisions and impairment losses on assets led to a credited amount of Euros 3,309 thousand. Consequently, results from operating activities stood at Euros 77,763 thousand, up 58.48% on 2017.
- Profit for the year amounted to Euros 63,983 thousand, 75.82% higher than in 2017.

2.4 Business units

The results of the different business segments comprising the Banco Cooperativo Español, S.A. Group's activity and their performance in 2018 and 2017 are summarised below.

	Thousands of Euros									
	Commercial banking		Asset management		Markets		Corporate activities		Total Group	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Gross margin	19,988	18,467	13,624	11,872	43,294	39,554	4,234	9,378	81,140	79,271
Administrative expenses and depreciation	(7,447)	(6,974)	(4,357)	(4,081)	(7,188)	(6,732)	(10,507)	(9,841)	(29,499)	(27,628)
Provisions and impairment losses on financial assets	(274)	(375)	-	-	-	297	3,575	(101)	3,301	(179)
Results from operating activities	12,267	11,118	9,267	7,791	36,106	33,119	(2,698)	(564)	54,942	51,464
Other profit	-	-	-	-	-	-	24	-	24	-
Profit/(loss) before income tax	12,267	11,118	9,267	7,791	36,106	33,119	(2,674)	(564)	54,966	51,464
Income tax	(3,444)	(3,051)	(2,602)	(2,137)	(10,138)	(9,087)	751	155	(15,433)	(14,120)
Consolidated profit/(loss) for the year	8,823	8,067	6,665	5,654	25,968	24,032	(1,923)	(409)	39,533	37,344

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 a 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.

	<u>2018</u>	<u>2017</u>
Average length of service (years)	12.1	11.9
Average age	42.5	41.9
Training:		
(%) University graduates	85	82
No. of hours of training	5,284	5,782
Hours of training/employee	23	25
Diversity (%)		
Female	48	47
Male	52	53
HR management (%)		
Internal promotion	13	11
Permanent contracts	98	99

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 a 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 2018 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 2018 stood at 281.9%, which is above minimum regulatory requirements for that date (100%).
- **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 2018 the net stable funding ratio was 307.1%, 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 manner 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 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 necessary to hold both now and in the future as per its capital planning and which is in keeping with the risks inherent to 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	
	2018	2017
Capital	115,811	115,811
Reserves	385,018	381,888
Deductions	(3,040)	(2,290)
Common Equity Tier 1 (CET1) capital	497,789	495,409
Additional CET1 elements	-	-
Tier 1 capital	497,789	495,409
General provision	-	10,761
Tier 2 capital	-	10,761
Total eligible capital	497,789	506,170
Credit, counterparty, dilution and delivery risk	97,792	106,152
Price, currency and commodity position risk	13,165	15,987
Operational risk and other	19,844	35,442
Total minimum capital requirement	130,801	157,581
Surplus	366,988	348,589
Capital ratio (%)	30.5	25.7
Tier 1 capital (%)	30.5	25.2

Eligible capital amounts to Euros 497,789 thousand, while capital requirements are Euros 130,801 thousand, giving rise to a surplus of Euros 366,988 thousand.

All eligible capital comprises common equity tier capital (CET 1).

The most significant figure in eligible capital corresponds to credit, counterparty, dilution and delivery risks, which stand at Euros 97,792 thousand and represent 74.8% of total capital requirements calculated in accordance with Banco de España regulations.

As a result, and the Tier I capital ratio stood at 30.5%.

4. Risks

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.

The Bank has a strategic risk framework, the purpose of which is to ensure the control and proactive management of all risks to which the Group is exposed. This framework is partly instrumented through a Risk Appetite Framework (RAF), which stipulates the quantity and diversity of risks sought and tolerated by the Bank to achieve its business objectives, while preserving a balance between risk and return.

The RAF is composed of quantitative metrics, which enable objective monitoring of risk management, and complementary qualitative aspects. Risk management and control is configured as a far-reaching set of principles, policies, procedures and advanced valuation methodologies, integrated to form an efficient decision-making structure under a risk governance framework that is compliant with the legislation in force.

For each relevant risk to which the Group is exposed, the RAF details the main parties involved, their functions, policies, methods and procedures, as well as the monitoring and control mechanisms. It also specifies the organisation of the risk function, indicating the roles and responsibilities of the different risk departments and committees and their control systems, which are tailored to the activities of the business units, including the function of granting loans and credit.

The main financial risks to which the Bank is exposed are capital risk, excessive leverage, liquidity risk, profitability risk, operational risk, interest rate risk, credit risk, concentration risk and market risk. The most relevant of these is credit risk.

The main non-financial risks to which the Group is exposed are operational risk, tax risk and regulatory compliance risk.

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 given, etc.), as well as in other types of financial assets (fixed-income securities of the Group, derivatives, etc.).

The 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 the Entity, 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 2018 and 2017 offset agreements have been implemented with 52 entities.

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 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, currency risk and risk concentration.

5. Outlook

In 2019, 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 Bank 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 Bank 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 2018.

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	Baa3
Fitch	BBB
DBRS	BBB

**APPROVAL BY THE BOARD OF DIRECTORS OF
THE 2018 ANNUAL ACCOUNTS OF
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 of Banco Cooperativo Español, S.A and subsidiaries for the year ended 31 December 2018, which were authorised for issue at the Board of Directors' meeting held on 27 March 2019 in Madrid and comprise the balance sheet, income statement, statement of recognised income and expense, statement of total changes in equity, cash flow statement, notes thereto comprising 62 pages (pages 9 to 126) and one appendix (page 127), as well as a Directors' report of 8 pages (pages 128 to 141).

All pages have been initialled by the secretary and this page and the following page signed by all the board members.

Madrid, 27 March 2019

Mr Ignacio Arrieta del Valle
- Chairman -

Mr José Luis García-Lomas Hernández
- First vice-chairman -

Mr Pedro García Romera
- Second vice-chairman -

Mr Fernando Bergé Royo
- Board member -

Mr Luis Esteban Chalmovsky
- Board member -

Mr. Carlos de la Sierra Torrijos
- Board member -

Mr Cipriano García Rodríguez
- Board member -

Mr Carlos Martínez Izquierdo
- Board member -

Mr Jesús Méndez Álvarez-Cedrón
- Board member -

Mr Ernesto Moronta Vicente
- Board member -

Mr José María Quirós Rodríguez
- Board member -

Mr Manuel Ruíz Escudero
- Board member -

Ms Dagmar Werner
- Board member -