# Audit Report on Banco Cooperativo Español, S.A.

(Together with the annual accounts and directors’ report of Banco Cooperativo Español, S.A. for the year ended 31 December 2019)

(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 2019, 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 2019, 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.

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## 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.

| **Impairment of the loans and advances to other debtors portfolio** (See notes 7 and 10 to the annual accounts) | |
|---|---|
| *Key audit matter* | *How the matter was addressed in our audit* |
| The Bank's portfolio of loans and advances to other debtors reflects a net balance of Euros 1,357,736 thousand at 31 December 2019, while allowances and provisions recognised at that date for impairment total Euros 25,913 thousand.<br><br>The process of estimating the impairment of the loans and advances to other debtors portfolio due to credit risk in accordance with Banco de España Circular 4/2017 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.<br><br>The consideration of this aspect as a key audit matter is based both on the significance for the Bank of the loans and advances to other debtors portfolio and on the relevance and complexity of the process for classifying financial assets for the purpose of estimating impairment thereon and of the calculation of that impairment. | In relation to the Bank's application 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.<br><br>Our audit approach included assessing the relevant controls linked to the processes of estimating impairment of the loans and advances to other debtors portfolio and performing different tests of detail on that estimate.<br><br>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.<br><br>Our tests of detail on the estimates of impairment of the loans and advances to other debtors portfolio basically encompassed the following:<br><br>– 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.<br><br>– 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.<br><br>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. |

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**Classification and measurement of financial instruments**
See notes 6, 7, 8, 9, 10 and 24 to the annual accounts

| *Key audit matter* | *How the matter was addressed in our audit* |
|---|---|
| The Bank has applied Banco de España Circular 4/2017, which includes the criteria for the classification and measurement of financial instruments.<br><br>The Bank has financial assets and financial liabilities measured and recognised at a fair value of Euros 3,444,805 thousand and Euros 1,664,696 thousand, respectively, on its balance sheet at 31 December 2019, of which Euros 997,526 thousand and Euros 1,664,696 thousand, respectively, of these amounts reflect the portion measured by the Bank using valuation techniques, as no quoted price in an active market was available (thus classified in level 2 or 3 for measurement purposes).<br><br>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.<br><br>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. | In relation to the Bank's application of Circular 4/2017 with regard to the classification and measurement 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.<br><br>Our procedures related to the control environment were focused on the following key areas and involved our market risk specialists:<br><br>– Governance: identification of the market risk management framework and controls.<br><br>– Transaction origination process: assessment of transaction settlement processes and custody at the depositary.<br><br>– Measurement estimation process: assessment of the relevant valuation controls.<br><br>– Databases: evaluation of the integrity, accuracy, quality and recency of the data and of the control and management process in place.<br><br>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 2019.<br><br>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. |

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## Risks associated with information technology

| *Key audit matter* | *How the matter was addressed in our audit* |
|---|---|
| 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.<br><br>The continuity of the Bank's business processes is highly dependent on its technological infrastructure and the controls in place.<br><br>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. | 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.<br><br>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.<br><br>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.<br><br>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. |

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## Other Information: Directors' Report

Other information solely comprises the 2019 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.

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 2019 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.

– 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.

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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 20 April 2020.

### Contract Period

We were appointed as auditor by the Shareholders at the Ordinary and Extraordinary General Meeting on 20 June 2019 for a period of one year, from the year commenced 1 January 2019.

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

20 April 2020

**BANCO COOPERATIVO ESPAÑOL, S.A.**

**Balance Sheets at 31 December 2019 and 2018**

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

| ASSETS | NOTE | In thousands of Euros 2019 | 2018 |
|---|---|---|---|
| **Cash, cash balances with central banks and other demand deposits** | **5** | **1,558,271** | **1,471,851** |
| **Financial assets held for trading** | **6** | **994,275** | **832,370** |
| Derivatives | | 937,657 | 804,826 |
| Equity instruments | | 3,258 | 1,071 |
| Debt securities | | 53,360 | 26,473 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | - | - |
| **Non-trading financial assets mandatorily at fair value through profit or loss** | **7** | **12,898** | **18,491** |
| Equity instruments | | - | 35 |
| Debt securities | | 2,068 | 4,066 |
| Loans and advances | | 10,830 | 14,390 |
| Other debtors | | 10,830 | 14,390 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | - | - |
| **Financial assets designated at fair value through profit or loss** | **8** | **107,696** | **197,904** |
| Debt securities | | 107,696 | 197,904 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | - | *10,221* |
| **Financial assets at fair value through other comprehensive income** | **9** | **2,329,929** | **2,286,350** |
| Equity instruments | | 40,007 | 27,785 |
| Debt securities | | 2,289,922 | 2,258,565 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | *2,025,650* | *764,798* |
| **Financial assets at amortised cost** | **10** | **4,067,794** | **3,657,443** |
| Debt securities | | 1,173,045 | 1,050,113 |
| Loans and advances | | 2,894,749 | 2,607,330 |
| Credit institutions | | 1,547,843 | 1,996,088 |
| Other debtors | | 1,346,906 | 611,242 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | *11,000* | *341,749* |
| **Derivatives - hedge accounting** | **16** | **7** | **4** |
| **Investments in subsidiaries, joint ventures and associates** | **11** | **7,037** | **7,037** |
| Subsidiaries | | 7,037 | 7,037 |
| **Tangible assets** | **12** | **4,888** | **1,728** |
| Fixed assets | | 4,888 | 1,728 |
| For own use | | 4,888 | 1,728 |
| **Intangible assets** | **13** | **2,930** | **3,041** |
| Other intangible assets | | 2,930 | 3,041 |
| **Tax assets** | **21** | **30,585** | **38,332** |
| Current tax assets | | 699 | 4,051 |
| Deferred tax assets | | 29,886 | 34,281 |
| **Other assets** | **15** | **5,694** | **15,941** |
| Other assets | | 5,694 | 15,941 |
| **TOTAL ASSETS** | | **9,122,004** | **8,530,492** |

**BANCO COOPERATIVO ESPAÑOL, S.A.**

**Balance Sheets at 31 December 2019 and 2018**

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

| **LIABILITIES** | **NOTE** | **In thousands of Euros** | |
|---|---|---|---|
| | | **2019** | **2018** |
| **Financial liabilities held for trading** | **6** | **1,319,020** | **853,832** |
| Derivatives | | **1,319,020** | 853,832 |
| Short positions | | **-** | - |
| **Financial liabilities designated at fair value through profit or loss** | **8** | **-** | **4,731** |
| Deposits | | - | 4,731 |
| Credit institutions | | - | 4,731 |
| *Memorandum item: subordinated liabilities* | | - | - |
| **Financial liabilities at amortised cost** | **14** | **6,832,127** | **6,920,635** |
| Deposits | | 6,780,694 | 6,870,335 |
| Central banks | | 366,098 | 367,598 |
| Credit institutions | | 5,236,415 | 5,398,425 |
| Other debtors | | 1,178,181 | 1,104,312 |
| Other financial liabilities | | 51,433 | 50,300 |
| *Memorandum item: subordinated liabilities* | | - | - |
| **Derivatives - hedge accounting** | **16** | **345,676** | **200,147** |
| **Provisions** | **17** | **4,714** | **463** |
| Commitments and guarantees given | | 4,714 | 463 |
| **Tax liabilities** | **21** | **22,665** | **11,055** |
| Current tax liabilities | | 583 | 413 |
| Deferred tax liabilities | | 22,082 | 10,642 |
| **Other liabilities** | **15** | **26,190** | **33,680** |
| **TOTAL LIABILITIES** | | **8,550,392** | **8,024,543** |

**BANCO COOPERATIVO ESPAÑOL, S.A.**

**Balance Sheets at 31 December 2019 and 2018**

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

| EQUITY | NOTE | In thousands of Euros 2019 | 2018 |
|---|---|---|---|
| **Shareholders' equity** | **19** | **543,924** | **512,279** |
| Share capital | 19.1 | 122,034 | 115,811 |
| Paid-in capital | | 122,034 | 115,811 |
| Share premium | 19.2 | 85,972 | 85,972 |
| Retained earnings | 20 | 308,519 | 260,616 |
| Revaluation reserves | 20 | - | 157 |
| Other reserves | 20 | (4,610) | (4,260) |
| Profit for the year | 3 | 32,009 | 63,983 |
| (-) Interim dividends | 3 | - | (10,000) |
| **Accumulated other comprehensive income** | 18 | **27,688** | **(6,330)** |
| Items that will not be reclassified to profit or loss | | 1,168 | (2,249) |
| Fair value changes of equity instruments measured at fair value through other comprehensive income | | 1,168 | (2,249) |
| Items that may be reclassified to profit or loss | | 26,520 | (4,081) |
| Hedging derivatives - cash flow hedging reserves [effective portion] | | (1,683) | (1,145) |
| Fair value changes of debt instruments measured at fair value through other comprehensive income | | 28,203 | (2,936) |
| **TOTAL EQUITY** | | **571,612** | **505,949** |
| **TOTAL LIABILITIES AND EQUITY** | | **9,122,004** | **8,530,492** |
| MEMORANDUM ITEM: Off-balance sheet exposures | | | |
| Loan commitments given | 22 | 707,240 | 70,420 |
| Financial guarantees given | 22 | 24,240 | 17,059 |
| Other commitments given | 22 | 167,046 | 151,462 |

**BANCO COOPERATIVO ESPAÑOL, S.A.**

**Income Statement for the years ended**

**31 December 2019 and 2018**

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

| | NOTE | In thousands of Euros | |
|---|---|---|---|
| | | **2019** | **2018** |
| Interest income | 25.a) | 88,670 | 88,045 |
| Financial assets at fair value through other comprehensive income | | 8,869 | 6,967 |
| Financial assets at amortised cost | | 21,832 | 39,416 |
| Other interest income | | 57,969 | 41,662 |
| (Interest expenses) | | (38,638) | (33,943) |
| **INTEREST MARGIN** | 25.b) | **50,032** | **54,102** |
| Dividend income | 26 | 1,570 | 29,603 |
| Fee and commission income | 27 | 27,516 | 28,737 |
| (Fee and commission expenses) | 27 | (15,538) | (16,703) |
| Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net | 28 | 1,791 | 4,282 |
| Other financial assets and liabilities | 28 | 1,791 | 4,282 |
| Gains or (-) losses on financial assets and liabilities held for trading, net | 28 | 5,237 | 7,917 |
| Other gains or (-) losses | | 5,237 | 7,917 |
| Gains or (-) losses on non-trading financial assets mandatorily at fair value through profit or loss, net | 28 | (3,921) | (2,474) |
| Other gains or (-) losses | | (3,921) | (2,474) |
| Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net | 28 | 2 | 47 |
| Gains or (-) losses from hedge accounting, net | 28 | 8 | (53) |
| Exchange differences [gain or (-) loss], net | 28 | 715 | 917 |
| Other operating income | 29 | 4,327 | 4,090 |
| (Other operating expenses) | 29 | (3,929) | (9,554) |
| **GROSS MARGIN** | | **67,810** | **100,911** |
| (Administrative expenses) | 30 | (25,332) | (24,706) |
| (Personnel expenses) | | (16,528) | (15,566) |
| (Other administrative expenses) | | (8,804) | (9,140) |
| (Depreciation and amortisation) | 12 and 13 | (2,818) | (1,775) |
| (Provisions) or reversal of provisions | 31 | (166) | (274) |
| (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 | 4,328 | 3,583 |
| (Financial assets at fair value through other comprehensive income) | | (210) | (56) |
| (Financial assets at amortised cost) | | 4,538 | 3,639 |
| Gains or (-) losses on derecognition of non-financial assets, net | | - | 24 |
| **PROFIT OR (-) LOSS BEFORE TAX FROM CONTINUING OPERATIONS** | | **43,822** | **77,763** |
| (Tax expense or (-) income related to profit or loss from continuing operations) | 21 | (11,813) | (13,780) |
| **PROFIT FOR THE YEAR** | 3 | **32,009** | **63,983** |
| | | | |
| **EARNINGS PER SHARE (in Euros)** | | | |
| Basic | 3 | 15.76 | 33.20 |
| Diluted | 3 | 15.76 | 33.20 |

**BANCO COOPERATIVO ESPAÑOL, S.A.**

**Statement of Recognised Income and Expense for the years ended 31 December 2019 and 2018**

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

| | NOTE | In thousands of Euros 2019 | 2018 |
|---|---|---|---|
| **Profit for the year** | | **32,009** | **63,983** |
| **Other comprehensive income** | | **34,018** | **(17,741)** |
| Items that will be reclassified to profit or loss | | 3,417 | (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 | | 4,882 | (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 | | (1,465) | 964 |
| Items that may be reclassified to profit or loss | | 30,601 | (15,492) |
| 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] | | (769) | (444) |
| Valuation gains or (-) losses taken to equity | | (769) | (444) |
| 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 | | 44,485 | (21,688) |
| Valuation gains or (-) losses taken to equity | | 46,309 | (17,411) |
| Transferred to profit or loss | | (1,824) | (4,277) |
| 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 | | (13,115) | 6,640 |
| **Total comprehensive income for the year** | | **66,027** | **46,242** |

**Banco Cooperativo Español, S.A.**

**Cash Flow Statement for the years ended**

**31 December 2019 and 2018**

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

| | NOTE | In thousands of Euros | |
|---|---|---|---|
| | | **2019** | **2018** |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | **70,087** | **1,376,240** |
| Profit for the year | | 32,009 | 63,983 |
| Adjustments to obtain cash flows from operating activities | | 10,302 | 11,972 |
| Depreciation and amortisation | | 2,818 | 1,775 |
| Other adjustments | | 7,484 | 10,197 |
| Net increase in operating assets | | (482,039) | 80,441 |
| Financial assets held for trading | | (161,905) | (178,300) |
| Non-trading financial assets mandatorily at fair value through profit or loss | | 5,593 | (18,491) |
| Financial assets designated at fair value through profit or loss | | 90,208 | (197,904) |
| Financial assets at fair value through other comprehensive income | | (9,909) | (30,883) |
| Financial assets at amortised cost | | (406,023) | 504,115 |
| Other operating assets | | (3) | 1,904 |
| Net increase/(decrease) in operating liabilities | | 517,478 | 1,233,565 |
| Financial liabilities held for trading | | 465,188 | 253,246 |
| Financial liabilities designated at fair value through profit or loss | | (4,731) | - |
| Financial liabilities at amortised cost | | (88,508) | 937,462 |
| Other operating liabilities | | 145,529 | 42,857 |
| Income tax paid | | (7,663) | (13,721) |
| **CASH FLOWS FROM (USED IN) INVESTING ACTIVITIES** | | **12,126** | **(23,777)** |
| Payments | | (5,869) | (27,996) |
| Tangible assets | | (4,413) | (181) |
| Intangible assets | | (1,456) | (2,077) |
| 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 | | 17,995 | 4,219 |
| 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 | | 17,995 | - |
| **CASH FLOWS FROM (USED) IN FINANCING ACTIVITIES** | | **4,207** | **(35,053)** |
| Payments | | (14) | (35,053) |
| Dividends | | (14) | (23,103) |
| Subordinated liabilities | | - | - |
| Redemption of own equity instruments | | - | - |
| Acquisition of own equity instruments | | - | - |
| Other payments relating to financing activities | | - | (11,950) |
| Collections | | 4,221 | - |
| Subordinated liabilities | | - | - |
| Issuance of own equity instruments | | - | - |
| Disposal of own equity instruments | | - | - |
| Other receipts relating to financing activities | | 4,221 | - |
| **EFFECT OF EXCHANGE RATE FLUCTUATIONS** | | **-** | **-** |
| **NET INCREASE IN CASH AND CASH EQUIVALENTS** | | **86,420** | **1,317,410** |
| **CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD** | | **1,471,851** | **154,441** |
| **CASH AND CASH EQUIVALENTS AT PERIOD END** | | **1,558,271** | **1,471,851** |
| **COMPOSITION OF CASH AND CASH EQUIVALENTS AT YEAR END** | | | |
| Cash | | 542 | 864 |
| Cash equivalents in central banks | | 247,520 | 425,253 |
| Other financial assets | | 1,310,209 | 1,045,734 |
| Less: Bank overdrafts repayable on demand | | - | - |

**Banco Cooperativo Español, S.A.**

**Statement of Changes in Equity for the years ended 31 December 2019 and 2018**

**(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 2018** | **115,811** | **85,972** | **-** | **260,616** | **157** | **(4,260)** | **-** | **63,983** | **(10,000)** | **(6,330)** | **505,949** |
| Effects of correction of errors | - | - | - | - | - | - | - | - | - | - | - |
| Effects of changes in accounting policies (see note 1.c) | - | - | - | - | - | - | - | - | - | - | - |
| **Opening balance 1/1/2019** | **115,811** | **85,972** | **-** | **260,616** | **157** | **(4,260)** | **-** | **63,983** | **(10,000)** | **(6,330)** | **505,949** |
| **Total comprehensive income for the year** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **32.009** | **-** | **34.018** | **66.027** |
| **Other changes in equity** | **6,223** | **-** | **-** | **47,903** | **(157)** | **(350)** | **-** | **(63,983)** | **10,000** | **-** | **(364)** |
| Issue of other equity instruments | - | - | - | - | - | - | - | - | - | - | - |
| Purchase of own shares | - | - | - | - | - | - | - | - | - | - | - |
| Share-based payments | - | - | - | - | - | - | - | - | - | - | - |
| Dividends (or shareholder remuneration) | - | - | - | - | - | - | - | - | - | - | - |
| Transfers between equity components | 6,223 | - | - | 47,917 | (157) | - | - | (63,983) | 10,000 | - | - |
| Other increases or (-) decreases in equity | - | - | - | (14) | - | (350) | - | - | - | - | (364) |
| **Balance at 31 December 2019** | **122,034** | **85,972** | **-** | **308,519** | **-** | **(4,610)** | **-** | **32,009** | **-** | **27,688** | **571,612** |

**Banco Cooperativo Español, S.A.**

**Statement of Changes in Equity for the years ended 31 December 2019 and 2018**

**(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 | - | - | - | - | - | (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** |

(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 2019 and 2018, the Bank forms part of the Grucajrural Group (hereinafter the Group), the parent of which is Grucajrural 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 Grucajrural 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 2019 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 2019 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 was 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 publication of Banco de España Circular 2/2018 of 21 December 2016 updates Circular 4/2017 to reflect the latest developments in banking regulation, while remaining entirely compatible with the IFRS-EU accounting framework.

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 2019 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 2019 will be approved by the Shareholders at the annual General Meeting without significant changes.

The annual accounts for 2018 were approved by the Shareholders at the annual General Meeting held on 20 June 2019.

### *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 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:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| **ASSETS** | **31.12.2017 Circular 4/2014** | **Classification of financial instruments** | **Impairment** | **Opening balance 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” were primarily due to classification under “Financial assets at fair value through other comprehensive income” and “Financial assets at amortised cost”.

| LIABILITIES AND EQUITY | 31.12.2017 Circular 4/2014 | Classification of financial instruments | Impairment | Opening balance sheet 01.01.2018 Circular 4/2017 |
|---|---|---|---|---|
| | **Thousands of Euros** | | | |
| 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 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 2019 and 2018 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.

### *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 2019 and 2018 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 2019 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 2018 contained in these annual accounts is presented solely for the purpose of comparison with the information at 31 December 2019, and therefore does not constitute the Bank's annual accounts for 2018.

As a result of applying Circular 2/2018 certain insignificant changes have been made to the comparative information for 2018 disclosed in these annual accounts in order to enhance comparison thereof with the figures for 2019. As of 1 January 2019 Circular 2/2018 includes amendments to lessee accounting (see note 2 (j)). The Bank has opted to apply the modified retrospective method and, as permitted by the standard, has not restated the comparative information for prior years. Therefore, 2018 figures are not comparative for those items affected by this new legislation (see note 12).

***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. 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.

Risk-weighted assets are determined according to the exposure of Banco Cooperativo Español, S.A. 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 announced its decision regarding the prudential capital requirements applicable to the Banco Cooperativo Español Group. This decision requires the Bank to maintain a total phase-in capital ratio of no less than 9.13% of the amount of its total risk exposure from 1 January 2020 onwards (9.39% in 2018), to which the capital buffers – which in 2020 stood at 2.50% of total risk exposure (same percentage as 2019) plus those that could eventually be determined by the competent authority during the year– should be added. In addition to this quantitative minimum capital ratio requirement, a qualitative requirement (composition of capital) demands that the Bank should maintain a CET 1 capital ratio of no less than 5.63% and a Tier 1 capital ratio of 7.13% or more. The buffers should also be covered by CET 1 capital.

On 24 February 2020 the Banco de España Executive Committee agreed to grant Banco Cooperativo Español exemption from compliance with the individual obligations set out in article 6.1 of Regulation (EU) no. 575/2013, because it is a subsidiary of a mixed financial holding company (Grucajrural Inversiones, S.L.). For the granting of this exception, which encompasses capital requirements, large exposures and leverage, the Banco de España has particularly taken into account the Bank and its Parent's willingness to restore the Bank's capital if required and not change its business model.

On 12 March 2020 the European Central Bank and the European Banking Authority announced a series of measures focused on mitigating the impact of coronavirus (COVID-19) on the banking sector. These measures include the possibility of banks partially using additional Tier 1 or Tier 2 instruments to meet Pillar 2 requirements under the supervision of the above entities. Banks would therefore be able to temporarily operate below the levels determined by the capital conservation buffer. Given the strength of the Group's capital ratios, which fully comprise common equity Tier 1 capital (maximum quality), it is not expected that it will have to take these measures.

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 eligible capital at 31 December 2019 and 2018 and the related capital ratios are shown in the following table:

| | **Thousands of Euros** | |
|---|---|---|
| | **2019** | **2018** |
| Capital | 122,034 | 115,811 |
| Share Premium | 85,972 | 85,972 |
| Reserves and other | 331,598 | 251,328 |
| Result of the exercise | 27,006 | 48,159 |
| Deductions | (8,040) | (3,481) |
| **Common Equity Tier 1 (CET 1) capital** | **558,570** | **497,789** |
| Additional Tier 1 items | - | - |
| **Tier 1 capital** | **558,570** | **497,789** |
| Collective provision | - | - |
| **Tier 2 capital** | **-** | **-** |
| **Total eligible capital** | **558,570** | **497,789** |
| | | |
| Credit, counterparty, dilution and delivery risk | 81,581 | 97,792 |
| Price, currency and commodity position risk | 20,688 | 13,165 |
| Operational and other risks | 23,282 | 19,844 |
| **Total capital requirement** | **125,551** | **130,801** |
| **Surplus** | **433,019** | **366,988** |
| **Capital ratio (%)** | **35.6** | **30.5** |
| **Tier 1 capital (%)** | **35.6** | **30.5** |

At 31 December 2019 and 2018, 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 Bank's regulatory capital and its book equity is as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | Regulatory capital | Book equity | Regulatory capital | Book equity |
| Capital | 122,034 | 122,034 | 115,811 | 115,811 |
| Share Premium | 85,972 | 85,972 | 85,972 | 85,972 |
| Reserves | 303,910 | 303,910 | 256,513 | 256,513 |
| Profit for the year | 27,006 | 32,009 | 48,159 | 53,983 |
| Valuation adjustments | 27,688 | 27,688 | (5,185) | (6,330) |
| Deductions | 8,040 | - | (3,481) | - |
| Temporary adjustments | - | - | - | - |
| **Common Equity Tier 1 (CET 1) capital** | **558,570** | **571,613** | **497,789** | **505,949** |

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

Deposit Guarantee Fund for Credit Institutions

The Bank contributes to the Deposit Guarantee Fund for Credit Institutions (hereinafter DGFCI). In 2019 and 2018 the expense incurred for ordinary, additional and extraordinary contributions to this fund amounted to Euros 59 thousand and Euros 94 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 DGFCI, indicating that the Management Committee will determine the annual contributions of the institutions that participate in the fund based on the criteria established in Article 6 of Royal Decree-Law 16/2011 of 14 October 2011 on the formation of the DGFCI.

In 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.

On 3 December 2019 the European Court of Justice (Grand Chamber) gave a preliminary ruling against the interests of ICCREA Banca. In a ruling dated 12 February 2020 the Supreme Court finally rejected the appeal filed by the Bank against the ex ante contribution to the NRF dating from 2015. This ruling is firm and cannot be appealed and, as a result, this matter is closed.

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 2019, the Bank's contribution amounted to Euros 2,414 thousand, of which Euros 2,061 thousand was recognised under “Other operating expenses” in the accompanying income statement and Euros 353 thousand took the form of an irrevocable commitment.

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.

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 (7,529 miles of euros paid directly on 23 June 2016 and 1,328 miles of euros as irrevocable payment commitments).

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. On 28 November 2019 the European General Court (EGC) passed judgement annulling, with regard to Banco Cooperativo Español, S.A., the decision of the SRB in its executive session of 15 April 2016 on the 2016 ex ante contributions to the Single Resolution Fund ((SRB/ES/SRF/2016/06). At the date of these annual accounts the judgement has yet to be enforced.

In relation to the ex ante contribution to the SRF for 2019, on 9 July 2019 the Bank filed an appeal for annulment before the European General Court as it understood that in the calculation of this contribution the SRB should have applied rules for Institutional Protection Schemes (IPS), as in 2018 the Bank was already included in an IPS together with various shareholder rural savings banks. The Court has yet to hand down its resolution at the date of these annual accounts.

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, these economic-administrative claims have been rejected and it is foreseen that an appeal only for 2016 will be filed in the contentious-administrative court, as there are no longer grounds for the appeal for 2015 as a result of the aforementioned ruling by the Supreme Court.

***i) Minimum reserve ratio***

At 31 December 2019, and throughout 2019 period, the Bank complied with the minimum reserve ratio stipulated in applicable legislation, Regulation (EC) No 1745/2003 of 12 September 2003 of the European Central Bank.

***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 1,500 thousand for 2019 (Euros 4,000 thousand in 2018), which has been recorded in "Other operating expenses" in the accompanying income statement (see note 29).

### *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:

| | 2019 | 2018 |
|---|---|---|
| | Days | |
| Average supplier payment period | 33.3 | 29.8 |
| Transactions paid ratio | 32.4 | 28.5 |
| Transactions payable ratio | 46.3 | 31.6 |
| | Thousands of Euros | |
| Total payments made | 46,337 | 44,613 |
| Total payments outstanding | 3,396 | 2,634 |

- 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, between 31 December 2019 and the date on which the Board of Directors of the Bank drawn-up the annual accounts, the following events have occurred:

Coronavirus (COVID-19)

On 11 March 2020, the World Health Organization declared the outbreak of Coronavirus disease 2019 (COVID-19) to be a pandemic, due to its rapid spread across the globe, having affected over 150 countries. The majority of governments are taking restrictive measures to contain the spread, including: isolation, confinement, quarantine and restrictions on the free movement of people, the closure of public and private premises (except for basic necessities and health services), border closures and a drastic reduction in air, sea, rail and land transport. In Spain, the government enacted Royal Decree 463/2020 of 14 March 2020, declaring a state of emergency to manage the health crisis triggered by COVID-19, which, a priori, will remain in force for 15 calendar days.

This situation is having a significant impact on the global economy due to the interruption or slowdown of supply chains and the substantial increase in economic uncertainty, evidenced by greater volatility in asset prices and exchange rates, and a drop in long-term interest rates.

To mitigate the economic impacts of this crisis, on Wednesday 18 March 2020, Royal Decree-law 8/2020 of 17 March 2020 on extraordinary urgent measures to address the economic and social impact of COVID-19 was published in Spain.

The consequences derived from COVID-19 are considered an event after the reporting period that does not require an adjustment in the annual accounts for 2019, but must be disclosed in the annual accounts for 2020.

Although no significant consequences have arisen at the date the annual accounts were authorised for issue, the Bank expects significant events to arise in the future, which cannot be reliably estimated at present. During 2020, the Bank will assess the impact of the abovementioned events on the equity and financial position at 31 December 2020 and on the results of operations and cash flows for the year then ended.

## 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 2019 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 2019 and 2018 is as follows:

| | % | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | **Assets** | **Liabilities** | **Assets** | **Liabilities** |
| Quoted price in active markets | 71.0 | - | 75.0 | - |
| Internal valuation models | 29.0 | 100.0 | 25.0 | 100.0 |
| | **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 though 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, whosoever the 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 “Financial assets at amortised cost” (“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 2019 and 2018 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:

| | **% annual** | **Estimated useful life (years)** |
|---|---|---|
| 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 "Financial assets at amortised cost" 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.

On 1 January 2019 Banco de España Circular 2/2018 entered into force and includes amendments to lessee accounting. The single lessee accounting model requires a lessee to recognise assets and liabilities for all leases. The standard sets out two exceptions to the recognition of lease assets and liabilities, that can be applied in the case of short-term contracts and those for which the underlying asset is of low value. The Bank has decided to apply both exceptions.

The lessee must recognise under assets a right to use that represents its right to use the leased asset and which is recognised under tangible assets - property, plant and equipment for own use on the balance sheet (see note 12) and a lease liability that represents its obligation to make lease payments that are recognised under financial liabilities at amortised cost - other financial liabilities on the balance sheet (see note 14).

At the commencement date, the lease liability represents the present value of the lease payments that are not paid at that date. Liabilities recognised in this balance sheet item are measured after initial recognition at amortised cost, which is determined using the effective interest method.

Right-of-use assets are initially recognised at cost. The cost of the right-of-use asset includes the initial measurement of the lease liability, any lease payments made at or before the commencement date, less any lease incentives received, all initial direct costs incurred; and an estimate of costs to be incurred by the lessee such as costs relating to dismantling and removing the underlying asset. The assets recognised in this balance sheet item are measured after their initial recognition at cost less:

- Any accumulated depreciation and any accumulated impairment losses; and

- Any remeasurement of the corresponding lease liability.

Interest on the lease liability is recognised under interest expenses in the income statement (see note 25 (a)). Variable lease payments not included in the initial measurement of the lease liability are recognised under administrative expenses - other administrative expenses (see note 30).

Depreciation is calculated, on a straight-line basis over the cost of the assets over the lease term. Depreciation of tangible assets is recognised under depreciation and amortisation in the income statement (see note 12).

If the lessee elects one of the two exceptions to not recognise the corresponding right-of-use asset and liability on the balance sheet, the lease payments associated with the corresponding leases are recognised in the income statement over the lease term or on a straight-line basis or any other basis that is more representative of the pattern of the lessee's benefit, under other operating expenses - other operating expenses (see note 29)..

Income from sub-leases and operating leases is recognised under other operating income in the income statement (see note 29).

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.

The lessor accounting model requires that, from commencement date, leases are classified as finance leases if they transfer substantially all the risks and rewards incidental to ownership of an underlying asset. Leases that are not finance leases are considered to be operating leases.

In operating leases, if the entities act as lessors, they recognise the acquisition cost of the leased assets under tangible assets - property, plant and equipment - leased out under operating leases on the balance sheet (see note 12). The depreciation policy for these assets is consistent with that for similar tangible assets for own use and income and expenses from operating leases is recognised in the income statement on a straight-line basis under other operating income and other operating expenses, respectively (see note 28).

In the case of sale and leasebacks at fair value, profit or loss on the sale is recognised for the part effectively transferred, in the income statement at the transaction date.

***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 2019 and 2018 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 2019 and 2018 reporting dates are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2019** | **2018** |
| Present value of obligations | (1,697) | (1,265) |
| Fair value of plan assets | 1,740 | 1,310 |
| **Positive difference** | **43** | **45** |

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:

| | **2019** | **2018** |
|---|---|---|
| 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 2019 be distributed as follows:

| | ***Thousands of Euros*** |
|---|---|
| Net profit for 2019 | 32,009 |
| Distribution: | |
| Interim dividend | - |
| Reserves: | 32,009 |
| Legal | 1,245 |
| Voluntary | 30,764 |

The distribution of the Bank's net profit for 2018, approved by the Shareholders at their annual General Meeting held on 20 June 2019, was as follows:

| | ***Thousands of Euros*** |
|---|---|
| Net profit for 2018 | 63,983 |
| Distribution: | |
| Dividends | 10,000 |
| Reserves: | 53,983 |
| Legal | - |
| Voluntary | 53,983 |

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:

| | **Thousands of Euros** |
|---|---|
| Profit before income tax at 30 November 2019 | 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.

| | 2019 | 2018 |
|---|---|---|
| Net profit (thousands of Euros) | 32,009 | 63,983 |
| Number of ordinary shares outstanding (note 19) | 2,030,520 | 1,926,970 |
| Earnings per share (Euros) | 15.76 | 33.20 |

## 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 2019 and 2018 are as follows:

| | Thousands of Euros | | |
|---|---|---|---|
| **Directors** | **2019** | **2018** | |
| D. Ignacio Arrieta del Valle (Chairman) | 12 | 12 | |
| D. José Luis García-Lomas Hernández (First Vice chairman) | 10 | 10 | |
| D. Pedro García Romera (Second Vice Chairman) | 12 | 10 | |
| D. Luis Esteban Chalmovsky | 9 | 8 | |
| D. Carlos Martínez Izquierdo | 12 | 10 | |
| D. Carlos de la Sierra Torrijos | 12 | 12 | |
| D. Cipriano García Rodríguez (1) | 12 | 11 | |
| Dña. Dagmar Werner | 12 | 10 | |
| D. José María Quirós Rodríguez | 6 | 12 | Director until 20/06/2019 |
| D. Fernando Berge Royo | 12 | 11 | |
| D. Jesús Méndez Álvarez-Cedrón (2) | 12 | 12 | |
| D. Manuel Antonio Ruíz Escudero | 12 | 11 | |
| D. Ernesto Moronta Vicente | 12 | 11 | |
| D. Gerónimo Luque Frías | 7 | - | Director since 31/05/2019 |
| D. Jose Luis García-Palacios Álvarez | 1 | - | Director since 30/10/2019 |
| D. Fernando Martínez Rodríguez | 1 | - | Director since 10/12/2019 |
| **Total** | **154** | **140** | |

*(1) Allowances received by Caja Rural de Zamora, SCC*
*(2) 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 2019 and 2018, 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 2019 or 2018.

*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 2019 and 2018, considered to be key management personnel within the Bank.

The following table details the remuneration received by Senior Management personnel in 2019 and 2018:

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | Remuneration received | | Deferred remuneration during the year (*) | | Total | |
| | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 |
| Senior Management personnel | 2,300 | 2,115 | 58 | 304 | 2,358 | 2,419 |

*(*) This remuneration accrued during 2019 and 2018 is payable at 31 December 2019 and 2018.*

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 2019 and 2018 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 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Cash | 542 | 864 |
| Cash balances with central banks | | |
| Banco de España | | |
| Current account | 247,520 | 425,253 |
| Other demand deposits | 1,310,209 | 1.045,734 |
| | **1,558,271** | **1,471,851** |

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 rading

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 2019 and 2018, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| **Assets** | | |
| Derivatives | 937,657 | 804,826 |
| Equity instruments | 3,258 | 1,071 |
| Debt securities | 53,360 | 26,473 |
| **Total assets** | **994,275** | **832,370** |
| **Liabilities** | | |
| Derivatives | 1,319,020 | 853,832 |
| **Total liabilities** | **1,319,020** | **853,832** |

***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 2019 and 2018, 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 2019 and 2018, are as follows:

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | 31.12.2019 | | | 31.12.2018 | | |
| | **Assets** | **Liabilities** | **Notional amount** | **Assets** | **Liabilities** | **Notional amount** |
| **Interest rate** | **908,261** | **1,290,448** | **28,310,604** | **763,770** | **813,811** | **24,723,031** |
| OTC options | 17,577 | 17,577 | 332,908 | 19,210 | 19,210 | 330,335 |
| OTC other | 890,684 | 1,272,871 | 27,944,096 | 744,560 | 794,601 | 24,374,196 |
| Organised market options | - | - | - | - | - | - |
| Organised market other | - | - | 33,600 | - | - | 18,500 |
| **Equity instruments** | **25,050** | **24,589** | **316,517** | **37,363** | **37,319** | **479,344** |
| OTC options | 1,541 | 660 | 27,196 | 600 | 245 | 28,974 |
| OTC other | 23,509 | 23,.929 | 289,321 | 36,763 | 37,074 | 450,370 |
| Organised market options | - | - | - | - | - | - |
| Organised market other | - | - | - | - | - | - |
| **Foreign exchange and gold** | **4,346** | **3,171** | **68,922** | **3,693** | **2,372** | **18,914** |
| OTC options | 54 | 54 | 5,875 | 135 | 135 | 18,914 |
| OTC other | 4,292 | 3,117 | 63,047 | 3,558 | 2,237 | - |
| Organised market options | - | - | - | - | - | - |
| Organised market other | - | - | - | - | - | - |
| **Credit** | - | - | - | - | - | - |
| Credit default swaps | - | - | - | - | - | - |
| Credit spread options | - | - | - | - | - | - |
| Total return swaps | - | - | - | - | - | - |
| Other | | - | - | | - | - |
| **Commodities** | - | - | - | - | - | - |
| **Other** | **-** | **812** | **7,701** | **-** | **330** | **7,930** |
| **Derivatives** | **937,657** | **1,319,020** | **28,703,744** | **804,826** | **853,832** | **25,229,219** |
| *Of which: OTC - Credit institutions* | *786,362* | *624,227* | *12,610,340* | *660,440* | *465,560* | *13,501,617* |
| *Of which: OTC - Other financial corporations* | *148,780* | *694,666* | *16,000,652* | *141,798* | *386,771* | *11,602,358* |
| *Of which: OTC - Other* | *2,515* | *127* | *92,752* | *2,588* | *1,501* | *125,244* |

***Financial assets held for trading. Equity instruments***

Details at 31 December 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Other financial corporations | 3,258 | 1,071 |
| **Total** | **3,258** | **1,071** |

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

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

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| General governments | 20,058 | 23,576 |
| Credit institutions | 11,690 | - |
| Other financial corporations | 10,491 | 1,458 |
| Non-financial corporations | 11,121 | 1,439 |
| **Total** | **53,360** | **26,473** |

At 31 December 2019 and 2018 the Bank did not have any loaned or pledged securities.

## 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 2019 and 2018 is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| **Instrument** | | |
| Equity instruments | - | 35 |
| Debt securities | 2,068 | 4,066 |
| Loans and advances | 10,830 | 14,390 |
| **Total** | **12,898** | **18,491** |

A breakdown of this item by geographical area and category of counterparty at 31 December 2019 and 2018 is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| **Geographical area** | | |
| Spain | 12,898 | 18,491 |
| Rest of European Union | - | - |
| Other | - | - |
| | **12,898** | **18,491** |
| **Counterparty** | | |
| Other financial corporations | 2,037 | 3,709 |
| Non-financial corporations | 10,861 | 14,782 |
| **Total** | **12,898** | **18,491** |

## 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 2019 and 2018, is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Debt securities | 107,696 | 197,904 |
| General governments | 77,564 | 159,727 |
| Credit institutions | 30,132 | 38,177 |
| **Total** | **107,696** | **197,904** |

A breakdown of financial liabilities designated at fair value through profit or loss at 31 December 2019 and 2018 is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Deposits | - | 4,731 |
| Credit institutions | - | 4,731 |
| Debt securities issued | - | - |
| **Total** | **-** | **4,731** |

At 31 December 2019 the Bank had no loaned or pledged securities (10,221 thousand euros at 31 December 2018).

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 | |
|---|---|---|
| | **2019** | **2018** |
| **Equity instruments** | **40,007** | **27,785** |
| Shares in Spanish companies | 40,007 | 27,785 |
| Credit institutions | 2,684 | 2,540 |
| Other financial corporations | 13,870 | 9,955 |
| Non-financial corporations | 23,453 | 15,290 |
| Shares in foreign companies | - | - |
| **Debt securities** | **2,289,922** | **2,258,565** |
| Central banks | - | - |
| General governments | 2,037,317 | 2,061,083 |
| Credit institutions | 30,686 | 21,171 |
| Other financial corporations | 107,018 | 82,724 |
| Non-financial corporations | 115,916 | 94,383 |
| Impairment losses | (1,015) | (796) |
| **Loans and advances** | **-** | **-** |
| | **2,329,929** | **2,286,350** |

Loaned or pledged securities amount to Euros 2,025,650 thousand at 31 December 2019 (Euros 764,798 thousand in 2018).

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 2019 and 2018 equity instruments are not considered to be impaired.

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 2019 and 2018, based on the nature of the financial instrument giving rise to them, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| **Debt securities** | **1,173,045** | **1,050,113** |
| *Of which: Impairment losses* | - | - |
| **Loans and advances to credit institutions** | **1,547,843** | **1,996,088** |
| *Of which: Impairment losses* | *(237)* | *(162)* |
| **Loans and advances to customers** | **1,346,906** | **611,242** |
| General governments | 364,376 | 19,518 |
| Other financial corporations | 488,141 | 165,010 |
| Non-financial corporations | 376,281 | 320,869 |
| Households | 118,108 | 105,845 |
| *Of which: Impairment losses* | *(22,353)* | *(28,228)* |
| **Total** | **4,067,794** | **3,657,443** |

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 assets at amortised cost. Debt securities***

Details at 31 December 2019 and 2018, by instrument, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| General governments | 1,173,045 | 1,050,113 |
| Other financial corporations | - | - |
| | **1,173,045** | **1,050,113** |
| Impairment losses | - | - |
| **Total** | **1,173,045** | **1,050,113** |

Securities recognised in this portfolio and totalling Euros 28,000 thousand matured in 2019 (Euros 36,638 thousand in 2018).

Loaned or pledged securities amount to Euros 11,000 thousand at 31 December 2019 (Euros 341,749 thousand at 31 December 2018).

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 assets at amortised cost. Loans and advances to credit institutions***

Details by instrument are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Credit card debt | 15 | 17 |
| Reverse repurchase loans | 1,277,762 | 1,740,233 |
| Other term loans | 240,951 | 228,501 |
| Advances that are not loans | 29,115 | 27,337 |
| **Total** | **1,547,843** | **1,996,088** |
| *Of which:* | | |
| *Impairment losses* | *(237)* | *(162)* |

***Financial assets at amortised cost. Loans and advances to customers***

Details by instrument and transaction status are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| On demand, short notice (current account) | 2,517 | 129 |
| Credit card debt | 631 | 649 |
| Commercial loan portfolio | 85,721 | 56,674 |
| Finance leases | 922 | 1,150 |
| Reverse repurchase loans | - | - |
| Other term loans | 800,049 | 427,709 |
| Advances that are not loans | 457,066 | 124,931 |
| **Total** | **1,346,906** | **611,242** |
| *Of which:* | | |
| *Impaired assets* | *1,681* | *2,101* |
| *Impairment losses* | *(22,353)* | *(28,228)* |

## 11. Investments in subsidiaries, joint ventures and associates

Details at 31 December 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Rural Informática, S.A. | 2,603 | 2,603 |
| 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** | **7,037** |

On 27 June 2018 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 2019 and 2018 are not quoted on official markets.

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

## 12. Tangible assets

Movement in 2019 and 2018 is as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | **Buildings** | **Furniture and fixtures** | **IT equipment** | **Total** |
| **Cost** | | | | |
| 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 |
| Additions | 3,823 | 359 | 219 | 4,401 |
| Disposals | - | - | - | - |
| Balances at 31 December 2019 | 3,823 | 4,139 | 3,970 | 11,932 |
| **Accumulated depreciation** | | | | |
| 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) |
| Charges | (722) | (222) | (297) | (1,241) |
| Disposals | - | - | - | - |
| Balances at 31 December 2019 | (722) | (2,915) | (3,407) | (7,044) |
| **Net tangible assets** | | | | |
| **Balances at 31 December 2018** | **-** | **1,087** | **641** | **1,728** |
| **Balances at 31 December 2019** | **3,101** | **1,224** | **563** | **4,888** |

At 31 December 2019 and 2018 the cost of fully depreciated tangible assets for own use amounts to Euros 3,804 thousand and Euros 3,787 thousand, respectively.

During the 2019 financial year, the Bank registered 3,823 thousand euros for rights to use leases (see note 2 (j)).

At 31 December 2019 and 2018, 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 2019 and 2018 is as follows:

| | Thousands of Euros |
|---|---|
| | Other intangible assets |
| **Cost** | |
| Balances at 31 December 2017 | 13,835 |
| Additions | 2,077 |
| Disposals | - |
| Balances at 31 December 2018 | 15,912 |
| Additions | 1,466 |
| Disposals | - |
| Balances at 31 December 2019 | 17,378 |
| **Accumulated depreciation** | |
| Balances at 31 December 2017 | (11,562) |
| Charges | (1,309) |
| Disposals | - |
| Balances at 31 December 2018 | (12,871) |
| Charges | (1,577) |
| Disposals | - |
| Balances at 31 December 2019 | (14,448) |
| **Net intangible assets** | |
| **Balances at 31 December 2018** | **3,041** |
| **Balances at 31 December 2019** | **2,930** |

At 31 December 2019 and 2018 the cost of fully depreciated intangible assets for own use in service amounts to Euros 9,928 thousand and Euros 9,316 thousand, respectively.

## 14. Financial liabilities at amortised cost

Details at 31 December 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Deposits | | |
| Deposits from central banks | 366,098 | 367,598 |
| Deposits from credit institutions | 5,236,415 | 5,398,425 |
| Deposits from other creditors | 1,178,181 | 1,104,312 |
| Other financial liabilities | 51,433 | 50,300 |
| **Total** | **6,832,127** | **6,920,635** |

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 2019 and 2018, by nature, are as follows:

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | Deposits from central banks | | Deposits from credit institutions | | Total | |
| | 2019 | 2018 | 2019 | 2018 | 2019 | 2018 |
| Current accounts / overnight deposits | - | - | 4,573,373 | 3,928,622 | 4,573,373 | 3,928,622 |
| Deposits redeemable at notice | 366,098 | 367,598 | 663,042 | 738,381 | 1,029,140 | 1,105,979 |
| Repurchase agreements | - | - | - | 731,422 | - | 731,422 |
| **Total** | **366,098** | **367,598** | **5,236,415** | **5,398,425** | **5,602,513** | **5,766,023** |

***Deposits from customers***

Details at 31 December 2019 and 2018, by nature, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Current accounts / overnight deposits | 887,126 | 780,675 |
| Deposits redeemable at notice | 7,289 | 7,334 |
| Repurchase agreements | 283,766 | 316,303 |
| **Total** | **1,178,181** | **1,104,312** |

Likewise, details by type of counterparty are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| General governments | 381,109 | 364,455 |
| Other financial corporations | 611,313 | 600,250 |
| Non-financial corporations | 107,241 | 72,102 |
| Households | 78,518 | 67,505 |
| **Total** | **1,178,181** | **1,104,312** |

***Other financial liabilities***

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Obligations payable | 1,664 | 748 |
| Collateral received | 20,740 | 3,060 |
| Tax collection accounts | 1,615 | 2,811 |
| Special accounts | 4,168 | 43,257 |
| Financial guarantees | 228 | 159 |
| Other items | 23,018 | 265 |
| **Total** | **51,433** | **50,300** |

At 31 December 2018, “Special accounts” reflected unsettled balances of Euros 37,362 thousand pertaining to securities sales, which were settled at the start of 2019.

At 31 December 2019 other includes the lease liability recognised by the Bank on 1 January 2019 based on the first-time adoption of Banco España Circular 2/2018 lease standard (see note 2 (j)). At 31 December 2019 this item also includes mainly transitory balances relating to the offset of credit and debit cards to be settled, which were settled at the start of 2020.

## 15. Other assets and liabilities

Details at 31 December 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **Other assets** | |
| | **2019** | **2018** |
| Accruals | 5,040 | 6,594 |
| Operations in transit | - | 1 |
| Other assets | 654 | 9,346 |
| **Total assets** | **5,694** | **15,941** |
| | **Other liabilities** | |
| | **2019** | **2018** |
| Accruals | 18,838 | 24,104 |
| Operations in transit | 1 | 1 |
| Other liabilities | 7,351 | 9,575 |
| **Total liabilities** | **26,190** | **33,680** |

Other assets at 31 December 2019 and 2018 mainly include transitory balances relating to the offset of credit and debit cards to be settled, which were settled at the start of 2020 and 2019, respectively.

Other liabilities mainly include balances payable to suppliers at 31 December 2019 and 2018.

## 16. Hedging derivatives

At 31 December 2019 and 2018, the Bank's main hedged positions and the derivatives designated to hedge those positions were as follows:

- Fair value hedges: Fixed-rate debt securities recorded in the financial assets portfolio at fair value with changes in other comprehensive income available for sale. The risk is hedged with interest rate derivatives (fixed-for-floating swap).

- Cash flow hedges: Hedged assets are inflation-indexed assets recorded in the financial assets portfolio at fair value with changes in other comprehensive income. 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 | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | 2018 | | Notional amount | |
| | Assets | Liabilities | Assets | Liabilities | 2019 | 2018 |
| Interest rate | 7 | 298,365 | 4 | 151,791 | 2,582,283 | 3,511,383 |
| OTC options | - | - | - | - | - | - |
| OTC other | 7 | 298,365 | 4 | 151,791 | 2,582,283 | 3,511,383 |
| Organised market options | - | - | - | - | - | - |
| Organised market other | - | - | - | - | - | - |
| Equity instruments | - | - | - | - | - | - |
| Foreign exchange and gold | - | - | - | - | - | - |
| Credit | - | - | - | - | - | - |
| Commodities | - | - | - | - | - | - |
| Other | - | 35,960 | - | 37,242 | 260,000 | 385,000 |
| **Fair value hedges** | **7** | **334,325** | **4** | **189,033** | **2,842,283** | **3,896,383** |
| Interest rate | | | - | - | | - |
| Equity instruments | | | - | - | | - |
| Foreign exchange and gold | - | 5,528 | - | 5,029 | 22,045 | 20,967 |
| Commodities | | | - | - | | - |
| Other | - | 5,823 | - | 6,085 | 20,000 | 20,000 |
| **Cash flow hedges** | | **11,351** | **-** | **11,114** | **42,045** | **40,967** |
| **Derivatives - hedge accounting** | **7** | **345,676** | **4** | **200,147** | **2,884,328** | **3,937,350** |
| *Of which: OTC - Credit institutions* | *7* | *238,268* | *4* | *114,830* | *1,736,583* | *1,271,583* |
| *Of which: OTC - Other financial corporations* | *-* | *107,408* | *-* | *85,317* | *1,147,745* | *2,665,767* |

Gains or losses on hedging instruments and the hedged item attributable to the hedged risk are not significant in 2019 and 2018 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 2019 and 2018 is as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| ***Opening balance*** | **463** | **196** |
| Additions (note 31) | 252 | 396 |
| (-) Amounts used | - | - |
| (-) Unused amounts reversed during the period (note 31) | (105) | (135) |
| Other movements | 4,104 | 6 |
| ***Closing balance*** | **4,714** | **463** |

## 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 unrealized changes in fair value of assets included, for the purposes of their valuation, as financial assets at fair value with changes in other comprehensive income and those derived from derivatives of cash flow hedges.

Movement during 2019 and 2018 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 |
|---|---|---|---|---|
| ***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)** |
| Effects of changes in accounting policies (see Note 1.c) | - | - | - | - |
| Fair value changes of equity instruments measured at fair value through other comprehensive income | 4,882 | - | - | 4,882 |
| Net valuation gains/(losses) | - | 46,309 | (769) | 45,540 |
| Amounts transferred to the income statement | - | (1,824) | - | (1,824) |
| Income tax | (1,465) | (13,346) | 231 | (14,580) |
| ***2019 closing balance*** | **1,168** | **28,203** | **(1,683)** | **27,688** |

## 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 and 2018 share capital represented 1,926,970 shares, fully subscribed and paid.

At their Ordinary General Meeting held on 20 June 2019 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 2 October 2019 capital was increased by 103,550 shares of Euros 60.10 par value. This increase was executed in a public deed and charged to voluntary reserves. Consequently, at 31 December 2019 share capital represented 2,030,520 shares, fully subscribed and paid.

Shareholders holding more than 10% of share capital at 31 December 2019 and 2018 are as follows:

| | **% ownership** | |
|---|---|---|
| **Entity** | **2019** | **2018** |
| 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 Grucajrural Inversiones, S.L. (hereinafter Grucajrural), 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 Grucajrural 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 Grucajrural being delivered to the contributing Savings Banks.

  At their General Meeting held on 29 December 2017, the Shareholders of Grucajrural 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 Grupcajrural in the capital increase, which was executed in a public deed on 9 March 2018.

  The Bank held no own shares at 31 December 2019 and 31 December 2018.

*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 2019 and 2018 the share premium amounts to Euros 85,972 thousand.

## 20. Retained Earnings, revaluation and other reserves

Details of these items at 31 December 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Legal reserve | 23,162 | 23,162 |
| Capitalisation and revaluation reserve | 19,753 | 14,513 |
| Other reserves | 260,994 | 218,838 |
| | **303,909** | **256,513** |

***Movement***

Details of changes in this item in 2019 and 2018 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 2019 and 2018, the Bank has appropriated to this reserve an amount of 23,162 thousand euros.

## 21. Taxation

***Tax Assets and Liabilities***

Details at 31 December 2019 and 2018 are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | Current | | Deferred | |
| | 2019 | 2018 | 2019 | 2018 |
| Tax assets | | | | |
| Temporary differences | - | - | 29,886 | 34,281 |
| Value added tax | 177 | 330 | - | - |
| Other items | 522 | 3,721 | - | - |
| **Total** | **699** | **4,051** | **29,886** | **34,281** |
| Tax liabilities | | | | |
| Temporary differences | - | - | 22,082 | 10,642 |
| Income tax | - | - | - | - |
| Value added tax | 583 | 413 | - | - |
| **Total** | **583** | **413** | **22,082** | **10,642** |

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 6,541 thousand and Euros 8,168 thousand at 31 December 2019 and 2018, 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 2019 and 2018 are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | Assets | | Liabilities | |
| | 2019 | 2018 | 2019 | 2018 |
| **Temporary differences** | | | | |
| Pension obligations | 406 | 413 | - | - |
| Impairment losses on bad debts | 6,135 | 7,755 | - | - |
| Other items | 13,170 | 12,799 | 40 | 40 |
| Temporary differences recognised under Equity - Financial instruments | 10,175 | 13,314 | 22,042 | 10,602 |
| **Unused tax deductions** | - | - | - | - |
| **Tax loss carryforwards** | - | - | - | - |
| **Total tax assets/liabilities** | **29,886** | **34,281** | **22,082** | **10,642** |

Movement in deferred tax assets and liabilities in 2019 and 2018 is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **Assets** | **Liabilities** |
| **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 | 1,662 | 12,898 |
| Disposals | (6,057) | (1,458) |
| **Balance at 31 December 2019** | **29,886** | **22,082** |

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.

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 2019 and 2018 with the taxable income that the Bank expects to declare after approval of the annual accounts is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Accounting profit for the year before tax | 43,822 | 77,763 |
| Permanent differences | | |
| Donations and non-deductible expenses | 37 | 35 |
| Exemption for double taxation on dividends | (58) | (28,884) |
| Capitalisation reserve | (4,355) | (3,023) |
| Taxable accounting income | 39,446 | 45,891 |
| Temporary differences | | |
| Provision for bad debts and pension obligations | (5,424) | (4,217) |
| Reversal of adjustments, first-time adoption Circular 4/2017 | 481 | (106) |
| Portfolio impairment, amortisation/depreciation and other | (243) | 3,906 |
| Valuation adjustments | - | (3,250) |
| Other adjustments to the tax base with no effect on the income tax expense | (509) | 3,486 |
| Taxable income | 34,768 | 45,710 |
| Tax at 30% | 10,430 | 13,713 |
| Withholdings and payments on account | (10,872) | (13,721) |
| Deductions and credits with effect on the income tax expense | (108) | (45) |
| Other deductions with no effect on the income tax expense | - | (86) |
| **Recoverable income tax** | **(550)** | **(139)** |

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 2019 due to the distribution of 2018 profit approved by the Shareholders at their General Meeting on 20 June 2019. Equity increased by Euros 53,983 thousand in 2019, whereby within the limit of the 10% increase in equity, taxable income would be reduced by an amount of up to Euros 5,398 thousand. In 2019, 4,355 thousand euros were reduced by applying the limit to the 10% reduction of the previous positive tax base for 2019, with 1,043 thousand euros pending in future years. Likewise, as of December 31, 2019, there were no amounts pending application corresponding to previous years.

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 10 thousand at 31 December 2019 (of Euros 3,350 thousand at 31 December 2018) and deductions totalling Euros 0 thousand (Euros 86 thousand at 31 December 2018) 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 499 thousand for the inclusion in taxable income of the amount charged to reserves, deriving from the transfer of financial assets at fair value with changes in other comprehensive income, 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 2019 and 2018 is calculated as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2019** | **2018** |
| Income tax expense for the year: | | |
| Taxable accounting income at 30% | 11,834 | 13,767 |
| Credits and deductions | (108) | (45) |
| Prior years' tax adjustments | (14) | 25 |
| **Income tax expense** | **11,712** | **13,747** |
| Foreign tax expense | 101 | 33 |
| **Total** | **11,813** | **13,780** |

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 2019 the Bank has open to inspection by the taxation authorities all the main applicable taxes since 2015, inclusive.

As a result of an inspection carried out by the Madrid taxation authorities' Delegation for Large Taxpayers on one of the Economic Interest Groupings (EIG) in which the Bank has participated, partial inspections are being carried out on the Bank's income tax declaration for 2014, with regard to tax impacts that the aforementioned investment had in that year. These inspections are still underway. In the opinion of the Bank's tax advisors, the arguments put forward to date by the inspectors should not be successful. In any case, an adverse outcome regarding these matters would not significantly affect these annual accounts.

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 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Tax relief | | |
| Deductions for international double taxation | 101 | 33 |
| Deduction for donations | 7 | 12 |
| **Total** | **108** | **45** |

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 10,175 thousand and Euros 13,314 thousand at the 2019 and 2018 reporting dates, respectively. Tax liabilities in the same respect amount to Euros 22,042 thousand and Euros 10,602 thousand at the 2019 and 2018 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 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 | |
|---|---|---|
| | **2019** | **2020** |
| Charges to reserves | 865 | 865 |
| Credits to reserves | (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 2019 and 2018 are as follows:

| | *Thousands of Euros* | |
|---|---|---|
| | **2019** | **2018** |
| **Contingent commitments given** | **707,240** | **70,420** |
| Central banks | - | - |
| General governments | 613,729 | - |
| Credit institutions | 106 | 114 |
| Other financial corporations | 4,159 | 4,892 |
| Non-financial corporations | 83,475 | 59,091 |
| Households | 5,771 | 6,323 |
| **Financial guarantees given** | **24,240** | **17,059** |
| Central banks | - | - |
| General governments | - | - |
| Credit institutions | 11,538 | 6,881 |
| Other financial corporations | - | - |
| Non-financial corporations | 12,684 | 10,155 |
| Households | 18 | 23 |
| **Other commitments given** | **167,046** | **151,462** |
| Central banks | - | - |
| General governments | 2,589 | 2,236 |
| Credit institutions | 84,758 | 82,936 |
| Other financial corporations | 7,161 | 10,161 |
| Non-financial corporations | 68,093 | 51,531 |
| Households | 4,445 | 4,598 |

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 2019 and 2018 are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2019** | **2018** |
| Investment companies and mutual funds | 5,053,090 | 4,823,338 |
| Customer portfolios managed on a discretionary basis | 1,324,544 | 1,268,971 |
| **Total** | **6,377,634** | **6,092,309** |

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

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

At 31 December 2019 and 2018 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.

| | 2019 | | | | | |
|---|---|---|---|---|---|---|
| **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 | 2,993 | - | - | 30,945 | - | 33,938 |
| Debt securities | 46,700 | - | 107,696 | 2,258,945 | - | 2,413,341 |
| **Level 2:** | | | | | | |
| Derivatives | 912,553 | - | - | - | 7 | 912,560 |
| Equity instruments | - | - | - | 93 | - | 93 |
| Debt securities | 4,029 | - | - | 28,332 | - | 32,361 |
| **Level 3:** | | | | | | |
| Derivatives | 25,104 | - | - | - | - | 25,104 |
| Equity instruments | 265 | - | - | 8,969 | - | 9,234 |
| Debt securities | 2,631 | 2,068 | - | 2,645 | - | 7,344 |
| Loans and advances | - | 10,830 | - | - | - | 10,830 |
| | **994,275** | **12,898** | **107,696** | **2,329,929** | **7** | **3,444,805** |

| | 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** |

The fair value and carrying amounts of financial assets carried at amortised cost at 31 December 2019 and 2018 are as follows:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** |
| Financial assets at amortised cost | | | | |
| Debt securities | 1,173,045 | 1,230,930 | 1,050,113 | 1,088,053 |
| Loans and advances | | | | |
| Credit institutions | 1,547,843 | 1,539,928 | 1,996,088 | 1,996,312 |
| Other customers | 1,346,906 | 1,420,100 | 611,242 | 668,876 |
| **Total** | **4,067,794** | **4,190,958** | **3,657,443** | **3,753,241** |

| | 2019 | | | |
|---|---|---|---|---|
| **Financial liabilities** | **Financial liabilities held for trading** | **Financial liabilities designated at fair value through profit or loss** | **Derivatives - hedge accounting** | **Total** |
| **Level 2:** | | | | |
| Derivatives | 1,293,899 | - | 345,676 | 1,639,575 |
| Deposits | - | - | - | - |
| **Level 3:** | - | - | - | - |
| Derivatives | 25,121 | - | - | 25,121 |
| | **1,319,020** | **-** | **345,676** | **1,664,696** |

| | 2018 | | | |
|---|---|---|---|---|
| **Financial liabilities** | **Financial liabilities held for trading** | **Financial liabilities designated at fair value through profit or loss** | **Derivatives - hedge accounting** | **Total** |
| **Level 2:** | - | 4,731 | - | 4,731 |
| 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** |

The fair value and carrying amounts of financial liabilities carried at amortised cost at 31 December 2019 and 2018 are as follows:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** |
| Financial liabilities at amortised cost | | | | |
| Deposits | | | | |
| Central banks and credit institutions | 5,602,513 | 5,602,203 | 5,766,023 | 5,767,511 |
| Other customers | 1,178,181 | 1,232,435 | 1,104,312 | 1,109,809 |
| **Total** | **6,780,694** | **6,834,638** | **6,870,335** | **6,877,320** |

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:

<u>Trading derivatives and hedging derivatives</u>

- 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 2019 and 2018 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 2,194 thousand (Euros 3,520 thousand in 2018), 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.

<u>Debt securities</u>

- 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 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Loans and advances to general governments | 558 | 19,352 |
| Loans and advances to credit institutions | 22 | 2,744 |
| Loans and advances to other financial corporations | 713 | 584 |
| Loans and advances to non-financial corporations | 4,781 | 4,647 |
| Loans and advances to households | 1,839 | 1,581 |
| Debt securities | 20,577 | 18,935 |
| Rectification of income originating from hedge accounting | 13,095 | 11,424 |
| Other interest | 44,080 | 28,778 |
| | **88,670** | **88,045** |
| *Of which:* | | |
| *Financial assets at fair value through other comprehensive income* | *8,869* | *6,967* |
| *Financial assets at amortised cost* | *21,832* | *39,416* |
| *Derivatives - hedge accounting* | *13,095* | *11,424* |
| *Other assets* | *44,874* | *30,238* |

Other interest during 2019 and 2018 mainly includes interest from simultaneous transactions.

b) Interest expenses

Details in 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Deposits from central banks | - | - |
| Deposits from general governments | 8 | 4 |
| Deposits from credit institutions | 8,919 | 7,386 |
| Deposits from other financial corporations | - | 21 |
| Deposits from non-financial corporations | 10 | 8 |
| Deposits from households | 16 | 22 |
| Other financial liabilities | 40 | - |
| Rectification of costs originating from hedge accounting | (1,053) | (857) |
| Other interest | 30,698 | 27,359 |
| | **38,638** | **33,943** |

Other interest during 2019 and 2018 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 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Financial assets held for trading | 388 | 197 |
| Financial assets designated at fair value through profit or loss | 1,182 | 523 |
| Investments in subsidiaries, joint ventures and associates consolidated using methods other than the equity method | - | 28,883 |
| | **1,570** | **29,603** |

## 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 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Securities | 340 | 648 |
| Asset management | 11,545 | 12,064 |
| Custody | 7,479 | 7,402 |
| Payment services | 2,439 | 2,385 |
| Customer resources distributed but not managed | 395 | 1,347 |
| Loan commitments given | 109 | 115 |
| Financial guarantees given | 59 | 73 |
| Other | 5,150 | 4,703 |
| | **27,516** | **28,737** |

Details of Fee and Commission Expenses in 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Commissions assigned to other entities and correspondents | 12,488 | 13,520 |
| Commissions paid for securities transactions | 3,011 | 3,078 |
| Others | 39 | 105 |
| | **15,538** | **16,703** |

## 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 2019 and 2018 by type of instrument are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net | 1,791 | 4,282 |
| Gains or losses on financial assets and liabilities held for trading, net | 5,237 | 7,917 |
| Gains or losses on non-trading financial assets mandatorily at fair value through profit or loss, net | (3,921) | (2,474) |
| Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net | 2 | 47 |
| Gains or losses on hedge accounting, net | 8 | (53) |
| | **3,117** | **9,719** |
| Exchange gains | 715 | 917 |
| | **3,832** | **10,636** |

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 2019 and 2018, based on the nature of the financial instruments giving rise to these balances, excluding exchange gains/losses, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Debt securities | 8,246 | 7,105 |
| Equity instruments | (78) | (29) |
| Loans and advances to other debtors | (3,560) | (3,322) |
| Trading derivatives and hedge accounting | (1,458) | 5,931 |
| Other | (33) | 34 |
| | **3,117** | **9,719** |

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 2019 and 2018 are as follows:

| | *Thousands of Euros* | |
|---|---|---|
| | **2019** | **2018** |
| Fair value changes of the hedging instrument including discontinued operations | (78,940) | (34,059) |
| Fair value changes of the hedged item attributable to the hedged risk | 78,948 | 34,006 |
| | **8** | **(53)** |

## 29. Other Operating Income and Expenses

Details of other operating income in the accompanying income statements for 2019 and 2018 are as follows:

| | *Thousands of Euros* | |
|---|---|---|
| | **2019** | **2018** |
| Sales and income from the provision of non-financial services | 3,958 | 3,889 |
| Costs incorporated to assets | 346 | - |
| Other non-recurring income | 22 | 79 |
| Other items | 1 | 122 |
| | **4,327** | **4,090** |

Details of other operating expenses in the accompanying income statements for 2019 and 2018 are as follows:

| | *Thousands of Euros* | |
|---|---|---|
| | **2019** | **2018** |
| Contribution to the Deposit Guarantee Fund and SRF | 2,120 | 5,385 |
| Contribution to the Institutional Protection Mechanism | 1,500 | 4,000 |
| Other items | 309 | 169 |
| | **3,929** | **9,554** |

## 30. Administrative expenses

<u>Personnel expenses</u>

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 2019 and 2018 are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2019** | **2018** |
| Salaries and wages | 13,450 | 12,536 |
| Social Security | 2,730 | 2,674 |
| Transfers to defined benefit plans | 25 | 25 |
| Transfers to defined contribution plans | 87 | 86 |
| Termination benefits | 33 | 81 |
| Other personnel expenses | 203 | 164 |
| | **16,528** | **15,566** |

The Group's average headcount, distributed by professional category and type of contract, during 2019 and 2018, as well as that existing at the related reporting dates, is as follows:

| | 2019 | | | 2018 | | |
|---|---|---|---|---|---|---|
| | **Male** | **Female** | **Average** | **Male** | **Female** | **Average** |
| Management team | 12 | 1 | 13 | 12 | 1 | 13 |
| Directors | 17 | 9 | 26 | 16 | 8 | 23 |
| Department managers | 14 | 12 | 26 | 13 | 12 | 23 |
| Technicians | 46 | 62 | 105 | 43 | 56 | 97 |
| Administrative staff | 23 | 37 | 56 | 25 | 39 | 63 |
| | 112 | 121 | 226 | 109 | 116 | 219 |
| By type of contract | | | | | | |
| Indefinite | 109 | 120 | 222 | 107 | 113 | 215 |
| Temporary | 3 | 1 | 4 | 2 | 3 | 4 |
| | 112 | 121 | 226 | 109 | 116 | 219 |

At 31 December 2019 and 2018, four Bank employees had a disability.

Other administrative expenses

Details for 2019 and 2018 are as follows:

| | ***Thousands of Euros*** | |
|---|---|---|
| | **2019** | **2018** |
| Property, fixtures and materials | 602 | 1,241 |
| Information technology | 2,241 | 1,939 |
| Communications | 1,464 | 1,496 |
| Advertising and publicity | 10 | 11 |
| Legal and lawyer expenses | 287 | 205 |
| Technical reports | 921 | 985 |
| Security and armoured cash transport services | 243 | 237 |
| Insurance premiums | 260 | 273 |
| Governing and control bodies | 208 | 195 |
| Entertainment and staff travel expenses | 302 | 294 |
| Association membership fees | 315 | 285 |
| Outsourced administrative services | 1,267 | 1,226 |
| Contributions and taxes | 513 | 569 |
| Other | 171 | 184 |
| | **8,804** | **9,140** |

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 2019 and 2018, as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Audit services | 52 | 32 |
| Other assurance services | 24 | 28 |
| | **76** | **60** |

The amounts detailed in the above table include the total fees for the 2019 and 2018 audits, irrespective of the invoice date.

Other assurance services provided to the Bank by KPMG Auditores, S.L. during the year ended 31 December 2019 comprise the following:

- Report on the protection of customer assets
- Review report of contributions to the Single Resolution Fund (FUR)

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 2019 and 2018:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Other services | 127 | 161 |

## 31. Provisions or reversals of provisions

In 2019 and 2018 net charges to this item of the income statements were:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Commitments and guarantees given (note 17) | 147 | 261 |
| Other provisions | 19 | 13 |
| | **166** | **274** |

## 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 2019 and 2018, recognised in the accompanying income statements is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Financial assets designated at fair value through other comprehensive income | (210) | (56) |
| Financial assets at amortised cost | 4,538 | 3,639 |
| | **4,328** | **3,583** |

## 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 2019 and 2018 and in the income statements for 2019 and 2018, originating from transactions with related parties are as follows:

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | **Subsidiaries** | | **Senior Management personnel** | | **Other related parties** | |
| **Assets** | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** |
| Loans and advances to customers | 98,976 | 88,395 | 1,037 | 1,050 | 86,593 | 90,405 |
| Derivatives | - | - | | - | 27,709 | 10,416 |
| Other assets | - | - | | - | | - |
| **Liabilities** | | | | | | |
| Deposits from customers | 7,651 | 4,209 | 1,852 | 1,257 | 206,776 | 168,133 |
| Derivatives | | - | | - | 7,037 | 17,951 |
| **Other** | | | | | | |
| Guarantees given | 70 | 86 | - | - | - | - |
| Contingent commitments given | 2,798 | 3,253 | 256 | 299 | 1,796 | 975 |
| **Profit and loss** | | | | | | |
| Interest income | 225 | 261 | 1 | 1 | 598 | 781 |
| Interest expenses | - | 1 | - | - | - | - |
| Dividends Income | - | 28,883 | - | - | - | 2 |
| Fee and commission income | 2,465 | 2,238 | - | - | 94 | 149 |
| Administrative Expenses | 1,002 | 994 | - | - | - | - |

## 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 2019 Annual Report presented by the head of the service to the Board of Directors at their meeting held on 29 January 2020.

During 2019 the Customer Service Department received 25 complaints, 20 of which were admitted. From the total number of complaints admitted, 19 were resolved in 2019 (of which three were resolved in favour of the customer and 16 in favour of the Bank) and one has been resolved in 2019. Only three of the complaints received have been lodged by a legal entity.

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 | |
|---|---|---|
| | 2019 | 2018 |
| Loans | 17 | 40 |
| Deposits | - | - |
| Other banking products | 4 | - |
| Investment services | 2 | 2 |
| Collection and payment services | 1 | - |
| Other | 1 | - |
| | **25** | **42** |

The number of complaints resolved during 2019, by autonomous region, is as follows:

| | Number | |
|---|---|---|
| | 2019 | 2018 |
| Castilla y León | 1 | - |
| Comunidad Valenciana | 1 | - |
| Andalucía | - | 1 |
| Castilla La Mancha | - | 2 |
| Madrid | 14 | 19 |
| País Vasco | 2 | - |
| Galicia | 1 | - |

## 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 Bank 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 Bank 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 Bank, 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 2019 and 2018 for each type of financial instrument, without deducting collateral or any other guarantees received to ensure repayment by borrowers:

| | Thousands of Euros | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2019 | | | | | | |
| **Type of instruments** | **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** | **Total** |
| **Debt instruments** | | | | | | | |
| Loans and advances to central banks | 247,520 | - | - | - | - | - | 247,520 |
| Loans and advances to credit institutions | 1,310,209 | - | - | - | - | 1,548,080 | 2,858,289 |
| Loans and advances to customers | - | - | 10,830 | - | - | 1,369,259 | 1,380,089 |
| Debt securities | - | 53,360 | 2,068 | 107,696 | 2,289,922 | 1,173,044 | 3,626,091 |
| **Total debt instruments** | **1,557,729** | **53,360** | **12,898** | **107,696** | **2,289,922** | **4,090,385** | **8,111,989** |
| **Equity instruments** | **-** | **3,258** | **-** | **-** | **40,007** | **-** | **43,265** |
| **Guarantees and commitments given** | | | | | | | |
| Financial guarantees given | - | - | - | - | - | 24,240 | 24,240 |
| Other commitments given | - | - | - | - | - | 167,046 | 167,046 |
| **Total guarantees and commitments given** | **-** | **-** | **-** | **-** | **-** | **191,286** | **191,286** |
| **Other exposures** | | | | | | | |
| Derivatives | - | 937,657 | - | - | - | - | 937,657 |
| Contingent commitments given | - | - | - | - | - | 707,240 | 707,240 |
| **Total other exposures** | **-** | **937,657** | **-** | **-** | **-** | **707,240** | **1,644,897** |
| **Maximum credit risk exposure level** | **1,557,729** | **994,275** | **12,898** | **107,696** | **2,329,929** | **4,988,910** | **9,991,437** |

| | Thousands of Euros | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2018 | | | | | | |
| **Type of instruments** | **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** | **Total** |
| **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** |

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 236,430 thousand and Euros 867,897 thousand at 31 December 2019 and 2018, respectively, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Cash, cash balances with central banks and other demand deposits | 4,990 | 195,875 |
| Financial assets designated at fair value through profit or loss - Debt securities | 107,696 | 197,904 |
| Financial assets at fair value through other comprehensive income - Debt securities | 123,744 | 463,118 |
| Financial assets at amortised cost - Loans and advances to credit institutions | - | 11,000 |
| | **236,430** | **867,897** |

Details of loans and advances, by counterparty and product, and net of impairment losses, classified in the different asset categories at 31 December 2019 and 2018 are as follows:

| | 31 December 2019 | | | | | |
|---|---|---|---|---|---|---|
| | **Central banks** | **General governments** | **Credit institutions** | **Other financial corporations** | **Non-financial corporations** | **Households** |
| On demand, short notice (current account) | 247,520 | - | 1,310,209 | 2,509 | 6 | 2 |
| Credit card debt | - | - | 15 | 7 | 66 | 558 |
| Trade receivables | - | - | - | - | 85,721 | - |
| Finance leases | - | - | - | - | 796 | 126 |
| Reverse repurchase loans | - | - | 1,277,762 | - | - | - |
| Other term loans | - | 363,944 | 240,951 | 34,583 | 295,047 | 117,305 |
| Advances that are not loans | - | 432 | 29,115 | 451,042 | 5,475 | 117 |
| **Loans and advances** | **247,520** | **364,376** | **2,858,052** | **488,141** | **387,111** | **118,108** |
| *Of which: loans secured by real estate collateral* | - | - | - | *75* | *18,329* | *77,057* |
| *Of which: other secured loans* | - | - | *3* | - | *25,560* | *18,622* |
| *Of which: consumer credit* | - | - | - | - | - | *22,025* |
| *Of which: home purchase loans* | - | - | - | - | - | *74,064* |
| *Of which: project finance loans* | - | - | - | - | - | - |

| | 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** |
| *Of which: loans secured by real estate collateral* | - | - | - | *83* | *12,278* | *70,047* |
| *Of which: other secured loans* | - | - | *11* | *2,809* | *21,176* | *16,267* |
| *Of which: consumer credit* | - | - | - | - | - | *18,279* |
| *Of which: home purchase loans* | - | - | - | - | - | *67,348* |
| *Of which: project finance loans* | - | - | - | - | - | - |

### *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 2019 and 2018, based on ratings (external or internal, in line with the credit rating models developed by the Entity) is as follows:

| | 2019 | | 2018 | |
|---|---|---|---|---|
| **Credit rating** | **Thousands of Euros** | **%** | **Thousands of Euros** | **%** |
| AAA | 264,401 | 3.4 | 124,296 | 1.7 |
| AA+ | 24,614 | 0.3 | 20,768 | 0.3 |
| AA | 393,882 | 5.1 | 536 | 0.0 |
| AA- | 168,916 | 2.2 | 40,464 | 0.6 |
| A+ | 642,678 | 8.3 | 304,040 | 4.1 |
| A. | 4,641,666 | 59.8 | 5,007,847 | 68.0 |
| A- | 185,282 | 2.4 | 54,751 | 0.7 |
| BBB+ | 259,375 | 3.3 | 545,829 | 7.4 |
| BBB | 318,811 | 4.1 | 598,869 | 8.1 |
| BBB- | 94,357 | 1.2 | 101,186 | 1.4 |
| BB+ | 29,591 | 0.4 | 28,283 | 0.4 |
| BB | 40,500 | 0.5 | 45,238 | 0.6 |
| BB- | 17,588 | 0.2 | | |
| B+ | 4,002 | 0.1 | | |
| B | 18,087 | 0.2 | | |
| B- | 83,176 | 1.1 | | |
| Below BB | - | - | 162,004 | 2.2 |
| Below B- | 41,699 | 0.5 | | |
| Not rated | 534,219 | 6.9 | 329,123 | 4.5 |
| **Total** | **7,762,844** | **100.0** | **7,363,234** | **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 2019 and 2018 are as follows:

| | 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 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** | **363,944** | - | - | - | - | - | - | - |
| **Other financial institutions** | **37,099** | 71 | 3,171 | - | 2,384 | 468 | - | 390 |
| **Non-financial corporations and sole proprietorships** | **384,026** | 18,893 | 24,969 | 16,214 | 8,647 | 6,208 | 1,611 | 11,182 |
| Real estate construction and property development | **35,026** | - | - | - | - | - | - | - |
| Construction of civil works | **31,944** | 74 | - | 74 | - | - | - | - |
| Other purposes | **317,056** | 18,819 | 24,969 | 16,140 | 8,647 | 6,208 | 1,611 | 11,182 |
| Large corporations | **169,293** | 3,957 | 13,684 | 7,837 | - | - | 1,236 | 8,568 |
| SMEs and sole proprietorships | **147,763** | 14,862 | 11,285 | 8,303 | 8,647 | 6,208 | 375 | 2,614 |
| **Other household loans** | **115,601** | 76,852 | 18,070 | 21,532 | 25,933 | 33,845 | 10,256 | 3,356 |
| Housing | **73,806** | 70,810 | 2,888 | 15,665 | 20,221 | 24,882 | 9,574 | 3,356 |
| Consumer | **21,982** | - | 1,411 | 884 | - | 527 | - | - |
| Other purposes | **19,813** | 6,042 | 13,771 | 4,983 | 5,712 | 8,436 | 682 | - |
| **TOTAL** | **900,670** | **95,816** | **46,210** | **37,746** | **36,964** | **40,521** | **11,867** | **14,928** |
| MEMORANDUM ITEM | | | | | | | | |
| *Refinancing, refinanced and restructured operations (net of specific provisions)* | ***4,160*** | - | *3,391* | *2,688* | - | - | - | *702* |

| | 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 and non-profit institutions serving households** | **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 | | | | | | | | |
| *Refinancing, refinanced and restructured operations (net of specific provisions)* | *7,698* | *601* | *4,597* | *3,479* | *101* | - | - | *1,618* |

*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 2019 the Bank's outstanding refinanced balance totals Euros 5,325 thousand (Euros 9,645 thousand at 31 December 2018). This figure includes loans classified as performing exposures and watchlist, and as non-performing exposures, representing 0.4% of total loans and advances to customers (1.6% in 2018).

| | **2019** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Thousands of Euros** | | | | | | | |
| | **Credit institutions** | **General governments** | **Other financial corporations and sole proprietorships (financial business)** | **Non-financial corporations and sole proprietorships (non-financial business)** | ***Of which: financing of real estate construction and property development (including land)*** | **Other household loans** | **Total** | **Additional information: financing classified as non-current assets and disposal groups held for sale** |
| **Unsecured** | | | | | | | | |
| Number of transactions | - | - | - | 9 | - | 3 | **12** | - |
| Gross carrying amount | - | - | - | 853 | - | 21 | **874** | - |
| **Secured** | | | | | | | | |
| Number of transactions | - | - | - | 6 | - | - | **6** | - |
| Gross carrying amount | - | - | - | 4,451 | - | - | **4,451** | - |
| **Impairment allowances** | - | - | - | (1,157) | - | (9) | **(1,166)** | - |
| ***Of which: doubtful exposures*** | | | | | | | | |
| ***Unsecured*** | | | | | | | | |
| *Number of transactions* | - | - | - | *1* | - | *2* | ***3*** | - |
| *Gross carrying amount* | - | - | - | *75* | - | *11* | ***86*** | - |
| ***Secured*** | | | | | | | | |
| *Number of transactions* | - | - | - | - | - | - | - | - |
| *Gross carrying amount* | - | - | - | - | - | - | - | - |
| ***Specific allowance or provision*** | - | - | - | - | - | - | - | - |
| **TOTAL** | | | | | | | | |
| Number of transactions | - | - | - | 15 | - | 3 | **18** | - |
| Gross carrying amount | - | - | - | 5,304 | - | 21 | **5,325** | - |
| Impairment allowances | - | - | - | (1,157) | - | (9) | **(1,166)** | - |

| | 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)** | ***Of which: financing of real estate construction and property development (including land)*** | **Other household loans** | **Total** | **Additional information: financing classified as non-current assets and disposal groups held for sale** |
| **TOTAL** | | | | | | | | |
| **Unsecured** | | | | | | | | |
| Number of transactions | - | - | - | 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)** | - |
| ***Of which: doubtful exposures*** | | | | | | | | |
| ***Unsecured*** | | | | | | | | |
| *Number of transactions* | | | | *2* | | *2* | ***4*** | |
| *Gross carrying amount* | - | - | - | *1,001* | - | *13* | ***1,014*** | - |
| ***Secured*** | - | - | - | | - | | | - |
| *Number of transactions* | | | | - | | - | - | |
| *Gross carrying amount* | - | - | - | - | - | - | - | - |
| ***Specific allowance or provision*** | - | - | - | - | - | - | - | - |
| **TOTAL** | - | - | - | | - | | | - |
| Number of transactions | - | - | - | 16 | 1 | 5 | **21** | - |
| Gross carrying amount | - | - | - | 9,463 | 3,086 | 182 | **9,645** | - |
| Impairment allowances | - | - | - | (1,932) | (3,086) | (15) | **(1,947)** | - |

## *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 2019 and 2018 are as follows:

| | **31.12.2018** | **Depreciation** | **Impairment** | **31.12.2019** |
|---|---|---|---|---|
| Non-trading financial assets mandatorily at fair value through profit or loss | 14,390 | - | (3,560) | 10,830 |
| Financial assets at amortised cost | 29,231 | (3,084) | - | 26,147 |
| | **43,621** | **(3,084)** | **(3,560)** | **36,977** |
| *Of which: doubtful* | - | - | | - |

| | **31.12.2017** | **Reclassification first-time adoption Circular 4/2017** | **01.01.2018** | **Derecognitions during the year** | **Depreciation** | **Impairment** | **31.12.2018** |
|---|---|---|---|---|---|---|---|
| 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** |
| *Of which: doubtful* | *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 2019 and 2018 are as follows:

| | 31.12.2018 | Charges to (reversal of) provisions for the year | 31.12.2019 |
|---|---|---|---|
| Financial assets at amortised cost | 557 | (60) | 497 |
| | **557** | **(60)** | **497** |
| *Of which: doubtful* | - | | - |

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 2019 and 2018 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2019 | 2018 |
| Total loans and advances to customers excluding general governments | 993,360 | 606,114 |
| Total assets | 9,122,004 | 8,530,492 |
| Impairment and provisions for exposures classified as performing and watchlist | (21,116) | (26,294) |

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

| | Thousands of Euros | |
|---|---|---|
| | Gross amount | |
| | 2019 | 2018 |
| 1. Unsecured | 36,977 | 43,621 |
| 2. With mortgage guarantee | - | - |
| 2.1. Finished buildings | - | - |
| 2.1.1 Housing | - | - |
| 2.1.2 Other | - | - |
| 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** | **36,977** | **43,621** |

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

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | 2019 | | 2018 | |
| | Gross amount | Of which: doubtful | Gross amount | Of which: doubtful |
| Home purchase loans | 73,122 | - | 66,563 | 1 |
| Unsecured | 2,917 | - | 1,861 | - |
| With mortgage guarantee | 70,205 | - | 64,702 | 1 |

The following table shows a breakdown of mortgage loans extended to acquire homes at 31 December 2019 and 2018 by percentage of total risk on the latest available appraisal value (LTV):

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | | | | |
| | LTV bracket | | | | | |
| | LTV < 40% | 40% < LTV < 60% | 60% < LTV < 80% | 80% < LTV < 100% | LTV > 100% | Total |
| Gross amount | 14,730 | 19,205 | 23,649 | 9,465 | 3,156 | 70,205 |
| *Of which: doubtful* | - | - | - | - | - | - |

| | 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* |

The Bank has not recognised any foreclosed assets at 31 December 2019 and 2018.

*35.1.5 Past-due unimpaired financial assets*

Details of past-due unimpaired financial assets at 31 December 2019 and 2018, classified on the basis of the time elapsed since maturity, by nature of the financial instrument and by counterparty, are as follows:

| | 31.12.2019 | | | |
|---|---|---|---|---|
| | 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 | 4 | 915 | 148 | 1,067 |
| Households | 140 | 123 | 268 | 531 |
| **Total** | **144** | **1,038** | **416** | **1,598** |

| | 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** |

### *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 | | | | | |
|---|---|---|---|---|---|---|
| | 2019 | | | | | |
| | 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 | 1,173,045 | - | - | - | - | 1,173,045 |
| Loans and advances | 2,917,339 | *1,681* | - | (1,237) | (21,353) | 2,894,749 |
| Central banks | - | - | - | - | - | - |
| General governments | 364,376 | - | - | - | - | 364,376 |
| Credit institutions | 1,548,080 | - | - | - | (237) | 1,547,843 |
| Other financial corporations | 489,780 | - | - | - | (1,639) | 488,141 |
| Non-financial corporations | 394,079 | *390* | - | (242) | (17,556) | 376,281 |
| Households | 121,024 | *1,291* | - | (995) | (1,921) | 118,108 |
| **Total** | **4,090,384** | ***1,681*** | **-** | **(1,237)** | **(21,353)** | **4,067,794** |

| | 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** |

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 except for the category of "Non-compulsory financial assets for negotiations mandatorily valued at fair value with changes in results" in 2019 and 2018 by type of financial asset is as follows:

| | **Thousands of Euros** | | | | |
|---|---|---|---|---|---|
| | **2019** | | | | |
| | **Balance at 31 December 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 2019** |
| **Specific impairment allowances for financial assets measured individually** | - | - | - | - | - |
| Loans and advances | - | - | - | - | - |
| **Specific impairment allowances for financial assets, estimated collectively** | **1,201** | **607** | **(766)** | **195** | **1,237** |
| Loans and advances | 37 | - | (37) | - | - |
| | 1,164 | 607 | (729) | 195 | 1,237 |
| **Collective impairment allowances for incurred but not reported losses on financial assets** | | | | | |
| Debt securities | **27,985** | **988** | **(6,410)** | **(195)** | **22,368** |
| Loans and advances | 759 | 256 | - | - | 1.015 |
| | 27,226 | 732 | (6,410) | (195) | 21,353 |
| **Total** | **29,186** | **1,595** | **(7,176)** | **-** | **23,605** |

| | 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** |

*35.1.8 Impaired and derecognised financial assets*

Movement in 2019 and 2018 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 | |
|---|---|---|
| | 2019 | 2018 |
| **Opening balance** | **10,277** | **7,224** |
| **Charges** | 1,295 | 4,154 |
| Application of accumulated impairment losses | 518 | 4,138 |
| Direct write-down in the income statement | 745 | 7 |
| Contractually payable interest | 32 | 10 |
| **Derecognitions** | (31) | (1,101) |
| Collection of principal from counterparties in cash | (5) | (15) |
| Collection of interest from counterparties in cash | (21) | (1) |
| Pardoning of debt | (5) | (1,085) |
| **Closing balance** | **11,541** | **10,277** |

*35.2 Liquidity risk*

Liquidity risk management consists of ensuring that the Bank 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 Bank 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 2019 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 2019 and 2018 was as follows:

| | 2019 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Thousands of Euros | | | | | | | |
| | **Demand** | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undetermined maturity** | **Total** |
| **Assets** | | | | | | | | |
| Cash, cash balances with central banks and other demand deposits (note 5) | 1,558,271 | - | - | - | - | - | - | 1,558,271 |
| Loans to credit institutions (note 10) | - | 1,304,213 | 71,716 | 77,927 | 92,874 | 1,113 | - | 1,547,843 |
| Loans and advances to customers (notes 7 and 10) | 3,162 | 16,529 | 66,111 | 186,693 | 894,004 | 191,237 | - | 1,357,736 |
| Fixed income portfolio (notes 6, 7, 8, 9 and 10) | - | 188,799 | 201,809 | 111,954 | 1,107,696 | 2,015,833 | - | 3,626,091 |
| Other assets | - | 93,767 | 140,650 | 215,662 | 487,585 | - | 94,399 | 1,032,063 |
| **Total assets** | **1,561,433** | **1,603,308** | **480,286** | **592,236** | **2,582,159** | **2,208,183** | **94,399** | **9,122,004** |
| **Liabilities** | | | | | | | | |
| Deposits from central banks and credit institutions (note 14) | 3,530,355 | 876,812 | 30,746 | 314,197 | 99,068 | 751,335 | - | 5,602,513 |
| Deposits from customers (note 14) | 887,416 | 284,379 | 1,199 | 4,165 | 815 | 207 | - | 1,178,181 |
| Other liabilities | 51,433 | 166,470 | 249,704 | 382,880 | 865,641 | - | 625,182 | 2,341,310 |
| **Total Liabilities** | **4,469,204** | **1,327,661** | **281,649** | **701,242** | **965,524** | **751,542** | **625,182** | **9,122,004** |
| Simple gap | (2,907,771) | 275,647 | 198,637 | (109,006) | 1,616,635 | 1,456,641 | (530,783) | - |
| Accumulated gap | (2,907,771) | (2,632,124) | (2,433,487) | (2,542,493) | (925,858) | 530,783 | - | - |

| | 2018 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Thousands of Euros | | | | | | | |
| | **Demand** | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undetermined maturity** | **Total** |
| **Assets** | | | | | | | | |
| Cash, cash balances with central banks and other demand deposits (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 | - | - |

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 2019 stood at 260.1% (281,9% at 31 December 2018), 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 2019, the net stable funding ratio was 244.2% (307.1% at 31 December 2018), 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 2019 and 2018 are as follows:

| | 2019 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Thousands of Euros | | | | | | |
| | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undeter-mined maturity** | **Total** |
| **Assets** | | | | | | | |
| Cash, cash balances with central banks and other demand deposits (note 5) | 1,558,271 | - | - | - | - | - | 1,558,271 |
| Loans to credit institutions (note 10) | 1,304,424 | 73,338 | 79,728 | 90,247 | 106 | - | 1,547,843 |
| Loans and advances to customers (notes 7 and 10) | 168,959 | 134,724 | 472,503 | 485,231 | 96,319 | - | 1,357,736 |
| Fixed income portfolio (notes 6, 7, 8, 9 and 10) | 196,908 | 234,599 | 118,947 | 1,064,340 | 2,011,297 | - | 3,626,091 |
| Other assets | 93,767 | 140,650 | 215,662 | 487,585 | - | 94,399 | 1,032,063 |
| **Total assets** | **3,322,329** | **583,311** | **886,840** | **2,127,403** | **2,107,722** | **94,399** | **9,122,004** |
| **Liabilities** | | | | | | | |
| Deposits from central banks and credit institutions (note 13) | 5,157,599 | 32,468 | 315,899 | 96,441 | 106 | - | 5,602,513 |
| Deposits from customers (note 13) | 968,982 | 37,869 | 88,368 | 42,972 | 39,990 | - | 1,178,181 |
| Other Liabilities | 166,470 | 249,705 | 382,879 | 865,642 | - | 676,614 | 2,341,310 |
| **Total liabilities** | **6,293,051** | **320,042** | **787,146** | **1,005,055** | **40,096** | **676,614** | **9,122,004** |
| Off-balance sheet operations | 688,297 | 252,254 | 1,511,744 | (627,746) | (1,824,549) | - | - |
| Simple gap | (2,282,425) | 515,523 | 1,611,438 | 494,602 | 243,077 | (582,215) | - |
| Accumulated gap | (2,282,425) | (1,766,902) | (155,464) | 339,138 | 582,215 | - | - |

| | 2018 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Thousands of Euros | | | | | | |
| | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undeter-mined maturity** | **Total** |
| **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 | - | - |

The average interest rates of financial instruments in 2019 and 2018 were as follows:

| | Percentage (%) | |
|---|---|---|
| | **2019** | **2018** |
| Cash, cash balances with central banks and other demand deposits | 0,00 | 0.00 |
| Financial assets held for trading | 0.31 | 0.90 |
| Non-trading financial assets mandatorily at fair value through profit or loss | 0.01 | 0.02 |
| Financial assets designated at fair value through profit or loss | 0.01 | 0.01 |
| Financial assets designated at fair value through other comprehensive income | 0.06 | (0.33) |
| Financial assets at amortised cost | | |
| Credit institutions | (0.22) | (0.25) |
| Other debtors | 1.01 | 2.18 |
| Financial liabilities at amortised cost | | |
| Credit institutions | (0.38) | (0.34) |
| Other debtors | 0.00 | 0.01 |

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 2019 and 2018, 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:

| | % | |
|---|---|---|
| | **2019** | **2018** |
| Sensitivity of the financial margin | | |
| + 100 b.p. | (8.90) | (3.75) |
| - 100 b.p. | 6.75 | 1.85 |

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 2019 and 2018 is as follows:

| | % | |
|---|---|---|
| | **2019** | **2018** |
| Sensitivity of equity | (7.50) | (8.76) |

*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. During the 2019 financial year, the calculation methodology was revised in order to include the credit risk of the fixed-income instruments that make up the different portfolios. To homogenize the 2018 figures, the figures have been recalculated according to the new methodology.

The maximum and average VaR are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| Average VaR | 10,160 | 7,453 |
| Maximum VaR | 13,144 | 9,642 |

*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 2019 and 2018 are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | **2019** | | **2018** | |
| | **Assets** | **Liabilities** | **Assets** | **Liabilities** |
| US Dollar | 131,415 | 104,775 | 108,617 | 101,794 |
| Pound Sterling | 47,358 | 21,478 | 41,874 | 19,946 |
| Swiss Franc | 1,276 | 1,535 | 666 | 598 |
| Norwegian Krone | 267 | 822 | 445 | 840 |
| Swedish Krona | 204 | 151 | 59 | 57 |
| Canadian Dollar | 886 | 975 | 1,126 | 965 |
| Danish Krone | 421 | 110 | 210 | 64 |
| Japanese Yen | 525 | 475 | 754 | 558 |
| Other | 1,498 | 784 | 2,686 | 822 |
| **Total** | **183,850** | **131,105** | **156,437** | **125,644** |

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

| | Thousands of Euros | |
|---|---|---|
| | **2019** | **2018** |
| **Assets** | | |
| Loans and advances to credit institutions | 125,637 | 112,457 |
| Loans and advances to customers | 14,209 | 3,862 |
| Debt securities | 28,467 | 25,520 |
| Other assets | 15,537 | 14,598 |
| **Total** | **183,850** | **156,437** |
| **Liabilities** | | |
| Deposits from credit institutions | 114,485 | 115,604 |
| Deposits from customers | 8,430 | 2,875 |
| Other liabilities | 8,190 | 7,165 |
| **Total** | **131,105** | **125,644** |

*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 2019 and 2018, broken down by geographical area, segment of activity, counterparty and purpose of the financing extended, is as follows:

| | 2019 | | | | |
|---|---|---|---|---|---|
| | Thousands of Euros | | | | |
| | Total | Spain | Rest of EU | Americas | Rest of the world |
| Central banks and credit institutions | 4,051,149 | 2,773,982 | 1,187,674 | 63,710 | 25,783 |
| General governments | 3,672,360 | 3,343,855 | 328,505 | - | - |
| Central government | 3,586,072 | 3,257,567 | 328,505 | - | - |
| Other general governments | 86,288 | 86,288 | - | - | - |
| Other financial corporations | 785,198 | 243,334 | 533,801 | 5,007 | 3,056 |
| Non-financial corporations and sole proprietorships | 637,373 | 540,931 | 77,618 | 8,704 | 10,120 |
| Real estate construction and development | 35,026 | 35,026 | - | - | - |
| Construction of civil works | 33,890 | 33,890 | - | - | - |
| Other purposes | 568,457 | 472,015 | 77,618 | 8,704 | 10,120 |
| Large corporations | 330,471 | 244,137 | 74,257 | 8,704 | 3,373 |
| SMEs and sole proprietorships | 237,986 | 227,878 | 3,361 | - | 6,747 |
| Other household loans | 122,571 | 122,090 | 370 | 111 | - |
| Housing | 74,063 | 73,664 | 369 | 30 | - |
| Consumer | 22,024 | 22,024 | - | - | - |
| Other purposes | 26,484 | 26,402 | 1 | 81 | - |
| **TOTAL** | **9,268,651** | **7,024,192** | **2,127,968** | **77,532** | **38,959** |

| | 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** |

The classification by geographical area and business segment in Spain at 31 December 2019 and 2018 is presented below:

**RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2019**

| | Thousands of Euros | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Total** | **Andalusia** | **Aragón** | **Asturias** | **Balearic Islands** | **Canary Islands** | **Cantabria** | **Castilla-La Mancha** | **Castile and León** | **Catalonia** |
| Credit institutions | 2,773,982 | 658,882 | 43,005 | 196,862 | - | 2,010 | - | 561,861 | 52,674 | - |
| General governments | 3,343,855 | 7,765 | 1,793 | 10,233 | 734 | - | - | 23,828 | 1,096 | - |
| Central government (*) | 3,257,567 | - | - | - | - | - | - | - | - | - |
| Other | 86,288 | 7,765 | 1,793 | 10,233 | 734 | - | - | 23,828 | 1,096 | - |
| Other financial institutions | 243,334 | - | - | - | - | - | - | - | 412 | - |
| Non-financial corporations and sole proprietorships | 540,931 | 15,291 | 42,364 | 10,289 | 7,292 | - | 2,464 | 10,094 | 6,263 | 12,827 |
| Real estate construction and property development | 35,026 | - | 35,026 | - | - | - | - | - | - | - |
| Construction of civil works | 33,890 | 2,520 | - | - | - | - | - | - | - | - |
| Other purposes | 472,015 | 12,771 | 7,338 | 10,289 | 7,292 | - | 2,464 | 10,094 | 6,263 | 12,827 |
| Large corporations | 244,137 | 6,988 | 1,486 | 299 | 7,292 | - | 536 | 3,856 | 3,599 | 7,565 |
| SMEs and sole proprietorships | 227,878 | 5,783 | 5,852 | 9,990 | - | - | 1,928 | 6,238 | 2,664 | 5,262 |
| Other household loans and non-profit institutions serving households | 122,090 | 1,327 | 138 | 156 | 104 | 546 | 50 | 980 | 829 | 2,420 |
| Housing | 73,664 | 178 | 91 | 94 | - | 76 | 21 | 290 | 569 | 221 |
| Consumer | 22,024 | 458 | 45 | 51 | 104 | 470 | 29 | 680 | 247 | 1,364 |
| Other purposes | 26,402 | 691 | 2 | 11 | - | - | - | 10 | 13 | 835 |
| **TOTAL** | **7,024,192** | **683,265** | **87,301** | **217,540** | **8,130** | **2,555** | **2,514** | **596,763** | **61,274** | **15,247** |

*(*) Balance not attributable to any specific Autonomous Region*

**RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2019**

| | Thousands of Euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Extremadura** | **Galicia** | **Madrid** | **Murcia** | **Navarre** | **Valencia** | **Basque Country** | **La Rioja** | **Ceuta and Melilla** |
| Credit institutions | 49,892 | 8,457 | 1,039,970 | - | 3,771 | 142,438 | 14,160 | - | - |
| General governments | - | 4,247 | 13,104 | 5,616 | 3,255 | 14,617 | - | - | - |
| Central government | - | - | - | - | - | - | - | - | - |
| Other | - | 4,247 | 13,104 | 5,616 | 3,255 | 14,617 | - | - | - |
| Other financial institutions | - | - | 242,922 | - | - | - | - | - | - |
| Non-financial corporations and sole proprietorships | - | 12,829 | 391,263 | 9,695 | 1,551 | 12,912 | 5,797 | - | - |
| Real estate construction and property development | - | - | - | - | - | - | - | - | - |
| Construction of civil works | - | - | 31,370 | - | - | - | - | - | - |
| Other purposes | - | 12,829 | 359,893 | 9,695 | 1,551 | 12,912 | 5,797 | - | - |
| Large corporations | - | 11,418 | 189,496 | 5,147 | 1,256 | 1,392 | 3,807 | - | - |
| SMEs and sole proprietorships | - | 1,411 | 170,397 | 4,548 | 295 | 11,520 | 1,990 | - | - |
| Other household loans and non-profit institutions serving households | 211 | 263 | 109,730 | 55 | 16 | 3,371 | 1,722 | 150 | 22 |
| Housing | - | 30 | 70,979 | - | - | 820 | 162 | 133 | - |
| Consumer | 211 | 124 | 17,559 | 55 | 16 | 558 | 14 | 17 | 22 |
| Other purposes | - | 109 | 21,192 | - | - | 1,993 | 1,546 | - | - |
| **TOTAL** | **50,103** | **25,796** | **1,796,989** | **15,366** | **8,593** | **173,338** | **21,679** | **150** | **22** |

**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** |

*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 2019 and 2018 are as follows:

| | Thousands of Euros | | | | |
|---|---|---|---|---|---|
| | 2019 | | | | |
| | **Held for trading** | **At fair value through profit or loss** | **At fair value through other comprehensive income** | **At amortised cost** | **Total** |
| Spain | 16,221 | 77,564 | 1,830,280 | 1,055,414 | 2,979,479 |
| Italy | 3,837 | - | 207,036 | 117,631 | 328,504 |
| **Total** | **20,058** | **77,564** | **2,037,316** | **1,173,045** | **3,307,983** |

| | 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** |

*35.8 Regulatory risks*

IBOR reform

In the framework of regulatory risks, the global benchmark interest rate reform is a key aspect to be monitored by the Bank. Interbank offered rates (IBORs) are key benchmarks underpinning many contracts within the financial sector globally. Following the Financial Stability Board (FSB) recommendations in 2014, the authorities of various countries have been promoting initiatives so that the financial system reduces its dependence on IBORs and makes a transition to alternative risk-free interest rates (RFR) for the end of 2021. These RFRs have been designed to overcome the pitfalls of IBORs, in particular to minimise reliance on expert judgement and ensure a better level of transparency and understanding in how they are formed. Transitions can be carried out from the rate used historically as a benchmark to the new RFR (i.e. transition from EONIA to €STR in Europe, or the transition from Dollar LIBOR to SOFR in the USA) or by developing the methodology used for the existing rate, both in cases of overnight or term rates.

The Bank has a large number of financial assets and liabilities, the contracts for which are pegged to IBORs. The EURIBOR can be identified as the most relevant benchmark rate and is used for loans and deposits, as well as an underlying in derivatives. The EONIA's presence is lower in the banking book but it is used as an underlying rate in derivative instruments in the trading book and for the treatment of collateral.

The Bank has in place different approaches and deadlines for transition to the new RFRs when evaluating the economic, operational, legal, financial, reputational or compliance risks associated with the transition, as well as to define the lines of action to mitigate these risks.

Application of this reform is not expected to have a significant impact on Banco Cooperativo Español, S.A.'s financial statements.

## 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;

- 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

**31.12.2019**

| Company | Registered office | Activity | % ownership Direct | % ownership Indirect | Thousands of Euros Amount of interest | Capital and reserves | Total assets | Profit/ (loss) | Other dividends | Interim dividend | Revenues |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Rural Informática, S.A. | Madrid | IT services | 99.8 | 0.2 | 2,603 | 3,511 | 76,147 | 143 | - | - | 799 |
| Gescooperativo, S.A., S.G.I.I.C. | Madrid | Manager of collective investment undertakings | - | 100 | 1,893 | 3,486 | 12,334 | 3,874 | - | - | 7,611 |
| Rural Inmobiliario, S.L. | Madrid | Real-estate holding | 100 | - | 3,486 | 8,215 | 33,988 | 78 | - | - | 793 |
| BCE Formación, S.A. | Madrid | Training services | 100 | - | 60 | 131 | 659 | 331 | - | - | 1,376 |
| Espiga Capital Gestión, SA. | Madrid | Venture capital management | 80 | - | 288 | 340 | 349 | 9 | - | - | 13 |
| Rural Renting, S.A. | Madrid | Financial | 100 | - | 600 | 726 | 2,747 | (5) | - | - | 53 |

**31.12.2018**

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

Appendix I forms an integral part of note 11 to the annual accounts for 2019, in conjunction with which it should be read.

Banco Cooperativo Español, S.A.

Directors' Report

2019

(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 2019, the Bank's twenty-ninth year since its incorporation in July 1990.

## 1. Position of the Entity

### *1.1Description*

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 2019 the Bank had assets totalling Euros 9,122 million, Shareholders' equity of Euros 544 million and 233 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 | |
|---|---|---|
| | **2019** | **2018** |
| **Balance sheet** | | |
| Total assets | 9,122,004 | 8,530,492 |
| On-balance sheet customer funds | 1,178,181 | 1,104,312 |
| Other funds managed (*) | 6,377,634 | 6,092,309 |
| Loans and advances to other debtors | 1,357,736 | 625,632 |
| Shareholders' equity | 543,924 | 512,279 |
| **Profits** | | |
| Gross margin | 67,810 | 100,911 |
| Profit before income tax | 43,822 | 77,763 |
| Profit for the year | 32,009 | 63,983 |
| **Significant ratios (%). Consolidated data** | | |
| Administrative expenses/gross margin | 37.36 | 24.48 |
| Net profit/average equity (ROE) | 6.08 | 13.24 |
| Net profit/average total assets (ROA) | 0.27 | 0.58 |
| Solvency ratio | 35.6 | 30.5 |

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

### *2.1 Economic environment*

In its last update in January 2020 of the World Economic Outlook Report, the International Monetary Fund projected that global growth would rise from an estimated 2.9% in 2019 to 3.3% in 2020 and 3.4% for 2021, a downward revision of 0.1 percentage point for 2019, 2020 and 0.2 for 2021. This downward revision primarily reflects negative surprises to economic activity in a few emerging market economies, notably India, which led to a reassessment of growth prospects over the next two years. In a few cases, this reassessment also reflects the impact of increased social unrest.

On the positive side, market sentiment has been boosted by tentative signs that manufacturing activity and global trade are bottoming out, a broad-based shift toward accommodative monetary policy, intermittent favourable news on US-China trade negotiations, and diminished fears of a no-deal Brexit, leading to some retreat from the risk-off environment that had set in at the time of the October WEO. However, few signs of turning points are yet visible in global macroeconomic data.

While the baseline growth projection is weaker, developments since the fall of 2019 point to a set of risks to global activity that is less tilted to the downside compared to the October 2019 WEO. These early signs of stabilization could persist and eventually reinforce the link between still-resilient consumer spending and improved business spending. Additional support could come from fading idiosyncratic drags in key emerging markets coupled with the effects of monetary easing. Downside risks, however, remain prominent, including rising geopolitical tensions, notably between the United States and Iran, intensifying social unrest, further worsening of relations between the United States and its trading partners, and deepening economic frictions between other countries. A materialization of these risks could lead to rapidly deteriorating sentiment, causing global growth to fall below the projected baseline.

Stronger multilateral cooperation and a more balanced policy mix at the national level, considering available monetary and fiscal space, are essential for strengthening economic activity and forestalling downside risks. Building financial resilience, strengthening growth potential, and enhancing inclusiveness remain overarching goals. Closer cross-border cooperation is needed in multiple areas, to address grievances with the rules-based trading system, curb greenhouse gas emissions, and strengthen the international tax architecture. National-level policies should provide timely demand support as needed, using both fiscal and monetary levers depending on available policy room.

However, these forecasts are completely out of date due to the outbreak of the Covid-19 virus in China and its spread worldwide.

For this reason, the International Monetary Fund has recently edited a new report in which it sets out the economic policy steps to address the corona crisis, which are summarised as follows:

Monitoring, containing and mitigating the effects of the coronavirus are top priorities. Timely and decisive actions by health authorities, central banks, fiscal, regulatory and supervisory authorities can help contain the virus outbreak and offset the economic impact of the pandemic.

Central banks must support demand and confidence by preventing a tightening of financial conditions, lowering borrowing costs for households and firms, and ensuring market liquidity.

Fiscal policy must step up to provide sizable support to the most affected people and firms, including in hard-to-reach informal sectors.

Regulatory and supervisory responses must aim to preserve financial stability and banking system soundness while sustaining economic activity.

Significant steps have been taken in recent days, going in the right direction, but more needs to be done. As the virus spreads across the globe, decisive and coordinated action is key to providing stability to the global economy and financial markets, boosting confidence, and preventing deep and prolonged economic effects. We must also help poorer and the most vulnerable countries by providing equipment and financing to prevent and treat infections.

The IMF stands ready to support its membership, including through financial support for the countries hardest hit.

### 2.2 *Balance sheet*

- Total assets increased by 6.9% to Euros 9,122,004 thousand.
- Loans and advances to customers amounted to Euros 625,632 thousand at 31 December 2019, increasing 117.0% compared to the 2018-year end.
- Deposits from customers grew by 6.7% to Euros 1,178,181 thousand.
- Deposits from credit institutions and central banks decreased by 2.9% to Euros 5,602,513 thousand.
- Shareholders' equity increased by 6.2% to Euros 543,924 thousand.

### 2.3 *Income statement*

- The interest margin was Euros 50,032 thousand, representing a decline of 7.5% on 2018.
- Gross margin decreased by 32.8% to stand at 67,810 euros. Without considering the dividends received from the Group companies, the decrease was 5.9%.
- Administrative and personnel expenses grew by 2.5% to Euros 25,332 thousand. Depreciation totalled Euros 2,818 thousand (up 58.8%). In 2019 the sum of provisions and impairment losses on assets led to a credited amount of Euros 4,162 thousand. Consequently, results from operating activities stood at Euros 43,822 thousand (decreased by 43.6% compared to 2018).
- Profit for the year amounted to Euros 32,009 thousand, 50.0% lower than in 2018.

### 2.4 *Business units*

The results of the different business segments comprising the Banco Cooperativo Español, S.A. and subsidiaries and their performance in 2019 and 2018 are summarised below.

| | **Thousands of Euros** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Commercial banking** | | **Asset management** | | **Markets** | | **Corporate activities** | | **Total Group** | |
| | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** | **2019** | **2018** |
| Gross margin | 16,837 | 19,988 | 14,202 | 13,624 | 42,076 | 43,294 | 7,707 | 4,234 | 80,821 | 81,140 |
| Administrative expenses and depreciation | 7,995 | 7,447 | 4,678 | 4,357 | 7,717 | 7,188 | 11,280 | 10,507 | 31,670 | 29,499 |
| Provisions and impairment losses on financial assets | (603) | 274 | | | | 0 | | (3,575) | (603) | (3,301) |
| Results from operating activities | 9,445 | 12,267 | 9,524 | 9,267 | 34,359 | 36,106 | (3,573) | (2,698) | 49,754 | 54,942 |
| Other profit | | | | | | | | 24 | | 24 |
| Profit/(loss) before income tax | 9,445 | 12,267 | 9,524 | 9,267 | 34,359 | 36,106 | (3,573) | (2,674) | 49,754 | 54,966 |
| Income tax | 2,526 | 3,444 | 2,547 | 2,602 | 9,188 | 10,138 | (956) | (751) | 13,305 | 15,433 |
| **Consolidated profit/(loss) for the year** | **6,919** | **8,823** | **6,977** | **6,665** | **25,171** | **25,968** | **(2,618)** | **(1,923)** | **36,449** | **39,533** |

### *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.

| | **2019** | **2018** |
|---|---|---|
| Average length of service (years) | 12.7 | 12.1 |
| Average age | 43.2 | 42.5 |
| Training: | | |
| (%) University graduates | 83 | 85 |
| No. of hours of training | 8,805 | 5,284 |
| Hours of training/employee | 34 | 23 |
| Diversity (%) | | |
| Female | 53 | 48 |
| Male | 47 | 52 |
| HR management (%) | | |
| Internal promotion | 11 | 13 |
| Permanent contracts | 99 | 98 |

## 3. Liquidity and capital

### *3.1 Liquidity*

Liquidity risk management consists of ensuring that the Group always has sufficient liquidity to meet its payment commitments associated with the settlement of its liabilities on their respective maturity dates without compromising its capacity to respond rapidly to strategic market opportunities. This function includes obtaining financing in wholesale markets at the lowest possible cost in the medium and long term, with a view to maintaining an optimum level of liquid assets in keeping with 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 2019 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 2019 stood at 260.1%, 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 2019 the net stable funding ratio was 244.2%, 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 35 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** | |
|---|---|---|
| | **2019** | **2018** |
| Capital | 122,034 | 115,811 |
| Share Premium | 85,972 | 85,972 |
| Reserves | 331,598 | 251,328 |
| Result of the exercise | 27,006 | 48,159 |
| Deductions | (8,040) | (3,481) |
| **Common Equity Tier 1 (CET1) capital** | **558,570** | **497,789** |
| Additional CET1 elements | - | - |
| **Tier 1 capital** | **558,570** | **497,789** |
| Collective provision | - | - |
| **Tier 2 capital** | **-** | |
| **Total eligible capital** | **558,570** | **497,789** |
| | | |
| Credit, counterparty, dilution and delivery risk | 81,581 | 97,792 |
| Price, currency and commodity position risk | 20,688 | 13,165 |
| Operational risk and other | 23,282 | 19,844 |
| **Total minimum capital requirement** | **125,551** | **130,801** |
| **Surplus** | **433,019** | **366,988** |
| **Capital ratio (%)** | **35.6** | **30.5** |
| **Tier 1 capital (%)** | **35.6** | **30.5** |

Eligible capital amounts to Euros 558,570 thousand, while capital requirements are Euros 125,551 thousand, giving rise to a surplus of Euros 433,019 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 81,581 thousand and represent 65.0% of total capital requirements calculated in accordance with Banco de España regulations.

As a result, and the Tier I capital ratio stood at 35.6%.

## 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 2019 offset agreements have been implemented with 56 entities (52 entities at 31 December 2018).

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 2020, 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 2019.

## 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 (high) |

## 9. Relevant Facts

On 11 March 2020, the World Health Organization declared the outbreak of Coronavirus disease 2019 (COVID-19) to be a pandemic, due to its rapid spread across the globe, having affected over 150 countries. The majority of governments are taking restrictive measures to contain the spread, including: isolation, confinement, quarantine and restrictions on the free movement of people, the closure of public and private premises (except for basic necessities and health services), border closures and a drastic reduction in air, sea, rail and land transport. In Spain, the government enacted Royal Decree 463/2020 of 14 March 2020, declaring a state of emergency to manage the health crisis triggered by COVID-19, which, a priori, will remain in force for 15 calendar days.

This situation is having a significant impact on the global economy due to the interruption or slowdown of supply chains and the substantial increase in economic uncertainty, evidenced by greater volatility in asset prices and exchange rates, and a drop in long-term interest rates.

To mitigate the economic impacts of this crisis, on Wednesday 18 March 2020, Royal Decree-law 8/2020 of 17 March 2020 on extraordinary urgent measures to address the economic and social impact of COVID-19 was published in Spain.

The consequences derived from COVID-19 are considered an event after the reporting period that does not require an adjustment in the annual accounts for 2019, but must be disclosed in the annual accounts for 2020.

Although no significant consequences have arisen at the date the annual accounts were authorised for issue, the Bank expects significant events to arise in the future, which cannot be reliably estimated at present. During 2020, the Bank will assess the impact of the abovementioned events on the equity and financial position at 31 December 2020 and on the results of operations and cash flows for the year then ended.

**APPROVAL BY THE BOARD OF DIRECTORS OF**
**THE 2019 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 2019, which were authorised for issue at the Board of Directors' meeting held on 25 March 2020 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 63 pages (pages 9 to 133 ) and one appendix (page 134), as well as a Directors' report of 8 pages (pages 135 to 150).

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

Madrid, 25 March 2020.

D. Ignacio Arrieta del Valle
- Presidente -

D. José Luis García-Lomas Hernández
- Vicepresidente 1º -

D. Pedro García Romera
- Vicepresidente 2º -

D. Fernando Berge Royo
- Consejero -

Dr. Luis Esteban Chalmovsky
- Consejero -

D. Carlos de la Sierra Torrijos
- Consejero -

D. Cipriano García Rodríguez
- Consejero -

D. José Luis García-Palacios Álvarez
- Consejero -

D. Gerónimo Luque Frías
- Consejero -

D. Carlos Martínez Izquierdo
- Consejero -

D. Fernando Martínez Rodríguez
- Consejero -

D. Jesús Méndez Álvarez-Cedrón
- Consejero -

D. Ernesto Moronta Vicente
- Consejero-

D. Manuel Ruíz Escudero
- Consejero -

Dña. Dagmar Werner
- Consejera -