

**Caja Laboral Popular Coop. de  
Crédito and subsidiaries  
(Consolidated Group)**

Audit report,  
Consolidated annual accounts at 31 December 2017  
and consolidated Directors' Report for 2017



This version of our report is a free translation from the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation

## *Independent auditor's report on the consolidated annual accounts*

To the members of Caja Laboral Popular Coop. de Crédito:

### *Report on the consolidated annual accounts*

---

#### *Opinion*

We have audited the consolidated annual accounts of Caja Laboral Popular Coop. de Crédito (the Parent company) and its subsidiaries (the Group), which comprise the balance sheet as at December 31, 2017, and the profit and loss account, statement of recognized income and expenditure, statement of changes in total net assets, cash flow statement and related notes, all consolidated, for the year then ended.

In our opinion, the accompanying consolidated annual accounts present fairly, in all material respects, the equity and financial position of the Group as at December 31, 2017, as well as its financial performance and cash flows, all consolidated, for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and other provisions of the financial reporting framework applicable in Spain.

---

#### *Basis for opinion*

We conducted our audit in accordance with legislation governing the audit practice in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated annual accounts* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the consolidated annual accounts in Spain, in accordance with legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, and situations or circumstances have not arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

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

---

#### *Key audit matters*

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



Key audit matter	How our audit addressed the key audit matter
------------------	--

*Impairment adjustments in the loan portfolio*

The identification of impaired credit exposures and the calculation of impairment adjustments in the loan portfolio are among the most complex and most important estimates made when preparing the accompanying consolidated financial statements.

The Group recognizes provisions for the impairment of its loan portfolio when there is objective evidence of impairment as a result of one or more events occurring after initial recognition and when they have an impact on the estimated cash flows from that portfolio, or the collateral specific to each operation.

The assessment of impairment due to credit risk is based on models with a high level of judgment when calculating the impairment losses, taking into consideration matters such as:

- The classification of the different loan portfolios based on their credit risk profile.
- The identification and classification of impaired assets, or those subject to special monitoring.
- The use of assumptions with an effect on the provisions, as well as estimates regarding the attainment of a certain level of cash flows by borrowers, the impairment of which is estimated on an individual basis in accordance with the latest information available.
- The fair value of the collateral associated with the loans granted.

In this context, the Group uses models that take into consideration statistical data and patterns covering the average performance of banking institutions in Spain and allows it to estimate the aggregate credit risk provisions through the additional application of specific calculation methods to estimate them on an individual basis.

Our work regarding the estimate of loan portfolio impairment focused on the analysis, assessment and verification of the general internal control framework, as well as on the performance of detailed tests regarding provisions estimated both on an aggregate and individual basis.

We have performed the following procedures to the internal control system, among other things:

- Understanding and reviewing the calculation methods applied.
- Verifying the adequacy of the various policies and procedures approved by the Group's governing bodies with respect to applicable regulatory requirements.
- Verifying the main matters relating to the security environment for the information systems supporting the calculation of the provisions.
- Reviewing the regular risk assessment and monitoring alerts applied by the Group to identify risks that may be considered to be impaired or under special monitoring.
- Determining that the regular review of borrower files within the process of monitoring their accounting classification and the recognition of impairment, where applicable, is adequately performed.

We have also performed detailed tests consisting of:

- The selective verification of the databases used to calculate provisions, comparing the primary determining attributes of the impairment provision against support documentation (purpose of the transaction, classification of the loan, segmentation, default date).
- A recalculation of the aggregate provisions for credit risk.
- An assessment of the suitability of the discounted cash flow models used in the calculation of provisions based on individual analysis.



Caja Laboral Popular Coop. de Crédito and its subsidiaries (Consolidated Group)

Key audit matter	How our audit addressed the key audit matter
<p>The Group takes into account real and personal guarantees considered to be effective when determining any impairment adjustments to be applied to the loan portfolio.</p> <p>See notes 13.h), 26 and 63 of the Notes to the accompanying consolidated financial statements.</p>	<ul style="list-style-type: none"> <li>A review of a sample of files to evaluate their adequate classification and recognition and, if appropriate, the relevant impairment.</li> </ul> <p>The described procedures resulted in our observation that the methods used to calculate the impairment of loan assets are adequate and any difference obtained as a result of our procedures compared against the calculations made by Management remained within a reasonable range in the context of the amount included in the accompanying consolidated financial statements.</p>
<p><i>Provisions for tax, legal and regulatory litigation</i></p> <p>The Group is involved in administrative, court or other proceedings relating primarily to legal, tax and regulatory matters as a result of the normal course of its business.</p> <p>Within this context there are also situations that, while not involved with court proceedings, require the recognition of provisions based on Management's judgment such as, those associated with the possible impact of refunding amounts received as a result of the hypothetical nullification by the courts of floor clauses and the application of Royal Decree-Law 1/2017 on consumer protection measures regarding floor clauses and amounts to compensate customers for the marketing of certain products.</p> <p>Due to the complexity of these proceedings and the long period over which they take place, they are generally particularly complex and uncertain in terms of their possible outcome and/or definitive amount. As a result, the recognition of provisions for litigation is one of the areas that involves a high level of estimation regarding the possible impact on the accompanying consolidated financial statements.</p> <p>The Group records a provision for these items and therefore estimates the associated outflow as probable based on the analyses performed and applies calculations that are consistent with success experience, legal assessments and the uncertain conditions inherent to the obligations concerned.</p> <p>See note 38 of the notes to the accompanying consolidated financial statements.</p>	<p>We have analysed and documented our understanding of the process implemented by the Group to identify and assess litigation and proceedings in progress, as well as the Group's process for recognizing provisions and we have focused our procedures on matters such as:</p> <ul style="list-style-type: none"> <li>Understanding the policy for classifying claims and litigation and assigning provisions, where necessary.</li> <li>Analysing the main types of lawsuits, claims and litigation in progress.</li> <li>Obtaining confirmation letters from attorneys and advisers that work with the Group in order to compare their assessment of the expected outcome of claims or litigation, verify the completeness of the information, the correct recognition of provisions and identify any potential omissions of liabilities.</li> <li>Analysing the reasonableness of the estimated expected outcome of the most significant tax proceedings with the support of our internal experts.</li> <li>Evaluating possible contingencies relating to compliance with tax obligations for all periods open to inspection.</li> <li>Analysing the recognition, estimation and movements in accounting provisions.</li> </ul> <p>Our procedures specifically relating to the provisions for compensating customers and covering the outcome of contingencies relating to floor clauses focused on:</p>



Caja Laboral Popular Coop. de Crédito and its subsidiaries (Consolidated Group)

Key audit matter	How our audit addressed the key audit matter
	<ul style="list-style-type: none"> <li>• Understanding the control environment, evaluating and verifying the controls associated with the calculation and reviewing the associated provision.</li> <li>• Evaluating the method and assumptions applied by the Group to verify that they are consistent with the applicable accounting framework.</li> <li>• Verifying the use of historic data to determine the provisions to be maintained.</li> <li>• Analysing a sample of lawsuits and claims, verifying the proper grouping of cases by type when calculating provisions.</li> <li>• Examining a selection of transactions involving floor clauses, verifying the traceability of the main determining attributes of the provision within the Group's calculations.</li> <li>• Obtaining confirmation from internal and external attorneys regarding the completeness of proceedings in progress.</li> </ul> <p>The result of our work has shown that the provisions for tax, legal and regulatory litigation included in the accompanying consolidated financial statements fall within an adequate range in terms of the results obtained through the application of reasonable judgment during the process of evaluating and estimating these items, taking into account the particularities of the diverse claims, litigation and other contingencies that have been identified and reported by Group management and/or its legal and tax advisers.</p>
<p><i>Measurement of insurance contract liabilities</i></p> <p>The Group engages in the life insurance business and markets term, endowment and unit-linked life insurance products. It also engages in the non-life insurance business, fundamentally consisting of automobile, liability and comprehensive casualty lines of business, primarily homeowners' insurance.</p> <p>The Group recognizes the liabilities associated with those contracts based on applicable regulations which, in some cases, require certain judgments and estimates by Group management to reflect the unearned amounts of premiums issued, the mathematical provision and the provision for benefits.</p>	<p>We have gained an understanding of the process of estimating and recognizing life and non-life insurance contract liabilities, which included an evaluation of the design and effectiveness of the internal control related to this area and controls over the most relevant information systems. Our procedures have focused on matters such as:</p> <ul style="list-style-type: none"> <li>• Understanding the method for calculating the provisions for life and non-life insurance contracts in accordance with the nature of the products, as well as its consistent application compared with the preceding year.</li> </ul>



Caja Laboral Popular Coop. de Crédito and its subsidiaries (Consolidated Group)

Key audit matter	How our audit addressed the key audit matter
<p>This included, with respect to risk life insurance contracts, the estimated cost of claims not yet settled, paid or reported at the date of the presentation of these consolidated financial statements. The Group also recognizes a liability for the internal costs that are necessary to settle outstanding claims, as well as a provision for unearned premiums and, in the event of insufficient premiums, a provision for unexpired risks.</p> <p>The Group calculates the mathematical provision for endowment life insurance contracts using complex actuarial techniques based on critical calculation assumptions such as the technical interest rate, cost assumptions or mortality tables, in accordance with applicable legislation.</p> <p>The calculation of the provisions for benefits and, specifically, the provision for claims incurred but not reported, is complex and significantly influenced by the projection methods and assumptions applied by management, such as the impact of the assessment of personal claims in accordance with applicable legislation.</p> <p>See note 37 of the notes to the accompanying consolidated financial statements.</p>	<ul style="list-style-type: none"> <li>• Verifying the proper accounting recognition of the provisions for life and non-life insurance contracts, as well as any variations during the period.</li> <li>• Reviewing the calculation and the attribution over time of the provision for unearned premiums.</li> <li>• Performing detailed tests regarding the consistency of the information relating to the reserves created at the year-end and the payments made during the year.</li> </ul> <p>We have performed additional supplementary procedures specifically on the mathematical provision together with actuarial specialists, as follows:</p> <ul style="list-style-type: none"> <li>• Review of the integrity and reconciliation of the base data in the technical-actuarial calculations.</li> <li>• Verification of the application of biometric assumptions that are in line with applicable legislation.</li> <li>• Review of the significant assumptions applied by management based on past experience and insurance industry practices.</li> <li>• Recalculation of the mathematical provision for a sample of policies.</li> </ul> <p>Our actuarial specialists specifically participated in matters regarding the provision for benefits, such as:</p> <ul style="list-style-type: none"> <li>• Review of the integrity and reconciliation of the base data in the technical-actuarial calculations.</li> <li>• Review, based on independent statistical projections, for a sample of business lines, placing particular emphasis on those with the highest weight and the provisions involving the highest level of estimation.</li> </ul> <p>Any difference obtained as a result of our procedures concerning the calculations made by management remained within a reasonable range compared with the amount of liabilities arising due to insurance contracts included in the accompanying consolidated financial statements.</p>



Caja Laboral Popular Coop. de Crédito and its subsidiaries (Consolidated Group)

Key audit matter	How our audit addressed the key audit matter
<p data-bbox="315 428 805 512"><i>Entry into force of IFRS 9 and disclosure of information relating to the estimate of the impact of this standard.</i></p> <p data-bbox="315 541 818 741">Note 2 in the accompanying notes to the consolidated financial statements describes the entry into force of IFRS 9 relating to the classification and measurement of financial instruments and the Group has developed an adaptation project overseen by the Governing Board covering the following areas:</p> <ul data-bbox="337 770 764 995" style="list-style-type: none"><li>a) Classification and measurement of financial instruments.</li><li>b) Measurement of any significant impairment of financial instrument credit risk.</li><li>c) Hedge accounting.</li></ul> <p data-bbox="315 1024 818 1276">As a result, the Group has made preliminary estimates and calculations of the future impacts that the future application of this standard will have within the aforementioned three areas of analysis, and certain qualitative and quantitative information in this respect has been disclosed in the notes to the accompanying consolidated financial statements.</p> <p data-bbox="315 1306 797 1360">See note 2 of the notes to the accompanying consolidated financial statements.</p>	<p data-bbox="857 541 1442 741">IFRS 9 is applicable to years commencing on or after 1 January 2018 and we have performed certain procedures in order to verify the reasonableness of the information disclosed in the notes to the accompanying consolidated financial statements. The primary procedures that we performed are described below:</p> <ul data-bbox="867 770 1442 995" style="list-style-type: none"><li>• Understanding the adaptation of the accounting policies and methodological framework in order to assess compliance with the new standard.</li><li>• Verifying the information provided in the notes to the consolidated financial statements regarding the future impact of IFRS 9 on the Group.</li></ul> <p data-bbox="857 1024 1414 1079">Our procedures regarding the classification and measurement of financial instruments focused on:</p> <ul data-bbox="867 1108 1430 1419" style="list-style-type: none"><li>• Verifying the analyses and documentation prepared by the Group to evaluate the new criteria for classifying financial instruments, including aspects such as the assessment of the business models and the characteristics of the contractual cash flows deriving from financial instruments.</li><li>• Verifying the reasonableness of the impacts on the classification and measurement of financial instruments.</li></ul> <p data-bbox="857 1449 1442 1533">Our procedures regarding the measurement of any significant impairment of financial instrument credit risk emphasized:</p> <ul data-bbox="867 1562 1446 1766" style="list-style-type: none"><li>• Verifying the criteria implemented by the Group to calculate the provisions under the new standard.</li><li>• Re-calculating the impact that the application of IFRS 9 will have on the measurement of the loan portfolio and receivables.</li></ul> <p data-bbox="857 1795 1344 1850">Our procedures regarding hedge accounting particularly examined:</p> <ul data-bbox="867 1879 1414 1934" style="list-style-type: none"><li>• The decisions taken by the Group to maintain hedge accounting under IAS 39.</li></ul>



Caja Laboral Popular Coop. de Crédito and its subsidiaries (Consolidated Group)

Key audit matter	How our audit addressed the key audit matter
	The described procedures resulted in our observation that the methods used to calculate the impairment of loan assets and to classify and measure financial instruments are adequate and any difference obtained as a result of our procedures compared with the estimates made by Management remained within a reasonable range within the context of the amount included in the accompanying consolidated financial statements, and we consider the disclosures made to be adequate.

*Other information: Consolidated management report*

Other information comprises only the consolidated management report for the 2017 financial year, the formulation of which is the responsibility of the Parent company’s directors and does not form an integral part of the consolidated annual accounts.

Our audit opinion on the consolidated annual accounts does not cover the consolidated management report. Our responsibility regarding the information included in the consolidated management report is defined in the company audit governing regulations, which establishes two differentiated responsibility levels:

- a) A specific level the is applicable to the statement of non-financial information, as well as to certain information included in the Annual Corporate Governance Report, defined in article 35.2.b) of Law 22/2015 on Accounts Auditing, which solely consists of verifying that the aforementioned information was included in the consolidated management report or, where applicable, verifying that a reference to the separate statement of non-financial information has been included in the form expected in the regulations, or otherwise, informing about it.
- b) A general level applicable to the rest of information included in the consolidated management report, which consists of evaluating and informing about the accordance of the mentioned information with the consolidated annual accounts, based on the knowledge of the Entity acquired from the audit of the accounts and without including information other than that obtained as evidence during such audit, as well as evaluating and informing about whether the content and presentation of this part of the consolidated management report comply with the applicable regulations. If we conclude, based on the work performed, that there are material misstatements, we would compelled to report on this.

On the basis of the work performed, as described in the previous paragraph, the information contained in the statement of non-financial information in the a) paragraph above is presented separately, “Non-financial Information Statement” referenced in the consolidated management report, the information included in the Annual Corporate Governance Report is included in the consolidated management report, and the rest of the information included in the consolidated management report is consistent with that contained in the consolidated annual accounts for the 2017 financial year, and its content and presentation are in accordance with the applicable regulations.





---

*Responsibility of the directors and the audit committee for the consolidated annual accounts*

The Parent company's directors are responsible for the preparation of the accompanying consolidated annual accounts, such that they fairly present the consolidated equity, financial position and financial performance of the Group, in accordance with International Financial Reporting Standards as adopted by the European Union and other provisions of the financial reporting framework applicable to the Group in Spain, and for such internal control as the directors determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated annual accounts, the Parent company's directors are responsible for assessing the Group'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 Group or to cease operations, or have no realistic alternative but to do so.

The Parent company's audit committee is responsible for overseeing the process of preparation and presentation of the consolidated annual accounts.

---

*Auditor's responsibilities for the audit of the consolidated annual accounts*

Our objectives are to obtain reasonable assurance about whether the consolidated 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 legislation governing the audit practice 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 the economic decisions of users taken on the basis of these consolidated annual accounts.

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated 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 Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Parent company's directors.



## Caja Laboral Popular Coop. de Crédito and its subsidiaries (Consolidated Group)

- Conclude on the appropriateness of the Parent company's 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 Group'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 consolidated 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 Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated annual accounts, including the disclosures, and whether the consolidated annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated annual accounts. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Parent company's audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

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

From the matters communicated with the Parent company's audit committee, we determine those matters that were of most significance in the audit of the consolidated annual accounts of the current period and 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*

---

#### *Report to the Parent company's audit committee*

The opinion expressed in this report is consistent with the content of our additional report to the Parent company's audit committee dated March 15, 2018.

---

#### *Appointment period*

The General Ordinary Members Meeting held on April 1, 2017 appointed us as auditors of the Group for a period of 1 year, as from the year ended December 31, 2016.

Previously, we were appointed by resolution of the General Ordinary Members Meeting for a period of 1 year and we have audited the accounts continuously since the year ended December 31, 2001.



Caja Laboral Popular Coop. de Crédito and its subsidiaries (Consolidated Group)

---

*Services provided*

Services provided to the Group for services other than the audit of the accounts, are disclosed in note 11 of the notes to the accompanying consolidated financial statements.

---

PricewaterhouseCoopers Auditores, S.L. (S0242)

Original in Spanish signed by José Antonio Simón Maestro (15886)

March 15, 2018

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**  
**CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2017**  
(Expressed in thousands of euros)

ASSETS	Note	2017	2016 (*)
<b>Cash, cash balances at central Banks and other on demand deposits (**)</b>	<b>22</b>	<b>1,848,245</b>	<b>453,030</b>
<b>Financial assets held for trading</b>	<b>23</b>	<b>144,461</b>	<b>183,689</b>
Derivatives		3,796	3,668
Equity instruments		541	620
Debt securities		140,124	179,401
<i>Memorandum-item: Loaned or pledged as security with sale or pledging rights</i>		68,712	43,143
<b>Financial assets designated at fair value through profit or loss</b>	<b>24</b>	<b>2,517</b>	<b>403</b>
Equity instruments		380	403
Debt securities		2,137	-
<i>Memorandum-item: Loaned or pledged as security with sale or pledging rights</i>		-	-
<b>Available-for-sale financial assets</b>	<b>25</b>	<b>5,081,194</b>	<b>5,048,900</b>
Equity instruments		223,912	318,286
Debt securities		4,857,282	4,730,614
<i>Memorandum-item: Loaned or pledged as security with sale or pledging rights</i>		612,103	1,207,304
<b>Loans and receivables</b>	<b>26</b>	<b>13,796,818</b>	<b>13,943,448</b>
Debt securities		50,360	49,281
Loans and advances		13,746,458	13,894,167
Credit institutions		342,130	392,590
Customers		13,404,328	13,501,577
<i>Memorandum-item: Loaned or pledged as security with sale or pledging rights</i>		-	-
<b>Investments held to maturity</b>	<b>27</b>	<b>410,937</b>	<b>439,533</b>
<i>Memorandum-item: Loaned or pledged as security with sale or pledging rights</i>		-	-
<b>Derivatives – Hedge accounting</b>	<b>28</b>	<b>143,642</b>	<b>186,213</b>
<b>Fair value changes of the hedged items in portfolio hedge of interest rate risk</b>		-	-
<b>Investments in joint ventures and associates</b>	<b>29</b>	<b>3,088</b>	<b>3,042</b>
Associates		3,088	3,042
<b>Assets under insurance or reinsurance contracts</b>	<b>30</b>	<b>27,239</b>	<b>26,572</b>
<b>Tangible assets</b>	<b>31</b>	<b>328,955</b>	<b>354,547</b>
Property, plant and equipment		277,201	298,658
For own use		263,773	286,927
Leased out under operating leases		12,699	10,971
Associated with Community Projects		729	760
Investment properties		51,754	55,889
<i>Of which: leased out under operating leases</i>		39,528	43,003
<i>Memorandum-item: acquired through finance leases</i>		-	-
<b>Intangible assets</b>	<b>32</b>	<b>33,592</b>	<b>33,568</b>
Goodwill		33,425	33,425
Other intangible assets		167	143
<b>Tax assets</b>	<b>33</b>	<b>286,186</b>	<b>299,290</b>
Current tax assets		8,853	13,330
Deferred tax assets		277,333	285,960
<b>Other assets</b>	<b>34</b>	<b>101,680</b>	<b>62,944</b>
Insurance contracts linked to pensions		-	-
Inventories		60,609	19,476
Rest of other assets		41,071	43,468
<b>Non-current assets and disposal groups classified as held for sale</b>	<b>35</b>	<b>227,235</b>	<b>278,987</b>
<b>TOTAL ASSETS</b>		<b>22,435,789</b>	<b>21,314,166</b>

(\*) Presented for comparative purposes only.

(\*\*) See details in the consolidated cash flow statements

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**  
**CONSOLIDATED BALANCE SHEET AS AT 31 DECEMBER 2017**  
**(Expressed in thousands of euros)**

LIABILITIES	Note	2017	2016 (*)
<b>Financial liabilities held for trading</b>	<b>23</b>	<b>1,533</b>	<b>2,297</b>
Derivatives		1,533	2,297
<b>Financial liabilities designated at fair value through profit or loss</b>		<b>-</b>	<b>-</b>
<i>Memorandum-item: subordinated liabilities</i>		-	-
<b>Financial liabilities measured at amortized cost</b>	<b>36</b>	<b>19,505,437</b>	<b>18,487,909</b>
Deposits		19,125,597	18,097,181
Central Banks		300,172	-
Credit institutions		212,571	202,981
Customers		18,612,854	17,894,200
Debt securities issued		149,550	174,810
Other financial liabilities		230,290	215,918
<i>Memorandum-item: subordinated liabilities</i>		-	-
<b>Derivatives – Hedge accounting</b>	<b>28</b>	<b>238,838</b>	<b>178,447</b>
<b>Fair value changes of the hedged items in portfolio hedge of interest rate risk</b>		<b>-</b>	<b>-</b>
<b>Liabilities under insurance or reinsurance contracts</b>	<b>37</b>	<b>579,907</b>	<b>558,752</b>
<b>Provisions</b>	<b>38</b>	<b>191,875</b>	<b>208,509</b>
Pensions and other post-employment defined benefit obligations		41,504	35,830
Other long-term employee benefits		-	-
Pending legal issues and tax litigation		-	-
Commitments and guarantees given		20,992	25,411
Other provisions		129,379	147,268
<b>Tax liabilities</b>	<b>33</b>	<b>112,498</b>	<b>121,363</b>
Current tax liabilities		4,572	3,868
Deferred tax liabilities		107,926	117,495
<b>Share capital repayable on demand</b>		<b>-</b>	<b>-</b>
<b>Other liabilities</b>	<b>34</b>	<b>77,273</b>	<b>72,502</b>
<i>Of which: community projects and social funds</i>		13,017	12,030
<b>Liabilities included in disposal groups classified as held for sale</b>		<b>-</b>	<b>-</b>
<b>TOTAL LIABILITIES</b>		<b>20,707,361</b>	<b>19,629,779</b>
<b>EQUITY</b>	<b>Note</b>	<b>2017</b>	<b>2016 (*)</b>
<b>Own Funds</b>	<b>39</b>	<b>1,619,363</b>	<b>1,552,862</b>
Capital		727,167	712,957
Paid up capital		727,167	712,957
<i>Memorandum-item: capital not called up</i>		-	-
Retained earnings		-	-
Revaluation reserves		-	-
Other reserves		809,891	766,469
Reserves or accumulated losses of investments in joint ventures and associates		144	93
Other		809,747	766,376
(-) Treasury shares		(1,431)	(1,393)
Profit/(loss) attributable to owners of the parent entity		112,849	103,473
(-) Interim dividends		(29,113)	(28,644)
<b>Accumulated other comprehensive income</b>	<b>40</b>	<b>109,065</b>	<b>131,525</b>
Items that may be reclassified to profit or loss		109,065	131,525
Hedging derivatives. Cash flow hedges (effective portion)		(30,837)	(11,533)
Available-for-sale financial assets		139,902	143,058
Debt securities		108,509	101,007
Equity instruments		31,393	42,051
<b>Minority interests (non-controlling interests)</b>		<b>-</b>	<b>-</b>
Accumulated other comprehensive income		-	-
Other items		-	-
<b>TOTAL EQUITY</b>		<b>1,728,428</b>	<b>1,684,387</b>
<b>TOTAL EQUITY AND TOTAL LIABILITIES</b>		<b>22,435,789</b>	<b>21,314,166</b>
<b>Memorandum-item: Off-balance sheet exposures</b>			
<b>Guarantees given</b>	<b>43</b>	<b>229,265</b>	<b>259,742</b>
<b>Contingent commitments given</b>	<b>44</b>	<b>1,105,293</b>	<b>1,045,076</b>

(\*) Presented for comparative purposes only.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**  
**CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31**  
**DECEMBER 2017 (Expressed in thousands of euros)**

	Note	2017	2016 (*)
Interest income	45	268,232	299,543
(Interest expenses)	46	20,889	28,415
(Expenses on share capital repayable on demand)		-	-
<b>NET INTEREST INCOME</b>		<b>247,343</b>	<b>271,128</b>
Dividend income	47	3,653	7,993
Share of profit or loss of entities accounted for using the equity method	48	47	51
Fee and commission income	49	107,923	105,461
(Fee and commission expenses)	50	11,527	11,764
Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	51	43,983	12,016
Gains or (-) losses on financial assets and liabilities held for trading, net	52	870	1,836
Gains or (-) losses on financial assets and liabilities recognized at fair value with changes in profit or loss, net	53	159	(282)
Gains or (-) losses from hedge accounting, net	54	117	197
Exchange differences [gains or (-) losses], net	55	(38)	1,030
Other operating income	56	16,247	16,019
(Other operating expenses)	57	47,187	43,683
<i>Of which: Mandatory appropriation to community projects and social funds</i>		<i>8,591</i>	<i>7,833</i>
Income from assets under insurance and reinsurance contracts	58	202,919	177,357
(Expenses on liabilities under insurance and reinsurance contracts)	59	153,019	131,854
<b>GROSS MARGIN</b>		<b>411,490</b>	<b>405,505</b>
(Administrative expenses)	60	232,355	238,229
(Staff expenses)		135,236	141,685
(Other administrative expenses)		97,119	96,544
(Depreciation)	61	18,027	19,719
(Provisions or (-) reversal of provisions)	62	26,785	24,824
(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss)	63	13,815	(32,361)
(Available-for-sale financial assets)		1,892	2,833
(Loans and receivables)		11,923	(35,194)
(Investments held to maturity)		-	-
<b>NET OPERATING INCOME</b>		<b>120,508</b>	<b>155,094</b>
(Impairment or (-) reversal of impairment of investments in joint ventures and associates)	64	-	-
(Impairment or (-) reversal of impairment on non-financial assets)	65	2,708	2,680
(Tangible assets)		2,708	2,680
(Intangible assets)		-	-
(Other)		-	-
Gains or (-) losses on derecognition of non-financial assets and shareholdings, net	66	5,466	(442)
<i>Of which: investments in dependents, joint ventures and associates</i>		<i>-</i>	<i>-</i>
Negative goodwill recognized in profit or loss		-	9
Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	67	2,414	(35,039)
<b>PROFIT OR (-) LOSS BEFORE TAX FROM CONTINUING OPERATIONS</b>		<b>125,680</b>	<b>116,942</b>
(Tax expenses or (-) income related to profit from continuing operations)	41	12,831	13,469
<b>PROFIT OR (-) LOSS AFTER TAX FROM CONTINUING OPERATIONS</b>		<b>112,849</b>	<b>103,473</b>
Profit or (-) loss from discontinued operations		-	-
<b>PROFIT/(LOSS) DURING THE YEAR</b>		<b>112,849</b>	<b>103,473</b>
Attributable to minority interests (non-controlling interests)		-	-
Attributable to owners of the parent entity	39	112,849	103,473

(\*) Presented for comparative purposes only.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**

**CONSOLIDATED STATEMENT OF RECOGNIZED INCOME AND EXPENDITURE FOR THE YEAR ENDED 31 DECEMBER 2017**

(Expressed in thousands of euros)

	<u>Note</u>	<u>2017</u>	<u>2016 (*)</u>
<b>PROFIT/(LOSS) DURING THE YEAR</b>		<b>112,849</b>	<b>103,473</b>
<b>OTHER COMPREHENSIVE INCOME</b>		<b>(22,460)</b>	<b>(3,765)</b>
<b>Items that will not be reclassified to profit or loss</b>		<b>-</b>	<b>-</b>
Actuarial gains or (-) losses on defined benefit pensions plans		-	-
Non-current assets and disposal groups held for sale		-	-
Share of other recognized income and expenses of investments in joint ventures and associates		-	-
Income tax related to items that will not be reclassified		-	-
<b>Items that may be reclassified to profit or loss</b>		<b>(22,460)</b>	<b>(3,765)</b>
<b>Hedge of net investments in foreign operations (effective portion)</b>		<b>-</b>	<b>-</b>
Valuation gains or (-) losses taken to equity		-	-
Transferred to profit or loss		-	-
Other reclassifications		-	-
<b>Foreign currency translation</b>		<b>-</b>	<b>-</b>
Valuation gains or (-) losses taken to equity		-	-
Transferred to profit or loss		-	-
Other reclassifications		-	-
<b>Cash flow hedges (effective portion)</b>	<b>40</b>	<b>(26,810)</b>	<b>(16,018)</b>
Valuation gains or (-) losses taken to equity		(26,810)	(16,018)
Transferred to profit or loss		-	-
Other reclassifications		-	-
<b>Available-for-sale financial assets</b>	<b>40</b>	<b>(4,384)</b>	<b>10,789</b>
Valuation gains or (-) losses taken to equity		37,288	19,672
Transferred to profit or loss		(41,672)	(8,883)
Other reclassifications		-	-
<b>Non-current assets and disposal groups held for sale</b>		<b>-</b>	<b>-</b>
Valuation gains or (-) losses taken to equity		-	-
Transferred to profit or loss		-	-
Other reclassifications		-	-
<b>Share of other recognized income and expenses of investments in joint ventures and associates</b>		<b>-</b>	<b>-</b>
<b>Income tax related to items that may be reclassified to profit or (-) loss</b>	<b>41</b>	<b>8,734</b>	<b>1,464</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>		<b>90,389</b>	<b>99,708</b>
Attributable to minority interests (non-controlling interests)		-	-
Attributable to owners of the parent entity		90,389	99,708

(\*) Presented for comparative purposes only.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**

**CONSOLIDATED STATEMENT OF CHANGES IN TOTAL NET ASSETS FOR THE YEAR ENDED 31 DECEMBER 2017**

(Expressed in thousands of euros)

**At 31 December 2017**

<u>Source of changes in equity</u>	<u>Capital</u>	<u>Other reserves</u>	<u>(-) Treasury shares</u>	<u>Profit/(loss) attributable to owners of the parent entity</u>	<u>(-) Interim dividends</u>	<u>Accumulated other comprehensive income</u>	<u>Minority interests</u>	<u>Total</u>
<b>Opening balance 1 January 2017</b>	<b>712,957</b>	<b>766,469</b>	<b>(1,393)</b>	<b>103,473</b>	<b>(28,644)</b>	<b>131,525</b>	-	<b>1,684,387</b>
Effects of error corrections	-	-	-	-	-	-	-	-
Effects of changes in accounting policies	-	-	-	-	-	-	-	-
<b>Opening balance 1 January 2017 (*)</b>	<b>712,957</b>	<b>766,469</b>	<b>(1,393)</b>	<b>103,473</b>	<b>(28,644)</b>	<b>131,525</b>	-	<b>1,684,387</b>
<b>Total comprehensive income for the year</b>	-	-	-	<b>112,849</b>	-	<b>(22,460)</b>	-	<b>90,389</b>
<b>Other changes in equity</b>	<b>14,210</b>	<b>43,422</b>	<b>(38)</b>	<b>(103,473)</b>	<b>(469)</b>	-	-	<b>(46,348)</b>
Issuance of ordinary shares	21,795	3	-	-	-	-	-	21,798
Issuance of preferred shares	-	-	-	-	-	-	-	-
Issuance of other equity instruments	-	-	-	-	-	-	-	-
Exercise or maturity of other issued equity instruments	-	-	-	-	-	-	-	-
Conversion of debt into equity	-	-	-	-	-	-	-	-
Capital reduction	(7,585)	-	-	-	-	-	-	(7,585)
Dividends (or remuneration paid to partners)	-	-	-	(19,583)	(29,113)	-	-	(48,696)
Purchase of treasury shares	-	-	(38)	-	-	-	-	(38)
Sale or cancellation of treasury shares	-	-	-	-	-	-	-	-
Reclassification of financial instruments from equity to liabilities	-	-	-	-	-	-	-	-
Reclassification of financial instruments from liabilities to equity	-	-	-	-	-	-	-	-
Transfers between equity components	-	43,496	-	(72,140)	28,644	-	-	-
Increase or (-) decrease in equity arising from business combinations	-	-	-	-	-	-	-	-
Payments based on shares	-	-	-	-	-	-	-	-
Other increases or (-) decreases in equity	-	(77)	-	(11,750)	-	-	-	(11,827)
<i>Of which: discretionary appropriation to community projects and social funds</i>	-	-	-	(11,750)	-	-	-	(11,750)
<b>Closing balance 31 December 2017</b>	<b>727,167</b>	<b>809,891</b>	<b>(1,431)</b>	<b>112,849</b>	<b>(29,113)</b>	<b>109,065</b>	-	<b>1,728,428</b>

(\*) Presented for comparative purposes only.



**CAJA LABORAL POPULAR COOP. DE CRÉDITO**
**CONSOLIDATED STATEMENT OF CHANGES IN TOTAL NET ASSETS FOR THE YEAR ENDED 31 DECEMBER 2017**

(Expressed in thousands of euros)

**As at 31 December 2016**

Source of changes in equity	Capital	Other reserves	(-) Treasury shares	Profit/(loss) attributable to owners of the parent entity	(-) Interim dividends	Accumulated other comprehensive income	Minority interests	Total
Opening balance 1 January 2016	708,403	722,703	(1,359)	102,787	(29,741)	135,290	-	1,638,083
Effects of error corrections	-	-	-	-	-	-	-	-
Effects of changes in accounting policies	-	-	-	-	-	-	-	-
Opening balance 1 January 2016 (*)	708,403	722,703	(1,359)	102,787	(29,741)	135,290	-	1,638,083
Total comprehensive income for the year	-	-	-	103,473	-	(3,765)	-	99,708
Other changes in equity	4,554	43,766	(34)	(102,787)	1,097	-	-	(53,404)
Issuance of ordinary shares	24,653	15	-	-	-	-	-	24,668
Issuance of preferred shares	-	-	-	-	-	-	-	-
Issuance of other equity instruments	-	-	-	-	-	-	-	-
Exercise or maturity of other issued equity instruments	-	-	-	-	-	-	-	-
Conversion of debt into equity	-	-	-	-	-	-	-	-
Capital reduction	(20,099)	-	-	-	-	-	-	(20,099)
Dividends (or remuneration paid to partners)	-	-	-	(18,845)	(28,644)	-	-	(47,489)
Purchase of treasury shares	-	-	(34)	-	-	-	-	(34)
Sale or cancellation of treasury shares	-	-	-	-	-	-	-	-
Reclassification of financial instruments from equity to liabilities	-	-	-	-	-	-	-	-
Reclassification of financial instruments from liabilities to equity	-	-	-	-	-	-	-	-
Transfers between equity components	-	42,895	-	(72,636)	29,741	-	-	-
Increase or (-) decrease in equity arising from business combinations	-	-	-	-	-	-	-	-
Payments based on shares	-	-	-	-	-	-	-	-
Other increases or (-) decreases in equity	-	856	-	(11,306)	-	-	-	(10,450)
<i>Of which: discretionary appropriation to community projects and social funds</i>	-	-	-	(11,306)	-	-	-	(11,306)
Closing balance 31 December 2016	712,957	766,469	(1,393)	103,473	(28,644)	131,525	-	1,684,387

(\*) Presented for comparative purposes only.

## CAJA LABORAL POPULAR COOP. DE CRÉDITO

### CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2017

(Expressed in thousands of euros)

	Note	2017	2016 (*)
<b>A) CASH FLOWS FROM OPERATING ACTIVITIES</b>		<b>1,356,019</b>	<b>(473,305)</b>
Profit/(loss) for the year		112,849	103,473
Adjustments to obtain cash flows from operating activities		63,990	83,629
Depreciation	61	18,027	19,719
Other adjustments (a)		45,963	63,910
<b>Net increase/decrease in operating assets</b>		<b>156,853</b>	<b>(283,864)</b>
Financial assets held for trading		39,228	75,277
Financial assets designated at fair value through profit or loss		(2,114)	155
Available-for-sale financial assets		(65,380)	(440,622)
Loans and receivables		158,554	2,814
Other operating assets		26,565	78,512
<b>Net increase/decrease in operating liabilities</b>		<b>1,023,305</b>	<b>(373,781)</b>
Financial liabilities held for trading		(764)	(1,133)
Financial liabilities designated at fair value through profit or loss		-	-
Financial liabilities measured at amortized cost		1,017,529	(384,375)
Other operating liabilities		6,540	11,727
<b>Collections/Payments due to income tax</b>		<b>(978)</b>	<b>(2,762)</b>
<b>B) CASH FLOWS FROM INVESTMENT ACTIVITIES</b>		<b>85,470</b>	<b>770,740</b>
<b>Payments</b>		<b>(23)</b>	<b>(36,729)</b>
Tangible assets	31	-	(20,596)
Intangible assets		(23)	(139)
Investments in joint ventures and associates		-	-
Subsidiaries and other business units	29	-	-
Non-current assets and liabilities classified as held for sale		-	-
Investments held to maturity	27	-	(15,994)
Other payments related to investment activities		-	-
<b>Collections</b>		<b>85,493</b>	<b>807,469</b>
Tangible assets (b)		10,290	11,131
Intangible assets		-	-
Investments in joint ventures and associates	29	-	103
Subsidiaries and other business units	29	-	-
Non-current assets and liabilities classified as held for sale		55,988	73,450
Investments held to maturity		19,215	722,785
Other payments related to investment activities		-	-
<b>C) CASH FLOWS FROM FINANCING ACTIVITIES</b>		<b>(46,274)</b>	<b>(54,260)</b>
<b>Payments</b>		<b>(48,487)</b>	<b>(60,083)</b>
Dividends	39	(29,113)	(28,644)
Subordinated liabilities		-	-
Own equity instruments amortization	39	(7,585)	(20,099)
Own equity instruments acquisition	39	(39)	(34)
Other payments related to financing activities	4	(11,750)	(11,306)
<b>Collections</b>		<b>2,213</b>	<b>5,823</b>
Subordinated liabilities		-	-
Issuance of own equity instruments		2,213	5,823
Disposal of own equity instruments		-	-
Other collections related to financing activities		-	-
<b>D) EFFECT OF EXCHANGE RATE CHANGES</b>		<b>-</b>	<b>-</b>
<b>E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS (A+B+C+D)</b>		<b>1,395,215</b>	<b>243,175</b>
<b>F) CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR</b>		<b>453,030</b>	<b>209,855</b>
<b>G) CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR</b>		<b>1,848,245</b>	<b>453,030</b>

#### MEMORANDUM-ITEM

##### COMPONENTS OF CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR

<i>Of which: held by group entities but not available to the group</i>		-	-
Cash		72,514	78,876
Balances of cash equivalents in central banks		1,682,657	327,385
Other on demand deposits		93,074	46,769
Other financial assets		-	-
Less: Bank overdrafts reimbursable on demand		-	-

(\*) Presented for comparative purposes only.

(a) Include mainly, provisions for impairment and other provisions that have not result in a cash outflow.

(b) Include profit or loss generated on sale.

## **CAJA LABORAL POPULAR COOP. DE CRÉDITO**

### **NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**

(Expressed in thousands of euros)

#### **1. Nature of the Entity**

Caja Laboral Popular Coop. de Crédito (hereinafter, indistinctly, the Entity, the Parent Entity Laboral Kutxa or Caja Laboral), with registered office in Mondragón (Gipuzkoa), was incorporated on 2 November 2012 as a credit cooperative as a result of the merger, giving rise to a newly-created entity, between Caja Laboral Popular Coop. de Crédito and Ipar Kutxa Rural, S.Coop. de Crédito. This entity is a qualified cooperative.

The Parent Entity is supervised by the Bank of Spain and, in addition, as issuer of securities, by the National Securities Market Commission (Comisión Nacional del Mercado de Valores).

The Parent Entity's capital is not listed on the stock exchange.

##### **1.1 Merger between Caja Laboral and Iparkutxa**

In 2012, following the resolutions adopted by the governing bodies of Caja Laboral Popular Coop. de Crédito and Ipar Kutxa Rural, S. Coop., the merger of the two entities was effected through the creation of a new credit union called "Caja Laboral Popular Coop. de Crédito", with the purpose, registered office, capital and other provisions detailed in its Articles of Association and governed by Law 13/1989, dated 26 May, on Credit Cooperatives and other applicable legal provisions.

Under the terms of the merger, the two merged credit cooperatives were dissolved and extinguished without going into liquidation, with 2 November 2012 being the date on which this was entered in the Companies Register of Gipuzkoa and the date from which the operations of the merged entities were deemed to have been performed by the New Credit Cooperative for accounting purposes.

##### **1.2 Articles of Association**

The Articles of Association of the Group's Parent Entity state that its business operations will not be limited to any specific territory and that its corporate purpose is to service the financial needs of its members and third parties by carrying out the activities typical of credit institutions. To this end, it may carry out all kinds of lending, borrowing and service operations which financial institutions are permitted to provide, including those relating to the promotion and fulfilment of its cooperative purpose, paying particular attention to its members' financial needs and complying with the legal limits on lending to third parties.

Credit cooperatives are regulated by sector-specific regulations, specifically including the requirement to:

- a) Maintain a minimum percentage of liquid assets on deposit at the Bank of Spain in order to cover their minimum reserve coefficient requirements.
- b) Contribute to the Deposit Guarantee Fund which is designed to guarantee deposit holders' ability to recover a minimum amount of their deposits.
- c) Distribute the annual net surplus to the Education and Development Fund and to reserves.
- d) Maintain a minimum level of capital that is determined by their risk-weighted assets.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Contribution to Intercooperative Cooperation Institutions

The Parent Entity, in accordance with the agreements of the MONDRAGON Conference held on 20 July 2016, contributes in the form of a grant to MONDRAGON Inversiones S. Coop. and to Fundación MONDRAGON, an amount equivalent to 15% of its net surplus available from the previous year (after taxes and interest on capital) deducted from the Intercooperative Social Fund (FSI) generated in the distribution of profit for the year.

Under the terms of the aforementioned Conference, the Parent Entity's commitment to continue providing a credit line in favour of the entities comprising Corporación MONDRAGON Corporation has ended. The undrawn limit of this credit line amounted to 82,055 thousand euros in 2016.

Caja Laboral is the Parent Entity of a Group of Investee Entities that comprise Caja Laboral Popular and its Investee Entities (hereinafter, the Group or Laboral Kutxa Group). As a result, the Parent Entity is obliged to present, in addition to its own individual annual financial statements, which must be audited, consolidated annual financial statements for the Group of which it is parent, which show any and all investments in subsidiaries, jointly controlled entities and associates. The entities comprising the Group carry out diverse business activities.

As at 31 December 2017, the total assets and equity of the Parent Entity represented 97.01%, 96.10% and 94.37%, respectively, of total Group assets and equity (as at 31 December 2016: 96.94%, 96.06% and 95.87%, respectively).

Below is a summary of the individual balance sheet, individual profit and loss account, individual statement of recognized income and expenses, individual statement of changes in total equity and individual statement of cash flows of the Parent Entity for the years ended 31 December 2017 and 2016, prepared in accordance with the same accounting principles and standards and measurement criteria applicable to the individual annual accounts of the Parent Entity.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

a) Individual balance sheets at 31 December 2017.

<b>ASSETS</b>	<b>2017</b>	<b>2016 (*)</b>
Cash, cash balances at central banks and other on demand deposits	1,822,276	426,830
Financial assets held for trading	143,920	183,069
Available-for-sale financial assets	4,563,443	4,555,082
Loans and receivables	13,739,368	13,889,385
Investments held to maturity	349,525	358,736
Derivatives – Hedge accounting	143,642	186,213
Investments in dependents, joint ventures and associates	159,694	132,618
Tangible assets	304,941	329,549
Intangible assets	-	-
Tax assets	278,164	289,855
Other assets	45,241	47,429
Non-current assets and disposal groups of items classified as held for sale	216,314	263,311
<b>Total assets</b>	<b>21,766,528</b>	<b>20,662,077</b>
<b>LIABILITIES AND EQUITY</b>	<b>2017</b>	<b>2016 (*)</b>
Financial liabilities held for trading	1,533	2,297
Financial liabilities measured at amortized cost	19,515,330	18,493,001
Derivatives – Hedge accounting	238,838	178,447
Provisions	190,604	207,320
Tax liabilities	93,745	101,016
Share capital repayable on demand	-	-
Other liabilities	65,378	61,909
<b>Total liabilities</b>	<b>20,105,428</b>	<b>19,043,990</b>
Own Funds:	1,575,077	1,514,877
Capital	727,167	712,957
Other reserves	770,589	731,421
Profit/(loss) for the year	106,491	99,199
(Interim dividends)	(29,170)	(28,700)
Accumulated other comprehensive income	86,023	103,210
<b>Total equity</b>	<b>1,661,100</b>	<b>1,618,087</b>
<b>Total liabilities and equity</b>	<b>21,766,528</b>	<b>20,662,077</b>
<b>MEMORANDUM-ITEM</b>		
Guarantees given	249,949	280,061
Contingent commitments given	1,114,259	1,076,891

(\*) Presented for comparative purposes only.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

b) Individual profit and loss account for the year ended 31 December 2017:

	<u>2017</u>	<u>2016 (*)</u>
Interest income	252,492	281,736
(Interest expenses)	20,889	28,408
(Capital expenditure repayable on demand)	-	-
<b>Net interest income</b>	<u>231,603</u>	<u>253,328</u>
Dividend income	10,804	14,827
Fee and commission income	95,729	93,254
(Fee and commission expenses)	5,367	5,473
Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net	42,862	10,604
Gains or (-) losses on financial assets and liabilities held for trading, net	441	1,801
Gains or (-) losses from hedge accounting, net	117	197
Exchange differences [gains or (-) losses], net	(38)	1,030
Other operating income	35,988	35,074
(Other operating expenses)	46,906	41,274
<b>Gross income</b>	<u>365,233</u>	<u>363,368</u>
(Administrative expenses)	184,841	191,020
(Depreciation)	17,415	18,950
(Provisions or (-) reversal of provisions)	26,785	25,459
(Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss)	18,157	(25,975)
<b>Net operating income</b>	<u>118,035</u>	<u>153,914</u>
(Impairment or (-) reversal of impairment of investments in dependents, joint ventures or associates)	(2,741)	-
(Impairment or (-) reversal of impairment on non-financial assets)	2,847	2,736
Gains or (-) losses on derecognition of non-financial assets and shareholdings, net	5,466	(442)
Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations	(8,222)	(41,758)
<b>Profit or (-) loss before tax from continuing operations</b>	<u>115,173</u>	<u>108,978</u>
(Tax expenses or (-) income related to profit from continuing operations)	8,682	9,779
<b>Profit or (-) loss after tax from continuing operations</b>	<u>106,491</u>	<u>99,199</u>
<b>Profit or (-) loss from discontinued operations</b>	<u>-</u>	<u>-</u>
<b>Profit/(loss) for the year</b>	<u>106,491</u>	<u>99,199</u>

(\*) Presented for comparative purposes only.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- c) Individual statement of recognized income and expenses relating to the year ended 31 December 2017:

	<u>2017</u>	<u>2016 (*)</u>
<b>PROFIT/(LOSS) DURING THE YEAR</b>	<b>106,491</b>	<b>99,199</b>
<b>OTHER COMPREHENSIVE INCOME</b>	<b>(17,187)</b>	<b>(2,904)</b>
<b>Items that may be reclassified to profit or loss</b>	<b>(17,187)</b>	<b>(2,904)</b>
Cash flow hedges (effective portion)	<b>(26,810)</b>	<b>(16,018)</b>
Valuation gains or (-) losses taken to equity	(26,810)	(16,018)
Available-for-sale financial assets	<b>2,940</b>	<b>11,985</b>
Valuation gains or (-) losses taken to equity	43,249	19,840
Transferred to profit or loss	(40,309)	(7,855)
Income tax related to items that may be reclassified to profit or (-) loss	<b>6,683</b>	<b>1,129</b>
<b>TOTAL COMPREHENSIVE INCOME FOR THE YEAR</b>	<b><u>89,304</u></b>	<b><u>96,295</u></b>

(\*) Presented for comparative purposes only.

- d) Statement of changes in total equity for the year ended 31 December 2017:

**Variation during 2017**

	<u>Own Funds</u>	<u>Accumulated other comprehensive income</u>	<u>Total equity</u>
<b>Opening balance 1 January 2017</b>	<b>1,514,877</b>	<b>103,210</b>	<b>1,618,087</b>
Effects of error corrections	-	-	-
Effects of changes in accounting policies	-	-	-
<b>Opening balance 1 January 2017</b>	<b>1,514,877</b>	<b>103,210</b>	<b>1,618,087</b>
<b>Total comprehensive income for the year</b>	<b>106,491</b>	<b>(17,187)</b>	<b>89,304</b>
<b>Other changes in equity</b>			
- Issuance of ordinary shares	21,797	-	21,797
- Capital reduction	(7,585)	-	(7,585)
- Dividends (or remuneration paid to partners)	(48,753)	-	(48,753)
- Transfers between equity components	-	-	-
- Other increases or (-) decreases in equity	(11,750)	-	(11,750)
<b>Total other changes in equity</b>	<b>(46,291)</b>	<b>-</b>	<b>(46,291)</b>
<b>Closing balance 31 December 2017</b>	<b><u>1,575,077</u></b>	<b><u>86,023</u></b>	<b><u>1,661,100</u></b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**Variation during 2016 (\*)**

	<u>Own Funds</u>	<u>Accumulated other comprehensive income</u>	<u>Total equity</u>
<b>Opening balance 1 January 2016</b>	<b>1,469,960</b>	<b>106,114</b>	<b>1,576,074</b>
Effects of error corrections	-	-	-
Effects of changes in accounting policies	-	-	-
<b>Opening balance 1 January 2016</b>	<b>1,469,960</b>	<b>106,114</b>	<b>1,576,074</b>
<b>Total comprehensive income for the year</b>	<b>99,199</b>	<b>(2,904)</b>	<b>96,295</b>
<b>Other changes in equity</b>			
- Issuance of ordinary shares	24,668	-	24,668
- Capital reduction	(20,099)	-	(20,099)
- Dividends (or remuneration paid to partners)	(47,545)	-	(47,545)
- Transfers between equity components	-	-	-
- Other increases or (-) decreases in equity	(11,306)	-	(11,306)
<b>Total other changes in equity</b>	<b>(54,282)</b>	<b>-</b>	<b>(54,282)</b>
<b>Closing balance 31 December 2016</b>	<b>1,514,877</b>	<b>103,210</b>	<b>1,618,087</b>

(\*) Presented for comparative purposes only.

e) Individual cash flow statement for the year ended 31 December 2017:

	<u>2017</u>	<u>2016 (*)</u>
<b>Cash flows from operating activities:</b>	<b>1,390,288</b>	<b>(473,485)</b>
Profit/(loss) for the year	106,491	99,199
Adjustments made to obtain cash flows from operating activities	100,937	96,416
Net Increase/Decrease in operating assets	178,190	(281,085)
Net Increase/ Decrease in operating liabilities	1,005,649	(385,253)
Collections/(Payments) due to income tax	(979)	(2,762)
<b>Cash flows from investing activities</b>	<b>51,449</b>	<b>759,229</b>
Payments	(24,351)	(19,764)
Collections	75,800	778,993
<b>Cash flows from financing activities</b>	<b>(46,291)</b>	<b>(54,282)</b>
<b>Effect of exchange rate change</b>	<b>-</b>	<b>-</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>1,395,446</b>	<b>231,462</b>
<b>Cash and cash equivalents at the beginning of the year</b>	<b>426,830</b>	<b>195,368</b>
<b>Cash and cash equivalents at the end of the year</b>	<b>1,822,276</b>	<b>426,830</b>

(\*) Presented for comparative purposes only.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**2. Basis for presentation of the consolidated annual accounts**

2.1 Fair presentation

The Group's annual consolidated financial statements have been prepared in conformity with the International Financial Reporting Standards adopted by the European Union as of 31 December 2017 (IFRS-EU) and Bank of Spain Circular 4/2004, of 22 December, and subsequent amendments, which together constitute the enactment and adaptation of IFRS-EU for the Spanish banking sector.

In these annual accounts the abbreviations IAS and IFRS are used to refer to International Accounting Standards and International Financial Reporting Standards, respectively, and the abbreviations IFRIC and SIC to refer to the Interpretations of the International Financial Reporting Standards Interpretations Committee and the previous Standing Interpretations Committee respectively, all of these approved by the European Union, and on the basis of which these consolidated annual accounts were prepared.

The consolidated annual accounts were prepared taking into account all of the accounting principles and standards and the obligatory valuation criteria that have a significant effect on these, so that they reflect a true image of the equity and of the financial situation of the Group at 31 December 2017 and of the consolidated results of its operations, changes in net equity and cash flows that took place in the Group during the year ended on that date.

Note 13 summarizes the most significant accounting principles and policies and the valuation criteria applied in the preparation of the consolidated annual accounts of the Group for 2017.

The consolidated annual accounts were prepared from the accounting records held by the Entity and by the other entities that are part the Group. However, since the accounting principles and valuation criteria applied in the preparation of the consolidated annual accounts of the Group for 2017 may differ from those applied by some of the entities that are part of the group, the adjustments and reclassifications needed were introduced during the consolidation process to homogenize these principles and criteria and to adequate them to those of IFRS-EU applied by the Entity.

The information contained in these present consolidated annual accounts is the responsibility of the Directors of the Parent Entity of the Group.

The Group's consolidated financial statements for 2017 were authorized for issue by the Directors of the Group's Parent Entity at a Governing Board meeting held on 28 February 2018. They are expected to be approved at the Parent Entity's General Assembly without material modification.

The accompanying consolidated financial statements are expressed in thousands of euros, unless expressly indicated to the contrary.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

2.2 Consolidation principles

The Group has been defined in accordance with International Financial Reporting Standards (IFRS) adopted by the European Union. All subsidiaries, jointly-controlled entities and associates are investee companies.

2.2.1) Dependent Entities

Dependent entities are entities over which the Group has control. The Group controls an entity when the Group is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity.

For control to exist, the following must be applicable:

- Power: An investor has power over an investee when it holds rights in effect which provide it with the capacity to direct its relevant activities, i.e. those which significantly affect the investee's returns.
- Returns: An investor is exposed, or has rights, to variable returns from its involvement in the investee when the returns it obtains from such involvement may vary depending on the investee's business performance. The returns may be only positive, only negative or both positive and negative.
- Relationship between power and returns: An investor controls an investee if the investor not only has power over the investee and is exposed, or has rights, to variable returns due to its involvement in the investee, but also the capacity to use its power to influence the returns obtained from such involvement in the investee.

Additionally, the Group takes into account any facts or circumstances which may affect the assessment of whether or not control exists and the analyses described in the guidelines for the implementation of the relevant legislation (for example, whether the Group holds a direct or indirect interest of more than 50% of the voting power of the entity being evaluated).

Information related to holdings in Dependent Entities at 31 December 2017 and 2016 is shown in Appendix I.

The annual accounts of the dependent entities are consolidated with the Entity applying the full consolidation method. As a result, all the balances derived from the transaction between the consolidated companies under this method that are significant have been eliminated in the consolidation process. Additionally, the participation of third parties in:

- The net equity of the Group is presented under the heading "Minority Interests" of net equity on the consolidated balance sheet.
- The consolidated results for the year is presented under the heading "Profit/(loss) during the year – Attributable to minority interests (non-controlling interests)" in the consolidated income statement.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The consolidation of the results generated by the dependent entities acquired by the Group during the year is performed taking into account, exclusively, those related to the period between the date of acquisition and close of the year. Additionally, the results generated by entities disposed of by the Group during the year is performed taking into account, exclusively, those related to the period between the beginning of the year and the date of disposal.

Intercompany transactions are eliminated, along with the balances, income and expenses in transactions between entities of the Group. The profits and losses arising from intragroup transactions are also eliminated when registered as assets. The accounting policies of dependent entities have been modified when it was necessary to ensure uniformity with the policies adopted by the Group.

In addition to the Dependent Entities, the Parent Entity has included through full consolidation the securitized funds "I.M. Caja Laboral 1, F.T.A." and "I.M. Caja Laboral 2, F.T.A.", entities established for the securitization of mortgage loans and the later issue of securitization bonds (see Note 2.2.6).

To book business combinations the Group applies the acquisition method. The consideration transferred for the acquisition of a dependent entity corresponds to the fair value of the assets transferred, the liabilities incurred with the previous owners of the entity and the participations in equity issued by the Group. The consideration transferred includes the fair value of any asset or liability arising from an agreement covering contingent considerations. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. In each business combination, the Group may opt to recognize any non-dominant participation in the acquired entity at fair value or at the proportional part of the non-dominant participation of the amounts recognized for the net identifiable assets of the acquired entity.

Costs related to the acquisition are recognized as expenses in the financial year in which these were incurred.

If the business combination is undertaken in stages, fair value on the date of acquisition of the participation in the net equity of the acquired entity held previously by the acquirer will be re-valued at fair value on the date of acquisition through the results for the year.

Any contingent consideration to be transferred by the Group is recognized at fair value on the acquisition date. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IAS 39 either in profit and loss or as a change in equity. A contingent consideration classified as net equity is not re-valued and its later settlement is booked within net equity.

Goodwill is initially valued as the surplus between the total consideration transferred and fair value of the non-controlling interest in the net identifiable assets acquired and the liabilities assumed. If this consideration is less than the fair value of the net assets of the dependent entity acquired, the difference is recognized in the consolidated results.

The Group's insurance companies are subject to supervision and regulations by various bodies. The laws in force in the different jurisdictions together with the need to meet minimum capital requirements and supervisory actions are matters that could affect these institutions' capacity to transfer funds in the form of cash, dividends, loans or advances.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

2.2.2) Changes in the participation in the ownership of dependent entities without a change in control.

Transactions in non-dominant participations that do not result in loss of control are booked as equity transactions, that is, as transactions with the owners in their condition as such. The difference between the fair value of the consideration paid and the corresponding proportion acquired of the carrying amount of the net assets of the dependent entity is booked as net equity. The gains or losses on disposal of non-dominant participations are also recognized in net equity.

2.2.3) Disposal of dependent entities

When the Group ceases to hold control, any participation retained in the entity is remeasured at fair value on the date on which control was lost, recognising the change in the carrying amount in books in the results. The fair value is the amount initially booked for the purpose of later recognition of the participation held as an associate, joint venture or financial asset. Moreover, any amount previously recognized in Valuation Adjustments in net equity related to this entity is booked as if the Group had directly sold the related assets or liabilities. This could mean that the amounts previously recognized in net equity are reclassified to the consolidated results.

2.2.4) Joint ventures – Jointly-controlled entities

A joint venture is a contractual arrangement whereby two or more entities, denominated ventures, undertake an economic activity that is subject to joint control, that is, to a contractual agreement to share the power to govern the financial and operating policies of an entity or other economic activity, in order to benefit from its operations, in which the unanimous consent of all ventures, which share control and have rights to its net assets, is required for taking decisions on relevant activities.

Likewise, those participations in entities that, not being dependent, are controlled jointly by two or more entities not linked between themselves, among which is the Group, are also considered as joint ventures.

The equity method of consolidation has been used for the annual accounts of joint ventures -jointly-controlled entities, in accordance with accounting regulations.

As at 31 December 2017 and 2016 there were no investments in Jointly controlled Entities.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

2.2.5) Associated entities

Those participated companies over which the Group has the capacity to exert significant influence are considered as associated entities. This significant influence is demonstrated, in general, although not exclusively, by holding a participation, directly or indirectly through another or other participated companies, of 20% or more of the voting rights of the participated company.

In the consolidation process the participation method was applied for associated entities, as is defined in IAS 28. Consequently, the participations in the associated entities were valued by the fraction that the Group's participation represents in their capital once the dividends received from them have been considered along with other equity eliminations. The results from transactions with an associated entity are eliminated in the proportion that the Group's participation represents. If as a result of the losses which an associated entity has suffered its equity in the accounts is negative, on the consolidated balance sheet of the Group this would appear at nil value, unless there is an obligation by the Group to back the entity financially.

However, at 31 December 2017 and 2016 the Group has holdings of more than 20% in the capital of certain companies, which have not been classified as Associated Entities, since the Group considers that it does not possess significant influence in these companies because a firm commitment exists for the acquisition of these holdings by Mondragón Inversiones at a fixed price. The book value of these investments as at 31 December 2017 and 2016 amounted to 5,634 thousand euros and 5,892 thousand euros, respectively (Note 25).

The relevant information of holdings in Associated Entities at 31 December 2017 and 2016 are shown in Appendix I.

Because the accounting principles and norms and the valuation criteria applied in the preparation of the consolidated annual accounts of the Group for the years 2017 and 2016 may differ from those applied in some of the subsidiaries, jointly-controlled entities and associates, during the consolidation process any significant adjustments or reclassifications required were applied to homogenize the accounting principles and norms and the valuation criteria.

At 31 December 2017 and 2016, no entity in the Group held a participation in the capital of other credit entities, national or foreign, equal to 5% or more of their capital or voting rights.

Likewise, at 31 December 2017 and 2016, no credit entity, national or foreign, or groups, as understood under article 4 of the Securities Market Law, which includes a credit entity, national or foreign, possesses any holding of more than 5% of the capital or voting rights of any credit entity included in the Group.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

2.2.6) Structured entities

In those cases in which the Group invests in or incorporates entities for the transfer of risks or other purposes, or for the purpose of allowing customers access to certain investments, it is determined, considering the provisions of the regulatory framework, whether control as described above exists and therefore whether or not they should be consolidated. In particular, whether the Group obtains success fees and the possibility of terminating relations with the managers of the underlying assets are taken into consideration. These entities include asset-backed securitization funds which are consolidated in cases where, based on the above analysis, it is determined that the Group has maintained control.

At 31 December 2017 and 2016 the contractual agreements for financial support to consolidated structured entities pertain to the support mechanisms which are commonly used in the securitization market. There are no significant financial support agreements other than those covered by the relevant contracts. Note 26 to the consolidated annual accounts provides information on the balances related to consolidated structured entities.

Voluntary benefit entities, investment funds and pension funds and companies managed by the Group (in most cases, retail funds without a legal personality in which investors acquire aliquot units providing them with ownership of the managed assets) are not regarded as meeting the requirements of the regulatory framework to be considered as structured entities, in addition to the fact that they are analysed using the same criteria as other dependent entities.

These entities and funds are self-sufficient as far as their activities are concerned and do not depend on a capital structure that could make them unable to carry on their activities without additional financial support. Fees accrued during the year for the services rendered to these entities and funds by Group (asset management services, portfolio deposits, etc.) are recorded under Fees received in the consolidated income statement (Note 49) together with fees generated by the depositing of portfolios owned by third parties.

2.2.7) Changes in the scope of consolidation

Changes in the scope of consolidation during 2017

During 2017, the Group company Credilka, S.A. was dissolved and liquidated in accordance with the provisions of Article 38 of the Spanish Companies Act, which did not have a significant impact on the consolidated financial statements as at 31 December 2017.

Changes in the scope of consolidation during 2016

During 2016, ISGA Inmuebles, S.A. carried out the merger by absorption of the Group company, Pienso del Norte, S.A. As a result of the merger, the Group no longer holds a direct interest in this company. Similarly, ISGA Inmuebles, S.A. acquired all the equity in the companies Copesa Montecerrao, S.L. and Copesa Ciempozuelos, S.L. As a result of the acquisition of Copesa Ciempozuelos, S.L., the group took control of the assets and liabilities of that company, which did not have a significant impact on the consolidated financial statements as at 31 December 2016.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**2.3 Entry into force of IFRS 9 - Financial instruments**

The first of January of 2018, IFRS 9 "Financial instruments", adopted by the European Union, entered into force. This standard introduces changes compared to the previous regulations regarding the classification, valuation and recognition of financial assets and liabilities. The main elements of this standard are the following ones:

- IFRS 9 retains but simplifies the mixed valuation model and establishes three main categories of measurement for financial assets: amortized cost, fair value through profit or loss and fair value through other comprehensive income. The basis of classification depends on the entity's business model and the characteristics of the contractual cash flows of the financial asset. It requires investments in equity instruments to be measured at fair value through profit or loss with the irrevocable option at the outset to present the changes in fair value in non-recyclable other comprehensive income, provided that the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are reported in profit or loss.

In relation to financial liabilities, IFRS 9 has not been changed regarding classification and valuation except for the recognition of changes in own credit risk in other comprehensive income for liabilities stated at fair value through profit or loss.

- Under IFRS 9, there is a new model of "expected credit losses", which replaces the model of "impairment losses incurred" in IAS 39, and which gives rise to a recognition of losses earlier than was the case before.

In accordance with this methodology, operations, after their initial recognition, are classified as "Phase 1" and expected losses are recognized in the following 12 months. If there is a significant increase in the risk of default with respect to the risk existing at the time of the initial recognition of the transaction, the operations are classified as "Phase 2", recognising expected losses for the term corresponding to the residual maturity of the operation, taking into account any extension options that may be exercised. Finally, when the operations are impaired, that is, those in which part of the investment is not expected to be recovered taking into account the time value of the money, they are classified as "Phase 3", recognising the expected loss at the residual maturity of the operations. Similarly, in impaired operations, interest is recognized on the basis of its book value net of provisions rather than the gross amount before provisions.

- IFRS 9 relaxes the requirements for hedge effectiveness, requiring an economic relationship between the hedged item and the hedging instrument and requiring the hedged ratio to be the same as the entity's actual risk management ratio. Under the above regulations, a hedge is highly effective, both prospectively and retrospectively.

The Group has developed an adjustment project supervised by the Governing Board that encompasses the following areas for the first application of the standard on the first of January of 2018:

a) Classification and valuation of financial instruments

The existing business models in the Group have been evaluated and identified, as well as the classification of the instruments according to these business models and compliance with the conditions "payment of principal and interest only".

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The main qualitative impacts for the Group in this area are the following ones:

- The classification and valuation of the financial assets in the "Loans and receivables" portfolio has not undergone any significant changes, as it follows a business model based on obtaining the contractual flows of the underlying financial assets in the different credit portfolios. Similarly, the analysis carried out has not identified portfolios with special characteristics that result in the non-fulfilment of the contractual cash flow criteria established in IFRS 9 for measuring the amortized cost.
- On the first of January of 2018, the Governing Board and the Assets and Liabilities Committee of the Parent Entity assessed the appropriate business models for the various sub-portfolios comprising the old "Financial assets available for sale" and "Investments held-to-maturity " portfolios, taking into account factors such as the frequency, timing and amount made from sales in previous years, the reasons for such sales, the sensitivity to interest rates and projections of future sales. In this regard, there have been significant reclassifications of portfolios of debt securities from fair value with changes in other comprehensive income to amortized cost. Fixed-income assets that do not meet the contractual cash flow criteria established in IFRS 9 were also reclassified from fair value with changes in other comprehensive income to fair value with changes in income.
- Certain equity instruments that were classified in the "Financial assets available for sale" portfolio have been classified at fair value with changes in the profit and loss account, mainly collective investment undertakings.
- The "Financial assets held for trading" portfolio has remained unchanged and is classified as fair value through profit and loss.
- The Group has not experienced any changes in financial liabilities as it does not have any liabilities that are measured at fair value through profit and loss.

b) Measurement of significant impairment of credit risk in financial instruments

The new impairment model based on expected credit losses has resulted in an increase in provisions in the loan investment portfolio. The Group has applied impairment models based on collective and individualized estimates for calculating the estimated expected loss under a transaction classification system that allows them to be allocated to the different risk phases of the standard.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The impairment estimation process takes into account all credit exposures, both debt instruments and off-balance sheet exposures. The Group has used the parameters and methodology established by the IFRS in force, under an expected loss methodology, as well as the rest of the local regulations in force, based on the statistical data and models which aggregate the average performance of the banking sector entities in Spain and which support their full compatibility with the framework formed by the IFRS, to define the classification and calculation of the extent to which the Group's balance sheet and off-balance sheet exposures maintained with customers are impaired. This methodology takes into account, among other matters, the segment of credit risk to which the transaction belongs, effective collateral and personal guarantees received, the economic-financial situation of the debtor and, if applicable, the age of overdue amounts.

c) Hedge accounting

The Group has opted to maintain the hedge accounting of IAS 39, so there have been no changes in this area.

d) Credit charges that form an integral part of the actual cost or performance of such transactions

Under IFRS 9, these charges must be deferred and recognized in the profit and loss account throughout the life of the transaction, replacing the previous criterion in IAS 39, under which the direct costs related to the services could be charged at the time of inception of the transaction. The Group has estimated the impact of the full deferral of the aforementioned previously allocated direct costs on the transactions outstanding as at 1 January 2018.

The results of the project to implement IFRS 9, which is currently being revised, are shown below:

	<u>Million euros</u>
<b>Net impact on balance sheet</b>	<b>(81.2)</b>
Increase in value adjustments due to impairment of loans and discounts	(10.1)
Decrease in value adjustments due to impairment losses on foreclosed assets	0.2
Recording of the revenue not yet allocated to credit charges	(7.0)
Reclassifications of investment portfolios	(95.9)
Deferred taxes associated with the impacts	31.6
<b>Impact on equity (decrease)</b>	<b>(81.2)</b>
Impact on valuation adjustments (decrease)	(77.4)
Impact on reserves (decrease)	(3.8)

The reclassification of certain fixed-income sub-portfolios from fair value with changes in other comprehensive income to fair value through profit or loss and to amortized cost has resulted in a significant reduction in the valuation adjustments.

The application of IFRS 9 had a negative impact on the CET1 Fully loaded ratio of the consolidated Group of around minus 93 basis points.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Lastly, the Laboral Kutxa Group has chosen not to apply the transitional adjustments for the mitigation of the impacts of IFRS 9 on capital, included in the EU regulation of the European Parliament and of the Council dated 12 December 2017 amending Regulation (EU) 575/2013, with regard to transitional provisions for mitigating the impact of the introduction of IFRS 9 on equity and for the treatment of large exposures related to certain public sector exposures denominated in the national currency of any Member State.

**2.4 Comparative information**

The information drawn up for financial reporting purposes under IFRS-EU corresponds to the year ended 31 December 2017. Comparable figures are provided for 2016 in all instances. The information relating to 2016 is only presented for comparison purposes with that of 2017 and does not form part of the Entity's annual accounts for 2017.

**3. Changes and errors in accounting policies and estimates**

The information contained in these consolidated annual accounts is the responsibility of the Directors of the Parent Entity. Estimates have been used, where appropriate, in these consolidated annual accounts, in the measurement of certain assets, liabilities, income, expenses and commitments, which have been made by the Senior Management of the Parent Entity and Investees and ratified by the Directors. These estimates relate to:

- The impairment losses on certain financial assets (Note 13.h).
- The useful lives of property, plant and equipment and intangible assets (Notes 13.q and 13.r).
- The fair value of certain financial assets not listed on regulated markets (Note 13.e).
- The cost and anticipated development of provisions and contingent liabilities (Note 13.u).
- Assumptions used to calculate insurance liabilities (Note 13.t).
- The actuarial assumptions used to calculate post-employment benefit liabilities and commitments (Note 13.o)
- The assessment of the ability to utilize the tax credits recognized (Note 13.p).
- The valuation of consolidated goodwill (Note 13.ab).
- The estimated calculation of Corporate Income Tax (Note 41)

Since these estimates have been made based on the best information available at 31 December 2017 concerning the items involved, future events may require changing them in some respect in subsequent years. Such changes will, if appropriate, be made on a prospective basis and the effects of the estimate change will be recognized in the relevant consolidated income statement.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

a) Changes in accounting criteria

Changes in accounting policies, either because they amend an accounting regulation that governs a certain transaction or event or because the Governing Board at the Parent Entity decides to change the accounting policy for justified reasons, are applied retroactively unless:

- It is impractical to determine the effect in each specific year deriving from a change in an accounting policy regarding comparative information from a preceding year, in which case the new accounting policy is applied at the start of the oldest year so that retroactive application becomes practicable. When it is impractical to determine the accumulated effect, at the start of the current year, deriving from the application of a new accounting policy to all preceding years the new accounting policy is applied on a prospective basis as from the oldest date on which it is practical to do so or,
- The accounting rule or regulation changes or establishes the application date.

During 2017 there have been changes in the accounting regulations applicable to the Group compared with those applied last year. A list of the changes that may be considered to be most relevant is provided below:

i) Standards, amended standards and interpretations effective for annual periods beginning on or after 1 January 2017

- IAS 7 (Amendment) "Disclosure initiative"

An entity is required to disclose information that enables users to understand changes in liabilities arising from financing activities. This includes changes arising from:

- Cash flows, such as withdrawals and repayments of loans; and
- Non-monetary changes, such as acquisitions, disposals and unrealized exchange differences.

Liabilities arising from financing activities are liabilities for which cash flows were, or cash flows will be, classified in the cash flow statement as cash flows from financing activities. In addition, changes in financial assets (for example, assets covering liabilities arising from financing activities) should be included in the new disclosure requirement if the cash flows of those financial assets were included, or future cash flows will be included in the cash flows from financing activities.

The amendment suggests that including a reconciliation between the opening and closing balance sheet balances for liabilities arising from financing activities would meet the disclosure requirement, although it does not establish a specific format.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The amendment will be effective for financial years starting on or after 1 January 2017.

The new amendments have not had a significant effect on the present Group's consolidated annual accounts.

- IAS 12 (Amendment) "Recognition of deferred tax assets due to unrealized losses"

The amendments to IAS 12 clarify the requirements to recognize deferred tax assets on unrealized losses. The amendments clarify the accounting treatment of deferred tax when an asset is valued at fair value and that fair value is below the tax base of the asset. It also clarifies other aspects of accounting for deferred tax assets.

The amendment will be effective for financial years starting on or after 1 January 2017.

The new amendments have not had a significant effect on the present Group's consolidated annual accounts.

ii) Standards, amendments and interpretations which have not yet come into effect but which may be adopted early in the years starting on or after 1 January 2017

At the date of signature of these consolidated annual accounts, the IASB and IFRS Interpretations Committee had published the standards, amendments and interpretations described below, the application of which is mandatory as from 2017 and which the Group has not adopted early:

- IFRS 4 (Amendment) "Application of IFRS 9 Financial Instruments" with IFRS 4 "Insurance Contracts"

The amendments to IFRS 4, which were published by the IASB in September 2016, introduce two optional approaches for insurance companies:

- A temporary exemption until 2021 for IFRS 9 for entities that meet specific requirements (applied at the level of the reporting entity); and
- The "overlapping approach": will provide all companies that issue insurance contracts with the option of recognizing in other comprehensive income, rather than in profit or loss, the volatility that could arise when IFRS 9 "Financial Instruments" is applied before the new standard for insurance contracts is published.

IFRS 4 (including the changes that have now been published) will be superseded by the next new insurance contract standard. Consequently, both the temporary exemption and the "overlapping approach" are expected to cease to apply when the new insurance standard comes into force.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

This amendment is not expected to have a material effect on the Group's consolidated annual accounts.

- IFRS 9 “Financial instruments”

This standard addresses the classification, measurement and recognition of financial assets and liabilities. The full version of IFRS 9 was published in July 2014 and replaces the guidance in IAS 39 on classification and measurement of financial instruments. IFRS 9 retains but simplifies the mixed valuation model and establishes three main categories of measurement for financial assets: amortized cost, fair value through profit or loss and fair value through other comprehensive income. The basis of classification depends on the entity's business model and the characteristics of the contractual cash flows of the financial asset. It requires investments in equity instruments to be measured at fair value through profit or loss with the irrevocable option at the outset to present the changes in fair value in non-recyclable other comprehensive income, provided that the instrument is not held for trading. If the equity instrument is held for trading, changes in fair value are reported in profit or loss. In relation to financial liabilities, there have been no changes regarding classification and valuation except for the recognition of changes in own credit risk in other comprehensive income for liabilities carried at fair value through profit or loss. Under IFRS 9 there is a new model for impairment losses, the expected credit loss model, which replaces the impairment loss model under IAS 39 and which will give rise to the recognition of losses earlier than was the case under IAS 39. IFRS 9 eases the requirements for hedges to be effective. Under IAS 39, a hedge must be highly efficient both prospectively and retrospectively. IFRS 9 replaces this approach by requiring an economic relation between the hedged item and the hedging instrument, and that the ratio covered is the same as that actually used by the entity in its risk management. Contemporaneous documentation is still required but is different from that which was prepared under IAS 39. Finally, extensive information is required, including a reconciliation between the initial and final amounts of the provision for expected credit losses, assumptions and data, and a reconciliation at the transition between the categories of the original classification under IAS 39 and the new classification categories under IFRS 9.

IFRS 9 will be effective for financial years starting on or after 1 January 2018; early application is permitted. IFRS 9 is to be applied retroactively but will not require comparative figures to be restated. If an entity chooses to apply IFRS 9 early, it must implement all the requirements simultaneously. Entities applying the standard before 1 February 2015 still have the option to apply it in stages.

The impacts arising from the application of IFRS 9 are described in Note 2.3.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- IFRS 15 "Revenue from contracts with customers"

In May 2014, the IASB and the FASB jointly issued a converged standard regarding the recognition of revenue from contracts with customers. Under this standard, revenue is recognized when a customer obtains control over the good or service sold, i.e. when it has the capacity both to direct the use and to obtain benefits from the good or service. This standard includes new guidelines to determine whether to recognise revenue over time or at a particular time. IFRS 15 requires extensive information on both recognized revenue and revenue expected to be recognized in the future in relation to existing contracts. Quantitative and qualitative information is also required about the significant judgements made by management in determining recognized revenue, as well as any changes in these judgements.

Subsequently, in April 2016, the IASB published amendments to this standard which, while not changing the fundamental principles, clarify some of the more complex aspects.

IFRS 15 will be effective for the financial years starting on or after 1 January 2018, although early application is permitted.

This new standard is not expected to have a material effect on the Group's consolidated annual accounts.

- IFRS 15 (Amendment) "Clarification of IFRS 15 Revenue from contracts with customers"

The IASB has amended IFRS 15 to:

- Clarify the guidance for the identification of performance obligations, intellectual property licensing accounting and principal versus agent evaluation (presentation of net versus gross revenue).
- Include new and modified illustrative examples for each of these areas of the guide.
- Provide additional practical resources related to the transition to the new standard.

These amendments do not change the fundamental principles of IFRS 15, but do clarify some of the more complex aspects of this standard. The amendments could be relevant to a wide range of entities and consideration should be given to how management assesses the impact of IFRS 15.

This amendment will be effective for financial years starting on or after 1 January 2018.

This amendment is not expected to have a material effect on the Group's consolidated annual accounts.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- IFRS 16 "Leases"

In January 2016, the IASB published a new standard on leases, as a result of a joint project with the FASB, which supersedes IAS 17 "Leases".

The IASB and FASB have reached the same conclusions in many areas related to lease recognition, including the definition of a lease, the requirement, as a general rule, to reflect leases on the balance sheet and the measurement of lease liabilities. The IASB and the FASB also agreed not to incorporate substantial changes into the accounting treatment by the lessor, maintaining requirements that are similar to those of the former standards.

However, there are still differences between the IASB and FASB regarding the recognition and disclosure of expenses related to leases in the income statement and in the cash flow statement.

IFRS 16 will be effective for financial years starting on or after 1 January 2019. Its early application is permitted but only if IFRS 15 "Revenue from contracts with customers" is also applied.

This new standard is not expected to have a material effect on the Group's consolidated annual accounts.

iii) Standards, amendments and interpretations of existing standards that cannot be adopted early or have not been adopted by the European Union

As of the date of signature of these consolidated annual accounts, the IASB and IFRIC had published the standards, amendments and interpretations described below, which are pending adoption by the European Union:

- IFRS 10 (Amendment) and IAS 28 (Amendment) "Sale or contribution of assets between an investor and its associate or joint venture"

These amendments clarify the accounting treatment of sales and contributions of assets between an investor and his associates and joint ventures which will depend on whether the non-monetary assets sold or contributed to an associate or joint venture constitute a "business". The investor will recognise the full gain or loss when the non-monetary assets constitute a "business". If the assets do not meet the definition for a business, the investor recognises the gain or loss to the extent of the interests of other investors. The amendments will only apply when an investor sells or contributes assets to his associate or joint venture.

Originally, these amendments to IFRS 10 and IAS 28 were prospective and applicable for years starting on or after 1 January 2016. However, at the end of 2015 the IASB decided to postpone the effective date of the amendments (without setting a new date) as it is planning a broader revision that could result in a simplification of the accounting treatment of these transactions and other aspects of the recognition of associates and joint ventures.

The amendments are not expected to have a material impact on the Group's consolidated annual accounts, if they are adopted by the European Union.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- IFRS 2 (Amendment) "Classification and valuation of share-based payment transactions"

The amendment to IFRS 2, which was developed through the IFRS Interpretations Committee, clarifies how to account for certain types of transactions with share-based payments. In this regard, it provides requirements for the accounting of:

- The effects of vesting conditions and non-vesting conditions on the valuation of cash-settled share-based payments;
- Share-based payment transactions with a net settlement characteristic for tax withholding obligations; and
- A change in the terms and conditions of a share-based payment that changes with the classification of the transaction from cash-settled to settled through equity.

The amendment is not expected to have a material impact on the Group's consolidated annual accounts, if it is adopted by the European Union.

- Annual Improvements in the IFRS. Cycle 2014 – 2016

The amendments affect IFRS 1, IFRS 12 and IAS 28 and will apply to annual periods beginning on or after 1 January 2018 in the case of amendments to IFRS 1 and IAS 28 and 1 January 2017 for those corresponding to IFRS 12, all of which are subject to its adoption by the EU. The main amendments relate to:

- IFRS 1, "First-time Adoption of International Financial Reporting Standards": Elimination of short-term exemptions for entities adopting IFRS for the first time.
- IFRS 12, "Disclosure of interests in other entities": Clarification on the scope of the Standard.
- IAS 28, "Investments in associates and joint ventures": Valuation of an investment in an associate or joint venture at fair value.

The Group is analysing the impact that the amendments may have on the Group's consolidated annual accounts, in the event that they are adopted by the European Union.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- IAS 40 (Amendment) "Transfers of investment property"

This amendment clarifies that to transfer to, or from, real estate investments there must be a change in use. In order to conclude whether there has been a change in use there must be an assessment of whether the property meets the definition of a real estate investment. This change must be supported by evidence. The IASB confirmed that a change in intention, in isolation, is not sufficient to support a transfer.

The amendment will be effective for financial years starting on or after 1 January 2018. Early application is permitted.

The Group is analysing the impact that the amendment may have on the Group's consolidated annual accounts should it be adopted by the European Union.

- IFRIC 22 "Foreign currency transactions and prepaid considerations"

This IFRIC addresses how to determine the date of the transaction when the foreign currency transaction standard, IAS 21, is applied. The interpretation applies when an entity pays or receives a prepayment for contracts denominated in foreign currency.

The date of the transaction determines the exchange rate to be used for the initial recognition of the corresponding asset, expense or income. The issue arises because IAS 21 requires the use of the "transaction date" exchange rate, which is defined as the date the transaction first qualifies for recognition. The question is therefore whether the date of the transaction is the date on which the asset, expense or income is initially recognized, or the earliest date on which the anticipated consideration is paid or charged, resulting in a prepayment or deferred income.

The interpretation provides a guidance when a single payment/collection is made, as well as for situations in which there are multiple payments/collections. The aim of the guide is to reduce diversity in practice.

The interpretation will be effective for financial years starting on or after 1 January 2018, although early application is permitted.

The interpretation is not expected to have a material impact on the Group's consolidated annual accounts, if it is adopted by the European Union.

- IFRS 17 "Insurance contracts"

In May 2017, the IASB completed its long-term project to develop an accounting standard for insurance contracts and published IFRS 17 'Insurance contracts'. IFRS 17 replaces IFRS 4 "Insurance Contracts", which currently permits a wide range of accounting practices. IFRS 17 will fundamentally change the accounting of all entities that issue insurance contracts and investment contracts with discretionary participation features.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The standard applies for the financial years beginning on or after 1 January 2021 and may be applied earlier if IFRS 15 "Revenue from customer contracts" and IFRS 9 "Financial instruments" are also applied. IFRS 17 is pending approval by the European Union.

The Group is analysing the impact that this standard may have on the Group's consolidated annual accounts should it be adopted by the European Union.

- IFRIC 23, "Uncertainty about the treatment of corporate income tax"

The interpretation provides requirements in addition to those of IAS 12 "Corporate Income Tax", and specifies how to reflect the effects of uncertainty in the accounting of corporate income tax. This interpretation clarifies how to apply the recognition and measurement requirements of IAS 12 when there is uncertainty over its accounting treatment.

The interpretation will be effective for financial years starting on or after 1 January 2019, although early application is permitted.

The Group is analysing the impact that this interpretation may have on the Group's consolidated annual accounts should it be adopted by the European Union.

- IFRS 9 (Amendment) "Prepayment features with negative compensation"

The terms of instruments with prepayment features with negative compensation, where the lender might be obliged to accept a prepayment amount substantially lower than the unpaid principal and interest amounts, were incompatible with the notion of "reasonable additional compensation" for early termination of a contract in accordance with IFRS 9. As a consequence, such instruments would not have contractual cash flows that are only principal and interest payments, which would be recognized at fair value with changes in the profit and loss account. The amendment to IFRS 9 clarifies that a party may pay or receive reasonable compensation when a contract is terminated early, which could allow these instruments to be measured at amortized cost or at fair value with changes in other comprehensive income. The amendment will be effective for financial years starting on or after 1 January 2019, although early application is permitted.

The Group is analysing the impact that this amendment may have on the Group's consolidated annual accounts should it be adopted by the European Union.

- IAS 28 (Amendment) "Long-term interest in associates and joint ventures"

This amendment of limited scope clarifies that long-term interests in an associate or joint venture that, in substance, are part of the net investment in the associate or joint venture, but to which the equity method is not applied, are accounted for in accordance with the requirements of IFRS 9 "Financial instruments". The IASB has also published an example illustrating how the requirements of IAS 28 and IFRS 9 should be applied in respect of these long-term interests. The amendment will be effective for financial years starting on or after 1 January 2019, although early application is permitted.

The amendment is not expected to have a material impact on the Group's consolidated annual accounts, if it is adopted by the European Union.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- Annual Improvements in the IFRS. Cycle 2015 – 2017

The amendments affect IFRS 3, IFRS 11, IAS 12 and IAS 23 and will apply for the financial years beginning on or after 1 January 2019, all of which are subject to adoption by the EU. The main amendments relate to:

- IFRS 3 "Business combinations": A previously held interest in a joint venture is re-measured when control of the business is obtained.
- IFRS 11 "Joint arrangements": A previously held interest in a joint venture is not measured again when joint control of the business is obtained.
- IAS 12 "Corporate income tax": All tax consequences of dividend payments are accounted for in the same way.
- IAS 23 "Borrowing costs": Any specific loan originally intended to develop a qualifying asset is considered to be part of the generic loans when the asset is ready for use or sale.

The Group is analysing the impact that these amendments may have on the Group's consolidated annual accounts should they be adopted by the European Union.

b) Errors and changes in accounting estimates

Errors in accounting estimates

Errors in the preparation of prior-year consolidated financial statements are the result of omissions or inaccuracies resulting from the failure to employ or use reliable information that was available when the consolidated financial statements for those periods were prepared and that the Parent Entity should have used when preparing those consolidated financial statements.

Errors relating to prior years are corrected retroactively in the first consolidated financial statements that are prepared after discovery, as if the error had never taken place:

- Re-expressing the amounts of the various financial consolidated financial statements affected by the error, including the notes to the consolidated financial statements that are published in the consolidated financial statements for the purposes of comparison, which relate to that year and prior years, if applicable.
- Re-expressing the consolidated opening balance for the oldest year for which information is presented if the error took place before the first consolidated financial statements that are presented for the purposes of comparison.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

When it is impractical to determine the effects arising in each specific year from an error involving comparative information from a preceding year, the opening balances for the oldest years are re-expressed, where possible. In the event that it is not practical to determine the accumulated effect, at the start of the current year, of an error involving all prior years, the comparative information is re-expressed correcting the error on a prospective basis as from the earliest date possible.

Errors from prior years that affect consolidated equity are corrected in the year discovered using the relevant consolidated equity account. Under no circumstances are errors from prior years corrected through the consolidated income statement for the year in which they are discovered, unless they have no relative importance or it is impractical to determine the effect of the error based on the provisions of the preceding paragraph.

Changes in accounting estimates

A change in an accounting estimate is an adjustment to the carrying value of an asset or liability, or the regular consumption of assets, arising after an evaluation of the current situation faced by the item concerned, as well as future expected benefits and the obligations associated with the assets and liabilities concerned.

Changes in accounting estimates are the result of obtaining additional information or knowledge about new events and therefore are not error corrections. These changes are recorded on a prospective basis in the consolidated income statement for the year and in future years affected by the change.

In 2017 and 2016 there have been no significant error corrections relating to prior years, nor have there been any significant changes in accounting estimates that might affect those years or future years.

**4. Application of the surplus for the year**

Law 13/1989 on Credit Cooperatives, amended by Law 20/1990 on the Tax Regime applicable to Cooperatives, lays down that the amounts not appropriated to the Mandatory Reserve Fund and Education and Development Fund will be made available to the General Assembly, which may distribute it as follows:

- Distribution or reimbursement to members
- Appropriation to the Voluntary Reserve Fund

The Parent Entity's Articles of Association stipulate that any surplus available after complying with obligations that might derive from the coverage of mandatory capital or the solvency ratio is to be used as follows:

- A minimum of 50% to the Mandatory Reserve Fund.
- A maximum of 25% to cover development and inter-cooperative needs. In particular, a minimum of 10% will be appropriated to the Education and Development Fund and a maximum of 15% will be appropriated to the Inter-Coop Company Fund.
- The remainder will be made available to the General Assembly, which can decide to distribute it as follows: reimbursement to members or appropriation to the voluntary reserve or similar funds.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The amount earmarked for reimbursement to cooperative members will be distributed equally among all working members and other members.

According to the Parent Entity's Articles of Association, the reimbursement to cooperative members shall be distributed to the labour cooperative members in proportion to their payroll advances, and to the remaining members in proportion to their transactions with the Parent Entity.

The proposed distribution of the Parent Entity's surplus for 2017 which the governing body of the Parent Entity will submit for the approval of the General Assembly, and that approved for 2016, is as follows:

	<u>2017</u>	<u>2016</u>
Appropriation:		
- Gross interest, distributed against the appropriation of gross surplus for the year, paid on share capital contributions		
Share capital	29,170	28,700
- Mandatory Reserve Fund	42,956	39,166
- Education and Development Fund (*)	-	-
- Reimbursements to members	21,478	19,583
- Intercooperative Social Fund	<u>12,887</u>	<u>11,750</u>
Profit/(loss) for the year	<u>106,491</u>	<u>99,199</u>

(\*) The amount allocated to the Education and Development Fund corresponds to the minimum mandatory sum of 8,591 thousand euros in 2017 and 7,833 thousand euros in 2016 (Note 57).

## 5. Information per business segment

In accordance with IFRS 8, the financial compliance of the business segments is reported below on the basis of the information that the Parent Entity Management uses internally to evaluate the performance of these segments.

IFRS 8 requires that all operating segments with revenues that account for at least 10% of the aggregate revenues of all operating segments or with revenues that account for at least 10% of the greater of the following measures shall be reported: (i) the aggregate profit of all the operating segments that have not reported losses, (ii) the aggregate reported loss of all the operating segments that have reported losses. Or, if the assets are at least 10% of the aggregated assets of all the operating segments. Similarly, information shall also be provided on those operating segments, regardless of their size, that represent, in aggregate, at least 75% of the Group's ordinary revenues.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Business segment reporting is a basic tool for monitoring and managing the various activities of the Laboral Kutxa Group:

- a. Segmentation criteria
  - Business Segmentation

The business units described below have been established based on the different business areas established according to the structure and organization of the Laboral Kutxa Group:

- Retail Banking
- Insurance Business

The Retail Banking business offers both investment and savings products. In investment, the main areas of activity are the marketing of mortgage products, consumer credit, working capital and corporate finance. As regards savings, the main products are deposits (on demand and term deposits), bank guarantees, means of payment services (credit and debit cards), investment funds, pension funds and EPSVs. This business is carried out mainly by Caja Laboral Popular Coop. de Crédito, through its network of branches, or by specific companies 100% dependent upon it, which are considered a direct extension of the activity carried out by the Parent Entity. Strategic, management and operational decision-making is focused on the Governing Board of Caja Laboral Popular Coop. de Crédito.

The "Insurance Business" includes the activity carried out by the Group through Seguros Lagun-Aro Vida, S.A. and Seguros Lagun-Aro, S.A. The Group is engaged in life insurance business, marketing life insurance, life savings policies and unit-linked policies. In addition, it is active in non-life insurance, mainly in motor insurance, civil liability and in areas of multi-risk, mainly household insurance. Strategic, management and operational decision-making is focused on the Boards of Directors of both companies.

Notwithstanding the above, the decisions of the Group's different businesses are taken in the control environment that their membership of the Laboral Kutxa Group implies.

- Geographical segmentation

The Group operates through a network of 324 branch offices as at 31 December 2017, with 194 located in the Autonomous Community of the Basque Country, 41 in Navarra and 89 in the rest of Spain (335 branches as at 31 December 2016, 203 in the Autonomous Community of the Basque Country, 43 in Navarra and 89 in the rest of Spain).

The geographical distribution of the Group's financial assets, loans and receivables is detailed in Note 21 of these consolidated annual accounts. Almost all of the Group's revenues are generated in Spain.

Therefore, as regards the criteria for segmentation by geographical area, there are no differences in the Group's area of activity (Autonomous Community of the Basque Country and Navarra and the rest of Spain) that justify segmented and differentiated information on the activity according to this criterion.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

b. The basis and methodology used in the preparation of the segmented information

The information presented is based on the individual accounts of each of the companies that make up the Laboral Kutxa Group, with the eliminations and adjustments relating to consolidation.

Each business unit is considered to be a separate business, so there are flows of income and expenses between businesses for the provision of distribution services for products, services or systems. Adjustments and eliminations mainly relate to the elimination of inter-company profit or loss between segments. The final impact on the group's profit and loss account is zero.

c. Business Segmentation

The main contributions to the consolidated balance sheet and consolidated profit and loss account, disregarding the effect of transactions with group entities, for 2017 and 2016 are shown below:

	<b>2017</b>		
	<b>Retail Banking</b>	<b>Insurance Business</b>	<b>Group Total</b>
<b>Consolidated income statement:</b>			
Contribution to gross margin	375,265	36,225	411,490
Administration costs	207,925	24,430	232,355
Profit/(loss) for the year	103,559	9,290	112,849
<b>Consolidated balance sheet:</b>			
Total assets	21,669,009	766,780	22,435,789
	<b>2016</b>		
	<b>Retail Banking</b>	<b>Insurance Business</b>	<b>Group Total</b>
<b>Consolidated income statement:</b>			
Contribution to gross margin	368,679	36,826	405,505
Administration costs	214,598	23,631	238,229
Profit/(loss) for the year	93,883	9,590	103,473
<b>Consolidated balance sheet:</b>			
Total assets	20,568,452	745,714	21,314,166

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**6. Minimum equity ratios**

6.1 Minimum equity ratios

The Basel Committee on Banking Supervision leads the harmonization of international financial regulation. This Committee introduced the first regulation on credit institutions which set a minimum capital of 8% on their risks as a whole (Basel I, 1988). Later, in 2004, Basel II improved the sensitivity of the risk estimation mechanisms and contributed two new pillars: capital adequacy and risk assessment for each entity (Pillar II) and market discipline (Pillar III). In December 2010, the Committee adopted a new regulatory framework (Basel III) increasing capital requirements with better instruments, seeking consistency and uniform application by institutions and countries. The new capital agreement improves transparency and comparability of capital ratios. It also brings in new prudential tools in the areas of liquidity and leverage.

The European Union brought those agreements (Basel III) into EU law through a phase-in arrangement running to 1 January 2019 under Parliament and Council Directive 2013/36/EU (CRD-IV) of 26 June 2013 relating to access to the business of credit institutions and prudential supervision of credit institutions and investment firms, and Parliament and Council Regulation (EU) No 575/2013 (CRR) of 26 June 2013 on prudential requirements for credit institutions and investment firms, applicable from 1 January 2014.

In order to adapt Spanish law to the regulatory changes in the international arena, Law 10/2014, of 26 June, on the organization, supervision and solvency of credit institutions was enacted continuing the transposition initiated by Royal Decree-Law 14/2013, of 29 November, and Bank of Spain Circular 2/2014, which lays down the regulatory options for requirements applicable during the transitional period. The minimum capital requirements established in current regulations (Pillar I) are calculated based on the Group's exposure to credit risk, foreign currency risk, trading portfolio risk, market risk and operational risk. In addition, the Group must comply with the risk concentration restrictions.

Royal Decree 84/2015 of 13 February which developed Law 10/2014 of 26 June on the organization, supervision and solvency of credit institutions, completes the regulatory development of said Law and brings together in a single text all the organizational and disciplinary regulatory standards for credit institutions that had been issued prior to its enactment.

It should also be noted that during the 2015-2017 period new regulations were published that complement the CRR Regulation on matters related to equity, liquidity, Pillar I risks and Capital requirements.

Thus, it should be noted that, on the second of February of 2016 the Bank of Spain Circular 2/2016 was issued, the main purpose of which was to complete the transfer of Directive 2013/36/EU into Spanish legalisation with respect to credit institutions. One of the options which EU Regulation 575/2013 attributes to the competent national authorities is also included, in addition to those already exercised in Circular 2/2014 by the Bank of Spain.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

This Circular Letter also develops some of the aspects of the transfer of Directive 2011/89/EU of the European Parliament and Council, of 16 November 2011, which amended Directives 98/78/EC, 2002/87/EC, 2006/48/EC and 2009/138/EC with respect to additional supervision of financial institutions that form part of a financial conglomerate. The essential aspects of this Directive have already been incorporated into Spanish legislation through the amendments introduced by Law 10/2014 and Royal Decree 84/2015 into Law 5/2005, dated 22 April, on the supervision of financial conglomerates, and which amended other laws in the financial sector, and into Royal Decree 1332/2005 which developed it.

Lastly, in 2017 the Bank of Spain published Circular 3/2017, dated 24 October, amending Circular 2/2014, dated 31 January. The main purpose of this Circular is to adapt certain aspects of Circular 2/2014, in relation to the less substantial credit institutions, to the latest provisions adopted by the European Central Bank for the larger institutions (mainly the European Central Bank Guideline (EU) 2017/697 dated 4 April 2017 on the exercise by the competent national authorities of the options and powers offered by Union law with respect to the smaller institutions). The rules on transitional options that applied until 2017 have also been removed.

Under the requirements set out in Regulation CRR, credit institutions must comply with a total capital ratio of 8% at all times. However, it should be noted that the regulators may exercise their powers under the new regulatory framework and require institutions to maintain additional capital levels.

In this sense, the Parent Entity received a notification from the Bank of Spain concerning the decision on the minimal prudential requirements applicable to the Entity, whereby Laboral Kutxa must have a Common Equity Tier 1 (CET 1) ratio of 8.005% measured on phased-in regulatory capital. This requirement includes the minimum required by Pillar 1 and the Pillar 2 requirement, including a capital conservation buffer. Similarly, based on the 8% requirement of Pillar 1, the minimum requirements phased-in of Total Capital is 11.505%.

The 8.005% CET1 requirement is composed of: the minimum level of CET1 required by Pillar 1 (4.5%), the Pillar 2 requirement (1.63%) and the capital conservation buffer (1.875%).

The strategic solvency management objectives set by the Group's management are the following ones:

- To comply at all times with prevailing applicable minimum capital requirements at both individual and consolidated levels.
- To manage the Group's capital as efficiently as possible so that the use of capital is considered a key investment decision-making variable, along with other return and risk parameters and considerations.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

To deliver these objectives, the Group has a series of capital management policies and procedures, the main guidelines of which are:

- A dedicated oversight unit which reports to the Entity's risk management department and analyses ongoing compliance with the Bank of Spain's minimum capital requirements.
- When planning its strategic and commercial initiatives, their potential impact on the Group's eligible capital and the relationship between capital usage, returns and risk is considered as a key in the decision-making input.
- Monitoring through the continuous supervision of the Group's solvency situation and its future planning, which includes both a central scenario that incorporates the most probable compliance hypotheses for the next three years, and various stress scenarios aimed at evaluating its financial capacity to overcome particularly adverse situations of various kinds.

The Group's capital management is in line, as concerns conceptual definitions, with the provisions of the solvency regulations described above:

	<b>2017</b>	<b>2016</b>
<u>Common Equity Tier 1 (CET1)</u>		
Capital	727,161	712,951
Qualifying results	70,792	63,023
Reserves	809,890	766,460
Valuation adjustments	109,065	131,525
(-) Other deductions	(59,769)	(59,081)
(-) CET1 adjustments due to prudential filters	(72,869)	(85,204)
	<u>1,584,270</u>	<u>1,529,674</u>
<u>Additional CET 1</u>		
Qualifying equity instruments	-	-
	<u>-</u>	<u>-</u>
<u>Common Equity Tier 2</u>		
Equity instruments and subordinated loans	-	-
Complementary coverage for credit risks using standard method	31,654	33,506
Valuation adjustments	-	-
Development and Education Fund	-	-
(-) Transitional adjustments	-	-
	<u>31,654</u>	<u>33,506</u>
Other items and deductions	-	-
Total qualifying equity	<u>1,615,924</u>	<u>1,563,180</u>
Total minimum equity	<u>698,698</u>	<u>739,321</u>
Risk weighted assets	<u>8,733,720</u>	<u>9,241,512</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

On 31 December 2017 and 2016, the following is the most significant data on the Group's minimum capital:

	<u>2017</u>	<u>2016</u>
CET 1 ratio	18.14%	16.55%
Tier 1 capital ratio	<u>18.14%</u>	<u>16.55%</u>
Total capital ratio	<u>18.50%</u>	<u>16.91%</u>

The CET 1 minimum ratio is 4.5% and the Tier 1 minimum capital ratio is 6.0%.

At the date of the present consolidated annual accounts, the Group complies with the above legislation.

## 6.2 Minimum reserve ratios

In accordance with Monetary Circular 1/1998 dated 29 September, with effect from 1 January 1999, the 10-year reserve ratio was repealed and replaced by the minimum reserve ratio.

The Official Journal of the European Union dated 21 December 2011, published Regulation (EU) 1358/2011 of the European Central Bank dated 14 December, which amended Regulation (EC) 1745/2003 concerning the application of minimum reserves. The amendment consisted of incorporating the reduction, approved by the Governing Council of the European Central Bank on 8 December 2011, in the level of the minimum reserve ratio to be held by institutions from 2% to 1% starting from the reserve maintenance period that began on 18 January 2012.

As at 31 December 2017 and 2016, as well as throughout 2017 and 2016, the Parent Entity complied with the minimum requirements for this ratio by the regulations applicable at any given time.

The amount of cash held by the Parent Entity in the Bank of Spain account for these purposes amounted to 1,682,657 thousand euros as at 31 December 2017 (327,385 thousand euros as at 31 December 2016) (Note 21), although the obligation to maintain the balance required by the applicable legislation in order to comply with the aforementioned minimum reserve ratio is calculated on the basis of the average of the end of day balances held on this account during the maintained period.

## 7. **Remuneration of the Parent Entity's Directors and Senior Management**

### a) Statutory remuneration

The working partners have not received any fixed or variable remuneration by reason of their involvement in the Governing Body, irrespective of the compensation received for their "habitual" work in the Parent Entity. Similarly, the other members of the Governing Body have not received any remuneration due to their membership of the Body.

Caja Laboral Popular remunerates the work of the Chairman and pays the Chairman's remuneration through the established procedures by applying the remuneration criteria laid down by Caja Laboral Popular, Coop. de Crédito.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The amounts accruing to the Chairman of the Governing Board are as follows:

	<b>Short-term compensation and subsistence</b>	
	<b>2017</b>	<b>2016</b>
Chairman of the Governing Body	161	161
	<b>161</b>	<b>161</b>

b) Other Governing Body and Senior Management Remuneration

The payments accrued by the 4 working partners who were members of the Governing Board as at 31 December 2017 (5 working partners as at 31 December 2016) for the performance of their duties were as follows:

	<b>Short-term compensation and subsistence</b>	
	<b>2017</b>	<b>2016</b>
Members of the Governing Board	249	363
	<b>249</b>	<b>363</b>

Also, 7 people have been considered as Senior Management personnel of the Parent Entity, who are members of the Board of Directors as at 31 December 2017 (9 people as at 31 December 2016).

The following table sets out the remuneration accrued in favour of senior management as defined above.

	<b>Short-term compensation and subsistence</b>	
	<b>2017</b>	<b>2016</b>
Senior management	957	1,286
	<b>957</b>	<b>1,286</b>

In addition, the yield on capital (interest) and the remuneration received as a complementary distribution of the available surplus (cooperative returns) by the members of the Governing Board and of senior management in 2017 and 2016 totalled 243.99 and 298.31 thousand euros, respectively.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

In addition to the amounts accrued during the year to the members of the Entity's Governing Body and Senior Management indicated here above, set out below is a breakdown of income and expenses recorded in the consolidated income statement for 2017 and 2016 in relation to the members of the Parent Entity's Governing Body and Senior Management:

	Interest revenue		Interest expenses		Fee and commission income	
	2017	2016	2017	2016	2017	2016
Directors and Senior Management	4	5	-	1	4	6

The members of the Parent Entity's Senior Management who act on behalf of the same on the Board of Directors of entities in which the Group has a shareholding have received no remuneration in respect of their positions as Directors of such Investees in 2017 and 2016.

- c) Loans, credits, fixed-term deposits and guarantees and commitments with members of the Governing Body and Senior Management

Set out below is a breakdown of asset and liability balances in the consolidated balance sheet that relate to transactions carried out with members of the Governing Body and Senior Management of the Parent Entity at 31 December 2017 and 2016:

	Assets- loans granted (gross amount)		Assets-credit accounts (gross amount)		Liabilities – Fixed- term deposits and On demand deposits		Guarantees and commitments	
	2017	2016	2017	2016	2017	2016	2017	2016
Directors and Senior Management	1,703	2,404	-	-	700	672	-	-

## 8. Agency contracts

In accordance with article 21 of Royal Decree 84/2015, dated 13 February, implementing Law 10/2014, dated 26 June, on the organization, supervision and solvency of credit institutions, Appendix II contains a list of the natural or legal persons to whom the Parent Entity, as at 31 December 2017 and 2016, had granted powers to deal with customers on a regular basis on behalf of the Parent Entity, for the purpose of arranging or formally agreeing business transactions of the type normally engaged in by a credit institution.

The list of these agents has been duly reported to the Bank of Spain at 31 December 2017 and 2016.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**9. Environmental impact**

The Group's global operations are governed, inter alia, by Laws on environmental protection (Environmental laws) and on worker safety and health. The Group deems that it substantially complies with these Laws and that the procedures it uses are designed to encourage and ensure compliance with said Laws.

The Group considers that it has taken appropriate environmental protection and improvement measures and for minimising, whenever applicable, the environmental impact, and complies with the rules in force in this regard. In this respect, in 2001 the Parent Entity obtained the Environmental Management Certification under ISO 14001 which is currently in effect. During 2017 and 2016, the Group did not deem it necessary to record any provision for risks and charges of an environmental nature as, in the opinion of the Governing Body of the Parent Entity, there are no contingencies under this heading that are likely to have a significant effect on these annual accounts.

**10. Deposit Guarantee Fund**

**10.1 Single Resolution Fund**

Directive 2014/59/EU, dated 15 May, was incorporated into Spanish legislation under Law 11/2015, dated 18 June, and the enabling regulations thereof under Royal Decree 1012/2015, dated 6 November. This law provides a new framework for the resolution of credit institutions and investment service companies, and is one of the laws that contribute to the creation of the Single Resolution Mechanism set up under EU Regulation 806/2014, dated 15 July, which establishes standards and procedures for credit institutions and investment firms within the framework of a Single Resolution Mechanism and a Single Resolution Fund at a European level.

In the context of the implementation of this regulation, on 1 January 2016, the Single Resolution Fund entered into force, which established itself as a financing instrument to be used by the Single Resolution Board, which is the European authority that will make the decisions on resolution, in order to effectively undertake the resolution measures adopted. The Single Resolution Fund will receive contributions from credit institutions and investment services companies subject to the same.

The Single Resolution Mechanism is supported by the Single Resolution Fund, which will be gradually provided by bank contributions during a transitional period that will last until 31 December 2024, until reaching a size equivalent to 1% of the guaranteed deposits.

The calculation of each entity's contribution to the Single Resolution Fund, regulated by Regulation (EU) 2015/63, is based on the proportion that each represents with respect to aggregate total liabilities of the entities adhered to the Fund, after shareholder's funds have been deducted and the guaranteed amount of the deposits are deducted. The latter is then adjusted to the entity's risk profile. The obligation to contribute to the Single Resolution Fund is accrued on 1 January of each year.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

In 2017, the expense incurred for the contribution to this body amounted to 3,140 thousand euros (4,836 thousand euros in 2016) (Note 57), which has been recorded in accordance with IFRIC 21 in a way similar to the expense recognized with respect to the Deposit Guarantee Fund.

**10.2 Deposit Guarantee Fund**

The Parent Entity is a member of the Deposit Guarantee Fund for Credit Institutions.

Royal Decree 2606/1996, dated 20 December, amended by Royal Decree 1012/2015, dated 6 November, establishes that the Management Committee of the Deposit Guarantee Fund shall determine the annual contributions of entities belonging to the Deposit Guarantee Fund for Credit Institutions. In the 2017 financial year, the Management Committee established a contribution of 1.8 per thousand of the guaranteed deposits on 30 June 2017 (in the 2016 financial year, the Management Committee established a contribution of 1.6 per thousand of the guaranteed deposits on 30 June 2016). The calculation of each entity's contribution was based on the amount of deposits guaranteed, and the risk profile of the entity taking into account indicators such as capital adequacy, the quality of the assets and liquidity, which have been defined in Bank of Spain Circular 5/2016 of 27 May. Furthermore, the contribution to the securities guarantee fund has been set at 0.02% of each 5% of the guaranteed amount of the securities and other financial instruments at 31 December 2017

The expense for ordinary contributions referred to in the above paragraph accrues in accordance with IFRIC 21, when the obligations exists to pay it, on 31 December each year.

On 30 July 2012 the Management Committee of the Deposit Guarantee Fund agreed to arrange an extraordinary contribution between member entities, payable by each entity through ten equal annual instalments. The extraordinary contribution to be made by the Parent Entity amounted to €35,277 thousand (ten annual instalments of €3,522 thousand each). These contributions will be deducted from the ordinary annual contributions which, if appropriate, are paid by the Parent Entity and up to the amount of that ordinary contribution. As at 31 December 2017, the Parent Entity has recorded this commitment in the amount of €17,614 thousand (€21,138 thousand as at 31 December 2016) under the heading "Other assets – Rest of other assets" on the assets side of the consolidated balance sheet (Note 34) and under "Financial liabilities measured at amortized cost - Other financial liabilities" (Note 36) on the liabilities side of the consolidated balance sheet.

Royal Decree-Law 6/2013 provided that, in order to strengthen the assets of the Deposit Guarantee Fund of Credit Institutions, the annual contribution envisaged under Article 3 of Royal Decree 2606/1996, dated 20 December, on Deposit Guarantee Funds of Credit Institutions, to be made by member entities to deposits at 31 December 2012, will be the object of an exceptional one-off increase of an additional 0.03%.

This increase is implemented in two tranches:

- a) A first tranche equivalent to two fifths of the total, payable within 20 business days as from 31 December 2013. This tranche was reduced as a result of the deductions stipulated by the regulations and was recorded, for an amount of €7,693 thousand, as an expense in the consolidated income statement for 2013.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- b) A second tranche equivalent to the remaining three fifths, amounting to €24,455 thousand, to be paid as from 1 January 2004 in accordance with the payment schedule set by the Management Committee within a maximum term of seven years. As mentioned in IFRIC 21, this expense was considered to accrue on the date that said Royal Decree-Law came into force (22 March 2013), since this contribution does not depend on the Parent Entity's future activity and should be recognized as a liability in full on said date, irrespective of the date of actual disbursement. The Entity paid €3,494 thousand on 30 September 2014. On 17 December 2014, the Management Committee of the Deposit Guarantee Fund for Credit Institutions, in accordance with the capacities conferred by the above-mentioned legislation, agreed that the remainder of said second tranche should be disbursed through two payments of equal amounts on 30 June 2015 and on 30 June 2016. On 30 June 2015 the Parent Entity paid €10,480 thousand. As at 31 December 2015, €10,480 thousand was outstanding, which was paid on 30 June 2016, thus the total amount of the second tranche has been paid.

In 2017, the expense incurred for all contributions to this Fund totalled €24,745 thousand (€20,671 thousand in 2016), which has been recognized under "Other operating expenses" in the accompanying consolidated profit and loss account (Note 57).

#### **11. Audit fees**

The cost of the contractual fees of PricewaterhouseCoopers Auditores, S.L. for external audit services in 2017 amounted to 510 thousand euros (486 thousand euros in 2016).

Other services provided by PricewaterhouseCoopers Auditores, S.L. and other firms associated with the PricewaterhouseCoopers trademark amounted to 273 thousand euros in 2017 (66 thousand euros in 2016). During 2017, the other services provided to the Group by PricewaterhouseCoopers Auditores, S.L., other than the audit of accounts, amounted to 266 thousand euros and corresponded to the Independent Auditor's Report on the Protection of Customer Assets required by the National Securities Market Commission's Circular 5/2009, dated 25 November, an Agreed Procedures Report on the level of compliance with the procedure designed by the Entity in relation to Royal Decree-Law 1/2017, dated 20 January, on urgent measures for the protection of consumers in relation to floor clauses, a Report on the degree of compliance of the Bank's manual of procedures in this area with the aforementioned Royal Decree-Law 1/2017, advice on the Internal capital adequacy assessment process (ICAAP) and the Internal liquidity adequacy assessment process (ILAAP) and a report on agreed procedures on certain information relating to the forms for targeted longer-term refinancing operations with specific objectives (TLTRO).

#### **12. Events after the balance sheet date**

As mentioned in note 2 to these consolidated annual accounts, on 1 January 2018, IFRS 9 - Financial Instruments entered into force. Note 2.3 details the main quantitative and qualitative impacts that the Group considers that this standard will have on its accounting figures.

In the period between 31 December 2017 until the date on which these consolidated annual accounts were prepared, no additional events have taken place that significantly affect the Group.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**13. Accounting principles and standards applied**

The most significant accounting principles and standards applied in the preparation of these consolidated annual accounts are described below:

a) Going concern

When drawing up the consolidated annual accounts it has been assumed that the companies in the Group will continue to operate as going concerns in the foreseeable future. Therefore the application of accounting standards does not aim to determine consolidated assets and liabilities for the purposes of their overall or partial transfer or the amount that would result in the event of liquidation.

b) Accruals principle

These consolidated annual accounts, except with respect to the consolidated cash flow statements, have been prepared on the basis of the real flow of goods and services, irrespective of the date of payment or collection.

c) Other general principles

The consolidated annual accounts have been drawn up using the historical cost method, albeit modified by the restatement, wherever appropriate, of land and buildings, performed on 1 January 2004, as described in Note 13.q, and of the fair value measurement of Financial assets available for sale and financial assets and liabilities (including derivatives).

The preparation of the consolidated annual accounts requires the use of certain accounting estimates. Similarly, Management is required to exercise judgement in the application of the Group's accounting policies. Estimates may affect the amount of assets and liabilities and the breakdown of contingent assets and liabilities at the date of the consolidated annual accounts and the amount of income and expenses over the period covered by the consolidated annual accounts. Although the estimates are based on Management's best understanding of the current and foreseeable circumstances, the final results could differ from such estimates.

d) Nature and operation of Financial derivatives

Financial derivatives are instruments that in addition to providing a loss or a gain may enable, under certain conditions, the offset of all or part of the credit and/or market risks associated with balances and transactions, using as underlying interest rates, certain indices, the prices of some securities, cross exchange rates or other similar references. The Group uses financial derivatives traded on organized markets or traded bilaterally with counter-parties on an over-the-counter (OTC) basis.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Financial derivatives are used to trade with customers who request them in order to manage the risks attaching to the Group's own positions (derivatives held for hedging) or in order to leverage changes in the relevant prices. Financial derivatives which may not be considered hedges are regarded as derivatives held for trading. The conditions that enable them to be accounted for as hedges are as follows:

- i) The financial derivative should cover the risk of changes in the value of assets and liabilities due to fluctuations in the interest rate and/or exchange rate (fair value hedge), the risk of changes in estimated cash flows resulting from financial assets and liabilities, highly probable foreseeable commitments and transactions (cash flow hedge) or the net investment risk in a foreign operation (hedging of net investment in foreign operations).
- ii) The financial derivative should efficiently eliminate any risk attached to the item or position hedged over the entire expected hedging period. Therefore it should have prospective efficiency, efficiency at the time the hedge is arranged under normal conditions and retrospective efficiency and there should be sufficient evidence that the efficiency of hedging will be maintained over the life of the item or position hedged.

In order to ensure the prospective and retrospective efficiency of hedging, the Entity conducts the relevant efficiency tests which evidence that the variation in the fair value of the hedge is highly comparable to the variation in the fair value of the hedged item. Therefore, in accordance with legislation in effect, it is assumed that the hedge is efficient when the accumulated variation in fair value of the hedging instrument varies from 80% to 125% of the accumulated variation in fair value of the hedged item. If a derivative complies at inception with the efficiency test and subsequently stops complying, it would thereafter be accounted for as a derivative held for trading and the hedging interruption rule would be applied.

- iii) Proper documentary evidence must be kept to show that the Financial Derivative was contracted specifically as a hedge for certain specific balances or transactions, as well as of the way in which such efficient hedging was aimed to be achieved and measured, as long as the method used is consistent with the Group's management of its own risks.

Hedges may be applied to individual items or balances or financial asset and liability portfolios. In this latter case, the set of financial assets or liabilities to be hedged should share the same type of risk, this being understood to be the case when sensitivity to interest rate fluctuations of the individual items hedged is similar.

The Parent Entity arranges hedging through different types of derivatives: interest rate, equity instruments, currency derivatives etc., on the basis of the underlying risk of the item to be hedged. The hedging instruments which may therefore be used are: Interest Rate Swaps (IRS), Call Money Swaps (CMS), FRAs, interest rate futures, bond futures, equity index futures, stock futures, foreign currency forwards, interest rate options, equity index options, share options, Forex Options, interest rate structure options, equity structure options and Equity swaps.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Hedging with derivative instruments arranged by the Group which generally speaking are considered fair value hedges aim to totally or partly cover the risk of changes in the fair value of certain liabilities or deposits issued by the Parent Entity with respect to changes in interest rates or the fair value of certain equity instruments in the available-for-sale financial asset portfolio.

The financial derivatives implicit in other financial instruments or other principal contracts are carried separately as derivatives when their risks and characteristics do not relate closely to the principal contracts and provided that such principal contracts are not classified under the Trading Portfolio and Other financial assets or liabilities at fair value with changes in the income statement.

In section e) Financial assets of this Note a description is provided of the measurement rules used for Financial derivatives.

e) Financial assets

Classification

Financial assets are classified in the consolidated balance sheet as follows:

- i) Cash, cash balances at Central Banks and other on demand deposits which correspond to cash balances and on demand deposits held with central banks and credit institutions.
- ii) Financial assets held for trading, which includes the financial assets that have been acquired in order to realise them in the short term. They form part of a portfolio of financial instruments identified and managed jointly for which actions have recently been carried out to obtain short-term gains or they are derivatives not designated as accounting hedges.
- iii) Financial assets designated at fair value through profit or loss which include the financial assets that, while not forming part of the financial assets held for trading, are regarded as hybrids and are carried in full at fair value and those which are managed jointly with insurance contract liabilities measured at fair value or with financial derivatives, the purpose or effect of which is to significantly reduce exposure to variations in fair value or which are managed jointly with financial liabilities and derivatives in order to significantly reduce interest rate exposure.
- iv) Available-for-sale financial assets which relate to debt securities not classified as held-to-maturity investments, designated at fair value through profit or loss, credits, loans and receivables or financial assets held for trading and equity instruments in companies which are not subsidiaries, associates or jointly-controlled entities and which have not been included in assets held for trading and financial assets designated at fair value through profit or loss categories.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- v) Loans and receivables which include the financial assets in respect of which while not being traded on an active market or not being obligatorily measured at fair value, cash flows involve a specific or determinable amount and in which the Group's entire outflow will be recovered, other than for reasons attributable to debtor solvency. It records the investment arising out of the typical credit activity, such as the cash amounts drawn down yet to be repaid by customers on loans or the deposits placed with other institutions, regardless of how they are instrumented legally, and unlisted debt securities, as well as the debt contracted by buyers of goods or users of services, which are part of the Group's business.
- vi) Held-to-maturity investments, which include debt securities traded on an active market with fixed maturities and determined or determinable cash payments that the Group has, both upon initial recognition and at all subsequent dates, as well as the positive intention and the proven ability to hold to maturity.
- vii) Derivatives – Hedge accounting that includes the financial derivatives purchased or issued by the group which qualify for consideration as accounting hedges.
- viii) Fair value changes of the hedged items in portfolio hedge of interest rate risk which relates to the balancing entry of the amounts credited to the consolidated income statement resulting from the measurement of the financial instrument portfolios which are efficiently covered with respect to the interest rate risk through fair value hedging derivatives.
- ix) Investments in joint ventures and associates which include equity instruments in associates, joint ventures and jointly-controlled entities.
- x) Assets under insurance or reinsurance contracts that correspond to the rights to be reimbursed by the insurance companies of part or all of the disbursement required in order to cancel a defined-benefit obligation when the insurance policies fail to meet the conditions to qualify as a Plan asset.
- xi) Non-current assets and disposal groups classified as held for sale relating to the carrying value of individual items, included in a disposal group or which form part of a business unit which is sought to sell (discontinued operations), the sale of which is likely to be effected under the current conditions of such assets within one year of the date to which these annual accounts refer. Therefore, the carrying value of these financial items will presumably be recovered through the price obtained upon disposal. There are other non-current non-financial assets for sale, the accounting treatment of which is described in Note 13.v).

Recognition and measurement

Generally financial assets are initially carried at cost. They are subsequently measured at the accounting close in accordance with the following criteria:

- i) Financial assets are measured at fair value except for loans and receivables, the held-to-maturity investments, equity instruments whose fair value may not be determined in a sufficiently objective manner, investments in dependent, joint ventures and associates and financial derivatives for which the underlying assets are such equity instruments and which are settled through the delivery of the same.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- ii) The fair value of a financial asset is understood to be the amount at which it may be delivered between duly informed interested parties in an arm's length transaction. The best evidence of fair value is the quote on an active market that is an organised, transparent and deep market.

Where there is no market price for a specific financial asset, fair value is estimated on the basis of the value established on recent transactions involving similar instruments and, alternatively, sufficiently verified valuation models. Similarly, the specific characteristics of the asset to be measured are taken into account and in particular, the different types of risks associated with the financial asset. Nonetheless, the actual limitations of the measurement models developed and the possible inaccuracies in the assumptions required by these models may mean that the fair value thus estimated of a financial asset does not exactly agree with the price at which it could be bought or sold at the measurement date.

- iii) The fair value of financial derivatives quoted on an active market is the daily price and if, for exceptional reasons, its price on a given date cannot be established, similar measurement methods may be used to those employed to measure OTC financial derivatives.

The fair value of OTC financial derivatives is the sum of future cash flows arising on the instrument and discounted at the measurement date using methods recognized by the financial markets.

- iv) Loans and receivables and the held-to-maturity investments are measured at amortized cost, using the effective interest rate method. Amortized cost is understood to be the acquisition cost of a financial asset as adjusted for the repayment of the principal and the part allocated to the income statement through the effective interest rate method of the difference between the initial cost and repayment value at maturity and less any impairment losses directly recognized as a decrease in the amount of the asset or through a value adjustment account. For Loans and receivables that are hedged in fair-value hedging operations, any changes that occur in their fair value relating to the risk or the risks being hedged by said hedging operations are recorded.

The effective interest rate is the discount rate which brings the value of a financial instrument exactly into line with estimated cash flows over the instrument's expected life on the basis of the relevant contractual conditions such as early repayment options, not taking into account losses resulting from future credit risks. For fixed- interest financial instruments, the effective interest rate agrees with the contractual interest rate established at the time of acquisition plus, if appropriate, the fees which, by nature, may be likened to an interest rate. For variable interest rate financial instruments, the effective interest rate agrees with the rate of return in effect for all items through to the first review of the reference rate.

- v) Holdings in the capital of other companies where the fair value cannot be calculated sufficiently objectively and the financial derivatives which have such instruments as their underlying asset and are settled by delivery of said instruments are stated at cost, corrected, as appropriate, to take into account any losses for impairment that they may have incurred.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Changes in the book amount of financial assets are generally recognized with a balancing entry in the consolidated profit and loss account, distinguishing between those arising from the accrual of interest and similar items, which are recognized under "Interest Income", and those corresponding to other causes, which are recognized, at their net amount, under "Gains or (-) losses on financial assets and liabilities held for trading, net" or "Gains or (-) losses on assets and liabilities designated at fair value through profit or loss" in the consolidated profit and loss account.

However, changes in the carrying amounts of the instruments included under "Available-for-sale financial assets" are recognized temporarily under "Other accumulated comprehensive income" in consolidated net equity unless they arise from exchange differences on monetary financial assets. The amounts included under "Other accumulated comprehensive income" remain in consolidated equity until they are derecognized from the asset in which they originate in the consolidated balance sheet, at which time they are reversed against the consolidated profit and loss account and recognized under " Profit or loss on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net".

In the case of Financial assets designated as hedges and hedged items, fair value differences are recognized as follows:

- i) For fair value hedges, differences in hedges and hedged items, with respect to the type of risk being hedged, are recognized directly in the consolidated income statement.
- ii) Measurement differences relating to the inefficient part of cash-flow hedges and net investment in foreign operation hedges are taken directly to the consolidated income statement.
- iii) For cash flow hedges, measurement differences arising on the efficient part of the cover of the hedges are temporarily recorded under Accumulated other comprehensive income to consolidated equity.
- iv) For net investment in foreign operation hedges, measurement differences arising on the efficient part of hedge cover are temporarily recorded under Accumulated other comprehensive income to consolidated equity.

In these latter two cases, measurement differences are not recognized as results until the gains or losses on the hedged item are recorded in the consolidated income statement or until maturity.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Reclassification between financial instrument portfolios

Reclassifications between financial instrument portfolios are made solely in the following circumstances:

- i) Except in the case of the exceptional circumstances indicated under paragraph iv) above, financial instruments classified as "Financial assets designated at fair value through profit or loss" cannot be reclassified either within or outside of this category of financial instruments once acquired, issued or assumed.
- ii) If, as a result of a change in the intention or the financial capacity, a financial asset ceases to be classified under the "Held-to-maturity investment portfolio" it is reclassified to the category "Financial assets available for sale". In this case, if the reclassified financial asset represents a significant amount in relation to the total amount of the assets included under the Held-to-maturity investment portfolio, the same treatment is applied to all financial instruments classified in the held-to-maturity investment portfolio, unless the reclassification falls under one of the cases allowed by legislation (sale very close to the maturity date or once practically all of the principal amount relating to the financial asset has been collected, etc.).

During 2017 and 2016 no sale not allowed by legislation applicable to financial assets classified as held-to-maturity was carried out.

- iii) As a result of a change in the Group's intention or financial capacity or, once the two year penalty period established by applicable legislation has elapsed in the event of the sale of financial assets classified under the Held-to-maturity investment portfolio, debt securities included under the category "Available-for-sale financial assets" may be reclassified to be "Held-to-maturity investment portfolio". In this case, the fair value of these financial instruments at the transfer date becomes their new amortized cost and the difference between this amount and the redemption value is taken to the profit and loss account by applying the effective interest rate method over the residual life of the instrument concerned.

During 2017 and 2016 no reclassification defined in the preceding paragraph took place.

- iv) A non-derivative financial asset can be reclassified out of the held for trading and available-for sale portfolios if it is no longer held for the purpose of being sold or repurchased in the short term, so long as one or more of the following circumstances is met:
  - a. In rare and exceptional circumstances, unless concerning assets that could have been included under the category of Loans and receivables. For these purposes, rare and exceptional circumstances are those that arise from a particular event that is unusual and highly unlikely to be repeated in the foreseeable future.
  - b. When the Group has the intention and financial capacity to maintain the financial asset for the foreseeable future or until maturity, provided that at initial recognition the definition of loans and receivables was met.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

If these situations are in place the asset may be reclassified at its fair value on the date of reclassification, without reversing results and considering this value to be its amortized cost. Assets reclassified in this manner cannot be reclassified again under the category of "Financial assets held for trading".

None of the financial assets included in the held for trading and available-for-sale portfolios were reclassified in either 2017 or 2016.

f) Financial liabilities

Classification

Financial liabilities are classified in the consolidated balance sheet as follows:

- i) Financial liabilities held for trading which includes the financial liabilities that have been issued for the purpose of buying them back on a current-asset basis, are part of a portfolio of financial instruments identified and managed jointly for which action has recently been taken to make short-term gains or are derivatives not designated as hedges in the accounts or originate in the firm sale of financial assets acquired on a current-asset basis or received as a loan.
- ii) Financial liabilities designated at fair value through profit or loss that relate to financial liabilities designated at initial recognition by the Group or when more relevant information is obtained upon recognition due to the fact that:
  - They eliminate or significantly reduce incoherency in the recognition or measurement that would arise by measuring assets or liabilities, or through the recognition of gains or losses, using different criteria.
  - A group of financial liabilities or financial assets and liabilities is managed and their yields are evaluated based on their fair value in accordance with a risk management strategy or documented investment strategy and information regarding the fair value of that group is disclosed to key members of Management.
- iii) Financial liabilities measured at amortized cost that correspond to the financial liabilities that do not fit into any of the other categories on the consolidated balance sheet and relate to operations typically carried out by financial institutions to bring in funds, regardless of how they are instrumented and their terms.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- iv) Derivatives – Hedge accounting that includes the financial derivatives purchased or issued by the group which qualify for consideration as accounting hedges.
- v) Fair value changes of the hedged items in portfolio hedge of interest rate risk which relates to the balancing entry of the amounts charged to the consolidated income statement resulting from the measurement of the financial instrument portfolios which are efficiently hedged against the interest rate risk through fair value hedging derivatives.
- vi) Liabilities under insurance or reinsurance contracts that relate to the technical reserves recorded by the Group to cover claims deriving from the insurance contracts which are in force at the year end.
- vii) Share capital repayable on demand, which includes the amount of the financial instruments issued by the Group that, although regarded as capital from a legal viewpoint, do not comply with the requirements to be classed as Equity. They are measured as financial liabilities designated at amortized cost unless the Group has designated them as financial liabilities designated at fair value through profit or loss if the conditions for doing so are met.

The Articles of Association of the Parent Entity establish that the repayment of the shares of the shareholders will be conditioned both by the favourable agreement of the Board of Directors of the Parent Entity and by the fact that this repayment will not result in insufficient coverage of the minimum share capital, equity or solvency ratio.

- viii) Liabilities included in disposal groups classified as held for sale which relate to creditor balances arising in Non-current assets for sale.

Recognition and measurement

Financial liabilities are recorded at amortized cost, as defined for financial assets in Note 13.e, except in the following cases:

- i) Financial liabilities included under the headings Financial liabilities held for trading and Financial liabilities designated at fair value through profit and loss are carried at fair value, as defined for financial assets under Note 13.e. Financial liabilities hedged through fair value hedges are adjusted by recording those variations in fair value in relation to the risk hedged in the hedging transaction, under the account "Microhedge transactions" under the heading to which those financial liabilities pertain.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- ii) Financial derivatives for which the underlying is an equity instrument whose fair value cannot be determined in a sufficiently objective manner and which are settled through their delivery are measured at cost.

Variations in the book value of financial liabilities are generally accounted for with the balancing entry in the consolidated profit and loss account, differentiating between those arising on the accrual of interest and similar charges, which are carried under “Interest expenses”, and those which relate to other causes, which are carried at net value under “Profit or loss on financial assets and liabilities held for trading, net” or “Profit or loss on financial assets and liabilities designated at fair value through profit or loss, net” in the consolidated profit and loss account.

Valuation differences in financial liabilities designated as hedged items and accounting hedges are recorded taking the criteria indicated for Financial assets in Note 13.e into account.

- g) Transfer and write-off of financial instruments from the consolidated balance sheet

The carrying value of financial assets is generally adjusted against the consolidated income statement when there is objective evidence that there are impairment losses. This is the case:

- i) If the risks and benefits are substantially transferred to third parties, such as unconditional sales, sales under a repurchase agreement at fair value at the date of repurchase, sales of financial assets with a call or put option written deeply out of money, asset securitizations in which the transferor does not retain subordinated financing or grant any type of credit enhancement to the new holders, etc., the transferred financial instrument is derecognized and any rights or obligations retained or created as a result of the transfer are recognized simultaneously.
- ii) If the risks and benefits associated with the transferred financial instrument are substantially retained, such as on the sale of financial assets under a repurchase agreement at a fixed price or at the sale price plus interest, securities lending contracts in which the borrower is required to repay the same or similar assets, etc., the transferred financial instrument is not derecognized from the consolidated balance sheet and continues to be measured using the same criteria used prior to the transfer. Nonetheless, the associated financial liability is recognized for accounting purposes for an amount equal to the consideration received which is measured subsequently at amortized cost, together with the revenue from the financial asset transferred but not written off and the expenses relating to the new financial liability.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- iii) If the risks and benefits linked to the financial instrument being transferred are neither substantially transferred nor substantially retained, as in the case of sales of financial assets with call and put options not written deeply in or out of money, securitizations of assets where the assignor assumes subordinate financing or any other kind of credit enhancement for a part of the asset transferred, etc., a distinction is made between:
- If the Group does not retain control of the financial instrument transferred, in which case it is written off the consolidated balance sheet and any right or obligation retained or created as a result of the transfer is recognized.
  - If the Group retains control of the financial instrument transferred, in which case it continues to recognize it in the balance sheet for an amount equal to its exposure to any changes in value and a financial liability associated with the financial asset transferred is recognized in an amount equal to the compensation received. This liability will be subsequently measured at its amortized cost, unless it meets the requirements to be classified as a financial liability at fair value through changes in profit and loss. As this does not constitute a present obligation, when calculating the amount of this financial liability a deduction will be made in the amount of financial instruments (such as securitization bonds and loans) owned by the Entity, and which constitute financing for the Entity, to which financial assets have been transferred, to the extent that these instruments specifically finance the transferred assets. The net amount of the asset transferred and associated liability will be the amortized cost of the rights and obligations retained if the asset transferred is measured at amortized cost or the fair value of the rights and obligations retained, if the asset transferred is measured at fair value.

Financial assets are, therefore, only written off the consolidated balance sheet when the cash flows they generate have been extinguished or when the risks and benefits they carry implicitly have been substantially transferred to third parties. Similarly, financial liabilities are only written off the consolidated balance sheet when the obligations that they generate have been extinguished or when they are purchased with a view to their cancellation or replacement.

In the consolidated financial statements for the 2017 and 2016 financial years, the Group fully consolidated the I.M. securitization funds. Caja Laboral 1, F.T.A. and I.M. Caja Laboral 2, F.T.A., to which the Group transferred certain loans in 2006 and 2008, respectively (see Notes 26 and 36).

However, the Group has not recognized, unless they are to be recorded as income from a transaction or a subsequent event, the financial assets and liabilities for transactions arising before 1 January 2004, other than derivative instruments, written off from the consolidated balance sheet under the former applicable legislation.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

h) Financial asset impairment

The carrying value of financial assets is generally adjusted against the consolidated income statement when there is objective evidence that there are impairment losses. This is the case where:

- i) For debt instruments, understood as loans and debt securities, when, following their initial recognition, there is an event or combined effect of various events which have a negative impact on the relevant future cash flows.
- ii) For equity instruments, when following their initial recognition, there is an event or the combined effect of various events, making it impossible to recover their carrying value.

As a general rule, the carrying value of financial instruments due to impairment is adjusted against the consolidated income statement for the period in which such impairment arises and the recovery of previously recorded impairment losses, if any, is recognized in the consolidated income statement for the period in which such impairment is eliminated or reduced. In the event that the recovery of any amount in respect of the impairment recorded is considered remote, such impairment is written off the consolidated balance sheet although the Group may carry out the necessary actions to attempt to secure collection until the definitive extinguishing of its debt claims due to lapsing, remission or other reasons.

The calculation of the impairment of financial assets is made based on the type of instrument and other circumstances that may affect them, once the guarantees received have been taken into account. The Group recognizes both corrective accounts, when provisions for insolvency are made to cover estimated losses, and direct write-downs against the asset, when the recovery is estimated to be remote. Generally, the recognition in the consolidated income statement of the accrual of interest on the basis of the contractual terms is interrupted for all debt instruments classified as impaired. If these interests are subsequently recovered, the amount collected is recognized on the consolidated income statement.

The criteria for impairment by type of instrument and portfolio are summarized below:

**Debt instruments measured at amortized cost and off-balance sheet exposures**

In order to determine impairment losses, the Group monitors borrowers individually, at least those who are significant borrowers, and collectively, for groups of financial assets that present similar credit risk characteristics that indicate of the capacity of the borrowers to pay their outstanding amounts. When a particular instrument cannot be included in any group of assets with similar risk characteristics, it will be analyzed on a solely individual basis to determine whether it is impaired and, if so, to estimate the losses due to impairment.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The Group has policies, methods and procedures to estimate the losses that may arise as a result of its credit risks, both due to insolvency attributed to counter-parties and due to country risk. These policies, methods and procedures are applied when granting, modifying, evaluating, monitoring and controlling the operations of debt instruments and off-balance sheet exposures, as well as in the identification of their possible impairment and, where applicable, when calculating the necessary amounts to cover such estimated losses.

Accounting classification based on credit risk attributable to insolvency

The Group has established criteria to identify borrowers who present weaknesses or objective evidence of impairment and classify them according to their credit risk.

The following sections develop the classification principles and methodology used by the Group.

1) Definition of the classification categories:

Debt instruments not included in the portfolio of financial assets held for trading, as well as off-balance sheet exposures, are classified, based on the credit risk due to insolvency, in:

- i) Standard exposures:
  - a. Operations which do not meet the requirements to be classified into other categories.
  - b. Standard exposure subject to special monitoring: This includes all transactions that, while not meeting the criteria for individual classification as doubtful or write-off, present weaknesses that may lead to incurring losses exceeding those on other similar transactions classified as standard exposures.
- ii) Doubtful risk:
  - a. As a result of borrower arrears: This category includes the amount of debt instruments, whatever their holder and guarantee, which have an amount past due by more than 90 days of principal, interest or contractually agreed expenses, unless they should be classified as being written off. Also included in this category are the guarantees given if the guaranteed party has fallen into arrears in the guaranteed transactions.

This category includes all the transactions of a holder when transactions with amounts with more than 90 days past due exceed 20% of the amounts outstanding. For the sole purpose of determining the percentage, considered in the numerator will be the gross amount of doubtful transactions as a result of borrower arrears and, in the denominator, the gross carrying amount of all transactions granted to the borrower. If the percentage calculated in this way exceeds 20%, both debt instruments and off-balance-sheet exposures involving credit risk of the holder shall be written off as doubtful due to late payment.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- b. Doubtful risk for reasons other than default of the holder: This includes debt instruments, whether due or not, in which, without the circumstances being present to classify them as bad or doubtful due to the default of the holder, there is reasonable doubt as to their total repayment (principal and interest) under the terms agreed in the contract; as well as off-balance sheet exposures not classified as doubtful due to the holder's default, for which payment by the Group is probable and their recovery is doubtful.

This category would include, among others, transactions whose borrowers are in situations that impair their creditworthiness.

- iii) Write-off risk: This category includes transactions, past due or not, for which, after an individualized analysis, their recovery is considered to be remote due to a noticeable or irrecoverable deterioration in the solvency of the operation or the borrower. The classification in this category will entail the full write-off of the gross carrying amount of the transaction.

2) Classification criteria for transactions:

The Group applies diverse criteria to classify borrowers and operations into different categories based on their credit risk. These categories include:

- Automatic criteria;
- Specific criteria for refinancing; and
- Criteria based on monitoring models under certain parameters.

The automatic factors and specific criteria for refinancing constitute a classification and cure process and are applied to the entire portfolio. Furthermore, and with the objective of early identification of the weaknesses and impairment of the transactions, the Group establishes a monitoring model that allows their corresponding treatment to be assigned, depending on the different levels of default risk.

For significant borrowers, a predictive model of non-payment is established, consisting of a system of variables/alerts with which it aims to detect future situations of non-payment by customers, calibrate and quantify their seriousness and establish different levels of probability of risk of non-payment. An expert team of risk analysts analyzes the borrowers with active alerts to draw conclusions about the existence of weaknesses or objective evidence of impairment and, in the case of evidence of impairment, whether the event or events causing the loss have an impact on the estimated future cash flows of the financial asset or its group.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Unless other reasons exist to classify them as doubtful risk, transactions classified as doubtful as a result of borrower arrears may be reclassified to standard exposures if, as a result of the collection of part of the overdue amounts, the causes that led to their classification disappear as doubtful risk and the borrower does not have amounts with more than 90 days past due in other transactions at the date of reclassification to the standard exposure category. If they are doubtful for reasons other than borrower arrears, they may be reclassified to standard exposure if the reasonable doubts about their full repayment under the contractual terms disappear and the borrower does not have amounts with more than 90 days past due in other transactions at the date of reclassification to the standard exposure category.

Refinancing and restructuring operations

Credit risk management policies and procedures applied by the Group guarantee detailed monitoring of borrowers, and demonstrate the need to make provisions when there is evidence of impairment to their solvency. For this purpose, the Group constitutes the insolvency provisions for transactions in which the borrower's circumstances requires them, prior to formalizing the restructuring/refinancing operations, which should be understood as follows:

- Refinancing operation: an operation which, whatever its owner or guarantees, is granted or used for economic or legal reasons related to current or foreseeable financial difficulties of the holder (or holders) to cancel one or more operations granted, by the entity itself or by other entities of its group, to the holder (or holders) or to another company or companies in its economic group, or by which the said operations are totally or partially paid, in order to enable holders of cancelled or refinanced operations the payment of debt (principal and interest) because they cannot, or are expected to be unable, to fulfil their payment in due time and proper form.
- Restructuring operation: the financial terms and conditions of an operation are amended for economic or legal reasons associated with current or foreseeable financial difficulties of the holder 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 terms that would be applied by other entities in the market for similar risks.

If a transaction is classified within a specific risk category, the refinancing transaction does not entail any automatic improvement in its risk assessment. For refinancing operating, its initial classification is established based on the characteristics of the operations, mainly that the borrower encounters financial difficulties, the fulfilment of certain clauses as well as long grace periods.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Subsequently to the initial classification, a reclassification into a lower risk category shall be considered if there is a significant evidence of improvement in the expected recovery of the operation, either because the borrower has been paying for a long period or the initial debt has been repaid in a significant percentage.

Hedging operations

The Group applies the criteria described below to calculate allowances and provisions for credit risk losses.

With regard to the transactions identified without negligible risk (fundamentally, transactions with central banks, general governments, public companies and financial entities, all whom are European Union countries or determined countries deemed to be risk-free), they are covered by 0%, except in the case of operations classified as doubtful, for which an individual estimate of impairment is made.

1) Individual estimates of allowances and provisions:

The following items must be estimated individually:

- i) Allowances and provisions for borrower transactions that are doubtful and that the Group considers to be significant. The Group has established a threshold of 3 million euros in terms of total risk exposure in order for borrowers to be considered significant.
- ii) The allowances of doubtful transactions that do not belong to a homogeneous risk group.
- iii) Allowances and provisions for transactions identified as being without negligible risk, classified as doubtful, whether due to arrears or for other reasons.

To estimate these provisions and allowances, certain criteria are used by analysts who assign the corresponding level of provisions depending on the specific situation of the client and the operation, based on:

- i) Cash flow generation: for debtors who are estimated as being capable of generating future cash flows through their own business activity, permitting through the development of their activity and the economic-financial structure of the borrower, the partial or full re-payment of the debt owed.
- ii) Recovery of collateral: debtors without the capacity to generate cash flows through their own business activities, with debt recovery being estimated through the foreclosure on collateral.

Likewise, the minimum coverage to be considered as an individualized estimate will be those that are applicable using the collective estimation criteria for doubtful risks, or in the case of operations of the promoter sector according to the criteria determined in Royal Decree-Law 2/2012 of 3 February.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

2) Collective coverage estimates:

The following items are subject to collective estimation:

- i) Exposures classified as normal risk (including those classified under special monitoring), except in cases where there are debtors, in which, without more than 90 days past due, the Group estimates, based on a detailed analysis of their economic-financial situation, that it is not considered doubtful for reasons other than borrower arrears, although it requires a reinforcement in the volume of provisions to be recorded higher than the resulting estimate from applying a collective provision calculation method depending on the credit risk segment to which the borrower belongs.

For those debtors who do not exceed the threshold of significance and who, moreover, have not been classified as doubtful, the Group has established parameters that, once surpassed, assume their automatic classification as normal risk subject to special monitoring (as general criteria basis, more than 30 days and less than 90 days past due with arrears exceeding the amount of 300 euros).

- ii) Exposures classed as doubtful, which are not evaluated through the individual estimation of coverage.

The impairment estimation process takes into account all credit exposures, both debt instruments and off-balance sheet exposures. In this regard, the Group has used the parameters and methodology established by the IFRS in force under a loss incurred methodology, as well as the rest of the local regulations in force, and which, based on the statistical data and models that aggregate the average performance of the banking sector entities in Spain and that support their full compatibility with the framework formed by IFRS, are applied to define the classification and calculation of the impairment of the balance sheet and off-balance sheet exposures. This methodology takes into account, among other things, the segment of credit risk to which the transaction belongs, effective collateral and personal guarantees received, the economic-financial situation of the debtor and, if applicable, the age of overdue amounts.

In estimates of credit risk allowances, the amount to be recovered from real estate collaterals will be the result of adjusting its reference value, by the adjustments necessary to adequately consider the uncertainty in its estimate and its reflection in potential value declines up to its execution and sale, as well as execution costs, maintenance costs and selling costs.

The Group determines the amount to be recovered from effective collateral by applying over its reference value the discounts estimated by the Bank of Spain in its Circular 4/2004, based on its experience and information from the Spanish banking sector.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Classification and coverage of credit risk due to country risk

Country risk is the risk arising in counterparties resident in a specific country for reasons other than normal commercial risk (sovereign risk, transfer risk or risks derived from international financial activity). The Group classifies transactions conducted with third parties into different groups depending on the economic changes of countries, their political situation, the regulatory and institutional framework and the payment capacity and experience, and assigns percentages of insolvency provisions, pursuant to that set forth in current regulations.

Assets considered doubtful due to the materialization of country risk are transactions in which the final borrowers are resident in countries experiencing long-term difficulties to meet their debt obligations, and the possibility of recovery is considered doubtful, as well as other off-balance sheet exposures whose recovery is considered remote due to circumstances attributable to the country.

The Group does not have provisions for this concept at the closure of 2017 and 2016, respectively.

Guarantees

Collateral and personal guarantees are defined as those which the Group is able to show as being valid as a means of mitigating credit risk. The analysis of the effectiveness of the collateral/guarantees takes into account, among others, the time required to execute them, the Group's capacity to do, as well as its previous experience in doing so.

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

In compliance with these conditions, collateral/guarantees can be defined as:

- i) Real estate mortgages, provided they are the first mortgage:
  - a. Complete buildings and parts thereof:
    - Housing.
    - Offices, commercial premises and multi-purpose industrial buildings.
    - Other buildings, such as single-purpose industrial buildings and hotels.
  - b. Urban land and regulated building land.
  - c. Other real estate.
- ii) Collateral in the form of pledged financial instruments:
  - Cash deposits
  - Debt securities and equity instruments issued by creditworthy issuers.
- iii) Other types of collateral:
  - Personal property received as collateral.
  - Second and subsequent mortgages of properties.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- iv) Personal guarantees, which imply the direct and joint liability of the guarantors to the client, and it is these persons or entities whose liquidity has been sufficiently proved for the purposes of guaranteeing the full amortization of the transaction under the terms agreed.

The Group has collateral assessment criteria for assets located in Spain aligned with current regulations. In particular, the Group applies selection and contracting criteria of appraisers that are geared towards assuring the independence of the appraisers, and the quality of the appraisals. For this purpose, all of the appraisal companies are registered in the Bank of Spain Special Registry and the assessments are carried out according to the criteria established in Ministerial Order ECO/805/2003 on standards for the appraisal of real estate and certain rights for financial purposes.

The real estate collaterals for credit operations and properties are appraised when they are granted or registered, the latter through a purchase, foreclosure or in lieu of payment and when the asset has suffered a significant reduction in value. In addition, the updating criteria established in Bank of Spain Circular 4/2004, modified by Circular 4/2016, are applied, including the annual updating of doubtful and foreclosed risks as a general rule.

**Debt securities measured at fair value**

The amount of impairment losses incurred in debt securities included under Available-for-sale financial assets is equal to the positive difference between their acquisition cost, net of any repayment of the principal, and their fair value less any impairment loss previously recognized in the consolidated income statement.

When there is objective evidence that the decline in fair value is attributable to impairment, the latent losses recognized directly under “Accumulated other comprehensive income” to consolidated equity are recorded immediately in the consolidated income statement. If subsequently all or part of the impairment losses are recovered, the amount involved is recognized, in the consolidated income statement for the recovery period.

In the case of debt securities classified as available-for-sale financial assets and/or held for trading, the Group deems the assets impaired in the event of principal or coupon payments past due by more than 90 days, capital losses of over 40% with respect to cost or ratings downgrades.

For debt securities classified under the heading Non-current assets and disposal groups classified as held for sale, any losses previously recognized in consolidated equity are considered realised and are recycled to the consolidated profit and loss account at the time of their classification.

**Equity instruments**

The amount of impairment losses incurred in equity instruments included under Available-for-sale financial assets is equal to the positive difference between their acquisition cost and their fair value less any impairment loss previously recognized in the consolidated income statement.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

When there is objective evidence that the decline in fair value is attributable to impairment, the latent losses recognized directly under Accumulated other comprehensive income to consolidated equity are recorded immediately in the consolidated income statement. If subsequently all or part of the impairment losses are recovered, the amount involved is recognized, under “Accumulated other comprehensive income” to consolidated equity.

The Group considers that there is evidence of impairment of equity instruments classified as available-for-sale financial assets when continuous capital losses arise over an uninterrupted period of 18 months and reach, at the time of the observation, a percentage higher than 40%.

For equity instruments classified under the heading Non-current assets and disposal groups classified as held for sale, any losses previously recognized in consolidated equity are considered realised and are recycled to the consolidated income statement at the time of classification as such.

Impairment losses on equity instruments carried at acquisition cost are measured at the difference between their carrying amounts and the present value of expected future cash flows, discount at market yields for similar securities. These impairment losses are recognized in the consolidated income statement in the year in which they arise by directly writing down the cost of the financial asset. They cannot be reversed unless the impaired assets are sold.

In the case of equity investments in jointly controlled entities and associates, the Group estimates impairment losses by comparing the investments’ recoverable and carrying amounts. These impairment losses are recognized in the consolidated profit and loss account in the year in which they arise and any subsequent reversals are similarly recognized in the consolidated profit and loss account in the year in which the impairment reversal occurs.

i) Measurement of foreign currency accounts

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

Set out below are the equivalent values in Euro of the total assets and liabilities denominated in foreign currency held by the Group at 31 December 2017 and 2016:

	2017		2016	
	Assets	Liabilities	Assets	Liabilities
US Dollars	59,841	27,762	62,406	24,162
Pounds sterling	4,389	1,152	7,034	711
Japanese yen	2,243	112	1,965	33
Swiss franc	679	126	1,210	199
Other	1,297	366	1,221	344
	<b>68,449</b>	<b>29,518</b>	<b>73,836</b>	<b>25,449</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The equivalent value in thousands of euros of the foreign currency assets and liabilities classified by type, held by the Group as at 31 December 2017 and 2016 is as follows:

	2017		2016	
	Assets	Liabilities	Assets	Liabilities
Cash, cash balances at central banks and other on demand deposits	18,330	-	8,652	-
Available-for-sale financial assets	36,099	-	48,901	-
Loans and receivables	14,020	-	16,283	-
Financial liabilities measured at amortized cost	-	28,016	-	24,751
Commitments and guarantees given	-	1,502	-	698
	<b>68,449</b>	<b>29,518</b>	<b>73,836</b>	<b>25,449</b>

When initially recognized, debtor and creditor balances denominated in foreign currency are translated to the functional currency using the spot exchange rate at the date of recognition, understood as the exchange rate for immediate delivery. After initial recognition, the following rules are applied to translate balances denominated in foreign currency to the functional currency:

- i) Monetary assets and liabilities are converted at the year end exchange rate, understood as the average spot exchange rate at the date to which the financial statements relate.
- ii) Non-monetary items measured at cost are converted at the exchange rate on the date of acquisition.
- iii) Non-monetary items measured at fair value are converted at the exchange rate on the date on which fair value is determined.
- iv) Income and expenses are converted by applying the exchange rate on the transaction date. Nonetheless, the average exchange rate for the period is used for all transactions carried out in that period, unless there have been significant fluctuations. Depreciation/ amortization is translated at the exchange rate applied to the relevant asset.

Exchange differences arising on translation of debtor and creditor balances denominated in foreign currency are generally recorded in the consolidated income statement. Nonetheless, in the case of exchange differences that arise on non-monetary items measured at fair value, for which the fair value adjustment is recorded under Accumulated other comprehensive income to consolidated Equity, the component of the exchange rate relating to the revaluation of the non-monetary element is broken down.

Balances in the annual accounts of investees where the functional currency is not the Euro are translated to Euro as follows:

- i) Assets and liabilities are converted through the application of the year-end exchange rate.
- ii) Income and expenses and cash flows are converted at the average exchange rates for the year.
- iii) Equity is converted at historical exchange rates.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Exchange differences resulting from the translation of the Investees' annual accounts where the functional currency is not the Euro are recorded under Accumulated other comprehensive income to consolidated Equity.

None of the functional currencies of the Investees relates to economies deemed highly inflationary according to the criteria established in this respect. Therefore, at the 2017 and 2016 accounting close, there has been no need to adjust the financial statements of any Investee to correct them for the effects of inflation.

j) Recognition of income and expenses

Income and expenses relating to interest and similar items are generally carried on an accruals basis and under the effective interest rate method. Dividends received from other companies are taken to income when the right to receive them vests.

Fees paid or collected for financial services, irrespective of their denomination under contract, are classified in the following categories that determine the manner in which they are allocated in the income statement:

- i) Financial fees are those that form an integral part of the return on or effective cost of a financial transaction and are allocated to the consolidated profit and loss account over the expected life of the transaction as an adjustment to cost or the effective return on the same. Among them we can mention the commissions for the opening of asset products, the commissions for credit surpluses and the commissions for the overdraft of liability accounts. Accrued financial fees in 2016 amounted to €5,030k (€5,916k in 2016).

Financial fees on operations formalized each year are deferred, as indicated above, insofar as they do not offset the direct costs of the operations in question. Fees taken to results in 2017 and 2016 to offset the direct costs of operations formalized are included under "Other operating income" in the consolidated income statement (Note 56).

- ii) Non-financial fees are those derived from the provision of services and may arise in the provision of a service performed over a period of time and in the provision of a service performed in a single act (see Notes 49 and 50).

Income and expenses in respect of fees and similar items are recorded in the consolidated income statement generally in accordance with the following:

- i) Those related to financial assets and liabilities measured at fair value with changes in the income statement are recorded at the time of collection.
- ii) Those that relate to transactions or services which are carried out during a period of time are recorded during the period in which such transactions or services take place.
- iii) Those that relate to a transaction or service which is carried out in a single act are recorded when the relevant act takes place.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Non-financial income and expenses are recorded on an accruals basis. Collections and payments deferred over more than one year are accounted for at the amount resulting from financially discounting the expected cash flows at market rates.

k) Offset of balances

Debtor and creditor balances arising on transactions which under contract or Legislation, provide for possible offset and the intention is to liquidate them at their net amount or realise the asset and pay the liability simultaneously, are presented in the consolidated balance sheet at the net amount.

l) Financial guarantees

A financial guarantee contract is an agreement that requires the issuer to make specific payments to reimburse the creditor for any loss incurred when a specific debtor fails to comply with repayment obligations in accordance with the original or amended conditions of a debt instrument, regardless of their legal form, which may be, among others, a guarantee, financial surety, insurance policy or credit derivative.

The entity issuing financial surety agreements recognizes them under “Financial liabilities measured at amortized cost - Other financial liabilities” at their fair value plus transaction costs that are directly attributable to the issue of the instrument, unless involving contracts issued by insurance companies.

Initially, unless evidence indicates otherwise, the fair value of a financial guarantee contract issued to a non-associated third party within an isolated transaction under conditions of mutual independence, is the premium received plus, if appropriate, the present value of cash flows to be received, applying an interest rate that is similar to that applied to financial assets granted by the Entity for similar terms and at similar risk levels. At the same time the present value of the future cash flows yet to be received is recognized as a credit on the asset side of the balance sheet, using the aforementioned interest rate.

After initial recognition the contracts are treated in accordance with the following criteria:

- i) The value of commissions or premiums to be received for financial guarantees is updated by recording the differences in the consolidated income statement as financial income.
- ii) The value of financial guarantee contracts that have not been classified as doubtful is the amount initially recognized under liabilities less the portion attributed to the consolidated income statement on a straight line basis over the expected life of the guarantee, or in accordance with other criteria, provided that they more adequately reflect the perception of the benefits and financial risks deriving from the guarantee

The classification of a financial guarantee contract as doubtful means that it will be reclassified to the heading “Provisions – Commitments and guarantees given”, which is measured by applying the provisions of Note 13.h, above.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR  
ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

m) Leases

Lease contracts are presented on the basis of the economic substance of the transaction, irrespective of its legal form, and are classified from inception as finance or operating leases.

- i) A lease is considered a finance lease when all the risks and benefits attaching to the ownership of the assets subject to the contract are substantially transferred.

Whenever the Group acts as a lessor of an asset, the sum of the present values of the amount that will be received from the lessee plus the guaranteed residual value, usually the purchase option price when the lease terminates, are recorded as financing provided to third parties. It is therefore included in the heading loans and receivables on the consolidated balance sheet, in accordance with the nature of the lessee.

When the Group acts as the lessee, the cost of the leased assets is recorded in the consolidated balance sheet, on the basis of the nature of the asset covered by the contract, and at the same time, a liability is booked for the same amount, which will be the lower of the fair value of the leased asset or the sum of the present value of the amounts payable to the lessor, plus, if appropriate, the purchase option exercise price. These assets are depreciated using similar rates as those applied to property, plant and equipment for own use as a whole.

Financial income and expenses arising on these contracts is credited and charged respectively, to accounts in the consolidated income statement such that the return is consistent over the contract term.

- ii) Lease contracts which are not considered finance leases are classified as operating leases.

When the Group acts as the lessor, the acquisition cost of the leased assets is recorded under Tangible assets - Property, plant and equipment. Such assets are depreciated in accordance with the policies adopted for similar property, plant and equipment for own use and the income from lease contracts is recognized in the consolidated profit and loss account on a straight-line basis.

When the Group acts as the lessee, lease expenses, including the incentives granted, if appropriate, by the lessor, are recorded on a straight-line basis in the consolidated income statement.

n) Equity managed

Equity managed by the Group which is owned by third parties is not included in the consolidated balance sheet. Fees generated by this activity are recorded under the heading Fee and commission income in the consolidated income statement (Note 49).



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

ñ) Investment funds and pension funds managed by the Group

The investment funds, pension funds and EPSV managed by the Group are not recorded on the consolidated balance sheet because their equity is owned by third parties (Note 69). Fees accrued in the year with respect to services rendered to these funds by the Group (capital management services, portfolio deposit, etc.) are recorded under Fee and commission income on the consolidated income statement (Note 49).

o) Staff costs and post-retirement remuneration

Remuneration paid to employees upon the termination of their employment is considered post-employment remuneration. Post-employment remuneration, including remuneration covered through internal or external pension funds, is classified as defined contribution plans or defined benefit plans on the basis of the conditions attaching to the relevant obligations, taking into account all the commitments taken on included in and excluded from the terms formally agreed with employees.

Post-employment remuneration is recognized as follows:

- i) In the consolidated income statement: the cost of services provided by employees, both during the year and in prior years (where not recognized in prior years), net interest on the provision (assets), and the gain or loss arising on settlement.
- ii) In the consolidated statement of changes in equity: the new valuations of the provision (asset) resulting from consolidated actuarial gains or losses, the return on plan assets which have not been included in net interest on the provision (asset), and variations in the present value of the asset resulting from changes in the present value of the flows available to the Group, which are not recorded in the net interest on the provision (asset). The amounts recognized in the consolidated statement of changes in equity will not be reclassified to the consolidated income statement in future years.

Accordingly, defined benefit plans are recognized in the consolidated income statement as follows:

- a) Current service costs, as staff expenses.
- b) Net interest on the provision, as interest expenses.
- c) Net interest on assets, as interest income.
- d) Past service costs, as appropriations to provisions or (-) reversal of provisions.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

PD II

As a result of the process of integration of Caja Laboral and Ipar Kutxa (see Note 1), in 2012 the Parent Entity formalized a plan called "PD II", approved by the Governing Board of the extinct Caja Laboral and aimed at a specific group of Caja Laboral's working partners, with a period of validity from 1 January 2013 to 31 December 2018. This new plan is voluntary and only applicable to the group to which it is addressed and once the willingness of the worker member to join it has been expressed in writing.

The main characteristics of this new scheme are as follows:

- i) members born between 1953 and 1954 are entitled to receive a specific payment/financial benefit when they retire upon turning 60 or 61, in keeping with an option exercised at the time of signing the corresponding contract. Those born in 1955 can also avail of this option in which case they have to retire at the age of 60 (members born in 1955 do not have the option of retiring at 61).
- ii) exclusively for members born between 1953 and 1957 that sign up between 1 and 4 January 2013, entitlement to certain special labour conditions and receipt of a specific payment/financial benefit that will accrue until the member retires.

The commitment accrued at years-end 2017 and 2016 is recognized in the item "Provisions – Pensions and other post-employment defined benefit obligations" on the consolidated balance sheet at that date (Note 38).

PD 58

Likewise, in 2016 the Parent Entity formalized a plan called "PD 58", approved by the Governing Board and aimed at a specific group of Caja Laboral Popular Coop. de Crédito's working partners, with a period of validity from 1 January 2017 to 30 June 2020. This new plan is voluntary and only applicable to the group to which it is addressed and once the willingness of the worker member to join it has been expressed in writing.

The main characteristic of this new scheme is as follows:

- i) it established the possibility for members born in 1958 to receive a specific financial consideration/assistance at the time of the cessation of their activity on reaching the age of 60 or 61, in accordance with the option they had exercised at the time of signing the corresponding contract.

The commitment, accrued at the 2017 and 2016 years-end, is recognized in the item "Provisions – Pensions and other post-employment defined benefit obligations" on the balance sheet at that date (Note 38).

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

New Network

In the 2016 and 2017 financial years, the Parent Entity defined specific working and economic conditions for a certain group of members of Caja Laboral Popular Coop. de Crédito. Under this plan, certain members have subscribed to certain labour conditions and to receive a specific payment/financial benefit that will accrue until the date of termination of member's services.

The commitment, accrued at the 2017 and 2016 years-end, is recognized in the item "Provisions – Pensions and other post-employment defined benefit obligations" on the balance sheet at that date (Note 38).

PD 59

Also, in 2017 the Parent Entity formalized a plan called "PD 59", approved by the Governing Board and aimed at a specific group of Caja Laboral Popular Coop. de Crédito's working partners, with a period of validity from 1 January 2018 to 30 June 2021. As with the previous plans, this new scheme is voluntary and targeted exclusively at certain individuals subject to a written request from them to sign up for the programme.

The main characteristic of this new scheme is as follows:

- i) it established the possibility for members born in 1959 to receive a specific financial consideration/assistance at the time of the cessation of their activity on reaching the age of 60 or 61, in accordance with the option they had exercised at the time of signing the corresponding contract.

The commitment accrued at year-end 2017 is recognized in the item "Provisions – Pensions and other post-employment defined benefit obligations" on the consolidated balance sheet at that date (Note 38).

Severance payments

Under current Spanish labour legislation, the Group is required to make indemnity payments to employees terminated without just cause. There are no labour force reduction plans making it necessary to record a provision in this connection.

- p) Corporate income tax

Corporate income tax is considered to be an expense and is recorded under the heading Tax expenses or (-) income related to profit from continuing operations in the consolidated income statement.

The corporate income tax expense is determined by tax payable calculated with respect to the tax base for the year, taking into account the variations during that year deriving from temporary differences, deductions and credits and tax losses. The tax base for the year may differ from the consolidated net surplus for the year since it excludes income and expense items which may be taxed or deducted in other years and items which are at no time taxed or deducted.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Deferred tax assets and liabilities relate to those taxes which are expected to be payable or recoverable in the differences between the carrying value of the assets and liabilities in the financial statements and the relevant tax bases. They are recorded using the liability method in the consolidated balance sheet and are quantified by applying to the temporary difference or credit involved the tax rate at which it is expected to be recovered or assessed.

A deferred tax asset, such as deferred tax, a credit in respect of deductions and rebates and a credit in respect of tax losses, is recognized provided that the Group is likely to obtain sufficient taxable income in the future against which to realize it. It is considered probable that the Group will obtain sufficient tax income when, inter alia:

- i) There are deferred tax liabilities which may be cancelled in the same year as that in which the deferred tax asset may be realized or in a subsequent year in which the existing tax loss or tax loss resulting from the amount advanced may be offset.
- ii) Tax losses have arisen due to the reasons identified and are unlikely to arise again.

Nonetheless, the deferred tax asset resulting from the recording of investments in Subsidiaries, Jointly-controlled entities or Associates is only recognized when its future realization is probable and sufficient tax income is expected to be obtained in the future against which to apply it. Nor is a deferred tax asset recognized when an equity item is initially recorded which is not a business combination, which at the time of recognition has not affected the accounting or tax results.

Deferred tax liabilities are always recorded, except when goodwill is recognized or they arise on recording investments in Subsidiaries, Jointly-controlled entities or Associates if the Group is able to control the time of reversal of the temporary difference and, moreover, such temporary difference is unlikely to reverse in the foreseeable future. Nor is a deferred tax liability recognized when an equity item is initially recorded which is not a business combination, which at the time of recognition has not affected the accounting or tax results.

At each accounting close deferred tax assets and liabilities are reviewed in order to verify that they are still valid and make the relevant adjustments.

To conduct the above-mentioned analysis, the following variables are taken into consideration:

- Forecasts of the results of each Entity that, where applicable, gave rise to the possibility of recording deferred tax assets (since there is no tax consolidation group), based on the financial budgets approved by the Governing Bodies of each one, subsequently applying constant growth rates estimated by the Management of each Entity.
- Estimation of the reversal of temporary differences, based on their nature, and;
- The term or deadline established by current laws for the reversal of the various tax assets.

Income or expenses recognized directly in the consolidated statement equity that do not affect profits for tax purposes are recorded as temporary differences.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

q) Tangible assets

Tangible assets include: property, plant and equipment held by the Group for current or future use which is expected to be used for over one year, property, plant and equipment transferred to customers under operating leases, tangible assets associated with community projects and investment properties, which include assets held in order to be leased out. The tangible assets are measured at acquisition cost less the relevant accumulated depreciation and, if appropriate, any impairment loss resulting from comparing the net value of each asset and the relevant recoverable amount. The acquisition cost of certain freely available property, plant and equipment for own use includes their fair value measurement at 1 January 2004 in accordance with Transitional Provision One of Circular 4/2004. That fair value at 1 January 2004 has been obtained based on independent expert valuations.

For foreclosure assets, the acquisition cost relates to the net amount of the financial assets delivered in exchange.

Depreciation is calculated systematically on a straight-line basis, by applying the estimated useful lives of the assets to cost less residual value. Land on which buildings and other constructions stand is understood to have an indefinite life and therefore no depreciation is charged. Annual depreciation charges in respect of property, plant and equipment are recorded against the consolidated income statement and are calculated on the basis of the following average estimated useful lives of the different asset groups:

	<u>Years of estimated useful life</u>
Buildings and estates	33 - 50
Furniture	7 - 10
Installations	7 - 10
Machinery, electronic equipment and other	4 - 6

At each accounting close, the Group analyzes whether there are any internal and external indications that the net value of property, plant and equipment exceeds the relevant recoverable amount. In this case, the Group reduces the carrying value of the relevant asset to its recoverable amount and adjusts future depreciation charges in proportion to the adjusted carrying value and new remaining useful life if it is necessary to re-estimate it. Moreover, when there is an indication that the value of an asset has been recovered, the Group records the reversal of the impairment loss recorded in prior periods and adjusts future depreciation charges accordingly. The reversal of the impairment loss of an asset in no event may entail an increase in its carrying value in excess of that which would be obtained if such prior year impairment losses had not been recognized.

At least at the end of each year the Group reviews the estimated useful lives of property, plant and equipment for own use in order to detect significant changes in the same which, if any, are adjusted through the relevant adjustment to the amount recorded in future consolidated income statements in respect of the depreciation charge in accordance with the new estimated useful life.

Conservation and maintenance expenses of property, plant and equipment for own use are recorded in the consolidated income statement in the year in which they are incurred.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Investment properties on tangible assets correspond to the net values of the land, buildings and other constructions that the Group has to let out or to earn a capital gain on their sale as a result of the increases in their respective market prices.

The criteria applied by the Group to recognize the acquisition cost of the assets assigned under operating lease with respect to depreciation and the estimate of their respective useful lives and the recording of impairment losses, agree with the those described for tangible assets for own use.

r) Intangible assets

Intangible assets are non-monetary assets which are identifiable but have no physical appearance. Intangible assets are considered identifiable when they may be separated from other assets because they may be sold, leased or disposed of individually or they derive from a contract or other type of legal business. An intangible asset is recognized when, in addition to conforming to the above definition, the Group considers the flow of economic benefits from that asset probable and its cost may be reliably estimated.

Intangible assets are recognized initially at acquisition or production cost and are subsequently measured at cost less, if appropriate, accumulated amortization and any impairment loss.

Goodwill represents the advance payment made by the Group for future financial benefits deriving from the assets of a company that has been acquired, which cannot be individually and separately identified and recognized and is only recognized if it has been acquired for valuable consideration in a business combination.

Positive differences between the cost of the shareholdings in the capital of Subsidiaries, Jointly-controlled entities and Associates with respect to the relevant carrying values acquired, adjusted at the date of the first consolidation, are allocated as follows:

- i) If they are assignable to specific equity items of the entities acquired, they are assigned by increasing the value of the assets or reducing the value of the liabilities, the market value of which is higher or lower, respectively, than the net carrying values in the predecessor balance sheets and whose accounting treatment is similar to that of the Group's same assets and liabilities, respectively.
- ii) If they are assignable to specific intangible assets, they are allocated through their explicit recognition on the consolidated balance sheet provided that their fair value at the acquisition date may be determined reliably.
- iii) Remaining differences which may not be allocated are recorded as goodwill which is assigned to one or more specific cash generating units.

Any negative differences between the cost of the Parent Entity's equity investments in jointly controlled entities and associates and the carrying amounts of the net assets acquired, as restated on the date of first-time consolidation, are accounted for as follows:

- i) If the differences can be allocated to specific assets or liabilities of the acquired Entities they are accounted for as an increase in the value of any liabilities or a reduction in the value of any assets whose fair values are higher or lower, respectively, than their carrying amounts and whose accounting treatment is similar to that of the Group's liabilities and assets, respectively.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- ii) Any remaining amounts that cannot be allocated are recognized in the consolidated income statement in the year in which the equity investment is made.

Other intangible assets are classified as having a defined useful life and are depreciated over their remaining estimated useful life using similar criteria to those used to depreciate property, plant and equipment.

The Group recognizes potential impairment losses on these assets with a balancing entry in the consolidated income statement. The criteria used to recognise impairment losses on intangible assets and any potential reversal of impairment losses recognized in prior years are similar to those used in respect of property, plant and equipment impairment.

- s) Inventories

Inventories are non-financial assets held by the Group for sale in the ordinary course of business, are going through the production, construction or development process with this end in mind or are going to be consumed in the production process or when providing services. Inventories include, therefore, land and other properties that are held by the Group for sale as part of its property development business.

Inventories are stated at the lower of cost, which includes all the costs incurred in acquiring and transforming them and any other direct and indirect costs, which have been incurred in order to bring them to their present condition and location, and their net realisable value. Net realizable value is defined as the estimated sale price of the inventories in the ordinary course of business, less the estimated cost of completing their production and the costs involved in selling them.

The cost of inventories that cannot ordinarily be exchanged for others and of the assets and services produced and segregated for specific projects is calculated by identifying their itemized costs under the FIFO method.

The amount of any restatement of inventories, for damage, obsolete items and decrease in the sale value, to their net realizable value and any losses under any other headings is charged to expenses in the consolidated income statement for the year the impairment or loss occurs. Any later recoveries in value are taken to the consolidated income statement for the year in which they occur.

The carrying value of inventories is written off the consolidated balance sheet and is charged to expenses in the consolidated income statement in the year the income from their sale is recognized. The indicated expenses are included under the heading Other operating expenses in the consolidated income statement.

- t) Insurance transactions

Subsidiaries which are insurance companies credit to the consolidated income statement the amounts of the premiums written and charge to the consolidated income statement the cost of the claims that they have to settle at the date of final settlement. Similarly, the amounts credited to the consolidated income statement and not accrued at that date and the costs incurred not charged in the consolidated income statement are accrued at the closing each year.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The most significant technical reserves connected with direct insurance activity are as follows:

- i) Unearned premium reserve which relates to the tariff premium collected in one year attributable to future years following the deduction of the loading for contingencies.
- ii) Unexpired risk reserve which complements the Unearned premium reserve when the Unearned premium reserve is insufficient to reflect the measurement of the risks and expenses to be covered that relate to the unexpired coverage period at the year end.
- iii) Technical reserve for claims which relates to the estimated measurement of outstanding obligations deriving from the claims occurred prior to the year end. This technical reserve includes claims pending settlement or payment and claims not yet reported. Outstanding obligations are calculated by deducting payments on account and taking into account the internal and external claims settlement expenses and, if appropriate, the additional provisions which may be needed to cover deviations in the measurement of claims involving long processing periods.
- iv) Life insurance technical reserve:
  - For life insurance where the coverage period is equal to one year or less, the unearned premium reserve relates to the tariff premium collected assignable to future years. When that technical reserve is not sufficient, an unexpired risk reserve is calculated which complements and covers the measurement of forecast risks and expenses in the period which has not expired at the year end date.
  - For life insurance for which the coverage period is more than one year, the Mathematical reserve is calculated as the difference between the present actuarial value of future obligations and those of the policyholder or insured, taking as a basis for the calculation of the inventory premium accrued in the year which comprises the risk premium plus the administration expenses charge according to the technical bases.
  - For life insurance where the investment risk is assumed by the policy holder, the technical reserve is determined on the basis of the assets specifically assigned in order to determine the value of the rights.
- v) Technical reserve for share in profit and returned premiums which relates to the benefits accrued to policyholders, insured or beneficiaries of the insurance and that for premiums that should be returned to policyholders or insured parties in accordance with the performance of the insured risk until they have been assigned individually to each of the former.
- vi) Claims equalization reserve which relates to the amount provided each year in respect of the specific loadings for contingencies for certain lines of insurance, up to the limit envisaged in the technical bases and which is cumulative in nature.

The reserves for accepted reinsurance are calculated in accordance with criteria which are similar to those applied in direct insurance and generally on the basis of the information provided by the ceding entities.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Technical provisions, in respect of direct insurance and accepted reinsurance alike, are included within the heading Liabilities under insurance or reinsurance contracts on the consolidated balance sheet. However, technical provisions in respect of possible future claims that are not the result of insurance contracts in existence at the reporting date, such as the Equalization Reserve, are not recognized within 'Liabilities under insurance or reinsurance contracts' on the consolidated balance sheet.

Amounts to which the Group is entitled under reinsurance contracts are recorded in Assets under insurance or reinsurance contracts on the consolidated balance sheet. These assets are determined on the basis of the same criteria as those used for direct insurance, in accordance with the contracts in force. The Group verifies whether said assets are impaired, in which case it recognizes the relevant loss directly in the consolidated income statement against said heading.

u) Provisions and contingent liabilities

The Group's present obligations resulting from past events are considered provisions when their nature is clearly defined at the date of the financial statements but the amount or time of settlement are not defined, and upon the maturity of which and in order to settle them the Group expects an outflow of resources which include economic benefits. Such obligations may arise due to the following:

- i) A legal or contractual provision.
- ii) An implicit or tacit obligation arising from a valid expectation created by the group vis-à-vis third parties with respect to the assumption of certain types of liabilities. Such expectations are created when the Group publicly accepts liabilities, and derive from past performance or business policies that are in the public domain.
- iii) The virtually certain development of certain aspects of legislation, in particular, legislative bills which the group will be unable to circumvent.

The Group's possible obligations resulting from past events, the existence of which is conditional on the occurrence or otherwise of one or more future events beyond the Group's control are contingent liabilities. Contingent liabilities include the Group's present obligations the settlement of which is unlikely to give rise to a decrease in resources that bring in economic benefits or the amount of which, in extremely rare cases, cannot be sufficiently reliably quantified.

Provisions and contingent liabilities are classified as probable when the likelihood of occurrence is greater than that of not occurrence, possible when the likelihood of occurrence is less than that of not occurrence, and remote when their occurrence is extremely rare.

The Group includes in the consolidated annual accounts all significant provisions and contingent liabilities with respect to which it considers that it is more likely than not to have to fulfil the obligation. Contingent liabilities classified as possible are not recognized in the consolidated accounts. Rather, they are disclosed unless the likelihood of a decrease in resources that bring in financial gain occurring is deemed to be remote.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Provisions are quantified taking into account the best available information concerning the consequences of the event that originated them and are estimated at each accounting close. They are used to address the specific obligations for which they were recognized and may be reversed in full or in part when such obligations no longer exist or decrease.

At 31 December 2017 and 2016 the Group may have to address certain litigations, responsibilities and obligations deriving from the ordinary performance of its operations. The Group's legal advisors and the Parent Entity's directors understand that the finalization of these proceedings and claims will not have a significant effect other than that provided for, if appropriate, in the consolidated annual accounts for the years in which they finalize.

v) Non-current assets and liabilities included in disposal groups classified as held for sale

The heading Non-current assets and disposal groups classified as held for sale in the consolidated balance sheet includes assets of any nature that, while not forming part of the Entity's operating activities, include amounts that are expected to be realized or recovered in more than one year after the date classified under this heading.

When on an exceptional basis the sale is expected to take place in more than one year, the Group evaluates the selling costs in present terms and records the increase in value deriving from the passage of time under the heading Profit or (-) Loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations in the consolidated profit and loss account.

Therefore the carrying value of these items, which may be financial and non-financial in nature, will presumably be recovered through the price obtained on their disposal, instead of ongoing use.

Therefore, the fixed assets or other long-term assets received by the Group to pay off all or part of the payment obligations of its debtors with regard to the Group are deemed non-current assets for sale, unless the Group has decided to use these assets on an ongoing basis.

Furthermore, Liabilities included in disposal groups classified as held for sale include the credit balances associated with the disposal groups or the discontinued operations of the Group.

The assets classified as Non-current assets and disposal groups classified as held for sale are generally measured at the lower of the carrying value at the time they are considered such and fair value net of the estimated selling costs of such assets, except those of a financial nature that are measured in accordance with the provisions of Note 13.e.xi). While they are classed as Non-current assets and disposal groups classified as held for sale, tangible and intangible assets which are depreciable/amortizable by nature are not depreciated/ amortized.

In the case of foreclosed real estate assets or assets received in payment of debts, regardless of the legal form used, they are initially recognized at the lower of the carrying amount of the financial assets applied, i.e. their amortized cost, taking into account their estimated impairment, and their fair value at the time the asset is foreclosed or received less estimated costs to sell, which is to be understood as the market value granted in full individual valuations less costs to sell.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

All the legal process expenses shall be recognized immediately in the Income statement for the period in which they are accrued. The registration expenses and taxes paid can be added to the recorded initial value when with this the valuation value less the estimated selling expenses referred to in the previous paragraph is not exceeded. All costs incurred between the date of adjudication and the date of disposal due to maintenance and protection of the asset, such as insurance or security services, will be recognized in the consolidated income statement for the period in which they are accrued.

After adjudication or receipt, the reference valuation is updated, which serves as the beginning for the estimation of the fair value. For the purpose of determining fair value net of costs of sales, the Group takes into account both valuations made by different valuation companies registered in the Special Registry of Bank of Spain and discounts on the reference value estimated by Bank of Spain, based on its experience and information from the Spanish banking sector. Also, when the property has a fair value less than or equal to 250,000 euros, updating is made by automated valuation models. In any case, when these properties reach a permanence of three years in balance sheet they will be updated, in any case, by means of a full appraisal. In addition, the appraisal company, which makes the valuation update, will be different from the one that made the previous one.

In the event that the carrying value exceeds the fair value of the assets net of selling costs, the Group adjusts the carrying value of the assets by that excess amount, with a balancing entry under consolidated Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations in the consolidated profit and loss account. In the event that there are subsequent increases in the fair value of the assets, the Group reverses the previously recorded losses and increases the book value of the assets up to the limit of the amount just prior to their possible impairment, with a balancing entry under Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations in the consolidated profit and loss account.

**Discontinued operations**

Discontinued operations are components of the Group that have been disposed of or classified as held for sale and which:

- Represent a line of business or geographical area which is significant and separate from the rest.
- Are part of a single coordinated plan to dispose of a line of business or geographical area which are significant and separate from the rest.
- Are subsidiaries acquired solely in order to be resold.

Income and expenses generated by Groups' components considered as discontinued operations are recorded under the heading profit or loss after tax from discontinued operations in the consolidated income statement, both when the business has been derecognized and when it continues to be recorded under assets at the end of the year. If subsequent to being presented as discontinued operations, operations are classified as continuing, their income and expenses are presented both in the consolidated income statement for the year and in the comparative year published in the consolidated annual accounts, under the corresponding items according to their nature.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

w) Consolidated cash flow statement

The consolidated cash flow statement uses certain terms with the following definitions:

- i) Cash flows are inflows and outflows of cash and cash equivalents, understood as short-term investments which are highly liquid and involve a low risk of changes in value.
- ii) Operating activities which are the Group's typical activities and other activities which may not be classified as investing or financing and the interest paid for any financing received, even if relating to financial liabilities classified as financing activities.
- iii) Investing activities are those activities relating to the acquisition, sale or disposal through other means of long-term assets and other investments not included in cash and cash equivalents, property, plant and equipment, intangible assets, shareholdings, non-current assets and associated liabilities available-for-sale, equity instruments classified as available-for-sale that relate to strategic investments and financial assets included in the held-to-maturity investment portfolio.
- iv) Financing activities are the activities that give rise to changes in the size and composition of consolidated equity and the liabilities that do not form part of operating activities.

The Group regards the balances included under "Cash, cash balances at central banks and other on demand deposits" in the consolidated balance sheets as cash and equivalents.

x) Cooperative Training, Promotion and Education Fund (FEP)

The Promotion and Education Fund is recorded under "Other liabilities" in the consolidated balance sheet.

Appropriations to that fund which, in accordance with the Law on Cooperatives and the Parent Entity's Articles of Association are mandatory, are accounted for as an expense for the year although quantified on the basis of the surplus for the year. The additional amounts that may be appropriated on a discretionary basis will be recognized as an application of the surplus for the year.

Grants, donations and other assistance related to the Cooperative Training, Promotion and Education Fund in accordance with the law or funds deriving from the levying of fines by the cooperative to members which, under applicable legislation, are related to said fund, will be recognized as cooperative income and an appropriation will be made to said fund for the same amount.

The application of the Cooperative Training, Promotion and Education Fund for the purpose for which it was set up will lead to its write-off normally by credit to cash accounts. When its application is through activities typical of a credit institution, the amount of the Cooperative Training, Promotion and Education Fund will be reduced and income will be simultaneously recognized in the credit cooperative's income statement in accordance with normal market conditions for that type of activities.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The Fund's property, plant and equipment is included under Tangible assets and is carried at restated cost in accordance with the rules described in paragraph r) above, less the relevant accumulated depreciation.

Property, plant and equipment is depreciated based on cost or restated cost, as appropriate, on a straight-line basis over the estimated useful lives of each asset group and using the rates described in paragraph q) above.

- y) Consolidated statement of changes in equity and statement of recognized income and expenses

These statements presented in these consolidated financial statements show all changes affecting equity during the year. The main characteristics of the information contained in both statements is set out below:

- i) Consolidated statement of recognized income and expenditure

This statement presents the revenues and expenses generated by the Group as a result of its activities during the year, making a distinction between those recorded as results in the consolidated income statement for the year and other revenues and expenses recorded, in accordance with the provisions of current legislation, directly under consolidated equity.

Therefore, this statement presents:

- a) The consolidated profit or loss for the year.
- b) The net amount of revenues and expenses recognized on a transitional basis as accumulated other comprehensive income under consolidated equity.
- c) The amount of revenues and expenses definitively recognized under consolidated equity.
- d) Corporate income tax accrued for the reasons indicated in paragraphs b) and c) above.
- e) Total recognized revenues and expenses, calculated as the sum of the aforementioned paragraphs.

Changes in recognized revenues and expenses under consolidated equity as measurement adjustments break down as follows:

- a) Valuation gains or (-) loss taken to equity: records the amount of revenues, net of expenses originating during the year, recognized directly under consolidated equity. The amounts recognized during the year under this account are maintained there, even if during that year they are transferred to the consolidated income statement at the initial value of other assets or liabilities or are reclassified to another heading.
- b) Transferred to profit or loss: records the amount of measurement gains or losses previously recognized under consolidated equity, even if during the same year, that are recorded in the consolidated income statement.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- c) Transferred to initial carrying amount to hedged items: records the amount of measurement gains or losses previously recognized under equity, even if during the same year, at the initial value of the assets or liabilities as a result of cash flow hedges.
- d) Other reclassifications: records the amount of transfers made during the year among accumulated other comprehensive income accounts in accordance with the criteria established in current legislation.

The amounts of these headings are presented at gross, reflecting the relevant tax effect under the heading "Income tax" in that statement.

ii) Consolidated statement of total changes in equity

This statement presents all movements recorded under consolidated equity, including those that originate from changes in accounting policies and error corrections. This statement therefore shows a reconciliation of the carrying value at the start and end of the year of all items that form part of consolidated equity, grouping movements based on their nature under the following accounts:

- a) Effects of changes in accounting policies and effects of error corrections: this includes changes in equity that arise as a result of the retroactive restatement of the balances in the financial statements originating from changes in accounting policies or error corrections.
- b) Total comprehensive income for the year: this records the aggregate total of items recognized in the statement of consolidated recognized revenues and expenses indicated above.
- c) Other changes in equity: this records all other items recorded under consolidated equity, such as capital increases or decreases, distribution of results, transactions involving treasury shares, payments involving equity instruments, transfers between consolidated equity accounts and any other increase or decrease affecting consolidated equity.

aa) Business combinations

Business combinations are transactions as a result of which two or more entities or businesses join to form a single entity or group of companies.

When the business combination entails the creation of a new entity that issues shares to the owners of two or more combining entities, the acquirer shall be identified from one of the entities formerly in existence and the transaction shall be accounted for in the same manner as one in which one entity acquires another.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The Group applies the acquisition method to account for business combinations. The consideration transferred for the acquisition of another company is the fair value of the assets transferred, the liabilities incurred vis-à-vis the former owners of the acquisition and the equity interests issued by the Entity. The consideration transferred includes the fair value of any asset or liability arising from an agreement covering contingent considerations. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair value at the acquisition date. The Entity recognizes any non-controlling interest in the acquisition on an acquisition-by-acquisition basis, either at fair value or at the non-controlling interest's proportionate share of the recognized amounts of the acquirer's identifiable net assets.

Costs related to the acquisition are recognized as expenses in the financial year in which they were incurred.

Any contingent consideration payable by the Entity is recognized at its acquisition-date fair value. Subsequent changes to the fair value of the contingent consideration that is deemed to be an asset or liability is recognized in accordance with IAS 39 either in profit and loss or as a change in equity. Contingent consideration that is classified as part of consolidated equity is not remeasured, and its subsequent settlement is accounted for within equity.

Goodwill is initially valued as the surplus between the total consideration transferred and fair value of the non-controlling interest in the net identifiable assets acquired and the liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized in profit or loss.

The date of the business combination marks the start of a one-year period called the 'measurement period' during which the acquirer can adjust the provisional amounts recognized once it has all the information necessary to complete the estimates made when preparing the first set of consolidated annual financial statements issued after the date of the business combination.

ab) Goodwill

A positive difference between the cost of a business combination and the acquired portion of the net fair value of the assets and contingent liabilities of the acquired entity is recognized on the balance sheet as goodwill. Goodwill represents a payment made by the Group in anticipation of the future economic benefits from assets of an acquired entity that are not capable of being individually or separately identified and recognized. Goodwill is recognized only if it has been purchased for valuable consideration through a business combination. Goodwill is not amortized, but at the end of each accounting period it is subjected to analysis for any possible impairment that would reduce its fair value to below its stated net cost and, if found to be impaired, is written down against the consolidated income statement.

In order to detect possible signs of goodwill impairment, measurements are made based mainly on the distributed profit discount method, taking into account the following parameters:

- Key business assumptions. The cash flow projections used in the measurement are based on these assumptions. For businesses with financial activities, variables are projects, such as the evolution of lending, non-performing loans, customer deposits and interest rates in a forecast macroeconomic scenario, and capital requirements.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- Estimated macroeconomic variables and other financial values.
- Term of the projections. The projection term/period is generally five years to arrive at a recurring level of profits and yields, taking into account the economic scenario existing at the measurement date.
- Discount rate. The present value of future dividends used to calculate value in use is calculated using as a discount rate the entity's cost of capital ( $K_e$ ) from the viewpoint of a market participant. It is determined using the CAPM method, based on the formula: " $K_e = R_f + \beta \times (\text{company's systemic risk ratio} \times R_m) + \alpha$ " where  $R_f$  = Expected market yield and  $\alpha$  = Non-systemic risk premium".
- Growth rate used to extrapolate the cash flow projections beyond the period covered by the most recent forecasts, based on long-term estimates of the main macroeconomic figures and of the key business variables, while taking into account the financial market situation at all times, estimating a 1% growth rate to perpetuity.

Goodwill impairment losses are not subsequently reversed.

#### **14. Customer ombudsman**

This Department addresses queries, complaints and claims filed by customers through the pertinent channels.

The department has officially two months to settle the written queries, complaints or claims filed although the Entity has undertaken to address such matters with the utmost diligence, before the end of that period.

Concerning the activity of the Customer Care Service of the parent entity, Caja Laboral Gestión, S.G.I.I.C., S.A. and Caja Laboral Pensiones, S.A.G.F.P., 15,748 cases were brought in 2017 (3,609 in 2016), of which 14,131 were admitted (3,393 in 2016), which were responded to. 1,617 cases were not admitted (216 in 2016) for the reasons set out in the Customer Care Service Regulations as grounds for rejecting complaints or claims.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

	<b>2017</b>	<b>2016</b>
<b>No. case files opened</b>		
- In writing: brochure / letter	12,996	2,424
- Internet	1,475	1,054
- By telephone	2	2
- Public bodies: OMIC / Regional Governments	1,275	129
	<b>15,748</b>	<b>3,609</b>
<b>No. case files processed</b>	<b>14,131</b>	<b>3,393</b>
<b>Nature of the Files</b>		
- Complaints	11,986	2,686
- Claims	3,367	508
- Queries	12	14
- Suggestions	6	3
- Letters of congratulation / gratitude	1	2
- Sundry petitions	376	396
	<b>15,748</b>	<b>3,609</b>
	<b>2017</b>	<b>2016</b>
<b>Amounts claimed</b>		
- Amounts relating to cases for which the decision favoured the Entity	6,394	269
- Amounts relating to cases for which the decision favoured the Customer:	129	373
. Indemnities paid by the Entity	129	371
. Indemnities paid by third parties	-	2
. Amounts returned to customers, recovered by the Entity	-	-
	<b>6,523</b>	<b>642</b>

Noteworthy is the fact that the reasons for claims focused on the following:

	<b>2017</b>	<b>2016</b>
Economic terms	9%	20%
Commissions and expenses	83%	23%
Missing or inaccurate information	1%	20%
Centralized customer services	1%	8%
Information missing or incorrect	1%	10%
Coverage of needs	1%	2%
Aspects of customer relations	1%	3%
Campaigns in general	-	1%
Other:	3%	13%
- Swift and efficient service at branches	-	1%
- Swift and efficient service at ATMs	1%	3%
- Miscellaneous	2%	8%
- Swift handling of formalities	-	1%
	<b>100%</b>	<b>100%</b>

With respect to the amounts claimed, the percentages are as follows:

	<b>2017</b>	<b>2016</b>
= < €10	0.01%	0.10%
> 10 <= €60	0.09%	0.71%
> 60 <= €100	0.04%	0.30%
> 100 <= €250	0.13%	0.93%
> 250 <= €1,000	8.48%	3.52%
> €1,000	91.25%	94.44%

The increase in the number of complaints on clauses related to mortgage transactions explains the change in the volume of complaints to the Customer Service Department in 2017.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

With respect to the Customer Service activity of Seguros Lagun Aro Vida, S.A., 32 complaints and claims were received in 2017 (27 in 2016) and 29 cases were processed in 2017 (29 in 2016). The main grounds for the claims and complaints were disagreements over compensation and redemptions. The results of the cases handled in respect of those classified as admissible in the course of 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
In favour of the customer	11	10
In favour of the Entity	17	16
Others	<u>1</u>	<u>3</u>
	<u>29</u>	<u>29</u>

The cost for the Entity of total complaints and claims favourable to customers has amounted to €15,802 in 2017 (€4,992 in 2016). Complaints and claims have on average been addressed within 7 days (15 days in 2016).

With respect to the Customer Ombudsman Department of Seguros Lagun Aro Vida, S.A., during the year 681 claims and complaints were made (765 in 2016), of which 691 were processed during 2017 (768 in 2016). The main reasons for the complaints or claims were disagreements over compensation, delays in the provision of services and the price of insurance.

The results of the cases handled in respect of those classified as admissible in the course of 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
In favour of the customer	269	355
In favour of the Entity	400	377
Others	<u>22</u>	<u>36</u>
	<u>691</u>	<u>768</u>

The cost for the Entity of total complaints and claims favourable to customers has amounted to €32,569 in 2017 (€54,897 in 2016). The average response time in 2017 was 8 days (13 days in 2016).

Concerning the activity of the Customer Care Service of Caja Laboral Bancaseguros O.B.S.V., S.L.U., 31 complaints and claims were received during the year (9 in 2016), and 30 cases were processed during 2017 (9 in 2016). The main reasons for the complaints or claims were disagreements over compensation, delays in the provision of services and the price of insurance.

The results of the cases handled in respect of those classified as admissible in the course of 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
In favour of the customer	1	4
In favour of the Entity	6	2
Others	<u>23</u>	<u>3</u>
	<u>30</u>	<u>9</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The cost for the Entity of total complaints and claims favourable to customers has amounted to 0 euros in 2017 (€316 in 2016). The average response time in 2017 was 2 days (6 days in 2016).

**15. Credit risk**

Credit risk is the risk of loss due to failure by the counterparty to make payments due to the Laboral Kutxa Group, in part or in full, or outside the agreed terms. From a management perspective, Laboral Kutxa distinguishes between the credit risk arising from the Treasury and Capital Markets activity (financial institutions and private fixed income) and the credit risk with Government Authorities, arising from traditional investment activity.

In relation to the latter, the Parent Entity's Board of Directors has delegated to the Main Operations Committee the maximum powers for all the amounts and risk figures, as well as the authorization of defaults without limit on the amount. The Main Committee delegates powers to the Executive Committee, which in turn delegates to the Risk Management Department and the Commercial Network. The network's capacity to sanction risk is based on the level of risk and an alert system that takes into account factors such as the volume of risk, type of product and the margin of the operation.

The Risk Area, reporting to the General Manager, integrates the Risk Management, Monitoring and Recovery, Global Risk Control and Legal Departments. This has led to an increase in the efficiency of the processes for the admission, monitoring and recovery of credit risk and has strengthened the integrated control over the Parent Entity's risks.

With regard to Domestic and Commercial Credit Risk, all these matters are specified in the Risk Policy Manual, the latest update of which was approved by the Governing Board on 31 January 2018, and other related documents such as: Credit Risk Manual - Summary, and Manual of Good Practices in the Granting of Domestic Risks and MAP.

These documents determine the procedures for the granting, controlling and monitoring of credit risk and describe the usable predictive models, their variables, weighting, and capacities and criteria for sanctioning risks, the acceptance process, and risk mitigation and reduction policies.

The control mechanisms implemented by the Parent Entity for the control of the effective monitoring of the above-mentioned policies, methods and procedures are based on the Global Risk Control Systems implemented in the Parent Entity, as well as on the independent supervision of the Internal Audit Department, ensuring the quality of the risk acceptance and management systems.

The Risk Management Department, through the Large Companies Risk Analysis and SME Risk Analysis sections, is responsible for the acceptance and follow-up of the portfolio companies. The objective of the Amicable and Pre-litigation Recovery section is to manage the protocols associated with pre-default alerts in non-portfolio companies as well as maximizing recoveries during the amicable phase (< 75 days of non-payment) and the pre-litigation phase (> 75 days of non-payment), while the Global Risk Control Department is responsible for developing and maintaining the internal models, as well as the measurement and control of structural interest rate and liquidity risk, market risk and operational risk. Finally, the Legal Counsel Department gives advice and legal documentary coverage for risk operations both in the initial stages and in possible debt refinancing or restructuring, as well as for the management of the recovery in litigation and the Entity's legal defence against claims by third parties and customers.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

To evaluate the credit risk associated with the various operations, Laboral Kutxa has developed internal rating and scoring models that enable customers (rating) or operations (scoring) to be distinguished on the basis of their level of risk. For individuals the reactive risk acceptance process is based on binding scorings which are complemented using proactive pre-grant models, on the basis of the rating, of consumer loans automatically available to the customer in the various channels. For corporate customers the acceptance processes utilize a dual analyst/manager arrangement, with a customer/analyst portfolio assignment. For taking decisions, analysts have available the internal ratings and a pre-default alert model. Internal models are, therefore, a basic factor in appraising risk and allow the Group to estimate both the expected loss and the regulatory capital allocated to each operation.

These internal models, prepared by the Risk Control Department and submitted to systematic reviews, are employed, therefore, in the decision process and, additionally, for the construction and development of integrated databases that allow calculations to be made of the severity, expected losses, capital consumption, etc., in the framework of the requirements of the New Basel Agreement on Capital. Moreover, both the scoring models and the rating models allow the Entity to calculate the risk Premium and the pricing of the various Company operations with Individuals.

In the area of policies for risk mitigation and reduction, this is achieved through various paths:

- In the admission process, although the admission criteria are based upon the borrowers' capacity to pay, in the calculation of which the internal models are essential protagonists, guarantees constitute the second means for collection. Bearing in mind that the majority of investment activity is related to home financing, the principal guarantee is the mortgage and the LTV relationship of the operations is particularly valued. Guarantee in the form of backing is very important, and cash deposits and financial assets as guarantees have lesser specific weighting.
- In the monitoring process, the Entity possesses internal pre-default models that allow prediction of payment default situations, so that those positions with a high default probability are managed in a proactive manner.
- In recovery management a procedure has been implemented that covers the intervention of various agents in the recovery of the default, depending upon the time phase in which the default operation lies. Within this context, it should be noted that in recovery management both internal agents (offices, tele-bank, pre-trial and litigation) act along with external agents (collection agencies).

In general, the Parent Entity measures real estate security at its appraised value, having established a policy of updating the value of property that meets the requirements laid down by Bank of Spain regulations.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

With respect to credit risk with financial institutions and private fixed interest securities in the Treasury and Capital Markets area, ordinary limits are set annually by counterparty, concentration by reference and manager, and by country. To this end, a procedure for allocating limits based on external ratings and an alert system has been implemented. All of this is reflected in the documents "Treasury Area Risks and CM" and its Annexes, approved by the Governing Board, and which establishes the risk policy of Treasury and Capital Markets of the Entity.

Below is the breakdown by counterparty of the Loans and Receivables - Customers as at 31 December 2017 and 2016, with a list of the amount covered by each of the main guarantees and the distribution of the secured financing by the percentage of the book value of the financing over the amount of the latest appraisal or valuation of the available guarantee:

**2017**

	Total	Of which: Real estate collateral	Of which: Other collateral	Loans with real guarantee. Carrying amount on the latest available valuation ( <i>loan to value</i> )				
				Less than or equal to 40%	Greater than 40% and less than or equal to 60%	Greater than 60% and less than or equal to 80%	Greater than 80% and less than or equal to 100%	> 100%
Government Bodies	228,962	36,356	377	139	16,182	5,521	-	14,891
Other financial companies and individual entrepreneurs	18,700	-	344	-	-	-	-	344
Other non-financial companies and individual entrepreneurs	2,386,038	680,072	301,767	436,972	236,538	147,620	38,083	122,626
– Property construction and development	84,640	75,248	209	2,776	12,486	15,319	11,002	33,874
– Public works construction	59,176	3,662	2,350	3,541	1,026	1,005	214	226
– Other purposes	2,242,222	601,162	299,208	430,655	223,026	131,296	26,867	88,526
– Large corporates	302,072	28,010	6,244	11,919	721	814	623	20,177
– SMEs and individual entrepreneurs	1,940,150	573,152	292,964	418,736	222,305	130,482	26,244	68,349
Other households	10,685,744	9,924,329	30,864	2,707,417	3,065,446	3,028,991	548,137	605,202
– Homes	9,985,115	9,753,039	10,461	2,609,329	3,018,895	3,002,340	543,343	589,593
– Consumer loans	374,951	37,826	837	26,972	6,607	2,615	448	2,021
– Other	325,678	133,464	19,566	71,116	39,944	24,036	3,346	13,588
<b>TOTAL</b>	<b>13,319,444</b>	<b>10,640,757</b>	<b>333,352</b>	<b>3,144,528</b>	<b>3,318,166</b>	<b>3,182,132</b>	<b>586,220</b>	<b>743,063</b>
MEMORANDUM ITEM								
Loan refinancing and restructuring transactions	304,602	227,547	19,856	33,495	52,381	52,774	31,467	77,287

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**2016**

	Total	Of which: Real estate collateral	Of which: Other collateral	Loans with real guarantee. Carrying amount on the latest available valuation ( <i>loan to value</i> )				
				Less than or equal to 40%	Greater than 40% and less than or equal to 60%	Greater than 60% and less than or equal to 80%	Greater than 80% and less than or equal to 100%	> 100%
Government Bodies	330,924	40,425	377	-	16,976	1,318	3,307	19,201
Other financial companies and individual entrepreneurs	22,487	-	604	-	-	-	-	604
Other non-financial companies and individual entrepreneurs	2,335,091	747,050	322,794	468,658	252,462	148,543	54,394	145,787
– Property construction and development	92,628	91,754	479	6,409	12,720	13,842	19,623	39,639
– Public works construction	72,649	8,958	3,230	4,119	1,679	1,887	2,571	1,932
– Other purposes	2,169,814	646,338	319,085	458,130	238,063	132,814	32,200	104,216
Large corporates	251,062	34,654	8,005	9,908	1,944	3,614	149	27,044
SMEs and individual entrepreneurs	1,918,752	611,684	311,080	448,222	236,119	129,200	32,051	77,172
Other households	10,757,571	10,141,782	31,928	2,694,152	2,987,540	2,855,529	613,796	1,022,693
– Homes	10,184,861	9,958,863	9,595	2,591,725	2,940,036	2,823,986	606,993	1,005,718
– Consumer loans	358,627	46,525	1,401	31,792	9,045	3,341	493	3,255
– Other	214,083	136,394	20,932	70,635	38,459	28,202	6,310	13,720
<b>TOTAL</b>	<b>13,446,073</b>	<b>10,929,257</b>	<b>355,703</b>	<b>3,162,810</b>	<b>3,256,978</b>	<b>3,005,390</b>	<b>671,497</b>	<b>1,188,285</b>
MEMORANDUM ITEM Loan refinancing and restructuring transactions	327,626	244,868	19,959	39,720	51,038	56,120	41,001	76,948

A breakdown of the maximum credit risk covered by each of the primary guarantees at 31 December 2017 and 2016 is set out below:

	2017							
	Real estate collateral	Pledge guarantee	Other real guarantees	Secured or insured personal guarantee	Unsecured personal guarantee	Unclassified	Valuation adjustments	Total
<b>Customer loans and advances</b>								
Drawn down	11,708,843	21,148	370,803	652,591	1,765,774	(737,567)	(384,288)	13,397,304
Value of the guarantee	28,616,935	31,559	1,470,315	652,591	231,576	-	-	31,002,976
	2016							
	Real estate collateral	Pledge guarantee	Other real guarantees	Secured or insured personal guarantee	Unsecured personal guarantee	Unclassified	Valuation adjustments	Total
<b>Customer loans and advances</b>								
Drawn down	11,127,088	21,224	398,992	624,608	1,625,540	148,385	(449,042)	13,496,795
Value of the guarantee	28,928,276	31,704	1,637,995	624,608	167,168	-	-	31,389,751

The value of guarantees received to ensure collection of operations with customers, distinguishing between real guarantees and other guarantees at 31 December 2017 and 2016 is as follows:

Value of guarantees received	2017	2016
Value of real guarantees	30,087,250	30,566,271
Of which: guarantees doubtful risks	1,104,144	1,504,725
Value of other guarantees	915,726	823,480
Of which: guarantees doubtful risks	6,823	5,119
<b>Total value of guarantees received</b>	<b>31,002,976</b>	<b>31,389,751</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The following is information about the value of the financial guarantees granted at 31 December 2017 and 31 December 2016:

	2017	2016
<b>Loan commitments granted</b>	960,576	893,307
<i>Of which: amount classified as doubtful</i>	8,127	2,729
Amount recorded in liabilities	-	-
<b>Financial guarantees granted</b>	93,520	108,848
<i>Of which: amount classified as doubtful</i>	15,683	16,615
Amount recorded in liabilities	20,992	25,411
<b>Other commitments granted</b>	280,463	302,663
<i>Of which: amount classified as doubtful</i>	-	-
Amount recorded in liabilities	-	-

In line with Bank of Spain recommendations on transparency in financing for construction and real estate promotion, financing for home acquisition and assets acquired in payment of debt and the valuation of the markets financing needs and using the disclosure models established in Circular 5/2011, of 30 November, by the Bank of Spain, the Group includes the following information:

a) Exposure to the construction and real estate promotion sector.

Financing destined to construction and real estate and coverage at 31 December 2017 and 2016 was as follows:

	2017		
	Gross carrying amount	Excess gross exposure over maximum recoverable amount of effective real guarantees	Accumulated impairment value
<b>Financing to construction and real estate promotion (businesses in Spain)</b>	<b>157,013</b>	<b>82,667</b>	<b>71,284</b>
Of which, doubtful	120,735	65,450	70,032
<b>Memorandum item:</b>			
Failed assets	328,436		
<b>Memorandum item:</b>	<b>Amount</b>		
- Loans to clients, excluding Government Bodies (businesses in Spain)	13,090,482		
- Total assets (total businesses)	22,435,790		
- Impairment and provisions for normal rated exposures (total businesses)	95,308		

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

	<b>2016</b>		
	<b>Gross carrying amount</b>	<b>Excess gross exposure over maximum recoverable amount of effective real guarantees</b>	<b>Accumulated impairment value</b>
<b>Financing to construction and real estate promotion (businesses in Spain)</b>	<b>195,600</b>	<b>90,128</b>	<b>100,096</b>
Of which, doubtful	164,481	81,568	99,301
<b>Memorandum item:</b>			
Failed assets	297,241		
<b>Memorandum item:</b>	<b>Amount</b>		
- Loans to clients, excluding Government Bodies (businesses in Spain)	13,115,149		
- Total assets (total businesses)	21,314,166		
- Impairment and provisions for normal rated exposures (total businesses)	97,431		

The following is a breakdown of financing for construction, real estate promotion and home purchase at 31 December 2017 and 2016:

	<b>Financing to construction and real estate promotion.</b>	
	<b>Gross carrying amount</b>	
	<b>2017</b>	<b>2016</b>
Without mortgage guarantee	18,103	15,431
With mortgage guarantee	138,910	180,169
Finished buildings	92,436	119,319
Homes	72,552	104,269
Other	19,884	15,050
Buildings under construction	2,339	2,342
Homes	522	2,342
Other	1,817	-
Land	44,135	58,508
Developed land	36,371	58,508
Other land	7,764	-
<b>Total</b>	<b>157,013</b>	<b>195,600</b>

The breakdown of credit to households for home purchase at 31 December 2017 and 2016 is as follows:

	<b>2017</b>		<b>2016</b>	
	<b>Gross carrying amount</b>	<b>Of which: Doubtful</b>	<b>Gross carrying amount</b>	<b>Of which: Doubtful</b>
Loans for home purchase	9,709,343	230,601	9,901,578	251,857
Without mortgage guarantee	183,242	3,075	177,899	3,015
With mortgage guarantee	9,526,101	227,526	9,723,679	248,842



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown of credit with mortgage guarantee to households for home purchase in accordance with the percentage that the total risk represents of the amount of the latest official valuation available at 31 December 2017 and 2016 is as follows:

	Gross carrying amount on the last available valuation ( <i>loan to value</i> )					
	2017					
	Less than or equal to 40 %	Greater than 40 % and less than or equal to 60 %	Greater than 60 % and less than or equal to 80 %	Greater than 80 % and less than or equal to 100 %	> 100 %	Total
Gross carrying amount	2,423,213	2,960,408	2,979,684	547,627	615,170	9,526,102
Of which, doubtful	15,793	26,967	41,575	35,653	107,538	227,526

	Gross carrying amount on the last available valuation ( <i>loan to value</i> )					
	2016					
	Less than or equal to 40 %	Greater than 40 % and less than or equal to 60 %	Greater than 60 % and less than or equal to 80 %	Greater than 80 % and less than or equal to 100 %	> 100 %	Total
Gross carrying amount	2,395,482	2,877,684	2,805,969	617,116	1,027,427	9,723,678
Of which, doubtful	20,914	34,509	50,604	49,599	93,216	248,842

The breakdown of assets received in payment of debt at 31 December 2017 and 2016 is as follows:

	2017		2016	
	Gross carrying amount	Accumulated impairment value	Gross carrying amount	Accumulated impairment value
<b>Real estate assets from financing to construction and real estate promotion companies</b>	<b>568,501</b>	<b>343,002</b>	<b>516,613</b>	<b>307,372</b>
Finished buildings	28,160	11,125	39,145	15,468
Homes	11,147	2,815	36,284	13,966
Other	17,013	8,310	2,861	1,502
Buildings under construction	130,929	67,871	25,550	12,439
Homes	130,929	67,871	25,550	12,439
Other	-	-	-	-
Land	409,412	264,006	451,918	279,465
Developed land	391,975	255,866	66,063	46,944
Other land	17,437	8,140	385,855	232,521
<b>Real estate assets from mortgage financing to households for home purchase</b>	<b>35,651</b>	<b>7,544</b>	<b>34,210</b>	<b>6,879</b>
<b>Other real estate assets received in payment for debt</b>	<b>21,750</b>	<b>5,980</b>	<b>23,016</b>	<b>4,595</b>
Equity instruments foreclosed or received in payment for debt	-	-	-	-
Equity instruments of entities holding foreclosed real estate assets or received in payment for debt	-	-	-	-
Financing to entities holding foreclosed real estate assets or received in payment for debts	-	-	14,291	6,718
<b>Total</b>	<b>625,902</b>	<b>356,256</b>	<b>588,130</b>	<b>325,564</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The value of guarantees received linked to financing for construction and real estate development as at 31 December 2017 and 2016 is as follows:

<b>Value of guarantees received– Construction and real estate development</b>	<b>2017</b>	<b>2016</b>
Value of real guarantees	366,461	464,335
<i>Of which: guarantees doubtful risks</i>	244,714	360,672
Value of other guarantees	431	58
<i>Of which: guarantees doubtful risks</i>	-	-
<b>Total value of guarantees received</b>	<b>366,892</b>	<b>464,393</b>

The value of the financial guarantees granted for operations for construction and real estate development as at 31 December 2017 and 2016 is as follows:

	<b>2017</b>	<b>2016</b>
Financial guarantees granted for construction and real estate development	17,917	20,056
Amount recorded in liabilities	3,137	3,407

**Management of problematic risk in the Promotion Sector**

**Prior considerations**

The Group's current policy is restrictive.

The admission criteria are as follows:

- Concerning current risks
  - Recover risks involving developers that have defaulted or are subject to risk of attachment or insolvency through the purchase of assets (amicable solution) via foreclosure or through the instigation of legal proceedings.
  - Restructure debt whenever this entails an improvement in the original situation (due to reduced exposure or improved guarantees) and does not entail additional provisions.
- Concerning new risk applications:
  - Land. We do not finance the purchase of land, limiting our involvement, where appropriate, to sales of land by the Asset-holding company of Laboral Kutxa to reputable developers.
  - Construction. The borrower and the financing project must meet stringent requirements to ensure their viability.
    - Only for developers with proven solvency. They require proven experience in the sector and a healthy balance sheet with a sustainable volume of debt and feasible projects.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- Requirements to be met by projects:
  - Land must be free of charges and encumbrances and paid for in full, i.e. without any outstanding payments, resolutive conditions or guarantees linked to its purchase, swaps, etc.
  - The promoter must provide at least 30% of the total cost of the project or the land value if higher.
 

If the land purchase is recent, the value of the land is considered to be the lower of the purchase value net of taxes and the appraised value.

Therefore, Laboral Kutxa will provide 70% of the cost at the most, including the cost of land.
  - Level of commercialization, pre-sales, considered as such once the purchase contract is signed, minimum of 70% of sales volume or at proposal of promotions must reach a minimum volume of at least 100% of the loan to be granted.
  - Term of around 2 - 3 years, depending on the duration of the work and a reasonable period for selling.
  - Drawdowns. Drawdowns may amount to a maximum of 100% of the progress billings signed by the managing architect, provided that the debt is less than 70% of the appraised value.

In compliance with Law 8/2012, at 31 December 2017 and 2016 the Group records real-estate assets derived from financing of construction and property development in various asset management companies. Percentage interest and details are contained in Appendix I to the notes to the consolidated annual accounts.

The foreclosure value as at 31 December 2017 and 2016 of the assets in said companies amounts to €624,860 thousand and €710,202 thousand, respectively. As at 31 December 2017, the balance of financing and capital or shareholder contributions to said companies amounted to €624,860 thousand and €113,154 thousand, respectively (€710,202 thousand and €56,299 thousand, respectively, as at 31 December 2016) which at said date recorded an impairment adjustment of €474,884 thousand and €65,455 thousand, respectively (€511,512 thousand and €37,486 thousand respectively as at 31 December 2016).

b) Refinancing transactions

The risk restructuring policy approved by the Group defines transaction restructuring as a risk management instrument designed to facilitate an amicable recovery. Accordingly, the Group distinguishes between refinancing transactions, in which a new loan is granted to extinguish an existing one, and restructuring transactions, in which one or more terms of an existing transaction are modified.

This policy stipulates that the power to authorise these kinds of transaction, regardless of whether or not there is a non-payment issue, resides exclusively with the Risk Management Department in its different sections.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

No refinancing and/or restructuring operation may be classed, for purposes of doubt, as normal; the types of classification may be:

A) Standard exposure subject to special monitoring

Those that are not Doubtful or Failed, but have weaknesses. Operationally, this kind of classification will be assigned by discard; If the refinancing/restructuring operation is not classified in any of the types indicated below, it will remain as standard exposure subject to special monitoring.

The cover of credit risk loss (necessary provision) will be made by collective estimation. Those that are not Doubtful or Failed, but have weaknesses.

B) Doubtful as a result of borrower arrears

Those in which the refinanced or restructured operations have over 90 days past due.

The cover of credit risk loss (necessary provision) will be made by collective estimation, except for those considered "significant" (€3 million Euro); where the Risk Analyst is the one who establishes the required provision.

C) Doubtful for reasons other than borrowing arrears

Those in which there are reasonable doubts about their full repayment. Indications or indicators will be observed to support this situation.

In compliance with the amendments introduced by Circular 6/2012, of 28 September, and Circular 4/2016, of 27 April, defining the criteria for classifying transactions as refinancing transactions, refinanced transactions and restructured transactions, as well as the policies set by the Parent Entity in this respect, here is the breakdown at 31 December 2017 and 2016 of refinancing, refinanced and restructured transactions:

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**2017**

	TOTAL							Of which: doubtful						
	Without real guarantee		With real guarantee				Accumulated impairment value	Without real guarantee		With real guarantee				Accumulated impairment value
	Number of operations	Gross carrying amount	Number of operations	Gross carrying amount	Maximum amount of real guarantee to be considered			Number of operations	Gross carrying amount	Number of operations	Gross carrying amount	Maximum amount of real guarantee to be considered		
					Real estate collateral	Other real guarantees						Real estate collateral	Other real guarantees	
Credit institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Government Bodies	-	-	9	11,607	1,421	8,094	-	-	-	1	7,107	-	7,106	-
Financial institutions and individual entrepreneurs	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-Financial institutions and individual entrepreneurs	1,036	78,072	817	260,331	57,786	42,231	(160,878)	805	30,822	687	192,996	45,543	31,581	(127,531)
<i>Of which: financing for construction and promotion (including land)</i>	9	958	103	89,052	21,723	14,753	(50,490)	9	958	90	83,763	18,667	13,322	(49,687)
Rest of households	839	8,071	1,455	146,073	106,970	3,422	(38,674)	619	5,941	1,178	119,181	80,845	3,247	(38,105)
<b>TOTAL</b>	<b>1,875</b>	<b>86,143</b>	<b>2,281</b>	<b>418,011</b>	<b>166,177</b>	<b>53,747</b>	<b>(199,552)</b>	<b>1,424</b>	<b>36,763</b>	<b>1,866</b>	<b>319,284</b>	<b>126,388</b>	<b>41,934</b>	<b>(165,636)</b>
<b>ADDITIONAL INFORMATION</b>														
Financing classified as Non-current assets and disposal groups classified as held for sale.	-	-	-	-	-	-	-	-	-	-	-	-	-	-

**2016**

	TOTAL							Of which: doubtful						
	Without real guarantee		With real guarantee				Accumulated impairment value	Without real guarantee		With real guarantee				Accumulated impairment value
	Number of operations	Gross carrying amount	Number of operations	Gross carrying amount	Maximum amount of real guarantee to be considered			Number of operations	Gross carrying amount	Number of operations	Gross carrying amount	Maximum amount of real guarantee to be considered		
					Real estate collateral	Other real guarantees						Real estate collateral	Other real guarantees	
Credit institutions	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Government Bodies	-	-	1	7,372	7,372	-	-	-	-	1	7,372	7,372	-	-
Financial institutions and individual entrepreneurs	1	-	-	-	-	-	-	-	-	-	-	-	-	-
Non-Financial institutions and individual entrepreneurs	854	86,213	881	317,140	93,956	16,293	(194,755)	601	29,124	774	243,594	74,033	13,357	(163,414)
<i>Of which: financing for construction and promotion (including land)</i>	7	252	121	124,349	43,886	346	(75,472)	6	241	111	119,210	39,160	346	(74,967)
Rest of households	734	6,765	1,541	147,504	106,616	2,656	(42,613)	623	5,887	1,355	130,168	89,661	2,656	(42,226)
<b>TOTAL</b>	<b>1,589</b>	<b>92,978</b>	<b>2,423</b>	<b>471,016</b>	<b>207,944</b>	<b>18,949</b>	<b>(237,368)</b>	<b>1,224</b>	<b>35,011</b>	<b>2,130</b>	<b>381,134</b>	<b>171,066</b>	<b>16,013</b>	<b>(205,640)</b>
<b>ADDITIONAL INFORMATION</b>														
Financing classified as Non-current assets and disposal groups classified as held for sale.	-	-	-	-	-	-	-	-	-	-	-	-	-	-

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The next table shows the breakdown as at 31 December 2017 and 2016 of the gross amounts of transactions classified as doubtful during the year subsequent to their refinancing or restructuring:

	<b>2017</b>		
	<b>Gross amount</b>		
	<b>Mortgage guarantee</b>	<b>Other real guarantees</b>	<b>Without real guarantees</b>
Government Bodies	-	-	-
Other legal persons and individual entrepreneurs	4,147	1,845	6,841
<i>Of which: Construction and development loans</i>	1,225	-	-
Other physical persons	23,596	-	313
	<b>2016</b>		
	<b>Gross amount</b>		
	<b>Mortgage guarantee</b>	<b>Other real guarantees</b>	<b>Without real guarantees</b>
Government Bodies	-	-	-
Other legal persons and individual entrepreneurs	4,839	857	6,953
<i>Of which: Construction and development loans</i>	742	199	-
Other physical persons	13,069	6,213	499

The value of guarantees received to ensure collection of refinancing and restructuring operations, distinguishing between real guarantees and other guarantees at 31 December 2017 and 2016 is as follows:

<b>Value of guarantees received – Refinancing</b>	<b>2017</b>	<b>2016</b>
Value of real guarantees	1,803,823	2,121,384
<i>Of which: guarantees doubtful risks</i>	591,137	845,015
Value of other guarantees	10,569	7,257
<i>Of which: guarantees doubtful risks</i>	2,740	2,355
<b>Total value of guarantees received</b>	<b>1,814,392</b>	<b>2,128,641</b>

The detailed movement of refinancing and restructuring operations, net of provisions, in 2017 and 2016 is as follows:

	<b>2017</b>	<b>2016</b>
<b>Opening balance</b>	<b>327,626</b>	<b>398,934</b>
(+) Refinancing and restructuring of the year	9,563	51,413
<i>Memorandum item: impact recorded in the profit and loss account for the period</i>	(22,944)	11,354
(-) Debt payments	(39,163)	(149,225)
(-) Adjudications	(4,370)	(263)
(-) Balance write-off (reclassification to failed)	(4)	(8,738)
(+)/(-) Other variations	10,950	35,505
<b>Balance at year end</b>	<b>304,602</b>	<b>327,626</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**16. Liquidity risk**

There are two different definitions of liquidity risk:

- Funds liquidity risk: is the risk that the Entity may not be able to efficiently face foreseen and unforeseen cash flows, present and future, as well as the contributions to guarantees resulting from its payment obligations, without its daily operations or financial situation being affected.
- Market liquidity risk: is the risk that a financial entity cannot compensate or easily dispose of a position at market prices because of a deep insufficiency or distortions on the market.

The Entity has always treated liquidity as a strategic objective, applying systematic management and control procedures over the past two decades. As part of this, Caja Laboral has a Liquidity Risk Policies and Procedures Guide approved by its Governing Body based on the Basel Committee on Banking Supervision's "Principles for sound liquidity risk management and supervision" (document dated September 2008) and establishes various liquidity objectives and a contingency plan including alert levels and action protocols. It is also worth mentioning that in 2015 the Parent Entity also prepared the Risk Appetite Framework, which is the subject of a systematic process of authorization and improvement, in which the different tolerance thresholds for certain key liquidity risk indicators are included, and, furthermore, the Recovery Plan, which updates the aforementioned alert levels and action protocols relating to situations of liquidity crisis.

As regards the tasks forming part of the procedures, liquidity management is supported by a control system that, on one hand determines key indicators limits like medium-term liquidity objectives and, on the other hand, systematically monitors the level of compliance with the objectives. These objectives are set out in a treasury plan that contains forecasts for the evolution of investible funds, lending and wholesale financing, as well as certain ratios; this is updated monthly, allowing the ALCO to use continuously updated information on the foreseeable evolution of liquidity in the medium term. The ALCO therefore has time to prepare appropriate actions to correct any imbalances in the evolution of aggregates affecting liquidity. Liquidity objectives include Available liquid assets and various liquidity ratios including, as from 2014, the liquidity coverage ratio (LCR); the Entity's LCR is at high levels at year-end 2017, well above the limit stipulated by the regulator for 1 January 2018.

Specifically, at year-end 2017, the Parent Entity has:

- An LCR of 400%.
- Liquid discountable (and available) assets in the European Central Bank (ECB) of €4,024 million (following the application of haircuts), which allow unexpected contingencies to be dealt with. Of this amount, €755 million is available as an ECB loan and €3,269 million are eligible assets in the ECB which can be drawn down as collateral. Over the year, the Entity has maintained high positive net liquidity levels. Moreover, in March 2017 the Parent Entity obtained an amount of 300 million euros in the framework of the ECB's TLTRO II long-term financing operations, although this did not entail an increase in liquidity, as it was obtained by pledging collateral.
- A Loan to Deposits Ratio standing at 78%.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

- Wholesale Financing in which the Entity has followed a prudent policy:
  - With an amount of €1,525 million, which represents 7% of the total balance. This amount includes Market bonds and money taken from the ECB, and excludes Bonds for treasury shares, Securitizations and ICO financing, as their maturity flows are matched to those corresponding to the assets they finance.
  - Diversified with respect to financing sources. Thus, at the end of the financial year Caja Laboral had at its disposal issues of mortgage bonds (excluding treasury stock) amounting to 1,225 million euros and money taken (TLTRO II) from the ECB for 300 million euros (Notes 28 and 36). The Parent Entity also has financing on the market through the securitization of mortgage bond holdings (discounting the tranches acquired by the entity itself) for an amount of 184 million euros, and 13 million euros with respect to financing obtained through the ICO, although, as mentioned above, neither the ICO Financing nor the Securitizations require refinancing at maturity.
  - Diversified with respect to maturity. Thus, the Mortgage Bonds are produced from 2019 onwards, and in a diversified manner, and the ECB financing is due to mature in March 2021.

The financing structure of the Parent Entity is distributed in accordance with the following breakdown:

<b>Financing structure</b>	<b>2017</b>	
	<b>Million euros</b>	<b>%</b>
Client deposits	16,844	77.38
Mortgage bonds (1)	1,225	5.63
ECB financing	300	1.38
Securitization (1)	184	0.84
ICO financing	13	0.06
<b>Total Assets</b>	<b>21,767</b>	

(1) Excluding own repurchased portfolio,

Set out below is a breakdown of wholesale financing by maturity date as from 2018:

<b>Maturities of wholesale issues</b>	<b>Million euros</b>			
	<b>2018</b>	<b>2019</b>	<b>2020</b>	<b>&gt; 2020</b>
Mortgage Bonds	-	100	500	625
Territorial Bonds	-	-	-	-
Senior Debt	-	-	-	-
Issues guaranteed by the State	-	-	-	-
Subordinate, Preferential and convertible	-	-	-	-
Securitizations sold to third parties	24	22	20	118
Taken from ECB	-	-	-	300
ICO financing	3	3	2	5
	<b>27</b>	<b>125</b>	<b>522</b>	<b>1,048</b>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Liquidity needs in the medium-term are amply covered by the financing capacities. Thus in the tables below Net Liquid Assets available are shown after the application of “haircuts” and the Entity’s Issue Capacity:

	Million euros	
	31.12.2017	
	Utilized	Available
<b>Net Liquid assets (2)</b>	-	4,024

(2) Criteria of the Bank of Spain liquidity statements (excluding equity instruments)

<u>Issue Capacity</u>	<u>Million euros</u>
Issue capacity in Mortgage Bonds	4,512
Issue capacity in Territorial Bonds	230
Available in issues guaranteed by the State	-
	<u>4,742</u>

The next table, meanwhile, analyses (in millions of euros) the Parent Entity’s assets and liabilities grouped by remaining term to contractual maturity under the criteria used to prepare the liquidity statements sent to the Bank of Spain (i.e. excluding past due balances, doubtful loans, foreclosed assets and non-performing assets written off):

**2017**

**BREAKDOWN OF ASSETS AND LIABILITIES BY REMAINING TERM TO MATURITY**

	Million euros							
	Total balance	On demand	Up to 1 month	More than 1 month up to 3 months	More than 3 months up to 6 months	More than 6 months up to 1 year	More than 1 year up to 5 years	More than 5 years
TOTAL cash inflows	17,762	67	589	441	390	1,373	5,894	9,007
TOTAL cash outflows	(19,060)	(14,358)	(783)	(448)	(515)	(1,163)	(1,695)	(97)
<b>Net</b>	<u>(1,298)</u>	<u>(14,291)</u>	<u>(194)</u>	<u>(7)</u>	<u>(125)</u>	<u>210</u>	<u>4,199</u>	<u>8,910</u>

**2016**

**BREAKDOWN OF ASSETS AND LIABILITIES BY REMAINING TERM TO MATURITY**

	Million euros							
	Total balance	On demand	Up to 1 month	More than 1 month up to 3 months	More than 3 months up to 6 months	More than 6 months up to 1 year	More than 1 year up to 5 years	More than 5 years
TOTAL cash inflows	17,873	81	625	544	503	825	6,224	9,072
TOTAL cash outflows	(17,976)	(12,193)	(782)	(798)	(1,064)	(1,592)	(1,438)	(110)
<b>Net</b>	<u>(103)</u>	<u>(12,112)</u>	<u>(157)</u>	<u>(254)</u>	<u>(561)</u>	<u>(767)</u>	<u>4,786</u>	<u>8,962</u>

**17. Interest rate risk**

The interest rate risk relates to losses that may arise in the income statement and the Group’s equity value as a result of adverse interest rate movements.

The Parent Entity’s Governing Body has delegated to the Asset and Liability Committee (ALCO) the management and control of this risk within the limit set by that Body. This limit is established in terms of the maximum acceptable loss between two interest rate scenarios: market and an unfavourable scenario.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The ALCO systematically analyses exposure to the interest rate risk and through active management, attempts to anticipate through its decisions any negative medium-term impact on the income statement of unwanted variations in market interest rates. Its decisions are based on the measurement of the Entity's long-term results under different interest rate scenarios, carried out through simulations that deal with balance sheet and off-balance sheet structural positions.

The accompanying table sets out the static gap of interest rate sensitive items, which represents an initial approximation to the Parent Entity's exposure to interest rate fluctuations. However, given the limitations that this entails, it should be noted that this is not the measurement technique used by Caja Laboral to measure that risk, which has been described above.

		Million euros							
	Balance on balance sheet as at 31.12.17	Up to 1 month	Between 1 month and 3 months	Between 3 months and 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years	More than 5 years
<b>Sensitive assets</b>	20,320	5,452	3,590	7,576	978	482	953	208	1,081
Money market	2,016	1,994	-	22	-	-	-	-	-
Credit market	14,160	2,864	3,188	5,875	427	286	219	188	1,113
Securities market	4,144	594	402	1,679	551	196	734	20	(32)
<b>Sensitive liabilities</b>	19,188	7,050	2,019	4,495	106	29	425	5,067	(3)
Wholesale market	1,911	362	527	611	5	5	404	(0)	(3)
Creditors	17,277	6,688	1,492	3,884	101	24	21	5,067	-
Simple GAP		(1,598)	1,571	3,081	872	453	528	(4,859)	1,084
% of total liabilities		(8%)	8%	15%	4%	2%	3%	(24%)	5%
Cumulative GAP		(1,598)	(27)	3,054	3,926	4,379	4,907	48	1,132
% of total liabilities		(8%)	(0%)	15%	19%	22%	24%	0%	6%

		Million euros							
	Balance on balance sheet as at 31/12/2016	Up to 1 month	Between 1 month and 3 months	Between 3 months and 1 year	Between 1 and 2 years	Between 2 and 3 years	Between 3 and 4 years	Between 4 and 5 years	More than 5 years
<b>Sensitive assets</b>	19,270	4,448	3,584	6,997	1,358	750	372	924	837
Money market	707	586	100	21	-	-	-	-	-
Credit market	14,248	2,956	3,320	6,012	416	262	199	193	890
Securities market	4,315	906	164	964	942	488	173	731	(53)
<b>Sensitive liabilities</b>	18,143	5,126	2,191	5,300	125	34	26	5,345	(4)
Wholesale market	1,738	471	526	617	7	6	6	105	-
Creditors	16,405	4,655	1,665	4,682	119	28	20	5,240	(4)
Simple GAP		(678)	1,393	1,697	1,233	716	346	(4,421)	841
% of total liabilities		(4%)	7%	9%	6%	4%	2%	(23%)	4%
Cumulative GAP		(678)	716	2,414	3,647	4,363	4,709	288	1,129
% of total liabilities		(4%)	4%	13%	19%	23%	24%	1%	6%

Those items with an associated contractual interest rate are considered interest rate sensitive and are therefore included in the gap. Other items are excluded, namely Measurement Adjustments, Non-classifiable Credit, Cash, Fixed Assets (including foreclosed assets), Derivatives, Sundry and Accrual Accounts, Community Projects, Special Funds, Capital and Reserves and Results for the year.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

In the gap items deemed sensitive are distributed in different timing tranches on the basis of the following criteria: Variable interest rate products are located in the timing tranche relating to the time when interest is revised (re-appreciated). Fixed interest rate items are distributed on the basis of time remaining to maturity. For on-demand products, the Parent Entity has established assumptions regarding behaviour based on estimates of balance variances. Econometric analyses have been performed on each type of account with no explicit maturity date (interest-free, administered and indexed accounts) based on the evolution of the interest rate applied to these accounts and the market interest rate.

According to the impact analysis performed by the Entity for the Supervisor, a fall of 200 basis points in interest rates would cause a reduction of approximately 2.52% in net interest income in year one. The criteria stipulated by the Supervisor for the preparation of these analyses are basically the maintenance of the initial balance sheet balances and structure, interest rate evolution in line with market expectations, and a five-year limit on the term of interest-free current accounts.

Also, in the case of variation in the economic value, a decrease of 200 basis points in interest rates would generate an increase of 29.6 million euros in the economic value of the Parent Entity, that is to say, around 1.84% of its Equity. On the other hand, an increase of the same magnitude would increase the Entity's economic value by 31.8 million euros, roughly 1.97% of its Equity. The criteria used to calculate this impact are the same as those outlined in the interest rate gap sensitivity analysis above.

**18. Other market risks**

The 2017 financial year was generally a good year for risky assets, with generalized rises in most stock market indices, High Yield fixed income indices and emerging bond indices, while sovereign bonds performed flatly (with slight upward or downward swings depending on the benchmark indices), with the clear losers being assets tied exclusively to dollar risk.

We can identify four elements that could explain such market behaviour. First, a synchronized economic expansion at world level, secondly, extremely cautious central banks in the implementation of their monetary policies, thirdly, a recovery in the price of raw materials and, lastly, unusually low volatilities which have led to a proactive attitude towards risk-taking.

As for the evolution of macroeconomic variables, 2017 ended with an acceleration that brought the growth rates of global GDP to 3.6% (four tenths more than the previous year), producing a synchronization in the main developed and emerging economies that had not been recorded for some time. The positive surprise was clearly in the rise of the Euro area with a growth of 2.2%, much higher than the 1.4% initially forecast, in clear contrast to the USA, which, although registering growth rates similar to those of the Euro area, is still below the forecasts. The emerging economies also performed well, with growth of 4.6% (slightly higher than expected), which was aided by the Chinese economy which, in contrast to the much-feared hard landing, ended the year with growth 6 tenths higher than expected, although it was again heavily influenced by the stimulus implemented by the Chinese government, once again relying on credit.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

As for the Central Banks, 2017 was a year in which the decoupling of the policies implemented by the EDF and the rest of the main Central Banks was clearly confirmed. The EDF carried out 3 interest-rate increases of 0.25% each, accumulating 5 increases and 1.25% since its very gradual normalization process began with the first rate increase in this cycle (0.25%) in December 2015. It also announced its plan to reduce its balance sheet. Despite the three increases and the above mentioned announcement, the EDF has been extremely cautious in its messages to the market, insisting time and time again that the process of monetary normalization will be very gradual and dependent on economic data, a message that has been backed up by inflation that has not yet rebounded and allows it to maintain its prudent approach to normalization.

Meanwhile, in Europe, the ECB, with Draghi at the helm, insisted that it was too early to talk about withdrawing stimulus and in October announced that it would extend the bond purchase programme (QE) for another 9 months (until September 2018), but it did so by halving the amount of monthly purchases while sending out the message that the programme would last as long as necessary to achieve inflation targets. In Japan, the BOJ reconfirmed that it would intervene in the markets (and did so several times) to keep 10-year interest rates at around 0%.

Despite this difference in monetary policy between the central banks, the US dollar depreciated considerably against the main currencies, particularly the Euro. The positive surprise in the growth of the Eurozone economy and the start of the "normalization" of the ECB's monetary policy (through the announcement of a reduction in the volume of purchases) outweighed the interest rate differential in favour of the dollar and the Euro appreciated by 14% against the dollar, rapidly approaching its theoretical equilibrium value on the basis of purchasing power parity. The dollar's depreciation was also fuelled by the rise in oil prices (more than 20% in the year), with which it maintains a fairly close correlation.

This may be one of the factors that could account for the different behaviour of their respective stock markets. While the S&P500 recorded revaluations of close to 20%, the Eurostoxx50 and the Ibex35 recorded increases of just over 6% and 7% respectively. In the case of the American index, the recovery of corporate profits and the greater weighting of the technology sector (with its giants Apple, Microsoft, Google, Amazon and Facebook at the top) were particularly helpful, despite the high multiples at which it is listed as it continues to record high growth in its earnings (and better than expected) and is in high demand by international portfolio managers. The MSCI World and the Nikkei index both showed gains of around 20%, while the MSCI Emerging index in local currency rose by 27%.

In the area of fixed income, the process of normalization of monetary policy has been so gradual and cautious that long-term rates have risen very slightly and less than expected and feared by the market at the beginning of the year, so that the main categories of bonds generally performed more favourably than expected, with the higher the credit risk in the category the better. Thus, to mention just a few of the main underlying factors, while the Iboxx Eurozone sovereign debt index recorded a flat performance (+0.07%), the European index of Euro-denominated corporate bonds rose by +2.37%, the Barclays High Yield Global Hedged Index rose by +8.42% and the J.P. Morgan EMBI Global emerging fixed-income index posted a return of +9.32%.

Lastly, raw materials also recorded another year of widespread price recovery, although the overall index gains were moderate (+2.19% and +4.31% of the Total and Industrial CRB Commodity indices respectively), some components recorded much higher increases (Brent Oil +20%, Gold +13% and Copper +31%).

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

In these circumstances, the securities included in the available-for-sale financial asset portfolio have performed in line with the market, which has been reflected in the net capital gain and capital loss balance figuring in the valuation adjustment accounts.

**19. Operational Risk**

This is the risk of incurring losses due to insufficient or failing procedures, human resources and internal systems or external events.

Laboral Kutxa has complied with its reporting obligations through the standard method, according to the methodology described in Regulation 575/2013 of the European Parliament and Council of 26 June 2013.

On a qualitative level, the Entity has risk maps and controls in all departments. Annually, a risk self-assessment is performed and then action plans are launched to mitigate the most critical risks.

The Parent Entity has a network of 56 coordinators and 28 validators to perform the functions required by the system (self-assessments and action plans). In December 2017 the tenth self-assessment is being completed, after which new action plans will be launched.

On a quantitative level, the Parent Entity has operated an internal database of operating losses since 2002. Each loss is assigned to an event type and business line, defined by Regulation 575/2013 of the European Parliament and Council of 26 June 2013.

Additionally, Laboral Kutxa belongs to the CERO Group (Spanish Operational Risk Consortium), in which the main financial entities are represented at state level and which shares information and experience related to operational risk.

**20. Insurance operation risk**

Risks relating to insurance policies include a number of variables that could significantly affect future cash flows in terms of both amount and chronological distribution.

Mortality, disability and longevity tables are variables that affect the loss ratio and therefore cash outflows due to claim payments. The Group periodically adjusts its technical bases for mortality and survival tables using the most recent data supplied by national and international insurance industry work groups and on statistics approved by the Directorate General for Insurance and Pension Funds.

In accordance with the regulations laid down by the Directorate General for Insurance, the Group has applied PERM/F-2000 tables to new insurance saving products since 15 October 2000. For the risk of death in new business the PASEM-2010 tables are used, while PEAIM-2007 tables are used for risk of disability. The shortfall in the portfolio existing when the tables were applied was absorbed in 2007, even though the prevailing legislation provided for a period of 15 years as from 1 January 1999.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

With respect to policies carrying a guaranteed technical interest rate in force before the Private Insurance Regulations (RD 2486/1998, 20 November) came into effect (the Regulations), the Group applies the provisions of Transitional Provision Two of the Regulations, verifying that the actual return on the investments linked to these policies is higher than the technical interest rate stipulated in the policies.

For policies in force that were issued after the Regulations took effect, the Group has used – every year - a technical interest rate for calculating the mathematical provision equal to or lower than the maximum interest rate set annually by the Directorate General for Insurance. In this respect, the Group avails of the provisions laid down in article 33.1 of the Regulations, assigning a portfolio and financial investments to this class of assets and checking each year that the real return on these assets is higher than the average return used to determine the mathematical reserve.

Even when the Group does not apply the provisions of article 33.2 of the Regulations to the majority of its assets, it monitors asset and liability cash flow projections as a whole, basing such projections on internal assumptions to calculate life expectancy and disability rates, surrender values and expenses and checks it has sufficient financial investments in respect of committed liabilities using these assumptions.

In keeping with Spanish legislation, the Group's policies cover the consequences of the catastrophes covered by the Insurance Compensation Consortium, an entity that reports to the Ministry for Finance.

Elsewhere, the Group uses reinsurance contracts to reduce the risk of claims under the policies entered into.

The directors believe that risk is not significantly concentrated because the Group's insurance business is based primarily on insuring the personal liabilities of individuals and therefore, barring catastrophe risk, which in any event is covered by the Insurance Compensation Consortium, risk levels are low.

The Claims Reserve is calculated in accordance with Private Insurance Regulations.

At the date of preparation of these annual accounts, the Parent Entity's Directors confirm that an internal risk and solvency assessment has been carried out and that the Group's Insurance Companies comply with the overall solvency requirements taking into account their profile risk tolerances, approved risk tolerance limits as well as business strategy.

It has implemented processes that are proportionate to the nature, volume and complexity of inherent risks to its activity and that make it possible to determine and evaluate the short and long term risks to which the Group's Insurance entities are or could be exposed.

The Parent Entity's directors also confirm that the Group's insurance companies continuously comply with capital requirements and technical provisions requirements.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**21. Risk concentration**

Pursuant to EU Parliament and Council Regulation 575/2013 and subsequent amendments concerning solvency requirements, with respect to major exposures, defined as those exceeding 10% of equity, no exposure to one party or group may exceed 25% of equity. If in an exceptional case exposures exceed that limit, the entity shall immediately report the size of the exposure to the competent authorities, which may grant the credit institution, if the circumstances so warrant, a limited period of time to comply with the limit. The Entity's risk appraisal policy takes into account these limits and criteria, having established risk limits by counterparty that are consistent with these requirements and control procedures over any excess.

At 31 December 2017 and 2016, only the risk with the MONDRAGON cooperatives, which for the purposes of large exposures are considered to be an economic risk unit, may be regarded as a "large exposure" as it exceeds 10% of equity.

The Parent Entity's concentrations of risk by geography (where the exposure is located) and counterparty category, showing the carrying amounts of these exposures at 31 December 2017 and 2016, are as follows:

**2017**

	Total (Carrying amount) (a)	Spain	Rest of the EU	America	Rest of the world
Central Banks and credit institutions	2,556,359	1,893,559	638,591	19,302	4,907
Government Bodies	5,355,574	4,826,328	529,246	-	-
– Central administration	4,949,377	4,420,131	529,246	-	-
– Other public administrations	406,197	406,197	-	-	-
Other financial companies and individual entrepreneurs	254,035	154,264	59,748	20,210	19,813
Other non-financial companies and individual entrepreneurs	2,726,937	2,674,113	47,294	4,246	1,284
– Property construction and development	92,030	91,949	81	-	-
– Public works construction	133,305	133,187	118	-	-
– Other purposes	2,501,602	2,448,977	47,095	4,246	1,284
Large corporates	444,025	393,343	46,618	2,982	1,082
SMEs and individual entrepreneurs	2,057,577	2,055,634	477	1,264	202
Other households	10,694,750	10,674,375	15,283	2,843	2,249
– Homes	9,985,115	9,965,785	14,504	2,599	2,227
– Consumer loans	374,951	374,613	288	28	22
– Other	334,684	333,977	491	216	-
<b>TOTAL</b>	<b>21,587,655</b>	<b>20,222,639</b>	<b>1,290,162</b>	<b>46,601</b>	<b>28,253</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**2016**

	Total (Carrying amount) (a)	Spain	Rest of the EU	America	Rest of the world
Central Banks and credit institutions	1,298,988	609,054	675,862	10,976	3,096
Government Bodies	5,216,406	5,177,481	38,925	-	-
– Central administration	4,693,543	4,654,847	38,696	-	-
– Other public administrations	522,863	522,634	229	-	-
Other financial companies and individual entrepreneurs	349,385	75,560	220,470	25,654	27,701
Other non-financial companies and individual entrepreneurs	2,805,342	2,735,828	60,896	5,325	3,293
– Property construction and development	151,731	151,731	-	-	-
– Public works construction	146,565	146,514	51	-	-
– Other purposes	2,507,046	2,437,583	60,845	5,325	3,293
Large corporates	458,724	395,976	56,354	3,329	3,065
SMEs and individual entrepreneurs	2,048,322	2,041,607	4,491	1,996	228
Other households	10,768,600	10,749,575	14,786	2,557	1,682
– Homes	10,185,915	10,167,723	14,138	2,396	1,658
– Consumer loans	358,627	358,270	287	46	24
– Other	224,058	223,582	361	115	-
<b>TOTAL</b>	<b>20,438,721</b>	<b>19,347,498</b>	<b>1,010,939</b>	<b>44,512</b>	<b>35,772</b>

(a) The definition of exposures includes loans and receivables, debt securities, equity instruments, derivatives held for trading, hedging derivatives, investments in dependent, joint ventures and associates and guarantees given, no matter under which balance sheet heading they are recorded.

The geographic breakdown is made depending on the country or Spanish regional government of residency of the borrower, securities issuer and counterparties to derivatives and guarantees given.

**2017**

Business in Spain	Total (Carrying amount) (a)	REGIONAL GOVERNMENTS OF SPAIN			
		Basque region	Navarra	Madrid	Other
Central Banks and credit institutions	1,893,559	33,455	-	1,783,769	76,335
Government Bodies	4,826,328	222,482	8,941	163,746	4,431,159
– Central administration	4,420,131	-	-	-	4,420,131
– Other public administrations	406,197	222,482	8,941	163,746	11,028
Other financial companies and individual entrepreneurs	154,264	66,987	674	46,762	39,841
Other non-financial companies and individual entrepreneurs	2,674,113	1,648,705	267,857	214,960	542,591
– Property construction and development	91,949	60,151	6,627	1,782	23,389
– Public works construction	133,187	74,613	6,578	42,670	9,326
– Other purposes	2,448,977	1,513,941	254,652	170,508	509,876
Large corporates	393,343	283,533	27,031	45,875	36,904
SMEs and individual entrepreneurs	2,055,634	1,230,408	227,621	124,633	472,972
Other households	10,674,375	6,189,158	1,268,594	463,024	2,753,599
– Homes	9,965,785	5,808,101	1,188,489	341,833	2,627,362
– Consumer loans	374,613	234,788	43,183	10,729	85,913
– Other	333,977	146,269	36,922	110,462	40,324
<b>TOTAL</b>	<b>20,222,639</b>	<b>8,160,787</b>	<b>1,546,066</b>	<b>2,672,261</b>	<b>7,843,525</b>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**2016**

Business in Spain	REGIONAL GOVERNMENTS OF SPAIN				
	Total (Carrying amount) (a)	Basque region	Navarra	Madrid	Other
Central Banks and credit institutions	609,054	33,136	-	541,566	34,352
Government Bodies	5,177,481	236,678	9,908	270,953	4,659,942
– Central administration	4,654,847	-	-	-	4,654,847
– Other public administrations	522,634	236,678	9,908	270,953	5,095
Other financial companies and individual entrepreneurs	75,560	15,255	679	56,354	3,272
Other non-financial companies and individual entrepreneurs	2,735,828	1,670,752	264,888	207,472	592,716
– Property construction and development	151,731	103,109	8,989	2,174	37,459
– Public works construction	146,514	75,826	5,915	55,421	9,352
– Other purposes	2,437,583	1,491,817	249,984	149,877	545,905
Large corporates	395,976	290,412	21,036	42,363	42,165
SMEs and individual entrepreneurs	2,041,607	1,201,405	228,948	107,514	503,740
Other households	10,749,575	6,035,810	1,153,235	305,894	3,254,636
– Homes	10,167,723	5,699,369	1,081,517	292,570	3,094,267
– Consumer loans	358,270	208,664	34,722	8,025	106,859
– Other	223,582	127,777	36,996	5,299	53,510
<b>TOTAL</b>	<b>19,347,498</b>	<b>7,991,631</b>	<b>1,428,710</b>	<b>1,382,239</b>	<b>8,544,918</b>

(a) The definition of exposures includes loans and receivables, debt securities, equity instruments, derivatives held for trading, hedging derivatives, investments in dependent, joint ventures and associates and guarantees given, no matter under which balance sheet heading they are recorded.

The following notes provide details of credit risk concentration at the Group by transaction type, sector of activity, geographic exposure, currency, credit quality, etc.

**22. Cash, cash balances at central banks and other on demand deposits**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	2017	2016
Cash	72,514	78,876
Cash balances at central banks	1,682,657	327,385
Other on demand deposits	93,074	46,769
	<b>1,848,245</b>	<b>453,030</b>
By currency:		
In euros	1,829,915	444,378
In dollars	13,406	5,821
In Swiss francs	73	60
In pounds sterling	1,369	1,509
In Japanese yen	2,185	45
Others	1,297	1,217
	<b>1,848,245</b>	<b>453,030</b>

The average rate of interest per annum in 2017 and 2016 on cash balances at central banks and other deposits amounted to 0.032% and 0.28%, respectively.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Under EC Regulation 1745/2003 of the European Central Bank, credit institutions in EU Member States were required to comply with a minimum reserve ratio of 1% at 31 December 2017 and 2016, respectively, calculated on the basis of their qualifying liabilities as determined in said Regulation. As at 31 December 2017 and 2016, part of the balance of the current account held with the Bank of Spain affected compliance with the minimum reserve ratio and the Parent Entity complied with the minimum requirements for this ratio under current regulations.

**23. Financial assets and liabilities held for trading**

The breakdown of these items in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	Assets		Liabilities	
	2017	2016	2017	2016
Derivatives	3,796	3,668	1,533	2,297
Equity instruments	541	620	-	-
Debt securities	140,124	179,401	-	-
	<u>144,461</u>	<u>183,689</u>	<u>1,533</u>	<u>2,297</u>

During the 2017 financial year, the "Financial assets held for trading" item decreased by approximately 39 million euros, mainly due to the sale of debt issued by the State and Autonomous Communities, as well as other fixed-income securities. During the 2016 financial year, financial assets held for trading fell by around 75 million euros, due mainly to the sale of debt and treasury bills issued by the State and other government authorities.

The fair value of the items included in financial assets and liabilities held for trading at 31 December 2017 and 2016, as well as the measurement techniques applied, are set out in Note 42.

The effect on the consolidated profit and loss accounts for the years ended 31 December 2017 and 2016 of changes in the fair value of items included in Financial assets and liabilities held for trading is as follows (Note 52):

	Gains		Losses	
	2017	2016	2017	2016
Derivatives	5,653	12,385	5,364	14,513
Equity instruments	-	28,382	-	25,540
Debt securities	57,032	74,170	56,451	73,048
	<u>62,685</u>	<u>114,937</u>	<u>61,815</u>	<u>113,101</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown based on the criterion for determining the fair value of the effect on the consolidated profit and loss accounts for the years ended 31 December 2017 and 2016 resulting from changes in fair value of the financial assets and liabilities held for trading is as follows:

	<b>Gains</b>		<b>Losses</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
Items whose fair value is:				
Determined by reference to quoted prices (Level 1)	57,032	94,197	56,451	96,465
Estimated through a measurement technique based on:				
Data supplied by the market (Level 2)	5,653	20,740	5,364	16,636
Data not supplied by the market (Level 3)	-	-	-	-
	<b>62,685</b>	<b>114,937</b>	<b>61,815</b>	<b>113,101</b>

The breakdown by currency and maturity of the financial assets and liabilities held for trading headings of the consolidated balance sheets at 31 December 2017 and 2016 is as follows:

	<b>Assets</b>		<b>Liabilities</b>	
	<b>2017</b>	<b>2016</b>	<b>2017</b>	<b>2016</b>
By currency:				
In euros	144,461	183,689	1,533	2,297
	<b>144,461</b>	<b>183,689</b>	<b>1,533</b>	<b>2,297</b>
By maturity:				
Up to 1 month	169	812	510	163
Between 1 month and 3 months	275	494	127	457
Between 3 months and 1 year	1,085	845	166	713
Between 1 and 5 years	41,351	51,168	566	439
More than 5 years	101,040	129,750	164	525
No set maturity	541	620	-	-
	<b>144,461</b>	<b>183,689</b>	<b>1,533</b>	<b>2,297</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

a) Credit risk

Set out below is an analysis of credit risk concentrations by the geographical sector in which the risk is located, counter-party categories, and instrument types, indicating book value at the dates in question:

	2017		2016	
	Amount	%	Amount	%
<b>By geographical sector:</b>				
Spain	144,447	99.99%	183,319	99.80%
Other European Union countries	14	0.01%	370	0.20%
Rest of the world	-	-	-	-
	<b>144,461</b>	<b>100.00%</b>	<b>183,689</b>	<b>100.00%</b>
<b>By counter-party categories:</b>				
Credit institutions	2,599	1.80%	1,931	1.05%
Resident Public Administrations	140,124	97.00%	179,401	97.67%
Other resident sectors	1,738	1.20%	2,357	1.28%
Other non-resident sectors	-	-	-	-
	<b>144,461</b>	<b>100.00%</b>	<b>183,689</b>	<b>100.00%</b>
<b>By instrument types:</b>				
Listed bonds and debentures	140,124	97.00%	179,401	97.66%
Other fixed income securities	-	-	-	-
Derivatives not traded on organised Markets	3,796	2.63%	3,668	1.99%
Listed shares	541	0.37%	620	0.35%
	<b>144,461</b>	<b>100.00%</b>	<b>183,689</b>	<b>100.00%</b>

The breakdown of the Financial assets held for trading based on external credit ratings assigned by the main rating agencies is as follows:

	2017		2016	
	Amount	%	Amount	%
Risks rated A	54	0.03%	366	0.20%
Risks rated B	137,564	95.23%	180,632	98.34%
Amounts not assigned	6,843	4.74%	2,691	1.46%
	<b>144,461</b>	<b>100.00%</b>	<b>183,689</b>	<b>100.00%</b>

b) Debt securities

Debt securities on the asset side of the consolidated balance sheets at 31 December 2017 and 2016 break down as follows:

	2017	2016
Spanish Public Debt	135,764	161,488
Official Credit Institute	-	-
Other fixed income securities	4,360	17,913
	<b>140,124</b>	<b>179,401</b>

The average annual interest rate on the debt securities of the banking business in 2017 and 2016 was 0.988% and 0.796%, respectively.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

c) Equity instruments

The breakdown of the balance of equity instruments on the asset side of the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Equity investments in Spanish entities	-	-
Equity investments in foreign entities	-	-
Shares in Investment Funds	541	620
Other shareholdings	-	-
	<u>541</u>	<u>620</u>

d) Derivatives held for trading

The breakdown of the balance of Derivatives under "Financial Assets Held for Trading" and "Financial Liabilities Held for Trading" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>Notional Value</u>	<u>2017</u>	
		<u>Fair Value Assets</u>	<u>Liabilities</u>
Un-matured currency purchases-sales			
Purchases	29,678	23	784
Sales	45,540	1,517	20
Financial and interest rate forwards			
Purchased	-	-	-
Sold	-	-	-
Securities options			
Purchased	39,180	948	-
Sold	1,383,798	-	-
Currency options			
Purchased	-	-	-
Sold	-	-	-
Interest rate options			
Purchased	19,998	896	-
Sold	1,398	-	5
Other interest rate operations			
FRAs	-	-	-
Financial swaps	23,526	207	136
Call Money Swap (CMS)	-	-	-
Other term transactions	-	205	588
		<u>3,796</u>	<u>1,533</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

	Notional Value	2016	
		Assets	Liabilities
Un-matured currency purchases-sales			
Purchases	51,717	1,203	100
Sales	86,972	778	1,058
Financial and interest rate forwards			
Purchased	-	-	-
Sold	21,391	-	-
Securities options			
Purchased	26,380	501	-
Sold	1,456,583	-	175
Currency options			
Purchased	-	-	-
Sold	-	-	-
Interest rate options			
Purchased	3,045	4	-
Sold	3,045	-	4
Other interest rate operations			
FRAs	-	-	-
Financial swaps	14,473	128	216
Call Money Swap (CMS)	-	-	-
Other term transactions	-	1,054	744
		<u>3,668</u>	<u>2,297</u>

The notional and/or contractual amount of contracts corresponding to Derivatives held for trading does not imply a quantification of the risk assumed by the Group since its net position is obtained from the offsetting and/or combination of these instruments.

The guarantees provided by the Group to certain investment funds and voluntary social welfare entities (all of which are managed by companies belonging to the Laboral Kutxa Group (See Appendix I)) are recorded as issued options on securities. The nominal value of these transactions as at 31 December 2017 and 2016 amounted to 1,384 and 1,447 million euros, respectively, with a fair value of 0 thousand euros in both cases.

The effect of the inclusion of both counterparty risk and own risk in the valuation of derivatives held for trading as at 31 December 2016 and 2017 is not material.

The differences between the value of derivatives sold and purchased to customers and those bought and sold to counter-parties, where there is a margin for the Group, are not material.

The market value of the embedded derivatives in structured deposits traded by the Group as at 31 December 2016 amounted to 172 thousand euros and were included under "Financial liabilities held for trading" on the liability side of the consolidated balance sheet at that date. The nominal value of these deposits amounted to 9,243 thousand euros and was included under the heading "Financial liabilities at amortized cost - Deposits - Customers - Other" on the liability side of the consolidated balance sheet. As at 31 December 2017, the Group had no hybrid deposits marketed to customers, since all those existing as at 31 December 2016 had matured.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

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

The breakdown of these items in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	Assets		Liabilities	
	2017	2016	2017	2016
Debt securities	2,137	-	-	-
Equity instruments	380	403	-	-
	<b>2,517</b>	<b>403</b>	<b>-</b>	<b>-</b>

The fair value of the items included in this category at 31 December 2017 and 2016, as well as the measurement techniques applied, are set out in Note 42.

The effect on the consolidated income statement for the years ended 31 December 2017 and 2016 resulting from changes in the fair value of the items recorded as assets and liabilities at fair value through changes in profit and loss, is as follows (Note 53):

	Gains		Losses	
	2017	2016	2017	2016
Equity instruments	124	19	48	8
Debt securities	111	797	28	1,090
	<b>235</b>	<b>816</b>	<b>76</b>	<b>1,098</b>

A breakdown based on the criterion for determining fair value of the effect on the consolidated income statement for the years ended 31 December 2017 and 2016, resulting from changes in the fair value of assets and liabilities at fair value through changes in profit and loss is as follows:

	Gains		Losses	
	2017	2016	2017	2016
Items whose fair value is:				
Determined by reference to quoted prices (Level 1)	235	816	76	1,098
Estimated through a measurement technique based on:				
Data supplied by the market (Level 2)	-	-	-	-
Data not supplied by the market (Level 3)	-	-	-	-
	<b>235</b>	<b>816</b>	<b>76</b>	<b>1,098</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown of the headings Financial assets and liabilities designated at fair value through profit and loss in the consolidated balance sheets at 31 December 2017 and 2016, by currency and maturity date, is as follows:

	Assets		Liabilities	
	2017	2016	2017	2016
By currency:				
In euros	2,517	403	-	-
	<b>2,517</b>	<b>403</b>	<b>-</b>	<b>-</b>
By maturity:				
On demand	-	-	-	-
Between 3 months and 1 year	-	-	-	-
Between 1 and 5 years	-	-	-	-
More than 5 years	2,137	-	-	-
No set maturity	380	403	-	-
	<b>2,517</b>	<b>403</b>	<b>-</b>	<b>-</b>

a) Credit risk

Set out below is an analysis of credit risk concentrations by the geographical sector in which the risk is located, counter-party categories, and instrument types, indicating book value at the dates in question:

	2017		2016	
	Amount	%	Amount	%
<b>By geographical sector:</b>				
Spain	2,517	100.00%	403	100.00%
Other European Union countries	-	-	-	-
Rest of the world	-	-	-	-
	<b>2,517</b>	<b>100.00%</b>	<b>403</b>	<b>100.00%</b>
<b>By counter-party categories:</b>				
Credit institutions	2,137	84.90%	-	-
Resident Public Administrations	-	-	-	-
Other resident sectors	380	15.10%	403	100.00%
Other non-resident sectors	-	-	-	-
	<b>2,517</b>	<b>100.00%</b>	<b>403</b>	<b>100.00%</b>
<b>By instrument types:</b>				
Listed bonds and debentures	2,137	84.90%	-	-
Other fixed income securities	-	-	-	-
Shares in Investment Funds	380	15.10%	403	100.00%
	<b>2,517</b>	<b>100.00%</b>	<b>403</b>	<b>100.00%</b>

The breakdown of other financial assets at fair value through changes in profit or loss based on external credit ratings assigned by the main rating agencies is as follows:

	2017		2016	
	Amount	%	Amount	%
Risks rated A	-	-	-	-
Risks rated B	2,137	84.90%	-	-
Amounts not assigned	380	15.10%	403	100.00%
	<b>2,517</b>	<b>100.00%</b>	<b>403</b>	<b>100.00%</b>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

b) Debt securities

Debt securities on the asset side of the consolidated balance sheets at 31 December 2017 and 2016 break down as follows:

	<u>2017</u>	<u>2016</u>
Spanish Public Debt	-	-
Other fixed income securities	2,137	-
	<u>2,137</u>	<u>-</u>

The average annual yields in 2017 and 2016 on debt securities in the insurance business stood at 9.58% and -0.60%, respectively.

c) Equity instruments

Equity instruments on the asset side of the consolidated balance sheet at 31 December 2017 and 2016 relates to shares in mutual funds managed by the Group.

**25. Available-for-sale financial assets**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Equity instruments	223,912	318,286
Holdings in Spanish entities	47,686	78,951
Equity investments in foreign entities	33,090	63,165
Shares in Investment Funds (*)	76,359	106,169
Shares in venture capital companies	63,340	66,564
Assets related to the Development and Education Fund	3,437	3,437
Debt securities	4,857,282	4,730,614
Spanish Public Debt	4,003,606	4,188,577
Treasury Bills	-	25,002
Government bonds and debentures	4,003,606	4,163,575
Other recorded debts	-	-
Other Spanish Public Administrations debt	39,278	39,941
Foreign public debt	25,370	26,963
Issued by credit institutions	258,548	308,246
Residents	25,288	108,947
Non-resident sectors	233,260	199,299
Other fixed income securities	524,823	166,403
Issued by other resident sectors	20,731	22,956
Issued by other non-resident sectors	504,092	143,447
Doubtful assets	16,626	10,190
Value adjustments due to asset impairment	(10,969)	(9,706)
Microhedge transactions	-	-
	<u>5,081,194</u>	<u>5,048,900</u>

(\*) As at 31 December 2017 and 2016, 4,864 and 12,785 thousand euros, respectively, related to investment funds managed by the Group.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

As at 31 December 2017, the "Equity Instruments" heading included 5,634 thousand euros (5,892 thousand euros as at 31 December 2016) relating to holdings in companies for which the Parent Entity has agreed to sell them at a specified date and at a price equivalent to the acquisition cost plus a yield linked to the Euribor.

The quantifiable fair value of the items included under the heading Available-for-sale financial assets at 31 December 2017 and 2016, as well as the measurement techniques applied, are set out in Note 42.

Note 40 provides a breakdown of the balance of the heading "Other accumulated comprehensive income" in consolidated equity as at 31 December 2017 and 2016 arising from the changes in the fair value of the items included under the heading "Available-for-sale financial assets".

During the years ended 31 December 2017 and 2016, the amount derecognized from Other accumulated comprehensive income in Equity and recognized in the consolidated profit and loss account for the sale of financial instruments classified in the Available-for-sale financial assets portfolio amounted to 31,668 thousand euros and 8,436 thousand euros, respectively, both net of their tax effect.

During the 2017 financial year, significant purchases of debt issued by the Italian State were made, which increased exposure to this type of instrument by approximately 410 million euros.

During 2016, the Parent Entity made significant purchases of debt issued by the State and other Government Authorities, which increased its exposure to this type of instrument by approximately 733 million euros.

The breakdown by currency and maturity of the heading Available-for-sale financial assets in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
By currency:		
In euros	5,045,095	4,999,999
In US dollars	32,637	42,340
In pounds sterling	2,909	5,478
In Swiss francs	553	1,083
Other	-	-
	<u>5,081,194</u>	<u>5,048,900</u>
By maturity:		
Up to 1 month	92,006	183,879
Between 1 month and 3 months	12,807	52,453
Between 3 months and 1 year	767,544	272,239
Between 1 and 5 years	2,982,085	3,348,125
More than 5 years	1,013,809	881,892
No set maturity	223,912	320,018
Value adjustments due to asset impairment	<u>(10,969)</u>	<u>(9,706)</u>
	<u>5,081,194</u>	<u>5,048,900</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The movements in Available-for-sale financial assets in 2017 and 2016 are shown below:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	5,048,900	4,616,341
Net additions/decreases	21,816	428,905
Changes in fair value	12,370	6,487
Net impairment losses recognized in profit or loss (Note 63)	(1,892)	(2,833)
Others	-	-
	<u>5,081,194</u>	<u>5,048,900</u>
Balance at the close of the year	<u>5,081,194</u>	<u>5,048,900</u>

The average annual interest rate on the debt securities in the banking business in 2017 and 2016 was 1.211% and 0.841%, respectively. The average annual yield in 2017 and 2016 on debt securities in the insurance business was 2.68% and 3.00%, respectively.

As at 31 December 2017, the "Debt Instruments - Issued by non-resident credit institutions" heading included four issues for a total amount of 109 million euros (five issues for an amount of 169 million euros as at 31 December 2016), with maturities in 2018 the yield on which is linked to interest rate parameters that have been limited with ceilings and floor caps.

The Available-for-sale financial asset portfolio as at 31 December 2017 also contains other subordinated debt instruments totalling €466 thousand (€492 thousand as at 31 December 2016).

As at 31 December 2017 and 2016, the Parent Entity had subscribed shares in the share capital of certain unlisted companies for which there are unpaid disbursements not required amounting to 397 thousand euros.

As at 31 December 2017 and 2016, the Group held fair value hedges on certain fixed-income issues included in the available-for-sale financial assets portfolio for a nominal amount of 225,000 thousand euros. This hedge was achieved by arranging OTC interest rate swaps with credit institutions, the fair value of which as at 31 December 2017 and 2016 amounted to (50,299) thousand euros and (60,707) thousand euros, respectively.

As at 31 December 2017 and 2016, the Group also had cash flow hedges on certain fixed-income securities included in the available-for-sale financial assets portfolio for a nominal amount of 1,219,382 and 650,000 thousand euros, respectively. This hedge was achieved by arranging OTC swaps (interest rate - Eurozone inflation) with credit institutions, the fair value of which as at 31 December 2017 and 2016 amounted to (138,953) and (58,696) thousand euros, respectively.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

a) Credit risk

Risk concentration by geographical sector in the debt securities portfolio is as follows:

	2017		2016	
	Amount	%	Amount	%
Spain	4,104,976	84.32%	4,363,078	92.04%
Other European Union countries	758,313	15.58%	357,525	7.54%
Rest of Europe	-	-	-	-
Rest of the world	4,962	0.10%	19,717	0.42%
	<u>4,868,251</u>	<u>100.00%</u>	<u>4,740,320</u>	<u>100.00%</u>
Value adjustments due to asset impairment	<u>(10,969)</u>		<u>(9,706)</u>	
	<u>4,857,282</u>		<u>4,730,614</u>	

A breakdown of debt securities based on external credit ratings assigned by the main rating agencies is as follows:

	2017		2016	
	Amount	%	Amount	%
Risks rated A	150,946	3.11%	112,796	2.38%
Risks rated B	4,700,110	96.76%	4,476,046	94.62%
Risks rated C	-	-	24	-
Unrated doubtful assets	5,841	0.12%	1,213	0.03%
Amounts not assigned	386	0.01%	140,535	2.97%
	<u>4,857,282</u>	<u>100.00%</u>	<u>4,730,614</u>	<u>100.00%</u>

Due mainly to the expectations concerning the recovery of future flows of certain financial assets, the evolution of the stock markets, the liquidity situation of certain bond issues and the increases in credit risk spreads, in 2016 the Group recognized an impairment with respect to certain debt instruments included in the Financial assets available for sale portfolio.

b) Asset impairment losses

The breakdown of the balance under the heading " Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss – Available-for-sale financial assets " in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is set out below (Note 63):

	2017	2016
Debt securities	1,263	(1,724)
Equity instruments	629	4,557
	<u>1,892</u>	<u>2,833</u>
Appropriations charged to income		
Determined individually	3,001	5,108
Determined collectively	(265)	(2,248)
Appropriations recovered taken to income	<u>(844)</u>	<u>(27)</u>
	<u>1,892</u>	<u>2,833</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Movements during 2017 and 2016 in value adjustments for asset impairment in the item Available-for-sale assets – Debt securities are set out below:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	9,706	40,272
Net appropriations/(Recoveries) charged/(credited) to the income statement	1,263	(1,724)
Transfer to write-offs against set-up funds	-	(16,000)
Application of constituted funds	-	(12,842)
	<u>10,969</u>	<u>9,706</u>

During 2016, impairment losses were applied in the amount of €12,842 thousand, as a result of the reduction in share capital undertaken by SAREB, S.A.

The breakdown, by determination criteria, of the balance of impairment losses on available-for-sale financial assets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
By manner of determination:		
Determined individually	10,951	9,423
Determined collectively	18	283
	<u>10,969</u>	<u>9,706</u>

**26. Loans and receivables**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Debt securities	50,360	49,281
Loans and advances	13,746,458	13,894,167
Credit institutions	342,130	392,590
Customers	13,404,328	13,501,577
	<u>13,796,818</u>	<u>13,943,448</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown by currency and maturity of Loans and receivables heading in the consolidated balance sheets at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
By currency:		
In euros	14,166,018	14,369,162
In dollars	13,798	14,249
In pounds sterling	111	47
In Japanese yen	58	1,920
In Swiss francs	53	67
Other	-	-
Valuation adjustments	<u>(383,220)</u>	<u>(441,997)</u>
	<u>13,796,818</u>	<u>13,943,448</u>
By maturity:		
On demand	421,628	265,873
Up to 1 month	103,449	324,818
Between 1 month and 3 months	50,826	117,494
Between 3 months and 1 year	192,800	430,887
Between 1 and 5 years	1,387,831	1,238,107
More than 5 years	11,446,359	11,796,863
No set maturity	577,144	211,403
Valuation adjustments	<u>(383,220)</u>	<u>(441,997)</u>
	<u>13,796,818</u>	<u>13,943,448</u>

Average annual interest rates on loans and advances to credit institutions for 2017 and 2016 were 1.703% and 1.84% respectively.

Concerning the breakdown of loans and advances - Customers based on credit ratings assigned, internally or externally, and the relevant default rate, as is detailed in the note on Credit Risk, the Entity has developed internal scoring and rating models that rate customers or score transactions based on risk level in order to improve risk management and secure the validation of such internal models in order to calculate regulatory capital in accordance with Basel requirements.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

At the close of the 2017 and 2016 financial years, the Parent Entity had information on the scoring models for mortgage and consumer transactions for private individuals, as well as that concerning the rating model for SMEs. However, in order to present a complete information about the level of credit risk within the Group, it has decided to include a breakdown of credits, loans and receivables based on their credit quality at 31 December 2017 and 2016:

	<b>2017</b>		
	<b>Gross amount</b>	<b>Impairment adjustments</b>	<b>Carrying amount</b>
Standard risk	13,497,282	81,476	13,415,806
<i>Of which: on special monitoring</i>	<i>292,194</i>	<i>55,717</i>	<i>236,477</i>
Doubtful risk	686,977	305,965	381,012
<b>TOTAL</b>	<b>14,184,259</b>	<b>387,441</b>	<b>13,796,818</b>

	<b>2016</b>		
	<b>Gross amount</b>	<b>Impairment adjustments</b>	<b>Carrying amount</b>
Standard risk	13,599,560	79,583	13,519,977
<i>Of which: on special monitoring</i>	<i>323,597</i>	<i>53,579</i>	<i>270,018</i>
Doubtful risk	789,263	365,792	423,471
<b>TOTAL</b>	<b>14,388,823</b>	<b>445,375</b>	<b>13,943,448</b>

Set out below is the default rate at the Parent Entity, calculated as the relation between balances classed for accounting purposes as doubtful and the balance of loans and advances - Customers, not taking into account measurement adjustments:

<b>2017</b>	<b>2016</b>	<b>2015</b>
4.98%	5.71%	7.21%

a) Credit institutions

The breakdown of this balance sheet heading by type of instrument is as follows:

	<b>2017</b>	<b>2016</b>
Fixed-term deposits	90,209	200,143
Reverse repurchase agreements	-	-
Other accounts	251,852	192,392
Valuation adjustments		
Value adjustments due to asset impairment	-	-
Other	69	55
	<b>342,130</b>	<b>392,590</b>

Average annual interest rates on loans and advances to credit institutions for 2017 and 2016 were 1.703% and 1.84% respectively.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

b) Customers

The breakdown, into various headings, of Customers in the heading of Loans and advances at 31 December 2017 and 2016, is as follows:

	<u>2017</u>	<u>2016</u>
By type and situation:		
Spanish Government Bodies	329,137	323,203
Commercial loans	329,288	296,319
Loans secured by mortgage guarantee	10,539,618	9,540,717
Loans secured by other real property guarantees	43,212	46,024
Other term loans	1,456,910	2,584,613
Finance leases	194,535	186,194
Demand loans and other	117,825	117,480
Reverse repurchase agreements with counterparty entities	-	-
Doubtful assets	686,977	789,263
Other financial assets	91,356	60,469
Valuation adjustments	(384,530)	(442,705)
Interest accrued	10,106	10,745
Value adjustments for asset impairment	(387,441)	(445,375)
Fees	(7,195)	(8,075)
	<u>13,404,328</u>	<u>13,501,577</u>
By sector of activity of borrower:		
Spanish Government Bodies	336,488	330,924
Other resident sectors:	<u>13,334,947</u>	<u>13,529,901</u>
Agriculture, farming, hunting, forestry and fisheries	61,907	60,791
Industries	760,965	694,787
Construction	294,930	368,462
Services	<u>1,257,708</u>	<u>1,393,387</u>
Commerce and hotel and catering	679,415	637,678
Transport and communications	195,321	192,315
Other services	382,972	563,394
Loans to individuals:	<u>10,687,076</u>	<u>10,766,826</u>
Homes	9,690,959	9,884,721
Consumer and other	996,117	882,105
Not classified	272,361	245,648
Valuation adjustments	(384,530)	(442,705)
Other non-resident sectors	32,538	27,715
Other financial assets	84,885	55,504
Reverse repurchase agreements with counterparty entities	-	238
	<u>13,404,328</u>	<u>13,501,577</u>
By geographical area:		
- Bizkaia	3,719,930	3,715,289
- Gipuzkoa	3,255,634	3,394,122
- Araba	1,489,372	1,520,514
- Navarra	1,564,390	1,590,159
- New network	3,759,532	3,724,198
- Unclassified	-	-
Valuation adjustments	(384,530)	(442,705)
	<u>13,404,328</u>	<u>13,501,577</u>
Due to interest rate applied		
Fixed interest rate	1,530,046	1,256,537
Variable interest rate linked to Euribor	11,686,724	12,106,189
Variable interest rate linked to CECA	-	-
Variable interest rate linked to IRHH	247,017	278,579
Others	325,071	302,977
Valuation adjustments	(384,530)	(442,705)
	<u>13,404,328</u>	<u>13,501,577</u>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown by currency and maturity of Customer loans in the consolidated balance sheets at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
By currency:		
In euros	13,774,495	13,928,327
In US dollars	14,045	13,937
In pounds sterling	109	31
In Japanese yen	156	1,920
In Swiss francs	53	67
Others	-	-
Valuation adjustments	<u>(384,530)</u>	<u>(442,705)</u>
	<u>13,404,328</u>	<u>13,501,577</u>
By maturity:		
On demand	220,724	15,218
Up to 1 month	103,449	324,818
Between 1 month and 3 months	50,826	117,494
Between 3 months and 1 year	168,466	330,887
Between 1 and 5 years	1,276,336	1,157,934
More than 5 years	11,441,142	11,786,528
No set maturity	527,915	211,403
Valuation adjustments	<u>(384,530)</u>	<u>(442,705)</u>
	<u>13,404,328</u>	<u>13,501,577</u>

As at 31 December 2017 and 2016, the Group has not recorded subordinated loans, under said heading.

At 31 December 2017 and 2016 the Group has finance leases with customers for property, plant and equipment which are recorded as described in Note 13.m). The residual value of these contracts, which corresponds to the amount of the last lease instalment, is secured by the asset forming the object of the lease. At 31 December 2017 and 2016 the investment outstanding and residual values by type of asset financed are as follows:

<u>Principal</u>	<u>2017</u>	<u>2016</u>
Capital goods	39,215	36,205
Computer hardware	905	1,035
Materials and transport vehicles	58,809	51,754
Cars	23,371	21,483
Other assets	<u>8,875</u>	<u>9,310</u>
Total moveable property	<u>131,175</u>	<u>119,787</u>
Property Assets	<u>43,588</u>	<u>52,566</u>
TOTAL	<u>174,763</u>	<u>172,353</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

<b>Residual value</b>	<b>2017</b>	<b>2016</b>
Capital goods	1,326	1,267
Computer hardware	38	37
Materials and transport vehicles	6,263	5,135
Cars	11,959	11,508
Other assets	519	487
Total moveable property	20,105	18,434
Property Assets	5,502	5,935
TOTAL	25,607	24,369

Of these balances, a total amount of 5,835 and 10,528 thousand euros related to Impaired assets included in the Doubtful assets item as at 31 December 2017 and 2016, respectively.

A breakdown of securitization and other asset transfers by the Parent Entity at 31 December 2017 and 2016 is as follows:

	<b>2017</b>	<b>2016</b>
Written off the balance sheets in their entirety:	-	-
Mortgage assets securitized through mortgage bond holdings	-	-
<i>Memorandum item: Written off the balance sheet:</i>		
<i>before 1 January 2004</i>	-	-
Carried in the balance sheet in their entirety:	608,118	667,899
Mortgage assets securitized through transfer certificates		
Mortgage	608,118	667,899
Other securitized assets	-	-
	608,118	667,899

In previous years, the Group carried out a number of asset securitization schemes transferring assets comprising mortgage and corporate loans to the securitization funds "I.M. Caja Laboral 1, F.T.A.", "I.M. Caja Laboral 2, F.T.A." and "I.M. Caja Laboral Empresas 1, F.T.A." for €900 million, €600 million and €294.5 million, respectively. Likewise, in 2016, the securitization fund "I.M. Caja Laboral Empresas 1, FTA" issued in 2011 has been settled in advance, with the express consent and acceptance of both the Parent Entity as the holder of all the Bonds and the counterparties with contracts in the fund, in accordance with the Fund Registration Document. These asset transfers did not meet the requirements laid down by the International Financial Reporting Standards for the derecognition of the transferred assets, since the Parent Entity retains the risks and rewards associated with ownership of the assets and also maintains control over them. As a result, a liability associated with the net assets transferred to the above-mentioned funds has been recognized (Note 36).

The outstanding balance of these assets as at 31 December 2017 amounts to 608,118 thousand euros (667,899 thousand euros as at 31 December 2016) and it is worth mentioning that the Parent Entity has subscribed all the asset-backed securities of the funds "I.M. Caja Laboral 2, F.T.A." and "I.M. Caja Laboral Empresas 1, F.T.A.", the latter having been settled in advance in 2016. The Entity intends to use these assets as collateral to secure Eurosystem credit transactions.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Additionally, as at 31 December 2017, the Parent Entity has granted subordinated loans to the aforementioned Asset Securitization Funds amounting to 27,021 thousand euros (27,979 thousand euros as at 31 December 2016).

b) Asset impairment losses

The breakdown of Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss – Loans and receivables in the consolidated income statement for the years ended 31 December 2017 and 2016 (Note 63) is as follows:

	<u>2017</u>	<u>2016</u>
Loans	11,923	(35,194)
Allocations	118,524	126,270
Doubtful loans recovered	(6,523)	(3,814)
Other loans recovered	(100,078)	(157,650)
	<u>11,923</u>	<u>(35,194)</u>
Appropriations charged to income	118,524	126,270
Determined individually	45,594	59,778
Determined collectively	72,930	66,492
Appropriations recovered taken to income	(100,078)	(157,650)
Suspense account items recovered	(6,523)	(3,814)
	<u>11,923</u>	<u>(35,194)</u>

The breakdown at 31 December 2017 and 2016 of the balance of Value Adjustments in respect of asset impairment under Credits, loans and discounts, is as follows:

	<u>2017</u>	<u>2016</u>
By type of cover:		
Specific cover	305,965	365,792
Generic cover	81,476	79,583
	<u>387,441</u>	<u>445,375</u>
By manner of determination:		
Determined individually	144,362	170,093
Determined collectively	243,079	275,282
	<u>387,441</u>	<u>445,375</u>
By counter-party:		
Other resident sectors	387,159	445,226
Other non-resident sectors	282	149
	<u>387,441</u>	<u>445,375</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

As at 31 December 2017, the balance of generic hedges includes 55,717 thousand euros for the value adjustment of the transactions classified as normal risk under special surveillance amounting to 292,194 thousand euros (53,579 and 323,597 thousand euros, respectively, as at 31 December 2016).

Movements during 2017 and 2016 of the balance of Measurement Adjustments in respect of asset impairment under Loans and receivables, is as follows:

	<u>Specific cover</u>	<u>Generic cover</u>	<u>Total</u>
Balance at the close of 2015	526,810	87,959	614,769
Net appropriations against income	126,270	-	126,270
Recoveries	(88,048)	(69,602)	(157,650)
Transfer to write-offs against set-up funds	(117,722)	-	(117,722)
Transfer between value adjustments	(61,267)	61,267	-
Others	(20,251)	(41)	(20,292)
Balance at the close of 2016	365,792	79,583	445,375
Net appropriations against income	104,487	14,037	118,524
Recoveries	(87,893)	(12,185)	(100,078)
Transfer to write-offs against set-up funds	(67,474)	-	(67,474)
Transfer between value adjustments	-	-	-
Others	(8,947)	41	(8,906)
Balance at the close of 2017	305,965	81,476	387,441

During 2017 and 2016 the item "Other" mainly reflects the reclassification of the specific provision on the funding extended to Grupo Fomenciar to "Non-current assets and disposal groups classified as held for sale" in the amount of 10,921 thousand euros and 20,106 thousand euros, respectively (Note 35).

The accumulated financial income not recognized in the consolidated profit and loss account of the impaired financial assets as at 31 December 2017 and 2016 amounted to 76,696 thousand euros and 97,659 thousand euros, respectively.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Set out below is a breakdown of the carrying value of impaired assets, without deduction of value adjustments for impairment:

	<u>2017</u>	<u>2016</u>
By geographical area:		
- Bizkaia	177,131	212,852
- Gipuzkoa	164,059	161,878
- Araba	55,190	65,847
- Navarra	81,213	103,421
- New network	209,384	245,265
- Unclassified	-	-
	<u>686,977</u>	<u>789,263</u>
By counter-party:		
Spanish Government Bodies	7,144	7,372
Other resident sectors	679,632	781,695
Other non-resident sectors	201	196
	<u>686,977</u>	<u>789,263</u>
By type of instrument:		
Commercial loans	12,428	10,378
Loans and credits	647,137	746,458
Finance leases	12,517	15,176
Other	14,895	17,251
	<u>686,977</u>	<u>789,263</u>

The breakdown of the age of the amounts classified as impaired is as follows:

	<u>2017</u>	<u>2016</u>
Up to 6 months	253,425	265,387
Over 6 months without exceeding 9 months	42,163	42,531
Over 9 months without exceeding 12 months	32,916	35,076
Over 12 months without exceeding 15 months	22,158	20,760
Over 15 months without exceeding 18 months	21,940	19,367
Over 18 months without exceeding 21 months	14,547	12,503
Over 21 months	299,828	393,639
	<u>686,977</u>	<u>789,263</u>

A breakdown is provided below at 31 December 2017 and 2016 of balances under loans and receivables written off the consolidated Group balance sheet based on the view that the possibilities of their recovery are remote:

	<u>2017</u>	<u>2016</u>
Loans and advances – Customers	499,294	460,167
	<u>499,294</u>	<u>460,167</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The movement in impaired financial assets written off because recovery is considered remote is as follows:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	460,167	377,051
Additions:	75,591	133,722
Value adjustment for asset impairment	75,591	133,722
Recoveries:	(6,523)	(3,814)
Due to collection in cash of principal	(6,523)	(3,814)
Definitive write-offs:	(29,941)	(46,792)
Condoned	(29,941)	(46,792)
Balance at year end	<u>499,294</u>	<u>460,167</u>

**27. Investments held to maturity**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Spanish Public Debt	355,904	370,505
Treasury Bills	-	-
Other recorded debts	355,904	370,505
Other Spanish Public Administrations debt	-	-
Foreign public debt	6,351	6,389
French public debt	1,031	1,033
German public debt	4,539	4,562
Dutch public debt	781	794
Bonds and debentures	2,924	7,500
Issued by credit institutions	2,924	7,500
Residents	949	912
Non-residents	1,975	6,588
Issued by Other sectors	-	-
Residents	-	-
Non-residents	-	-
Value adjustments due to asset impairment	-	-
Micro-hedging	45,758	55,139
	<u>410,937</u>	<u>439,533</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown by currency, maturity date in the listed price of the Held-to-maturity investments in the balance sheets at 31 December 2017 and 2016, without taking into consideration Measurement adjustments for asset impairment, is as follows:

	<u>2017</u>	<u>2016</u>
By currency:		
In Euro	410,937	439,533
	<u>410,937</u>	<u>439,533</u>
By maturity:		
Up to 1 year	3,056	18,822
Between 1 and 5 years	7,302	10,381
More than 5 years	354,821	355,191
Valuation adjustments	45,758	55,139
	<u>410,937</u>	<u>439,533</u>
By ratings:		
Risks classified as Rating A	8,326	12,977
Risks classified as Rating B	402,611	426,556
Amounts not assigned	-	-
	<u>410,937</u>	<u>439,533</u>

Movements in 2017 and 2016 in the Held-to-maturity investments are set out below:

	<u>2017</u>	<u>2016</u>
Balance at beginning of the year	439,533	1,142,714
Additions due to purchases	554	15,994
Amortization	(20,003)	(733,226)
Microhedge transactions	(9,381)	3,610
Collected interests	(15,056)	(13,867)
Apportionment of interest	15,290	24,308
Impairment losses (Note 63)	-	-
Balance at the close of the year	<u>410,937</u>	<u>439,533</u>

The average interest rate during 2017 and 2016 for held-to-maturity investments in the banking business was 2.023% and 2.785%, respectively. Average annual yields in 2017 and 2016 in held-to-maturity investments in the insurance business stood at 3.63% and 4.08%, respectively.

The carrying value shown in the above tables represents the maximum credit risk exposure with respect to the financial instruments indicated.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The quantifiable fair value of the items included under the heading Held-to-maturity investments at 31 December 2017 and 2016, as well as the measurements techniques applied, are set out in Note 42.

During 2016, €691 million was amortized upon maturity, of which €609 million corresponded to the amortization of bonds issued by the Official Credit Institute (ICO).

At 31 December 2017 and 2016, the Parent Entity maintains a fair value hedging on the State Bonds, included in the investment portfolio with nominal maturity amounting to €200,000k. This hedge was performed through contracting OTC financial swaps on interest rates with non-resident credit entities, the fair value of which as at 31 December 2017 and 2016, amounted to €45,758k and (€55,139k), respectively.

**28. Asset and liability Derivatives – Hedge accounting**

The breakdown of these items in the consolidated balance sheets as at 31 December 2017 and 2016 is the following one:

	Assets		Liabilities	
	2017	2016	2017	2016
Micro-hedges:				
Fair value hedges	143,642	186,213	238,838	178,447
Cash flow hedges	-	-	138,953	58,696
	<u>143,642</u>	<u>186,213</u>	<u>238,838</u>	<u>178,447</u>

The breakdown by currency and maturity of asset and liability derivatives – hedge accounting in the consolidated balance sheets at 31 December 2017 and 2016 is the following one:

	Assets		Liabilities	
	2017	2016	2017	2016
By currency:				
In euros	143,642	186,213	238,838	178,447
	<u>143,642</u>	<u>186,213</u>	<u>238,838</u>	<u>178,447</u>
By maturity:				
Up to 1 month	-	-	-	-
Between 1 month and 3 months	-	-	-	-
Between 3 months and 1 year	-	20	-	20
Between 1 and 5 years	141,205	185,940	102,624	27,126
More than 5 years	2,437	253	136,214	151,301
	<u>143,642</u>	<u>186,213</u>	<u>238,838</u>	<u>178,447</u>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The balance of hedging derivatives – hedge accounting on the asset and liability sides of the consolidated balance sheets at 31 December 2017 and 2016 breaks down as follows:

	<b>2017</b>		
	<b>Notional Value</b>	<b>Fair Value</b>	
		<b>Assets</b>	<b>Liabilities</b>
Other interest rate operations			
Financial swaps	2,783,600	143,642	238,838
Other share operations			
Financial swaps	-	-	-
		<b>143,642</b>	<b>238,838</b>
	<b>2016</b>		
	<b>Notional Value</b>	<b>Fair Value</b>	
		<b>Assets</b>	<b>Liabilities</b>
Other interest rate operations			
Financial swaps	3,074,971	186,213	178,447
Other share operations			
Financial swaps	-	-	-
		<b>186,213</b>	<b>178,447</b>

The notional and/ or contractual amount of asset and liability derivatives – hedge accounting does not represent the risk assumed by the Group since its net position is obtained from the offset and/or combination of such instruments

The characteristics of the main hedges held by the Group as at 31 December 2017 and their variations with respect to December 2016 are described below:

Fair value hedges:

- Micro-hedges of the risk of changes in fair value as a result of changes in the risk-free interest rate of a range of public debt instruments and individually considered and classified in the "Available-for-sale financial assets" and "Held-to-maturity investments" portfolios, through these hedges fixed interest rate exposure is exchanged for floating interest rate exposure.

As at 31 December 2017 and 2016, these debt instruments (Hedged items) had a nominal value of 425,000 thousand euros in both cases (Notes 25 and 27).

- Micro-hedges of the risk of changes in fair value as a result of changes in the risk-free interest rate of a series of financing instruments (mortgage bonds) individually considered and classified as "Financial liabilities at amortized cost", through which exposure to fixed interest rates is exchanged for exposure to floating interest rates.

As at 31 December 2017 and 2016, these financial liabilities at amortized cost (hedged items) had a nominal value of 1,125,000 thousand euros, in both cases (Note 36). During the year, no new hedges were created on financing instruments individually considered and classified as "Financial liabilities at amortized cost".

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Cash flow hedges:

- Micro-hedges of the risk of changes in cash flows due to inflation on certain bonds in the "Available-for-sale financial assets" portfolio. The coupon on these bonds is linked to inflation in the Eurozone. The financial products used to hedge this exchange rate are swaps for a notional amount of 1,219,382 thousand euros and 650,000 thousand euros as at 31 December 2017 and 2016, respectively. During the financial year, micro-hedges on current and future inflation were recorded for a total notional amount of 569,382 thousand euros.

**29. Investments in joint ventures and associates**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Jointly-controlled entities:		
Net value	-	-
Cost	-	-
Value adjustments due to asset impairment	-	-
Associates:		
Net value	3,088	3,042
Cost	3,088	3,042
Value adjustments due to asset impairment	-	-
	<u>3,088</u>	<u>3,042</u>

Movements during 2017 and 2016 in the balance of Investments in joint ventures and associates are as follows:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	3,042	3,091
Acquisitions	-	-
Disposals due to sale	-	-
Disposals due to capital redemption	-	(103)
Profit sharing (Note 48)	47	51
Provision for impairment (Note 64)	-	-
Share of valuation gains/(losses)	-	-
Dividend payment	-	-
Others	(1)	3
Balance at year end	<u>3,088</u>	<u>3,042</u>

Appendix I includes significant information on shareholdings in Jointly-controlled entities and Associates and Subsidiaries which have been consolidated under the full consolidation method at 31 December 2017 and 2016.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**30. Assets under insurance or reinsurance contracts**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Technical provision for unconsumed premiums	11,540	11,721
Life insurance technical reserves	981	967
Technical reserves for claims	13,798	13,113
Credits for reinsurance operations	<u>920</u>	<u>771</u>
	<u>27,239</u>	<u>26,572</u>

**31. Tangible assets**

The breakdown of this heading in the consolidated balance sheets at 31 December 2017 and 2016 is the following one:

	<u>2017</u>	<u>2016</u>
<u>Property, plant and equipment</u>	<u>277,201</u>	<u>298,658</u>
For own use:	<u>263,773</u>	<u>286,927</u>
Data processing equipment and installations	5,878	7,893
Furnishings, vehicles and other installations	33,097	30,213
Buildings	263,065	288,974
Work in progress	1,244	1,244
Others	2	3
Impairment adjustments	(39,513)	(41,400)
Leased out under operating leases	12,699	10,971
Associated with Community Projects	<u>729</u>	<u>760</u>
Furniture and installations	3	3
Buildings	726	757
<u>Investment properties</u>	<u>51,754</u>	<u>55,889</u>
Buildings	61,119	66,086
Rural properties, land and plots	1,349	1,349
Impairment adjustments	(10,714)	(11,546)
	<u>328,955</u>	<u>354,547</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The movement in 2017 and 2016 in the Tangible assets balance is the following one:

	For own use	Leased out under operating leases	Associated with Community Projects	Investment properties	Total
<b>Gross</b>					
Balance as at 1 January 2016	582,215	18,171	2,135	91,870	694,391
Additions	13,230	6,539	-	827	20,596
Withdrawals	(12,487)	(5,102)	-	(14,098)	(31,687)
Transfers	(2,195)	-	-	2,195	-
Transfers to non-current assets for sale	(17,418)	-	-	1,797	(15,621)
Balance as at 31 December 2016	<u>563,345</u>	<u>19,608</u>	<u>2,135</u>	<u>82,591</u>	<u>667,679</u>
Additions	12,765	11,586	-	-	24,351
Withdrawals	(50,039)	(10,851)	-	(4,282)	(65,172)
Transfers	673	-	-	(673)	-
Transfers to non-current assets for sale	(16)	-	-	(601)	(617)
Balance as at 31 December 2017	<u>526,728</u>	<u>20,343</u>	<u>2,135</u>	<u>77,035</u>	<u>626,241</u>
<b>Accumulated amortization</b>					
Balance as at 1 January 2016	234,822	7,745	1,344	18,206	262,117
Allocations	14,697	3,956	31	1,004	19,688
Withdrawals	(9,805)	(3,064)	-	(4,915)	(17,784)
Transfers	(388)	-	-	388	-
Transfers to non-current assets for sale	(4,331)	-	-	489	(3,842)
Others	23	-	-	(16)	7
Balance as at 31 December 2016	<u>235,018</u>	<u>8,637</u>	<u>1,375</u>	<u>15,156</u>	<u>260,186</u>
Allocations	12,447	4,633	31	848	17,959
Withdrawals	(23,750)	(5,626)	-	(1,653)	(31,029)
Transfers	(250)	-	-	250	-
Transfers to non-current assets for sale	(16)	-	-	(34)	(50)
Others	(7)	-	-	-	(7)
Balance as at 31 December 2017	<u>223,442</u>	<u>7,644</u>	<u>1,406</u>	<u>14,567</u>	<u>247,059</u>
<b>Value adjustments due to asset impairment</b>					
Balance as at 1 January 2016	<u>(40,768)</u>	-	-	<u>(11,835)</u>	<u>(52,603)</u>
Additions (Note 65)	(527)	-	-	(2,153)	(2,680)
Withdrawals	-	-	-	2,338	2,338
Transfers	(104)	-	-	104	-
Others	(1)	-	-	-	(1)
Balance as at 31 December 2016	<u>(41,400)</u>	-	-	<u>(11,546)</u>	<u>(52,946)</u>
Additions (Note 65)	(2,823)	-	-	115	(2,708)
Withdrawals	4,710	-	-	717	5,427
Transfers	-	-	-	-	-
Others	-	-	-	-	-
Balance as at 31 December 2017	<u>(39,513)</u>	-	-	<u>(10,714)</u>	<u>(50,227)</u>
<b>Net</b>					
Balance as at 31 December 2016	<u>286,927</u>	<u>10,971</u>	<u>760</u>	<u>55,889</u>	<u>354,547</u>
Balance as at 31 December 2017	<u>263,773</u>	<u>12,699</u>	<u>729</u>	<u>51,754</u>	<u>328,955</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

In 2017 and 2016, items of property, plant and equipment for own use were derecognized for a gross amount of 50,329 and 11,638 thousand euros, respectively, with a net amount of 21,569 and 2,385 thousand euros, respectively. As at 31 December 2017, the disposal of fixed assets for own use mainly related to the sale of 9 properties with a net book value of 21,507 thousand euros.

During 2017, investment property items were derecognized for a gross figure of 4,282 thousand euros (9,182 thousand euros in 2016), mainly relating to the sale of garages and properties. In the 2017 and 2016 financial years, profits (losses) on the sale of tangible assets amounted to 5,465 thousand euros and (442) thousand euros (Note 66).

During 2017, some "Investment Property" was transferred to "Property, Plant and Equipment for Own Use" for a net carrying amount of 923 thousand euros, corresponding to two offices that were no longer rented out to third parties, and from "Non-current assets held for sale" to "Investment property" for a net book value of 260 thousand euros (3,011 thousand euros of "Property, plant and equipment for own use" and "Non-current assets held for sale" to "Investment property" in 2016, corresponding to 5 offices that were rented out to third parties in that year).

In 2017, transfers were made from "Property, plant and equipment for own use" to "Non-current assets held for sale" for a net amount of 0 thousand euros (13,087 thousand euros in 2016, corresponding mainly to the closure of 35 offices).

The heading Property, plant and equipment for own use on the consolidated balance sheets at 31 December 2017 and 2016 breaks down as follows:

	<b>Gross</b>	<b>Accumulated amortization</b>	<b>Impairment adjustments</b>	<b>Net</b>
<b>As at 31 December 2017</b>				
Data processing equipment and installations	45,363	(39,485)	-	5,878
Furnishings, vehicles and other installations	164,426	(131,329)	-	33,097
Buildings	314,803	(51,739)	(39,513)	223,551
Work in progress	1,244	-	-	1,244
Others	892	(889)	-	3
	<b>526,728</b>	<b>(223,442)</b>	<b>(39,513)</b>	<b>263,773</b>
<b>As at 31 December 2016</b>				
Data processing equipment and installations	57,575	(49,682)	-	7,893
Furnishings, vehicles and other installations	162,067	(131,854)	-	30,213
Buildings	341,567	(52,593)	(41,400)	247,574
Work in progress	1,244	-	-	1,244
Others	892	(889)	-	3
	<b>563,345</b>	<b>(235,018)</b>	<b>(41,400)</b>	<b>286,927</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The fair value of Property, plant and equipment for own use is included in Note 42 to the annual accounts.

The net balance at 31 December 2017 and 2016 of Property, plant and equipment for own use does not include any amount in respect of property, plant and equipment not in use.

The gross value of the Group's property, plant and equipment for own use that was in use and fully depreciated at 31 December 2017 and 2016 amounted to approximately 145,486 and 146,340 thousand euros, respectively.

The balance of Investment properties in the consolidated balance sheets at 31 December 2017 and 2016 breaks down as follows:

	<u>Gross</u>	<u>Accumulated amortization</u>	<u>Impairment adjustments</u>	<u>Net</u>
<b>As at 31 December 2017</b>				
Buildings	75,686	(14,567)	(10,714)	50,405
Rural properties, land and plots	1,349	-	-	1,349
	<u>77,035</u>	<u>(14,567)</u>	<u>(10,714)</u>	<u>51,754</u>
<b>As at 31 December 2016</b>				
Buildings	81,242	(15,156)	(11,546)	54,540
Rural properties, land and plots	1,349	-	-	1,349
	<u>82,591</u>	<u>(15,156)</u>	<u>(11,546)</u>	<u>55,889</u>

The fair value of Investment properties is indicated in Note 42 to the annual accounts.

Net operating income from the Group's Investment properties during 2017 and 2016 amounted to approximately 2,432 and 2,626 thousand euros, respectively.

When dealing with the lease of commercial premises or similar, contracts have a defined maturity, the term being established in each specific case.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Set out below is a breakdown of the balance of Leased out under operating leases in the consolidated balance sheets at 31 December 2017 and 2016:

	<u>Gross</u>	<u>Accumulated amortization</u>	<u>Net</u>
<b>As at 31 December 2017</b>			
Machinery	4,667	(2,109)	2,558
Furnishings and fixtures	322	(129)	193
Buildings	-	-	-
Computer hardware	12,358	(4,910)	7,448
Medical equipment	339	(85)	254
Vehicles	2,000	(105)	1,895
Others	657	(306)	351
	<u>20,343</u>	<u>(7,644)</u>	<u>12,699</u>
<b>As at 31 December 2016</b>			
Machinery	4,572	(2,080)	2,492
Furnishings and fixtures	328	(59)	269
Buildings	-	-	-
Computer hardware	9,052	(3,991)	5,061
Medical equipment	234	(18)	216
Vehicles	4,759	(2,299)	2,460
Others	663	(190)	473
	<u>19,608</u>	<u>(8,637)</u>	<u>10,971</u>

Income from rent from Assets assigned under operating leases by the Group in 2017 and 2016 amounted to approximately €5,568 and €4,943 thousand, respectively. Operating expenses of all kinds corresponding to Assets assigned under operating leases of the Group in 2017 and 2016 amounted to approximately €380 and €458 thousand, respectively (Note 56).

At 31 December 2017 and 2016, the Group had the following commitments in relation to its Property, plant and equipment:

- The Group is the lessee of certain properties for which it has accrued rent of €5,867 thousand and €6,003 thousand, respectively, in 2017 and 2016 (Note 60-b). At 31 December 2017 and 2016, the average remaining term of the lease agreements was 14 years.
- The following shows the present value of the total minimum future payments to be made in the following periods:

	<u>2017</u>	<u>2016</u>
Up to 1 year	4,408	4,533
Between 1 and 5 years	13,533	13,896
More than 5 years	11,771	13,148
	<u>29,712</u>	<u>31,577</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**32. Intangible assets**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Goodwill	33,425	33,425
Other intangible assets	<u>167</u>	<u>143</u>
With undefined useful life	167	143
Amortized cost	<u>167</u>	<u>143</u>
Value adjustments due to asset impairment	-	-
With defined useful life	<u>-</u>	<u>-</u>
Amortized cost	-	-
	<u>33,592</u>	<u>33,568</u>

The breakdown of the balance in Goodwill in the consolidated balance sheets at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Seguros Lagun Aro, S.A.		
Gross	33,425	33,425
Impairment adjustments	<u>-</u>	<u>-</u>
	<u>33,425</u>	<u>33,425</u>

Until 20 December 2011, the Group directly held 36.05% of the share capital of Seguros Lagun Aro, S.A. and indirectly held 4.94%. On that date, the Group acquired 59.01% of the share capital, thus obtaining control of Seguros Lagun Aro, S.A., a company that operates as a risk insurer in the main non-life areas of the insurance sector, with the hedging legally established for each area.

Goodwill of €33,425 thousand arising on the acquisition is attributable to the customer base acquired and to the economies of scale that will foreseeably be generated by combining the Group's operations with those of Seguros Lagun Aro, S.A.

On the basis of the estimates and projections held by the Parent Entity's Directors, forecast income attributable to the Group from the investee entities that generated the goodwill is sufficient to cover the carrying amount of the goodwill.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Without taking into account the corrections for impairment of the assets, the movement of the balance in Goodwill during 2017 and 2016 was as follows:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	33,425	33,425
Movements due to modifications in the consolidation scope for business combinations.	<u>-</u>	<u>-</u>
	<u>33,425</u>	<u>33,425</u>

There were no corrections recorded for impairment under the heading "Impairment or (-) reversal of impairment on non-financial assets - Goodwill" in the consolidated profit and loss account during the years ended 31 December 2017 and 2016.

Macroeconomic assumptions and interest rates used in the evaluation of goodwill impairment are as follows:

Each year, the Parent Entity submits the goodwill recognized as a result of the acquisition of 100% of Seguros Lagun Aro, S.A. to the impairment analysis established in the accounting standards, which include a sensitivity analysis. This analysis is based on the analysis of the impairment of the cash-generating unit to which this goodwill has been allocated, in this case Seguros Lagun Aro, S.A. This unit would be impaired if its book value were to be higher than its value in use, defined as the present value of its estimated cash flows. This circumstance has not occurred since its acquisition.

The estimated cash flows are derived from the business plan of Seguros Lagun Aro, S.A. in its most prudent scenario, with moderate growth rates and excluding the positive net flows that might arise from structural changes in the business or in its efficiency. Specifically, the projection of cash flows takes as a starting hypothesis the projection of the results of the financial years for which planning is prepared.

Concerning the goodwill resulting from the business combination consisting of the acquisition of assets from Seguros Lagun Aro, S.A., at the close of 2017 and 2016 the Group carried out an assessment of whether there were any indications of impairment to that goodwill and estimated the recoverable value. As the recoverable amounts are higher than their respective carrying amounts, no impairment has been recognized.

The value was calculated by discounting future distributable net profits from the business carried on by the insurance company for a five-year projection period (to 2022, plus a calculation of its terminal value applying a 1% perpetuity growth rate, which corresponds to the target inflation rate in the economic environment in which the company operates. Previous experience has been greater than 1%). The key variables on which the financial projections were built are the evolution of the gross margin from direct insurance (conditioned by expected business volumes and interest rates) and the evolution of the other income statement items and of solvency levels.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The present value of the flows to be distributed, used to calculate value in use, was calculated applying as a discount rate the cost of capital (Ke) of Seguros Lagun Aro, S.A. from the viewpoint of a market participant. It was determined using the CAPM (Capital Asset Pricing Model)

Under this method, the pre-tax discount rate applied to the cash flow projections was 6.26%, as the cost of capital was considered internally. This estimate of the cost of capital is in line with those applied by independent analysts in the sector.

Annualized growth rates used in the forecast period (CAGR) for earned premiums have ranged from 1% and 2.65%, and for technical insurance expenses have ranged from 1% to 6.24%.

At 31 December 2017 and 2016, sensitivity analyses were conducted of the key valuation variables, and it was concluded that there was no evidence of impairment.

Under current tax legislation, at 31 December 2017 and 2016, generated goodwill is not tax deductible.

### 33. Tax assets and liabilities

The breakdown of these items in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	Assets		Liabilities	
	2017	2016	2017	2016
Current taxes:	8,853	13,330	4,572	3,868
Corporate income tax	-	1,113	4,277	3,868
VAT	7,875	9,455	-	-
Withholdings refundable/payable	978	2,762	-	-
Others	-	-	295	-
Deferred taxes:	277,333	285,960	107,926	117,495
Valuation adjustments of the available-for-sale portfolio	27,767	25,621	71,826	76,450
Fixed asset restatement	-	-	31,070	34,037
Opening fees	-	141	-	-
Tax credits	197,760	205,515	-	-
Reinvestment of fixed assets	-	-	-	-
Provision for pensions and similar obligations	11,621	10,032	-	-
Provision for bad debts and other provisions	35,871	41,189	-	-
Depreciation and amortization	-	-	-	-
Impairment of shareholdings	-	-	-	-
Revaluation of own financial liabilities - mortgage bonds	-	-	5,030	5,030
Deposit Guarantee Fund	-	-	-	-
Other items	4,314	3,462	-	1,978
	<u>286,186</u>	<u>299,290</u>	<u>112,498</u>	<u>121,363</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

As a result of current Corporate Income Tax legislation applicable to the Parent Entity and the Investee Entities, certain differences have arisen in 2017 and 2016 between accounting and tax criteria which have been recorded as Deferred tax assets and Deferred tax liabilities upon calculation and recording of the corresponding tax expense related to profit from continuing operations.

Movements in 2017 and 2016 in the deferred tax asset and liability balances are set out below:

	Assets		Liabilities	
	2017	2016	2017	2016
Balance at start of the year	285,960	301,522	117,495	125,263
Increases / (decreases)	(8,627)	(15,562)	(9,569)	(7,768)
Bad-debt provision and other provisions	(5,318)	(1,316)	-	-
Reinvestment of fixed assets	-	-	-	-
Valuation adjustments Available-for-sale financial assets	2,146	878	(4,624)	(557)
Fixed-asset revaluation	-	-	(2,967)	(7,156)
Opening fees	(141)	(73)	-	-
Tax credits	(7,755)	(17,972)	-	-
Provision for pensions and similar obligations	1,589	2,786	-	-
Deposit Guarantee Fund	-	-	-	-
Others	852	135	(1,978)	(55)
Balance at the close of the year	277,333	285,960	107,926	117,495

Deferred tax assets for unrecognized tax losses and deductions are recognized to the extent that it is probable that the related tax benefit will be realised through taxable profit in the next 10 years from the year-end. As at 31 December 2017, the Parent Entity had recognized deferred tax assets for the aforementioned items amounting to 169,629 thousand euros and 28,131 thousand euros, respectively (178,024 thousand euros and 27,491 thousand euros, respectively, as at 31 December 2016), which are expected to be offset in future years against the tax benefits generated by the Parent Entity, as indicated in the Management's Annual Management Plans.

Pursuant to the Second Final Provision of Royal Decree-Law 14/2013, dated 29 November, on urgent measures for the adaptation of Spanish law to European Union regulations on the supervision and solvency of financial institutions, and its transposition into regional regulations in accordance with the provisions of Regional Regulation 17/2014, dated 16 December, of the Regional Government of Gipuzkoa, the Group has deferred tax assets available for conversion into receivables from the tax authorities amounting to an estimated 170 million euros as at 31 December 2017 (178 million euros as at 31 December 2016).

Also, as from the 2016 financial year, in order for this conversion to be effective, it has an equity benefit associated with it of 1.5% of the amount of the aforementioned assets (see Note 57).

Note 41 outlines the Group's tax matters in further detail.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**34. Other assets and liabilities**

The breakdown of these items in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	Assets		Liabilities	
	2017	2016	2017	2016
Inventories	60,609	19,476	-	-
Time-apportionment of accrued fees	22,002	21,507	-	-
Other accrual items	17,614	21,163	58,818	52,922
Transactions in progress	931	463	244	1,332
Commercial creditors and other accounts payable	-	-	3,805	4,614
Community projects fund	-	-	13,017	12,030
Other items	524	335	1,389	1,604
	<b>101,680</b>	<b>62,944</b>	<b>77,273</b>	<b>72,502</b>

As mentioned in Note 10, as at 31 December 2017 and 2016 the heading "Other assets – other accrual items" includes €17,614 thousand and €21,138 thousand, respectively, relating to the contribution to be made to the Deposit Guarantee Fund under Royal Decree-Law 2/2012, dated 3 February.

In 2017 and 2016, the amounts of €17,626 thousand and €17,842 thousand respectively were transferred from the heading "Non-current assets and disposal groups of items classified as held for sale" to "Other assets - Inventories", related to foreclosed assets that will be promoted and developed by the Group.

Community projects fund

Set out below is a breakdown of this item included under the heading "Other liabilities in the consolidated balance sheets at 31 December 2017 and 2016:

	2017	2016
Development and Education Fund	13,017	12,030
Appropriation:	12,638	11,651
Applied to Property, plant and equipment	350	381
Applied to other investments - Available-for-sale financial assets (Note 25)	3,437	3,437
Expenses committed during the year	7,833	7,538
Current year maintenance expenses	(7,833)	(7,538)
Amount not committed	8,851	7,833
Revaluation reserves	379	379
	<b>13,017</b>	<b>12,030</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Movements during 2017 and 2016 in the balance of the Community Projects Fund are as follows:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	12,030	11,765
Mandatory provision charged against the surplus for the year	8,591	7,833
Appropriation against the surplus for the year	(7,833)	(7,538)
Fixed asset depreciation (Note 31)	(31)	(31)
Others	260	1
	<u>13,017</u>	<u>12,030</u>
Balance at year end	<u>13,017</u>	<u>12,030</u>

Law 13/1989 on Credit Cooperatives, amended by Law 20/1990 concerning the Tax Regime applicable to Cooperatives, maintains the distribution criteria contained in Royal Decree 2860/1978, of 3 November 1978, under which 10% of the net surplus, at least, should be appropriated to the Development and Education Fund (Note 4).

The transfers to this Fund are to be used, among other purposes, for the development of cooperativism and to meet the assistance or cultural needs of the community, or to be invested in assets that meet these objectives. In this respect, the mandatory allocation for 2017 and 2016 amounted to 7,833 and 7,538 thousand euros, respectively, and in 2017, 4,739 and 588 thousand euros (2016: 4,644 and 482 thousand euros) were allocated to the financing of corporate institutions of the MONDRAGON Group and to the Inter-cooperative Education and Promotion Fund, respectively.

**35. Non-current assets and disposal groups classified as held for sale**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Tangible assets	227,235	278,987
Property, plant and equipment for own use	25,068	25,508
Investment properties	11,391	12,845
Tangible assets foreclosed	714,288	808,381
Value adjustments due to asset impairment	(523,512)	(567,747)
	<u>227,235</u>	<u>278,987</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Movements during 2017 and 2016 under in Non-current assets and disposal groups classified as held for sale are as follows:

	<u>2017</u>	<u>2016</u>
Individualised items:		
Balance at start of the year	278,987	354,765
Additions	27,227	32,254
Disposals	(92,097)	(90,227)
Balances due to business combination	-	-
Net impairment charges (Note 67)	30,127	(11,742)
Transfers to tangible assets (Note 31)	617	11,779
Transfers to write-off assets	-	-
Transfers to inventories (Note 34)	(17,626)	(17,842)
Balance at the close of the year	<u>227,235</u>	<u>278,987</u>

The breakdown of the impairment losses or reversals of non-current assets and disposal groups of items classified as held for sale recognized in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows (see Note 67):

	<u>2017</u>	<u>2016</u>
Tangible assets	30,127	(11,742)
Other assets	-	-
	<u>30,127</u>	<u>(11,742)</u>
Appropriations charged to income	<u>30,127</u>	<u>(11,742)</u>
	<u>30,127</u>	<u>(11,742)</u>

The movement in Value Adjustments due to asset impairment under Non-current assets and disposal groups classified as held for sale during December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	567,747	566,038
Net appropriations against income	(30,127)	11,742
Additions due to business combination	-	-
Transfers to loans and receivables (Note 26)	10,921	20,106
Transfers to written off assets and disposals	5,673	3,288
Transfers to inventories (Note 34)	(30,702)	(33,427)
Others	-	-
	<u>523,512</u>	<u>567,747</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown of Measurement Adjustments for asset impairment under Non-current assets and disposal groups classified as held for sale at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Individualized items	523,512	567,747
	<u>523,512</u>	<u>567,747</u>

**36. Financial liabilities measured at amortized cost**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Deposits from central banks	300,172	-
Deposits by credit institutions	212,571	202,981
Customer funds	18,612,854	17,894,200
Debt securities issued	149,550	174,810
Other financial liabilities	230,290	215,918
	<u>19,505,437</u>	<u>18,487,909</u>

The breakdown by currency and maturity of financial liabilities measured at amortized cost in the consolidated balance sheets at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
By currency:		
In euros	19,477,421	18,463,158
In dollars	26,437	23,583
In pounds sterling	1,152	711
In Swiss francs	126	199
In Japanese yen	112	33
Other	189	225
	<u>19,505,437</u>	<u>18,487,909</u>
By maturity:		
On demand	13,891,164	12,542,554
Up to 1 month	736,099	985,462
Between 1 month and 3 months	631,524	1,222,234
Between 3 months and 1 year	2,070,880	3,161,928
Between 1 and 5 years	1,316,938	7,460
More than 5 years	481,700	201,025
No set maturity	228,394	172,697
Valuation adjustments	<u>148,738</u>	<u>194,549</u>
	<u>19,505,437</u>	<u>18,487,909</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

a) Deposits from central banks

The balance of Deposits by central banks in the consolidated balance sheets at 31 December 2017 and 2016 breaks down as follows:

	<u>2017</u>	<u>2016</u>
Bank of Spain	300,000	-
Valuation adjustments	<u>172</u>	<u>-</u>
	<u>300,172</u>	<u>-</u>

As indicated in Note 16, in accordance with the Entity's active funding and liquidity monitoring policy, during the 2017 financial year the second series of longer-term refinancing operations with a specific objective (TLTRO II) announced by the European Central Bank was used to finance a total of 300 thousand euros.

The average rates of interest per annum on Deposits by Central Bank in 2017 and in 2016 were 0.00% and 0.00%, respectively.

The limit assigned by the Bank of Spain to the Parent Entity as at 31 December 2017 in the credit system guaranteed by public funds amounted to 1,054,981 thousand euros (653,056 thousand euros as at 31 December 2016).

b) Deposits by credit institutions

The balance of Deposits by credit institutions in the consolidated balance sheets at 31 December 2017 and 2016 breaks down as follows:

	<u>2017</u>	<u>2016</u>
Fixed-term deposits	12,761	19,427
Repurchase agreements	55,715	-
Other accounts	143,998	183,453
Valuation adjustments	<u>97</u>	<u>101</u>
	<u>212,571</u>	<u>202,981</u>

The average rates of interest per annum on Deposits by credit institutions in 2017 and in 2016 were 0.714% and 0.37% respectively.

As at 31 December 2017 and 2016, 143,430 thousand euros and 183,453 thousand euros, respectively, were recorded under the "Other Accounts" heading in respect of deposits by credit institutions to guarantee compliance with the commitments acquired with respect to these institutions as a result of the Parent Entity's transactions in derivative instruments.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

c) Customer funds

Set out below is a breakdown of the balance of Customer funds in the consolidated balance sheets at 31 December 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Spanish Government Bodies	273,377	208,728
Assets sold under repo agreements with counterparties	3,414	102,857
Other resident sectors:	<u>18,294,153</u>	<u>17,541,489</u>
Demand deposits	<u>13,376,301</u>	<u>11,326,419</u>
Current accounts	4,065,579	3,230,375
Savings deposits	9,286,661	8,069,670
Others	24,061	26,374
Fixed- term deposits:	<u>4,341,443</u>	<u>4,928,523</u>
Time deposits	4,297,440	4,872,535
Others	44,003	55,988
Repurchase agreements	427,940	1,092,155
Valuation adjustments	<u>148,469</u>	<u>194,392</u>
Interest accrued	27,495	29,535
Micro-hedging	120,974	164,857
Other non-resident sectors	<u>41,910</u>	<u>41,126</u>
	<u>18,612,854</u>	<u>17,894,200</u>

Average rates of interest per annum during 2017 and 2016 on Customer funds may be broken down by product as follows:

	<u>2017</u>	<u>2016</u>
Demand deposits	0.05%	0.06%
Fixed- term deposits	1.08%	1.19%
Repurchase agreements	0.06%	0.19%

As at 31 December 2017, the Parent Entity had credit balances with cooperatives, other associated companies and investment funds managed by the Group amounting to 523,036 thousand euros (705,121 thousand euros in 2016).

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

As at 31 December 2017, under the heading “Term deposits” 1,225 million euros (1,225 million euros as at 31 December 2016) were recorded relating to the issue by the Parent Entity of one-off mortgage bonds, which were underwritten by various Asset Securitization Funds, the characteristics of which are as follows:

Fund name	Disbursement date	Mortgage bond		Maturity date
		Nominal amount (thousands of euros)		
		2017	2016	
TDA5 bonds, Asset Securitization Fund	29/11/2004	100,000	100,000	27/11/2019
IM Bonds 5, Asset Securitization Fund	15/06/2005	500,000	500,000	15/06/2020
IM Bonds 7, Asset Securitization Fund	31/03/2006	625,000	625,000	31/03/2021
		<u>1,225,000</u>	<u>1,225,000</u>	

The annual nominal interest rate of the bonds issued at 31 December 2017 ranges between 3.50% and 4.12% (between 3.50% and 4.12% at 31 December 2016). The heading “Other resident sectors - valuation adjustments” as at 31 December 2017 includes 120,974 thousand euros (164,857 thousand euros as at 31 December 2016) which mainly relates to changes in the fair value of mortgage secured bonds attributable to interest rate risk for which hedging has been arranged, as described in Note 28.

The heading "Other sectors - Term deposits - Other" includes 149,061 thousand euros as at 31 December 2017 (174,204 thousand euros as at 31 December 2016) relating to the net amount of financing obtained in the issue of bonds through securitization funds "I.M. Caja Laboral 1, F.T.A.", "I.M. Caja Laboral 2, F.T.A.". Certain loans were contributed to these funds and, as they do not comply with the requirements for derecognition, they remain on the Entity's balance sheet as at 31 December 2017 and 2016 (Note 24).

This heading mainly includes the outstanding balance of the loans contributed to these funds amounting to 606,799 thousand euros (666,452 thousand euros as at 31 December 2016), net of the bonds subscribed by the Group amounting to 422,209 thousand euros (454,709 thousand euros as at 31 December 2016).

It is to be noted that it is the Group's intention to use the bonds subscribed to the "I.M. Caja Laboral 2 F.T.A." fund as collateral in the implementation of Eurosystem credit transactions.

In Laboral Kutxa's capacity as issuer of mortgage bonds and in compliance with the provisions of article 21 of Royal Decree 716/2009 (of 24 April) and Bank of Spain Circular 7/2010 (of 30 November), note 70 to these annual consolidated financial statements includes the information regarding the special accounting treatment applicable to issuers of covered and mortgage bonds.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Set out below is a breakdown by currency and maturity of the balance of Customer funds in the consolidated balance sheets as at 31 December 2017 and 2016:

	<b>2017</b>	<b>2016</b>
By currency:		
In euros	18,584,838	17,869,450
In dollars	26,437	23,582
In pounds sterling	1,152	711
In Swiss francs	126	199
In Japanese yen	112	33
Other	189	225
	<b>18,612,854</b>	<b>17,894,200</b>
By maturity:		
On demand	13,662,497	12,335,351
Up to 1 month	736,099	985,393
Between 1 month and 3 months	631,524	1,222,154
Between 3 months and 1 year	2,070,865	3,156,536
Between 1 and 5 years	1,316,938	318
More than 5 years	11,761	-
No set maturity	34,701	-
	<b>18,464,385</b>	<b>17,699,752</b>
Valuation adjustments	148,469	194,448
	<b>18,612,854</b>	<b>17,894,200</b>

d) Debt securities issued

Set out below is a breakdown of the balance of debt securities issued in the consolidated balance sheets at 31 December 2017 and 2016:

	<b>2017</b>	<b>2016</b>
Promissory notes and bills	-	-
Other inconvertible securities	-	-
Mortgage securities	299,550	1,024,810
Measurement adjustments	(150,000)	(850,000)
Valuation adjustments	-	-
	<b>149,550</b>	<b>174,810</b>

Mortgage securities

During the year 2006 the Group contributed certain mortgage loans to the Securitization fund "I.M. Caja Laboral 1, F.T.A.". Likewise, during 2008 and 2011 the Group contributed certain loans to the securitization funds "I.M. Caja Laboral 2, F.T.A." and "I.M. Caja Laboral Empresas 1, F.T.A." (the latter was settled in advanced during 2016 (Note 26)), respectively for the issue of securitization bonds, which were totally subscribed by the Group. It is the Group's intention to use these subscribed bonds as guarantee in credit operations with the Eurosystem.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

At 31 December 2017 the securitization bonds issued through the “I.M. Caja Laboral 1, F.T.A.” and “I.M. Caja Laboral 2, F.T.A.” funds subscribed by third parties amounted to €149,549 thousand (€174,810 thousand as at 31 December 2016). These bonds mature in October 2049 and in January 2051, respectively, and bear annual interest at the Euribor plus a mark-up between 0.15% and 0.21% and 0.30% and 1%, respectively.

At 31 December 2014, this heading also included €150 million corresponding to the par value of two unique mortgage-backed securities issues due in 2019 and 2020 that were bought in full by the European Investment Bank (EIB).

During 2015, the Parent Entity executed the purchase option granted to the issuer of the mortgage secured bonds as a result of the repayment of the financing obtained from the European Investment Bank. Therefore, at 31 December 2017 and 2016 no balance is reflected under this heading because the nominal value of these mortgage secured bonds is included under “Own securities”.

The yield on the securities subscribed by the European Investment Bank maturing in 2020 and 2019 was determined by means of a variable interest rate on the nominal value indexed to the 3-month Euribor plus a margin of 5.50% and 3.35% payable quarterly, respectively.

During 2012, the Parent Entity issued 2 covered bonds with an individual value of €700 million maturing in 2016 and 2017 which have been retained in full and recorded under “Own securities” to serve as collateral in the obtention of rediscounting facilities with the European Central Bank.

Movements in 2017 and 2016 in Marketable debt securities are set out below:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	174,810	166,333
Issues	-	-
Securities issued by third parties	-	8,444
Amortization	(725,144)	(700,000)
Own securities of the Group	700,000	700,000
Valuation adjustments	<u>(117)</u>	<u>33</u>
Balance at the close of the year	<u>149,549</u>	<u>174,810</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

e) Other financial liabilities

The breakdown of the balance of the heading Other financial liabilities in the balance sheet as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Obligations payable	7,159	7,075
Deposits received	3,672	3,648
Clearing Houses	30,063	25,881
Collection accounts	97,992	94,565
Special accounts	1,224	864
Accruals and deferred income from financial guarantees	2,544	3,217
Other items	87,636	80,668
	<u>230,290</u>	<u>215,918</u>

**37. Liabilities under insurance or reinsurance contracts**

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Life insurance technical reserves:	496,281	478,136
Unearned premium and unexpired risk reserves:	80,069	69,424
Direct insurance	80,069	69,424
Mathematical reserves	416,212	408,712
Direct insurance	416,212	408,712
Technical reserves for life insurance when the investment risk is assumed by policyholders:	326	355
Direct insurance	326	355
Technical reserves for claims:	83,265	80,066
Direct insurance	83,265	80,066
Technical reserves for share in gains and returned premiums:	35	195
Direct insurance	35	195
Deposits received in respect of ceded reinsurance	-	-
	<u>579,907</u>	<u>558,752</u>

**38. Provisions**

The breakdown of this heading in the consolidated balance sheets at 31 December 2017 and 2016 is the following one:

	<u>2017</u>	<u>2016</u>
Pensions and other post-employment defined benefit obligations	41,504	35,830
Other long-term employee benefits	-	-
Pending legal issues and tax litigation	-	-
Commitments and guarantees given	20,992	25,411
Other provisions	129,379	147,268
	<u>191,875</u>	<u>208,509</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Movements in Provisions during 2017 and 2016 are set out below:

	<u>Pensions and other post-employment defined benefit obligations</u>	<u>Other long-term employee benefits</u>	<u>Pending legal issues and tax litigation</u>	<u>Commitments and guarantees given</u>	<u>Other provisions</u>	<u>Total</u>
<b>As at 31 December 2016</b>						
Balance at the beginning of the year	25,879	-	-	31,187	145,590	202,656
Additions, including increases in existing provisions	21,437	-	-	29,305	28,211	78,953
(-) Amounts used	(11,486)	-	-	-	(17,935)	(29,421)
(-) Unused amounts reversed during the period	-	-	-	(34,224)	(19,905)	(54,129)
Other movements	-	-	-	(857)	11,307	10,450
Balance at the end of the year	<u>35,830</u>	<u>-</u>	<u>-</u>	<u>25,411</u>	<u>147,268</u>	<u>208,509</u>
<b>As at 31 December 2017</b>						
Balance at the beginning of the year	35,830	-	-	25,411	147,268	208,509
Additions, including increases in existing provisions	19,704	-	-	-	12,779	32,483
(-) Amounts used	(12,775)	-	-	-	(38,501)	(51,276)
(-) Unused amounts reversed during the period	(1,255)	-	-	(4,443)	-	(5,698)
Other movements	-	-	-	24	7,833	7,857
Balance at the end of the year	<u>41,504</u>	<u>-</u>	<u>-</u>	<u>20,992</u>	<u>129,379</u>	<u>191,875</u>

a) Pensions and other post-employment defined benefit obligations

At 31 December 2017 and 2016, the Parent Entity had entered into future commitments with some of its partners under the voluntary agreement to adhere to the "PD II", "PD 58", "PD 59" and "New Network" plans. Consequently, the Parent Entity has recorded provisions to cover commitments for serving personnel accruing since the date of implementation of the scheme to the date on which they cease their employment with the Parent Entity for the salary supplements and other welfare charges that they will receive until its employees' actual retirement.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The present value of the commitments entered into by the Parent Entity relating to post-employment remuneration and the way in which these commitments were covered are as set out below:

	<u>2017</u>	<u>2016</u>
Commitments entered into	41,504	35,830
	<u>41,504</u>	<u>35,830</u>
Hedges		
Internal funds	41,504	35,830
	<u>41,504</u>	<u>35,830</u>

On 31 December 2017 and 2016 future flows of benefits were measured regarding the cover of the commitments for post-employment compensation using the projected credit unit method of calculation and taking the retirement age of each employee to be the earliest date on which he becomes entitled to retire.

The financial-actuarial assumptions used in the actuarial valuation are set out below:

	<u>2017</u>	<u>2016</u>
Discount rate	0%	0%
Growth in advance gross future consumption	0%	0%
Growth in benefits	0%	0%
Growth in RPI	2%	2%
Retirement age	Earliest possible age	Earliest possible age

The discount rate applied to the commitments was determined on the basis of the duration of the commitment – 1.8 years – and the reference curve was calculated based on the Euro Denominated Corporate Bonds AA curve at 31 December 2017 (Source: Bloomberg).

b) Other provisions

The balance in the heading “Provisions – Other provisions”, which includes provisions for possible expenses, losses and/or probable or certain costs arising from lawsuits or claims in progress, or obligations derived from the Group’s business activities, among other items, was estimated using prudent calculation procedures to reflect the uncertainty inherent in the obligations covered.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The Group's general policy is to record provisions for legal proceedings in which the risk of loss is deemed probable and no provisions are recorded when the risk of loss is possible or remote. The amounts to be allocated are calculated in accordance with the best estimate of the amount required to settle the corresponding claim, based, inter alia, on an individualized analysis of the facts and legal opinions of the internal and external advisors or taking into account the historical average number of losses arising from claims of this nature. The final date of the release of resources which incorporate economic benefits for the Group depends on each one of the obligations. In some cases, the obligations do not have a fixed settlement period and, in other cases, they depend on ongoing legal processes.

The Group has estimated the relative obligations to each claim and/or legal process and has recognized, when necessary, adequate provisions that reasonably cover the liabilities that might arise from the claims received and/or from the legal proceedings opened.

It should be noted that following the judgement of the European Court of Justice published on 21 December 2016 on floor clauses and the entry into force of Royal Decree Law 1/2017 dated 20 January on urgent consumer protection measures, the Parent Entity increased the provisions for 2016 in this respect by a net amount of 11 million euros.

### 39. Own Funds

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Capital	727,167	712,957
Other reserves	809,891	766,469
(Treasury shares)	(1,431)	(1,393)
Profit/(loss) attributable to owners of the parent entity	112,849	103,473
(Interim dividends)	(29,113)	(28,644)
	<u>1,619,363</u>	<u>1,552,862</u>

#### Capital

The Parent Entity's share capital is made up of contributions made and paid by working members, collaborating members and Associate Cooperatives. In accordance with the Parent Entity's Articles of Association (Note 1), the total amount of contributions by each member may not exceed 20% of share capital, for legal entities, and 2.5% of share capital, for individuals. Members' liability for the entity's debts is equal to the value of their contributions.



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

For each year, the General Assembly, at the proposal of the Governing Body, approves, where appropriate, the remuneration on account applicable to these contributions, which, in accordance with the Regulations concerning the Credit Cooperative Law, may not exceed the legal interest rate increased by six points. The annual rate applied in 2017 and 2016 stood at 4%, respectively.

Movements in 2017 and 2016 in the Parent Entity's capital balance are set out below:

	<u>2017</u>	<u>2016</u>
Balances at the beginning of the year	712,957	708,403
Cooperative returns from the distribution of previous year's surplus (Note 4)	19,583	18,845
Capitalized remuneration of contributions to share capital in the present year	-	-
Contributions to share capital		
- Associate cooperatives	463	2,318
- Members and other	1,749	3,490
Less, liquidation of contributions owing to departures		
- Associate cooperatives	(913)	(5,637)
- Members and other	(6,672)	(14,462)
Transfers to capital classed as financial liabilities	-	-
	<u>727,167</u>	<u>712,957</u>
Balances at the end of the year		

At 31 December 2017, the only entity that directly or indirectly has a shareholding of 10% or more in the share capital of the Entity is Lagun-Aro, Entidad de Previsión Social Voluntaria, which owns 15.26% (15.19% in 2016).

In 2013 and 2012, the Parent Entity issued equity twice.

- i) The first issue was aimed at working members, collaborating members and Associated Cooperatives, with a subscription term from April to October 2012. As at 31 December 2017 and 2016, the amount subscribed for this first issue was €36,874 thousand and €37,480 thousand, respectively. The remuneration associated with the first issue is an annual rate of 7.5% up to 15 December 2015, on which date the remuneration was aligned with the rate on other ordinary contributions approved at the Entity's General Assembly.
- ii) The second issue was launched in December 2012 and is targeted at customers with specific ties to the Parent Entity. As at 31 December 2017 and 2016, subscriptions for this second issue were 56,511 thousand euros and 57,095 thousand euros, respectively. The remuneration on this second issue is an annual rate of 6% until 30 December 2014, on which date remuneration aligned with the rate on other ordinary contributions approved at the Entity's General Assembly.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Contributions (parts in the Entity) are transferable "inter vivos" only to other members and to parties wishing to acquire such status, in accordance with the terms and conditions contained in the Parent Entity's Articles of Association, and by succession "mortis causa", if the successor is a member or acquires member status within six months. In the event of departure, the member or his successors are entitled to request the reimbursement of the contributions to share capital, the value of which, following the relevant reduction, where appropriate, by a percentage determined by the Governing Body on the basis of the reason for the forfeiture of member status, will be estimated based on the balance sheet approved by the General Assembly following the definitive departure date. The reimbursement period will be set by the Governing Body and may not exceed five years following the date of departure or one year from the member's death, where appropriate.

Final Provision Six of Royal Decree 1309/2005, dated 4 November, introduced certain amendments to Article 10 of Royal Decree 84/1993 which approved the Regulations on credit cooperatives, which enabled credit cooperatives to establish restrictions in their articles of association on the reimbursement of members' contributions to capital. The Parent Entity's Articles of Association provide that the reimbursement of contributions to members is subject to the approval of the Governing Body of the Parent Entity and to the condition that said reimbursement does not lead to insufficient coverage of minimum share capital, equity or solvency ratios.

Under the Parent Entity's Articles of Association, minimum share capital is €10 million and must be fully paid in.

At 31 December 2017 and 2016, equity instruments in subsidiaries held by the Parent Entity, ISGA Inmuebles, S.A. and Caja Laboral Euskadiko Kutxa Cartera, S.L.U. and their nominal values, as well as payments pending on those dates, are the following:

	2017			2016		
	Number of shares	Nominal value (in euros)	Payments pending	Number of shares	Nominal value (in euros)	Payments pending
Seguros Lagun Aro Vida, S.A.	285,000	111.88	8,565	285,000	111.88	8,565
Seguros Lagun Aro, S.A.	87,360	90.15	-	87,360	90.15	-
Caja Laboral Gestión, SGIIC, S.A.	1,045,000	6.01	-	1,045,000	6.01	-
Caja Laboral Pensiones, G.F.P., S.A.	250,000	10	-	250,000	10	-
Caja Laboral Euskadiko Kutxa Cartera, S.L.U.	1,237,500	6	-	1,237,500	6	-
Caja Laboral Bancaseguros O.B.S.V., S.L.U.	10,000	1	-	10,000	1	-
Sociedad Gestión Activos Caja Laboral, S.A.U.	995,889	1	-	995,889	1	-
Credilka, S.A. (***)	-	-	-	700,000	1	-
Piensos del Norte, S.A. (*)	-	-	-	-	-	-
ISGA Inmuebles, S.A. (*)	60,000	1	-	60,000	1	-
Copesa Montecerrao, S.L. (**)	-	-	-	-	-	-

(\*) During 2016, ISGA Inmuebles, S.A. merged by absorption with Piensos del Norte, S.A.

(\*\*) During 2016, ISGA Inmuebles, S.A. acquired the shareholding held by Laboral Kutxa in Copesa Montecerrao, S.L. In addition, during 2016, Copesa Montecerrao, S.L. went into liquidation.

(\*\*\*) During the 2017 financial year, Credilka, S.A. went into liquidation.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Other reserves

Set out below is a breakdown of the balance of other reserves in the consolidated balance sheets at 31 December 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Reserves or accumulated losses of investments in joint ventures and associates:		
Associates	144	93
Jointly-controlled entities	-	-
Revaluation reserves:		
Parent Entity	-	-
Other:	809,747	766,376
Reserves (losses) attributed to Parent Entity	940,963	840,292
Reserves (losses) attributed to Subsidiaries	(131,216)	(73,916)
	<u>809,891</u>	<u>766,469</u>

The movements experienced during the 2017 and 2016 financial years in the balance of Other Reserves are shown below:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	766,469	722,703
Prior year surplus distribution	43,496	42,895
Share capital increases	3	15
Others	(77)	856
Balance at the close of the year	<u>809,891</u>	<u>766,469</u>

Law 13/1989, of 26 May 1989, on Credit Cooperatives, partially amended by Law 20/1990, of 19 December 1990 on the Tax Regime applicable to Cooperatives, established new bases for arranging credit in relation to these entities. In 1993 Royal Decree 84/1993, of 22 January 1993, was published which approves the enabling regulations of Law 13/1989, of 26 May 1989, on Credit Cooperatives. The criteria employed to distribute the surplus available from the year are described in Note 4.

Mandatory Reserve Fund

As at 31 December 2017 and 2016, the Other Reserves heading includes 623,074 thousand euros and 583,906 thousand euros, respectively, corresponding to the Mandatory Reserve Fund. Law 13/1989 established that at least 50% of the available surplus for the year should be appropriated to this Mandatory Reserve Fund. Law 20/1990 amended previous legislation and established that at least 20% of the available surplus for the year should be appropriated to the Mandatory Reserve Fund. Under the Parent Entity's current Articles of Association, 50%, at least, of the available surplus for the year should be distributed. A breakdown is included in Note 4.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Reserve for insolvency risks

Prior to effectiveness of Law 13/1989, qualifying credit cooperatives had to earmark at least 15% of their available annual surpluses to endowing this reserve. Laws 13/1989 and 20/1990 do not require any specific provisions to such an insolvency reserve fund within the criteria for distributing available surplus for the year.

Revaluation reserve

The Parent Entity availed itself of Transitional Provision One of Bank of Spain Circular 4/2004 concerning the restatement of tangible fixed assets whereby enterprises were allowed to record, at 1 January 2004, tangible fixed assets at fair value, subject to the assets being freely available.

Voluntary Reserves

On 26 December 2011, the Governing Board of the Parent Entity, with a view to simplifying the composition of its own funds, particularly its reserve accounts, and on the basis of analysis thereof, determined that, considering the grounds for their original constitution and the time elapsing since then, the reserve for insolvency risks, the revaluation reserve and the reserve for first-time transition to new accounting rules effectively constituted unrestricted reserves. On the basis of the foregoing, the members of Caja Laboral approved the unification of these reserves into a single reserve heading called "Voluntary reserves" totalling €88,947k at the General Assembly meeting of 28 April 2012. The Parent Entity registered the transfer at year-end 2011.

The breakdown by Entity of the balance of Other reserves – Reserves/(losses) attributable to subsidiaries at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Seguros Lagun-Aro, Vida, S.A.	54	(165)
Caja Laboral Gestión, SGIIC, S.A.	1,257	1,257
Caja Laboral Pensiones, G.F.P., S.A.	99	97
Credilka, S.A.	-	858
Seguros Lagun-Aro, S.A.	2,123	2,133
Caja Laboral Kutxa Cartera, S.L.U.	4,979	1,505
Caja Laboral Bancaseguros O.B.S.V., S.L.U.	2,337	3,291
Sociedad Gestión Activos Caja Laboral, S.A.U.	(13,707)	(13,014)
ISGA Inmuebles, S.A.	(128,359)	(69,878)
	<u>(131,217)</u>	<u>(73,916)</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown of the balance of reserves or accumulated losses of investments in joint ventures and associates at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Associates:	144	93
ICR Institutional Investment Management, S.G.I.I.C., S.A.	144	93
Jointly-controlled entities:	-	-
Fomenclar, S.L.	-	-
Property Development Companies (see Appendix I)	-	-
IK – LKS Corporate, S.L.	-	-
	<u>144</u>	<u>93</u>

Provided below is a breakdown by Entities of the contribution to Income attributed to the Group at 31 December 2017 and 2016:

	<u>2017</u>	<u>2016</u>
Parent Entity	117,561	103,695
Subsidiaries:	(4,759)	(273)
Seguros Lagun Aro Vida, S.A.	2,319	3,520
Caja Laboral Gestión S.G.I.I.C., S.A.	921	873
Caja Laboral Pensiones, G.F.P., S.A.	66	18
Seguros Lagun Aro, S.A.	6,971	6,070
Caja Laboral Euskadiko Kutxa Cartera, S.L.U.	(11)	(10)
Caja Laboral, Bancaseguros, O.B.S.V. S.L.U.	1,702	678
Credilka, S.A.	-	(1)
Sociedad Gestión Activos Caja Laboral, S.A.U.	876	(143)
ISGA Inmuebles, S.A.	(17,603)	(11,278)
Entities measured under the equity method	47	51
- Associates:	47	51
ICR Institutional Investment Management, S.G.I.I.C., S.A.	47	51
- Jointly-controlled entities:	-	-
Fomenclar, S.L.	-	-
Property Development Companies (see Appendix I)	-	-
IK – LKS Corporate, S.L.	-	-
	<u>112,849</u>	<u>103,473</u>

#### 40. Accumulated other comprehensive income

The breakdown of this heading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Items that may be reclassified to profit or loss	109,065	131,525
Hedging derivatives. Cash flow hedges (effective portion)	(30,837)	(11,533)
Available-for-sale financial assets:	139,902	143,058
Debt securities	108,509	101,007
Equity instruments	31,393	42,051
	<u>109,065</u>	<u>131,525</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The balance included under "Other accumulated comprehensive income" in equity - Available-for-sale financial assets relates to the net tax effect of the changes in fair value attributable to the Group in relation to the financial instruments in this portfolio and is an integral part of the Group's equity. When available-for-sale assets are sold, the changes are recorded on the consolidated profit and loss account. The changes in the total of the "Other accumulated comprehensive income" heading in equity in 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Balance at start of the year	131,525	135,290
Net movement charged /(credited) to income	<u>(30,306)</u>	<u>(6,612)</u>
Sales and redemptions	(31,668)	(8,652)
Impairment losses (net) charged against income statement	1,362	2,040
Net valuation gains / (losses)	27,150	14,380
Variations in micro-hedging cash flows	(19,304)	(11,533)
Others	<u>-</u>	<u>-</u>
	<u>109,065</u>	<u>131,525</u>

In order to adequately evaluate the evolution of this heading, the exceptional circumstances in the financial markets during 2017 and 2016 must be taken into consideration, as explained in Note 18.

The breakdown by Entity of the amount included in "Other accumulated comprehensive income" in equity as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Parent Entity	86,023	103,210
Subsidiaries:	<u>23,042</u>	<u>28,315</u>
- Seguros Lagun-Aro Vida, S.A.	20,579	24,778
- Seguros Lagun Aro, S.A.	2,463	3,537
Associates and Jointly-controlled companies	<u>-</u>	<u>-</u>
	<u>109,065</u>	<u>131,525</u>

#### **41. Tax situation**

The Parent Entity and Investees file individual income tax returns in accordance with tax regulations applicable to them.

Pursuant to Provincial Regulation 2/97 of the Gipuzkoa Tax Regime for Cooperatives, the tax rate applicable to credit cooperatives is 28%. In the remaining dependent financial companies the applicable tax rate was 28% in 2017 and 2016.

The legislation applicable to the payment of corporate income tax for 2017 for the main Investees consists of Provincial Regulation 2/2014, of 17 January, the Gipuzkoa regional authority and Provincial Regulation 11/2013, of 5 December, of the Bizkaia regional authority, depending on the region in which each investee operates and files its corporate income tax returns.

The Directors of the Parent Entity and the Investees have calculated the amounts related to this tax for 2017, and those years open to inspection, in accordance with regional legislation in force at each year end.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Loss carryforwards and tax credits generated under Gipuzkoa regulations must be applied within 15 years.

The reconciliation for the Parent Entity of accounting income for 2017 and 2016 to the corporate income tax base is as follows:

	<u>2017</u>	<u>2016</u>
Accounting income for the year before taxes (*)	123,764	116,811
Permanent differences:		
Increases		
- Non-deductible expenses	118	620
- Other items		528
Decreases		
- Mandatory allocation to Development and Education Fund (Note 57) (*)	(8,591)	(7,833)
- Allocation to the Inter-Coop Company Fund	(11,750)	(11,306)
- Deductible gross interest paid on account in respect of contributions to share capital	(29,170)	(28,700)
- 50% of the mandatory allocation to the Mandatory Reserve Fund	(21,478)	(19,583)
- Capital gains reinvested in fixed assets used in the business	(9,922)	-
- Deductions for double taxation	(8,289)	(9,416)
- Other items	-	-
Taxable income (tax loss)	<u>34,682</u>	<u>41,121</u>
Temporary differences		
- Arising in the present year	(13,317)	5,250
- Dynamic Payroll Plan	5,675	9,951
- Appropriations to other provisions	(18,992)	(4,701)
- Others	-	-
- Arising in previous years	<u>10,003</u>	<u>14,863</u>
Tax base	<u>31,368</u>	<u>61,234</u>
Offset of tax losses	<u>(31,368)</u>	<u>(61,234)</u>
Net tax base	<u>-</u>	<u>-</u>
Gross tax payable (28%)	-	-
Deductions and allowances	-	-
Net tax payable	-	-
Withholdings and payments on account	<u>(979)</u>	<u>(2,762)</u>
Corporate income tax payable / (refundable)	<u>(979)</u>	<u>(2,762)</u>

(\*) Profit before tax, without considering the mandatory appropriation to community projects and social funds, included under the heading Other operating expenses in consolidated income statements (Note 57).

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown of "Tax expenses or (-) income related to profit from continuing operations" in the 2017 and 2016 consolidated income statements is as follows:

	<u>2017</u>	<u>2016</u>
Accounting base at the applicable rate	9,711	11,514
Deductions and allowances	(782)	(1,376)
Other items	(247)	(359)
	<u>8,682</u>	<u>9,779</u>

The composition of "Expenditure or (-) Income for Taxes on Profit from continuing operations" in the consolidated profit and loss account for 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Accounting base at the applicable rate	9,711	11,514
Deductions and allowances	(782)	(1,376)
Other items	(247)	(359)
Corporate income tax, Parent Entity	<u>8,682</u>	<u>9,779</u>
Corporate income tax, Investee Entities		
Accounting base at the applicable rate	4,149	3,690
Other items	-	-
	<u>12,831</u>	<u>13,469</u>

In addition to the "Expenditure or (-) Income for Taxes on Profit from continuing operations" in the profit and loss account, deferred taxes arising from other accumulated comprehensive income from equity in 2017 and 2016 were generated or reversed for the following items and amounts:

	<u>2017</u>	<u>2016</u>
Accumulated other comprehensive income:		
Available-for-sale financial assets	(1,227)	(1,464)
Cash flow hedges	(7,507)	-
	<u>(8,734)</u>	<u>(1,464)</u>

At 31 December 2017 and 2016, the breakdown of deductions and allowances from corporate income tax of the Parent Entity pending application in future years, is as follows:

	<u>Last clearing year</u>	<u>2017</u>	<u>2016</u>
Unused tax losses	2027	605,817	635,800
		<u>605,817</u>	<u>635,800</u>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

At 31 December 2017 and 2016, the breakdown of deductions and allowances from corporate income tax of the Parent Entity pending application in future years, is as follows:

	<b>Last year of use</b>	<b>2017</b>	<b>2016</b>
Deductions for double taxation	2032	10,891	10,971
Deductions with limit over gross tax payable	2032	12,588	12,558
Deductions without limit over gross tax payable	2032	4,652	3,962
		28,131	27,491

Deductions without a limit over gross tax payable relate mainly to deductions generated as a result of Parent Entity investments in R&D&I.

The directors of the Parent Entity believe that it is probable that it will generate sufficient taxable profit in the future to enable the utilization of the amounts shown above, to which end it has capitalized all of the above unused tax credits and unused tax losses as deferred tax assets (Note 33).

In accordance with prevailing tax legislation, tax returns cannot be considered final until they have been inspected by the tax authorities or until the four-year inspection period has elapsed.

At 31 December 2017 the Parent Entity's tax returns for 2013 to 2016 for the principal taxes to which it is subject are open to inspection by the tax authorities.

The Parent Entity's Directors consider that any liabilities that could arise from the years open to inspection would not have a significant effect on the consolidated annual accounts for 2017. Due to the different interpretations that may be afforded to tax regulations applicable to the transactions performed by the Group, for the years pending inspection certain contingent tax liabilities could exist. However, in the opinion of the Parent Entity's Directors, the possibility of such contingent liabilities arising is remote and, in any event, the tax liability which could arise would not have a significant effect on the Group's consolidated annual accounts as a whole.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**42. Fair value of balance sheet assets and liabilities**

i) Fair value of financial assets and liabilities.

As mentioned in Note 13, the Group's financial assets are recorded in the consolidated balance sheet at their fair value, with the exception of Credits, loans and discounts, the Held-to-maturity investment portfolio and Equity instruments of which the market value cannot be reliability estimated. Similarly, the Group's financial liabilities are recorded in the accompanying consolidated balance sheet at their fair value, with the exception of Capital repayable on demand and Financial liabilities at amortized cost, which are not covered by accounting provisions.

The following table summarizes the fair values at the end of 2017 and 2016 assigned to the following financial assets and liabilities, classified in accordance with the various measurement methods applied by the Group:

	<u>2017</u>				
	<u>Total Balance</u>	<u>Fair Value</u>	<u>Fair value hierarchy</u>		
			<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash, cash balances at central banks and other on demand deposits	1,848,245	1,848,245	-	-	1,848,245
Financial assets held for trading	144,461	144,461	140,870	3,591	-
Financial assets designated at fair value through profit or loss	2,517	2,517	380	2,137	-
Available-for-sale financial assets	5,081,194	5,081,013	4,716,263	224,436	140,314
Loans and receivables	13,796,818	13,801,350	-	55,434	13,745,916
Investments held to maturity	410,937	371,512	370,270	1,242	-
Derivatives – Hedge accounting	143,642	143,642	-	143,642	-
<b>TOTAL FINANCIAL ASSETS</b>	<b>21,427,814</b>	<b>21,392,740</b>	<b>5,227,783</b>	<b>430,482</b>	<b>15,734,475</b>
Financial liabilities held for trading	1,533	1,533	589	944	-
Financial liabilities measured at amortized cost	19,505,437	19,505,437	-	-	19,505,437
Derivatives – Hedge accounting	238,838	238,838	-	238,772	66
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>19,745,808</b>	<b>19,745,808</b>	<b>589</b>	<b>239,716</b>	<b>19,505,503</b>
<u>2016</u>					
	<u>Total Balance</u>	<u>Fair Value</u>	<u>Fair value hierarchy</u>		
			<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Cash, cash balances at central banks and other on demand deposits	453,030	453,030	-	-	453,030
Financial assets held for trading	183,689	183,689	181,075	2,614	-
Financial assets designated at fair value through profit or loss	403	403	403	-	-
Available-for-sale financial assets	5,048,900	5,022,265	4,555,591	194,488	272,186
Loans and receivables	13,943,448	13,949,689	-	55,522	13,894,167
Investments held to maturity	439,533	531,311	528,899	2,412	-
Derivatives – Hedge accounting	186,213	186,213	-	186,213	-
<b>TOTAL FINANCIAL ASSETS</b>	<b>20,255,216</b>	<b>20,326,600</b>	<b>5,265,968</b>	<b>441,249</b>	<b>14,619,383</b>
Financial liabilities held for trading	2,297	2,297	744	1,553	-
Financial liabilities measured at amortized cost	18,487,909	18,487,909	-	-	18,487,909
Derivatives – Hedge accounting	178,447	178,447	-	178,447	-
<b>TOTAL FINANCIAL LIABILITIES</b>	<b>18,668,653</b>	<b>18,668,653</b>	<b>744</b>	<b>180,000</b>	<b>18,487,909</b>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The criteria used to determine fair value are as follows:

Level 1: using listed prices on active markets for the same financial instruments.

Level 2: using listed prices on active markets for similar instruments or other measuring techniques in which all significant inputs are based on market data that is observable either directly or indirectly.

Level 3: using measurement techniques in which some significant inputs are not based on observable market data.

The measurement techniques used, and the assumptions applied to determine fair value, were as follows:

- Cash, cash balances at central Banks and other on demand deposits: Fair value is considered to coincide with the carrying value as these consist of on demand deposits or amounts that can be realized in the short-term.
- Debt securities: For public debt assets and certain fixed-income securities issued by credit entities, fair value is based on listed prices on active markets (Level 1). Certain fixed-income securities whose returns are benchmarked to trends in interest rates were measured using valuation techniques based on discounted cash flow analysis taking the interest rate curve and market spreads for similar instruments as inputs (Level 2). The value of all other debt securities was measured using prices calculated by authorized external valuation agents (Level 3).
- Equity instruments: The listed price on active markets (Level 1) has been used, except for certain mutual funds and venture capital funds, for which the prices were calculated by external appraisers (Levels 2 and 3).

In addition, as at 31 December 2017 and 2016 there are unlisted equity instruments classified in the available-for-sale financial assets portfolio at historical cost amounting to 26,239 thousand euros and 26,635 thousand euros, respectively, which were therefore not considered in the above table.

- Loans and advances - Customers: The carrying amount of these loans is considered a good proxy for their fair value as the vast majority of loans granted by the former Caja Laboral are benchmarked to floating rates and/or, if not, they mature within 12 months of the reporting date. Moreover, the impairment provisions for loan losses on this portfolio were calculated in keeping with prevailing applicable regulations and these provisions are deemed sufficient to cover the related credit risk.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

However, in financial and economic scenarios such as the current situation, and given that there is no market for those financial assets, the amount by which they may be exchanged between interested parties could be different to their recognized net value since the potential buyer could not only discount the losses incurred and recognized in accordance with applicable accounting rules, but also the losses that could be incurred in the future in the case of a prolonged existence of the current economic situation, exceptional in terms of its length and effects.

- Financial liabilities measured at amortized cost: No significant differences are deemed to exist between their carrying value and fair value due to the fact that most are indexed to a variable interest rate and/or, if this is not the case, they mature within 12 months.

The reasons why there may be differences between fair value and the carrying value of financial instruments are as follows:

- For fixed rate instruments, the fair value varies based on market interest rates. The variance is higher the longer the instrument's residual life.
- For variable rate instruments, fair value may differ from carrying value if the margins relating to the interest rate of reference have changed since the instrument was issued. If the margins remain constant the fair value coincides with the carrying value only on the repricing dates. At all other dates there is interest rate risk for flows that have already been calculated.

The movement of the balances of financial assets and liabilities at fair value classified as Level 3 in the accompanying consolidated balance sheets is shown below:

	<u>Assets</u>	<u>Liabilities</u>
<b>Balances at 31 December 2015</b>	<b>297,281</b>	-
Valuation adjustment recorded on income statement	3,632	-
Valuation adjustment not recorded on income statement	16,841	-
Purchases, sales and liquidations	(45,568)	-
Net additions/(exists) on Level 3	-	-
Currency exchanges and others	-	-
<b>Balance as at 31 December 2016</b>	<b>272,186</b>	-
Valuation adjustment recorded on income statement	30,856	-
Valuation adjustment not recorded on income statement	12,286	66
Purchases, sales and liquidations	(175,014)	-
Net additions/(exists) on Level 3	-	-
Currency exchanges and others	-	-
<b>Balance as at 31 December 2017</b>	<b>140,314</b>	<b>66</b>

During 2017 and 2016, there were no transfers of financial instruments between the different levels of valuation.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

ii) Fair value of non-financial assets

The comparison at 31 December 2017 and 2016 between the carrying value in the balance sheet of the Group's non-financial assets which are measured other than at fair value together with the pertinent fair value is as follows:

	2017		2016	
	Value recorded	Fair Value	Value recorded	Fair Value
<b>Assets</b>				
Tangible assets:				
For own use and investment properties	315,527	360,671	342,816	364,652
Non-current assets and disposal groups classified as held for sale	227,235	227,235	278,987	278,987
Inventories	60,609	60,609	19,476	19,476

The fair value of these assets has been determined as follows:

- At 31 December 2017 and 2016 the fair value of the properties included under the headings Property, plant and equipment for own use and Investment properties was calculated, at 87% and 90%, respectively, of the carrying cost through valuations, performed in 2013 and 2017 by independent entities, in line with the rules set out by the Bank of Spain. For the rest of the buildings the previous valuations were updated prior to 2011 (internal valuations and assessments) to which, in light of the current situation and market expectations, the Entity applied an objectively calculated correction factor.

For all other items of property, plant and equipment, the respective carrying amounts were believed to provide the most reliable estimate of fair value at both year-ends.

- The fair value of non-current assets held for sale which are located in Spain has been estimated taking into account the expected recoverability, applying the parameters set out in Section V of Appendix IX to Bank of Spain Circular 4/2016, and for assets related to real estate development existing as at 31 December 2011, the criteria established in Royal Decree-Law 2/2012, of 3 February. In determining said value, the appraisals conducted by the valuation companies registered with the Bank of Spain have also been utilized, in accordance with MO ECO/805/2003 of 27 March and the current situation in the property market and the economic cycle.

The Entity mainly uses the services of the following valuation companies: Sociedad de Tasación, S.A., Krata, S.A., Técnicas de Tasación, S.A. and Servicios Vascos de Tasaciones, S.A.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**43. Guarantees given**

The breakdown of this heading as at 31 December 2017 and 2016 which relates to the amounts that the Group should pay on behalf of third parties in the event of default by the parties originally required to effect payment, as a result of the commitments assumed by the Group in the ordinary course of business is as follows:

	<u>2017</u>	<u>2016</u>
Financial guarantees	85,900	102,438
Other guarantees and sureties	131,812	146,972
Irrevocable documentary credits	11,553	10,332
	<u>229,265</u>	<u>259,742</u>

**44. Contingent commitments given**

The breakdown of this heading as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Balances drawable by third parties:	952,010	893,232
Credit institutions	165	-
The Public Administrations sector	137,152	103,008
Other resident sectors	823,077	781,122
Non-residents	182	139
Securities subscribed pending disbursement	397	8,963
Other contingent commitments	144,320	151,844
Documents delivered to Clearing Houses	144,320	151,844
	<u>1,105,293</u>	<u>1,045,076</u>

**45. Interest income**

The breakdown of this heading in the consolidated income statement for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Financial assets held for trading	1,387	1,458
Financial assets designated at fair value through profit or loss	48	-
Available-for-sale financial assets	76,451	87,570
Loans and receivables	185,743	209,227
Investments held to maturity	2,448	12,917
Derivatives - hedge accounting, interest rate risk	1,201	(13,569)
Other assets	8	44
Interest income from liabilities	946	1,896
	<u>268,232</u>	<u>299,543</u>

The "Loans and Receivables" heading includes 111,946 thousand euros in 2017 relating to mortgage-backed transactions (134,525 thousand euros in 2016).

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Most of the interest income was generated by financial assets of the Parent Entity which are measured either at amortized cost or at fair value through profit or loss.

The following is a breakdown of the origin of the interest income earned in the last two years:

	<u>2017</u>	<u>2016</u>
Loans and advances	181,390	206,097
Central Banks	-	-
Credit institutions	3,633	3,836
Customers	177,757	202,261
Debt securities	67,412	87,007
Money market transactions	339	1,018
Doubtful assets	2,105	1,156
Financial income from insurance activities	15,783	17,798
Rectification of revenues owing to hedging operations	1,201	(13,569)
Other interest	<u>2</u>	<u>36</u>
	<u>268,232</u>	<u>299,543</u>

Of the total interest income in the above table as at 31 December 2017 and 2016, most of it has been calculated using the effective interest rate method.

The distribution by geographical area of the number of the Group's bank branches at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Bizkaia	92	94
Gipuzkoa	69	73
Araba	33	36
Navarra	41	43
New Network	<u>89</u>	<u>89</u>
	<u>324</u>	<u>335</u>

#### **46. Interest expenses**

The breakdown of this heading in the consolidated income statement for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Financial liabilities held for trading	-	-
Financial liabilities designated at fair value through profit or loss	-	-
Financial liabilities measured at amortized cost	53,468	78,228
Derivatives - hedge accounting, interest rate risk	(45,238)	(51,456)
Other liabilities	89	70
Interest expenditure on assets	<u>12,570</u>	<u>1,573</u>
	<u>20,889</u>	<u>28,415</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

Most of the interest expenses were generated by financial liabilities of the Parent Entity which are measured at amortized cost.

The breakdown of interest expenses in the last two years is as follows:

	<u>2017</u>	<u>2016</u>
Deposits	53,466	78,900
Central Banks	-	3
Credit institutions	245	1,061
Customers	53,221	77,836
Money market transactions	-	139
Marketable debt securities (Note 36)	-	-
Rectification of expenses owing to hedging operations	(45,238)	(51,456)
Other interest	89	61
Interest expenditure on assets	12,572	771
	<u>20,889</u>	<u>28,415</u>

Of the total interest expenditure in the above table as at 31 December 2017 and 2016, most of it has been calculated using the effective interest rate method.

The rectification of expenses owing to hedging operations mainly refers to financial Swaps arranged to hedge the fair value of certain mortgage bond issues (Notes 36 y 28).

**47. Dividend income**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Equity instruments:	3,653	7,993
Shares	3,653	7,993
	<u>3,653</u>	<u>7,993</u>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**48. Share of profit or loss of entities accounted for using the equity method**

The breakdown of this heading in the consolidated income statement for the years ended 31 December 2017 and 2016 is as follows (Note 29):

	<u>2017</u>	<u>2016</u>
Associates	47	51
Jointly-controlled entities	-	-
	<u>47</u>	<u>51</u>

**49. Fee and commission income**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
For contingent exposures	3,140	3,606
For contingent commitments	1,038	1,052
For currency and foreign bank notes exchange	103	109
For collection and payment services	47,815	45,848
For securities services:	<u>22,756</u>	<u>21,789</u>
Underwriting and placement of securities	-	-
Purchase-sale of securities	870	850
Administration and custody	1,545	1,739
Asset management	20,341	19,200
For marketing of non-bank financial products:	<u>18,448</u>	<u>17,958</u>
Investment funds	1,920	1,748
Pension funds	15,056	14,849
Insurance	1,472	1,361
Others	-	-
Other fees	<u>14,623</u>	<u>15,099</u>
	<u>107,923</u>	<u>105,461</u>

**50. Fee and commission expenses**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Brokerage in asset and liability transactions	34	35
Fees assigned to other correspondent entities:	<u>3,805</u>	<u>3,695</u>
For collection or return of bills	4	6
For other items	3,801	3,689
Fees paid on securities operations	<u>934</u>	<u>1,105</u>
With market intermediaries	895	1,033
Others	39	72
Other fees	<u>6,754</u>	<u>6,929</u>
	<u>11,527</u>	<u>11,764</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**51. Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Available-for-sale financial assets	43,564	11,716
Loans and receivables	380	300
Investments held to maturity	39	-
	<u>43,983</u>	<u>12,016</u>
Gains	51,699	26,003
Losses	(7,716)	(13,987)
	<u>43,983</u>	<u>12,016</u>

**52. Gains or (-) losses on financial assets and liabilities held for trading, net**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Financial assets held for trading	870	1,836
	<u>870</u>	<u>1,836</u>
Gains	62,685	114,937
Losses	(61,815)	(113,101)
	<u>870</u>	<u>1,836</u>

**53. Gains or (-) losses on financial assets and liabilities recognized at fair value with changes in profit or loss, net**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Financial assets designated at fair value through profit or loss	159	(282)
	<u>159</u>	<u>(282)</u>
Gains	235	816
Losses	(76)	(1,098)
	<u>159</u>	<u>(282)</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**54. Gains or (-) losses from hedge accounting, net**

The breakdown of this heading in the consolidated income statement for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Hedging derivatives	(43,286)	(31,015)
Hedged items	<u>43,403</u>	<u>31,212</u>
	<u>117</u>	<u>197</u>
Gains	277,217	4,313,827
Losses	<u>(277,100)</u>	<u>(4,313,630)</u>
	<u>117</u>	<u>197</u>

“Gains or (-) losses from hedge accounting – Hedging derivatives” refers to the measurement adjustments of the hedging derivatives for fair value hedges, for the years 2017 and 2016. Also, the heading “Gains or (-) losses from hedge accounting – Hedged items” includes the valuation adjustments to the hedged items under these contracts designated as fair value hedges (Note 13.e).

**55. Exchange differences [gains or (-) losses], net**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Gains	92,703	155,823
Losses	<u>(92,741)</u>	<u>(154,793)</u>
	<u>(38)</u>	<u>1,030</u>

**56. Other operating income**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Sales and revenues from non-financial services rendered	2,062	4,957
Other operating revenues	<u>14,185</u>	<u>11,062</u>
Financial fees offsetting costs	2,888	2,337
Revenues from other operating leases (net) (Note 31)	5,188	4,485
Inventory variations in real estate assets	-	-
Other	<u>6,109</u>	<u>4,240</u>
	<u>16,247</u>	<u>16,019</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**57. Other operating expenses**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Contribution to Deposits Guarantee Fund (Note 10)	24,745	20,671
Contribution to National Resolution Fund (Note 10)	3,140	4,836
Mandatory allocation to welfare funds (Notes 4 and 34)	8,591	7,833
Purchases and expenses related to real estate assets	-	-
Other items	10,711	10,343
Change in inventories	-	-
	<u>47,187</u>	<u>43,683</u>

The amounts recorded under the heading “Other operating expenses - Mandatory allocation to welfare funds” in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 totalling 8,591 and 7,833 thousand euros, respectively, relate to the mandatory allocation to the Promotion and Education Fund in accordance with the Law on Cooperatives and the Parent Entity’s articles of association (Note 4).

In addition, the heading “Other operating expenses– Other” as at 31 December 2017 included the estimated financial contributions for the conversion of deferred tax assets into credit receivable by the Tax Authority amounting to 2,568 thousand euros (3,000 thousand euros in 2016).

**58. Income from assets under insurance and reinsurance contracts**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Revenues from insurance and reinsurance policies issued	202,919	177,357
	<u>202,919</u>	<u>177,357</u>

**59. Expenses on liabilities under insurance and reinsurance contracts**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Expenses for insurance and reinsurance policies	153,019	131,854
	<u>153,019</u>	<u>131,854</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**60. Administration costs**

a) Staff expenses

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Salaries and bonuses paid to serving employees	125,729	131,749
Social security contributions	5,436	5,812
Severance payments	2,137	1,658
Staff training expenses	1,144	1,547
Other staff costs	790	919
	<u>135,236</u>	<u>141,685</u>

As at 31 December 2017 and 2016 the Parent Entity records remuneration related to services provided in the course of business, as analyzed below:

	<u>2017</u>			<u>2016</u>		
	Subsidized interest	Market interest	Difference	Subsidized interest	Market interest	Difference
Low interest rate loans	<u>5</u>	<u>364</u>	<u>359</u>	<u>82</u>	<u>499</u>	<u>417</u>

The average number of employees of the Group in the years 2017 and 2016 distributed by categories is as follows:

	<u>2017</u>	<u>2016</u>
Directors	52	55
Managers	453	461
Specialists	869	942
Administrative personnel	<u>1,016</u>	<u>1,031</u>
	<u>2,390</u>	<u>2,489</u>

Of the total workforce at 31 December 2017, 15 people had some degree of recognized disability (14 at 31 December 2016).

As at 31 December 2017 and 2016 the distribution of the Group's personnel by gender is as follows:

	<u>Number of members</u>					
	<u>2017</u>			<u>2016</u>		
	Women	Men	Total	Women	Men	Total
Directors	7	46	53	5	50	55
Managers	140	312	452	132	321	453
Specialists	462	400	862	481	425	906
Administrative personnel	<u>604</u>	<u>395</u>	<u>999</u>	<u>613</u>	<u>420</u>	<u>1,033</u>
	<u>1,213</u>	<u>1,153</u>	<u>2,366</u>	<u>1,231</u>	<u>1,216</u>	<u>2,447</u>
Parent Entity	946	1,042	1,988	952	1,093	2,045
All other Investee Entities: Subsidiaries	<u>267</u>	<u>111</u>	<u>378</u>	<u>279</u>	<u>123</u>	<u>402</u>
	<u>1,213</u>	<u>1,153</u>	<u>2,366</u>	<u>1,231</u>	<u>1,216</u>	<u>2,447</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The breakdown of the number of members of the Governing Body of the Parent Entity by gender, at 31 December 2017 and 2016, was as follows:

	Number of members					
	2017			2016		
	Women	Men	Total	Women	Men	Total
Members of the Governing Board	6	6	12	3	11	14

Other administrative expenses

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	2017	2016
For buildings, installations and materials:	16,669	17,698
Rentals (Note 31)	5,867	6,003
Maintenance of fixed assets	6,683	7,115
Lighting, water and heating	2,658	2,997
Forms and office materials	1,461	1,583
IT	7,862	7,356
Communications	5,336	5,638
Advertising and publicity	8,025	8,868
Legal costs and lawyers' fees	3,957	3,643
Technical reports	28,412	27,654
Surveillance and transfer of funds services	1,898	1,908
Insurance and self-insurance premiums	962	1,066
By Governing and Control Bodies	177	196
Entertainment and staff travel expenses	1,822	2,127
Association charges	216	221
Administrative services subcontracted	6,354	6,145
Rates and taxes	9,362	10,930
Other expenses	6,067	3,094
	<b>97,119</b>	<b>96,544</b>

The leases under which the Group is the lessee largely refer to business premises used as branches by the Parent Entity's commercial network and which are formalized through contracts for specific terms which generally exceed 20 years.

In addition, "Other administrative expenses - Contributions and taxes" includes as at 31 December 2017 the tax on deposits with credit institutions amounting to 5,402 thousand euros (5,088 thousand euros in 2016) (Note 33).

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**61. Depreciation**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Property, plant and equipment:	17,928	19,657
Property, plant and equipment	17,080	18,653
For own use	12,447	14,697
Assigned under operating leases	4,633	3,956
Investment properties	848	1,004
Intangible assets	99	62
	<u>18,027</u>	<u>19,719</u>

**62. Provisions or (-) reversal of provisions**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Pensions and other post-employment defined benefit obligations (Note 38)	18,449	21,437
Commitments and guarantees given (Note 38)	(4,443)	(4,919)
Pending legal issues and tax litigation (Note 38)	-	-
Other provisions (Note 38)	12,779	8,306
	<u>26,785</u>	<u>24,824</u>

**63. Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Available-for-sale financial assets (Note 25)	1,892	2,833
Debt securities	1,263	(1,724)
Equity instruments	629	4,557
Loans and receivables (Note 26)	11,923	(35,194)
Customers	11,923	(35,194)
	<u>13,815</u>	<u>(32,361)</u>

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**64. Impairment or (-) reversal of impairment of investments in joint ventures and associates**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Associates (Note 29)	-	-
Jointly-controlled entities (Note 29)	-	-
	<u>-</u>	<u>-</u>

**65. Impairment or (-) reversal of impairment on non-financial assets**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Tangible assets (Note 31)	2,708	2,680
Other assets	-	-
	<u>2,708</u>	<u>2,680</u>

**66. Gains or (-) losses on derecognition of non-financial assets and shareholdings, net**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Net gains (losses) on the sale of tangible assets	5,465	(442)
Net gains (losses) on disposal of shareholdings	1	-
	<u>5,466</u>	<u>(442)</u>

**67. Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations**

The breakdown of this heading in the consolidated profit and loss account for the years ended 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Net gains/(losses) on sale of non-current assets	(27,713)	(23,297)
Impairment losses of Non-current assets for sale (Note 35)	30,127	(11,742)
	<u>2,414</u>	<u>(35,039)</u>



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**68. Transactions with Subsidiaries, Jointly-controlled entities and Associates**

The significant balances recorded as at 31 December 2017 and 2016 between the Parent Entity and Subsidiaries and the effect of the transactions between them during the years ended on the same date have been eliminated on consolidation. The summary of the balances as at 31 December 2017 and 2016 relating to assets and liabilities held with jointly controlled entities and associates is as follows:

	<u>2017</u>	<u>2016</u>
<b>Balances</b>		
Customer funds	-	-
Non-current assets for sale	-	-
Guarantees	-	-

The most significant transactions carried out in 2017 and 2016 with Jointly-controlled entities and Associates are as follows:

	<u>2017</u>	<u>2016</u>
Interest and similar charges	-	-
Fees collected	-	-
Interest and similar income	-	-

**69. Other information**

A breakdown of customer funds off the Group's consolidated balance sheet as at 31 December 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Managed by the Entity's Group:	4,282,539	3,892,822
Investment Funds and companies	2,208,094	1,868,333
Pension funds and EPSVs	1,670,810	1,639,971
Insurance contract saving	403,635	384,518
Customer portfolios managed on a discretionary basis	-	-
Marketed but not managed by the Entity's Group	843,894	500,550
	<u>5,126,433</u>	<u>4,393,372</u>

As at 31 December 2017, the balance of deposits of securities owned by third parties amounted to 4,321,753 thousand euros (4,703,839 thousand euros as at 31 December 2016).

Total debt securities assigned by the Group as at 31 December 2017 and 2016 amounted to €680,815 thousand and €1,250,447 thousand, respectively, which had been assigned to third parties and recognized mainly under the heading of Financial liabilities at amortized cost - Customer deposits on the balance sheet. The remaining balance at the end of each year is included under Financial liabilities at amortized cost - Deposits in credit institutions on the balance sheet.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**70. Information of issuers on the mortgage market and on the special accounting register**

As indicated in Note 36, the Parent Entity issued mortgage bonds, so that we include hereinafter the information on the data from the special accounting register of the issuing entity, referred to in Article 21 of Royal Decree 716/2009, of 24 April, by virtue of what is set out in Circular 7/2010, to credit entities, which develops certain aspects of the mortgage market and with a disclosure level established in Circular 5/2011, of 30 November, from the Bank of Spain.

Also, in accordance with the provisions of Royal Decree 716/2009, dated 24 April, which develops certain aspects of Law 2/1981, dated 25 March, regulating the mortgage market and other rules of the financial mortgage system, the Board of Directors of the Parent Entity states that, as at 31 December 2017, the Parent Entity has a set of policies and procedures to guarantee compliance with the regulations governing the mortgage market.

These policies and procedures include, among other items the following points:

The criteria for granting risks are based on the capacity of the borrowers to pay, and in estimating this the internal models (Scorings and Ratings) are a fundamental element.

The principal relieving factors admitted are the mortgage guarantee, with particular emphasis on the LTV ratio of the operation and the guarantors.

These models, based upon the data introduced and on the historic behaviour of certain variables, are capable of estimating the probability of payment default and therefore of assigning a first credit rating to the request. Each operation is classified on a scale of levels from lesser to greater risk, establishing a PD – Probability of Default for each one.

The models evaluate various variables that quantify the level of earnings or income, the equity or indebtedness, the payment behaviour, the degree of links and personal aspects of the borrower and certain characteristics of the risk operation.

Specifically, the current models consider the following types of variables: the personal characteristics, payment default history, the capacity to obtain income or earnings, debt profile, net patrimony, links with the entity, the characteristics of the operation itself and the coverage of the operation (mitigating factors).

Moreover, there are also procedures to check the information incorporated into the system covering the data introduced, especially those related to income, equity, the mortgage guarantee through a valuation of the property, the use of the financing, the general data on the client and the behaviour bases of the client.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

To determine the value of the real estate assets being used as a mortgage guarantee in the risk operation the valuations being employed must meet the following conditions:

- Be performed by a valuation company registered in the Official Registry of Valuation in the Bank of Spain.
- That the content of Ministerial Order OM ECO/805/2003 of 27 March is applied

The value of these assets is revised with a certain variable frequency depending on the classification of the operation they are guaranteeing, the amount and the LTV (value/risk), and various policies are established for operations classified as problematic (doubtful, substandard or foreclosed) and those classified as normal or for special monitoring.

a) Asset operations

The nominal value of the whole mortgage loans and credits portfolio pending as at 31 December 2017 and 2016 amounts to €10,312 million and €10,636 million, respectively, of which those that comply with the characteristics of being eligible (without considering the limits to their computation established in article 12 of the mentioned Royal Decree) amount to €7,301 and €7,549 million, respectively.

The following table shows the nominal value of the Entity's total loans and credits with mortgage guarantees, as well as those that are eligible in line with content of the norm applicable for the purpose of issuing mortgage bonds and securities:

	Million euros	
	2017	2016
	Nominal value	Nominal value
<b>Total loans (a)</b>	<b>10,920</b>	<b>11,495</b>
<b>Mortgage bonds issued</b>	-	-
Of which: loans recognized in balance sheet	-	-
<b>Mortgage transfer certificates issued</b>	<b>608</b>	<b>859</b>
Of which: loans recognized in balance sheet	608	859
<b>Mortgage loans securing financing received</b>	-	-
<b>Loans securing issues of mortgage bonds and covered bonds</b>	<b>10,312</b>	<b>10,636</b>
Non-eligible loans (b)	3,011	3,087
They fulfil requirements to be eligible, except the limit stipulated in Article 5.1 of RD 716/2009	1,565	1,996
Rest of non-eligible loans	1,446	1,091
Eligible loans (c)	7,301	7,549
Loans covering mortgage bond issues	-	-
Loans eligible for covered bond issue coverage	7,301	7,549
Non-computable amounts (d)	8	9
Computable amounts	7,293	7,540

- (a) Balance available pending collection of the loans and credits guaranteed by mortgages registered in the entity's favour (including those acquired through mortgage participations and certificates of mortgage transfers), although they have been removed from the balance sheet, whatever be the percentage that the risk represents of the amount of the latest valuation (*loan to value*).
- (b) Loans with mortgage guarantee not transferred to third parties or subject to financing received that do not meet the requirements of article 3 of Royal Decree 716/2009 for being eligible for the issue of mortgage bonds or mortgage securities.
- (c) Loans eligible for the issue of mortgage bonds or securities in line with article 3 of Royal Decree 716/2009, without deducting the limits to their computing established in article 12 of Royal Decree 716/2009.
- (d) Amount of the eligible loans that, in line with the criteria set in article 12 of Royal Decree 716/2009, are not computable to offer coverage for the issue of mortgage bonds or securities.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The following table shows a breakdown of the mortgage loans and credits according to the various attributes of these amounts at 31 December 2017 and 2016:

	Million euros			
	2017		2016	
	Loans that support the issue of mortgage bonds and mortgage securities (a)	Of which: Eligible loans (b)	Loans that support the issue of mortgage bonds and mortgage securities (a)	Of which: Eligible loans (b)
<b>TOTAL</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
<b>1 ORIGIN OF THE OPERATIONS</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
1.1 Originated by the entity	10,235	7,244	10,547	7,486
1.2 Subrogated from other entities	77	57	89	63
1.3 Rest	-	-	-	-
<b>2 CURRENCY</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
2.1 Euro	10,312	7,301	10,636	7,549
2.2 Rest of currencies	-	-	-	-
<b>3 PAYMENT SITUATION</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
3.1 Normal in payment	9,667	7,097	9,880	7,486
3.2 Other situations	645	204	756	63
<b>4 AVERAGE RESIDUAL MATURITY</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
4.1 Up to ten years	4,503	2,967	4,497	2,961
4.2 Over ten years up to twenty years	5,803	4,330	6,119	4,577
4.3 Over twenty years up to thirty years	6	4	20	11
4.4 More than thirty years	-	-	-	-
<b>5 INTEREST RATES</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
5.1 Fixed	323	160	176	64
5.2 Variable	-	-	-	-
5.3 Mixed	9,989	7,141	10,460	7,485
<b>6 OWNERS</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
6.1 Legal entities and individual entrepreneurs (business activities)	1,141	1	1,280	2
<i>Of which: Property construction and development</i>	86	-	128	-
6.2 Rest	9,171	7,300	9,356	7,547
<b>7 TYPE OF GUARANTEE</b>	<b>10,312</b>	<b>7,301</b>	<b>10,636</b>	<b>7,549</b>
7.1 Assets/finished buildings	10,213	7,290	10,501	7,536
7.1.1 Homes	9,622	7,270	9,867	7,514
<i>Of which: Homes with official protection</i>	280	201	310	228
7.1.2 Offices and commercial premises	326	16	345	18
7.1.3 Other buildings and constructions	265	4	289	4
7.2 Assets/Buildings under construction	8	-	6	-
7.2.1 Homes	8	-	6	-
<i>Of which: Homes with official protection</i>	-	-	-	-
7.2.2 Offices and commercial premises	-	-	-	-
7.2.3 Other buildings and constructions	-	-	-	-
7.3 Land	91	11	129	13
7.3.1 Developed	33	6	104	6
7.3.2 Rest	58	5	25	7

- (a) Balance available pending collection of the loans with mortgage guarantee, whatever be the percentage that the risk represents of the amount of the latest valuation (loan to value) not transferred to third parties nor affected by financing received.
- (b) Loans eligible for the issue of mortgage bonds or securities in line with article 3 of Royal Decree 716/2009, without deducting the limits to their computing established in article 12 of Royal Decree 716/2009.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The amount that, in line with the criteria set in article 12 of the above mentioned Royal Decree is computable to allow coverage to the issue of mortgage bonds as at 31 December 2017 and 2016 amounts to €7,293 million and €7,540 million, respectively.

In reference to the nominal and updated values, this latter calculated in line with article 23 of the above mentioned Royal Decree, as at 31 December 2017 and 2016, the Parent Entity had no mortgage bonds issued, and the nominal value of the mortgage loans and credits that, although still appearing in the portfolio, were mobilized through mortgage participations or mortgage transmission certificates as at 31 December 2017 and 2016 amount to €608 million and €859 million, respectively.

The nominal value of all non-eligible loans and mortgage loans totalled €3,011 million as at 31 December 2017 (€3,087 million as at 31 December 2016); loans not eligible because the limits stipulated in Article 5.1 of Royal Decree 716/2009 are not fulfilled but which fulfil the other eligibility requirements (stated in Article 4 of the Royal Decree) totalled €1,565 million and €1,996 million at the 2017 and 2016 year-ends, respectively.

The distribution of the nominal values of the mortgage loans and credits eligible for the issue of mortgage bonds and securities based upon the percentage that they represent on the latest valuation available for the purposes of the mortgage market, at 31 December 2017 and 2016, is as follows:

As at 31 December 2017

	Million euros				
	Principal disposed on the last available appraisal ( <i>loan to value</i> ) (b)				
	2017				
	Less than or equal to 40%	Greater than 40% and less than or equal to 60%	Greater than 60% and less than or equal to 80%	> 80%	TOTAL
<b>Loans eligible for the issue of mortgage bonds or securities (a)</b>	<b>2,328</b>	<b>2,677</b>	<b>2,296</b>	-	<b>7,301</b>
- On homes	2,310	2,661	2,287	-	7,258
- On others	18	16	9	-	43

As at 31 December 2016

	Million euros				
	Principal disposed on the last available appraisal ( <i>loan to value</i> ) (b)				
	2016				
	Less than or equal to 40%	Greater than 40% and less than or equal to 60%	Greater than 60% and less than or equal to 80%	> 80%	TOTAL
<b>Loans eligible for the issue of mortgage bonds or securities (a)</b>	<b>2,368</b>	<b>2,708</b>	<b>2,473</b>	-	<b>7,549</b>
- On homes	2,350	2,689	2,463	-	7,502
- On others	18	19	10	-	47

- (a) Loans eligible for the issue of mortgage bonds and securities, according to article 3 of Royal Decree 716/2009 without deducting the limits to their computing established in article 12 of said Royal Decree.  
(b) The loan to value is the ratio resulting from dividing the principal disposed of each operation on the value of the latest available appraisal.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The movements in the nominal values of the mortgage loans and credits that back the issue of mortgage bonds or securities (eligible or non-eligible) in the years 2017 and 2016 are as follows:

	Million euros	
	Eligible loans (a)	Non-eligible loans (b)
<b>1 Opening balance 2016</b>	7,911	3,034
<b>2 Derecognized during the year</b>	1,160	734
2.1 Terminations at maturity	9	28
2.2 Advanced cancellations	105	130
2.3 Subrogations from other entities	-	-
2.4 Rest	1,046	576
<b>3 Additions during the year</b>	798	787
3.1 Originated by the entity	446	227
3.2 Subrogations from other entities	-	-
3.3 Rest	352	560
3.4 Additions due to business combinations	-	-
<b>4 Closing balance 2016</b>	<b>7,549</b>	<b>3,087</b>
<b>1 Opening balance 2017</b>	7,549	3,087
<b>2 Derecognized during the year</b>	574	621
2.1 Terminations at maturity	15	21
2.2 Advanced cancellations	113	78
2.3 Subrogations from other entities	2	1
2.4 Rest	444	521
<b>3 Additions during the year</b>	326	545
3.1 Originated by the entity	324	542
3.2 Subrogations from other entities	2	3
3.3 Rest	-	-
3.4 Additions due to business combinations	-	-
<b>4 Closing balance 2017</b>	<b>7,301</b>	<b>3,011</b>

(a) Loans eligible for the issue of mortgage bonds or securities in line with article 3 of Royal Decree 716/2009, without deducting the limits to their computing established in article 12 of Royal Decree 716/2009.

(b) Loans with mortgage guarantee not transferred to third parties or subject to financing received that do not meet the requirements of article 3 of Royal Decree 716/2009 for being eligible for the issue of mortgage bonds or mortgage securities.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

The balances available of mortgage loans and credits that back the issue of Mortgage bonds and securities at 31 December 2017 and 2016 are as follows:

	Million euros	
	2017	2016
	<u>Principals available (a)</u>	<u>Principals available (a)</u>
<b>Mortgage loans that back the issue of mortgage bonds and securities</b>	<b>33</b>	<b>28</b>
- Potentially eligible (b)	-	-
- Non-eligible	33	28

(a) Amounts committed (limit) less the amounts used in all loans with a mortgage guarantee whatever be their percentage of total risk against the latest valuation (loan to value) not transferred to third parties nor affected to financing received. The available balance also includes the amounts that are only passed to promoters when they sell the homes.

(b) Potentially eligible loans for the issue of mortgage bonds and securities in line with article 3 of Royal Decree 716/2009

At 31 December 2017 and 2016 the Parent Entity has not identified substitution assets for the issue of live mortgage bonds, because it did not consider it to be necessary since the percentage of issues done, at those dates, over the total of eligible assets to support these issues were 18.83% and 27.49%, respectively, compared to the maximum of 80% established in the Article 16 of Law 2/1981, of 25 March, on the Regulation of the Mortgage Market.

**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

b) Liabilities operations

The following is a breakdown of the issues made and collateralized from the portfolio of mortgage loans and credits of the Entity at 31 December 2017 and 2016:

	Million euros			
	2017		2016	
<b>Mortgages</b>	<b>Nominal value</b>	<b>Average residual maturity (in months)</b>	<b>Nominal value</b>	<b>Average residual maturity (in months)</b>
<b>1 Mortgage bonds issued</b>	-		-	
<b>2 Mortgage warrants issued</b>	<b>1,375</b>		<b>2,075</b>	
<i>Of which: registered in liabilities on balance sheet</i>	1,225		1,225	
2.1 Securities representing debt. Issued through public offer	150		850	
2.1.1 Residual maturity up to one year	-		-	
2.1.2 Residual maturity greater than one year and up to two years	75		700	
2.1.3 Residual maturity greater than two years and up to three years	75		75	
2.1.4 Residual maturity greater than three years and up to five years	-		75	
2.1.5 Residual maturity greater than five years and up to ten years	-		-	
2.1.6 Residual maturity greater than ten years	-		-	
2.2 Securities representing debt. Rest of issues	-		-	
2.2.1 Residual maturity up to one year	-		-	
2.2.2 Residual maturity greater than one year and up to two years	-		-	
2.2.3 Residual maturity greater than two years and up to three years	-		-	
2.2.4 Residual maturity greater than three years and up to five years	-		-	
2.2.5 Residual maturity greater than five years and up to ten years	-		-	
2.2.6 Residual maturity greater than ten years	-		-	
2.3 Deposits	1,225		1,225	
2.3.1 Residual maturity up to one year	-		-	
2.3.2 Residual maturity greater than one year and up to two years	100		-	
2.3.3 Residual maturity greater than two years and up to three years	500		100	
2.3.4 Residual maturity greater than three years and up to five years	625		1,125	
2.3.5 Residual maturity greater than five years and up to ten years	-		-	
2.3.6 Residual maturity greater than ten years	-		-	
<b>3 Mortgage Participations issued (b)</b>	-		-	
3.1 Issued through public offer	-		-	
3.2 Rest of issues	-		-	
<b>4 Mortgage transfer certificates issued (b)</b>	<b>608</b>	<b>235</b>	<b>859</b>	<b>243</b>
4.1 Issued through public offer	-	-	-	-
4.2 Rest of issues	608	235	859	243

- (a) The mortgage warrants issued include all those issued by the entity pending amortization, independently of not being registered in liabilities (because they were not placed with third parties or were re-bought)
- (b) The amount of mortgage participations and of the mortgage transfer certificates issued corresponding exclusively to the mortgage loans and credits registered in assets (held on the balance sheet).



**NOTES TO THE CONSOLIDATED ANNUAL FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**  
(Expressed in thousands of euros)

**71. Information on the average supplier payment period. Third Additional Provision. Disclosure requirement Law 15/2010**

In accordance with Law 31/2014 of 3 December on the improvement of corporate governance which amended Additional Provision Three of Law 15/2010 of 5 July on the amendment of Law 3/2004 of 29 December, which implemented measures to combat late payment in business transactions, and considering the Single Additional Provision of the Resolution of 29 January 2016 by the Institute of Accountants and Auditors, for the purpose of complying with the relevant disclosure requirements, information on the average supplier payment period during 2017 is set out below:

	<b>Days</b>	
	<b>2017</b>	<b>2016</b>
Average supplier payment period	10	15
Transactions paid ratio	10	14
Transactions pending payment ratio	22	17
	<b>Amount (thousand Euro)</b>	
	<b>2017</b>	<b>2016</b>
Total payments made	281,418	322,193
Total payments outstanding	5,643	2,578

**72. Business combinations and the acquisition of participation in Dependent, Jointly-controlled and Associated Entities**

- a) Information on acquisitions of equity in Dependent, Jointly-controlled and Associated Entities

In 2017 there were no acquisitions in the share capital of Subsidiary, Jointly Controlled and Associated Entities of any significance to the Group.

- b) Business combinations

During 2017, there were no business combinations of relevance to the Group.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**
**INDIVIDUAL BREAKDOWN OF GROUP COMPANIES AND OTHER SHAREHOLDINGS AT 31 December 2017**

(Expressed in thousands of euros)

Company	Address	Business activity	2017								
			Ownership interest %		Carrying amount			Investee earnings data (*)			
			Direct	Indirect	Gross	Impairment	Net	Assets	Equity	Income from services/sales	Net profit (loss)
<b>Subsidiaries:</b>											
Seguros Lagun-Aro Vida, S.A. (a)	Bilbao	Insurance	76%	24%	25,943	-	25,943	546,386	65,361	69,886	2,319
Seguros Lagun-Aro, S.A.	Bilbao	Insurance	49.64%	50.36%	17,649	-	17,649	220,394	59,873	92,280	6,971
Caja Laboral Gestión, S.G.I.I.C, S.A.	Mondragón	Investment fund manager	100%	-	6,281	-	6,281	12,753	8,458	16,128	921
Caja Laboral Pensiones, G.F.P., S.A.	Mondragón	Pension fund manager	100%	-	2,500	-	2,500	3,399	2,665	2,975	66
Caja Laboral Euskadiko Kutxa Cartera, S.L.U.	Mondragón	Holding company	100%	-	59,673	-	59,673	64,645	64,637	3,485	3,469
Caja Laboral Bancaseguros O.B.S.V., S.L.U.	Bilbao	Bancassurance operator	100%	-	10	-	10	12,654	4,091	35,746	1,702
Sociedad Gestión Activos Caja Laboral, S.A.U.	Mondragón	Property Asset Manager	100%	-	4,968	(4,000)	968	8,002	7,182	2,998	(29)
ISGA Inmuebles, S.A.	Mondragón	Property Asset Manager	100%	-	108,085	(61,445)	46,640	225,225	190,282	50,462	(21,854)
					<u>225,109</u>	<u>(65,445)</u>	<u>159,664</u>				

Company	Address	Business activity	2017								
			Ownership interest %		Carrying amount			Investee earnings data (*)			
			Direct	Indirect	Gross	Impairment	Net	Assets	Equity	Income from services/sales	Net profit (loss)
<b>Associates</b>											
ICR Institutional Investment Management SGIIC, S.A.	Madrid	Investment fund manager	21.43%	-	30	-	30	1,123	985	1,482	217
					<u>30</u>	<u>-</u>	<u>30</u>				

(a) As at 31 December 2017 the Parent Entity has an uncalled share capital, for the share holdings in Seguros Lagun-Aro Vida, S.A. amounting to 8,565 thousand euros.

(\*) The above figures for equity relate to the standardized financial statements of the investee entities as at 31 December 2017.

This appendix forms an integrated part of Note 27 to the consolidated annual accounts and should be read together with it.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**
**INDIVIDUAL BREAKDOWN OF GROUP COMPANIES AND OTHER SHAREHOLDINGS AT 31 DECEMBER 2016**  
**(Expressed in thousands of euros)**

Company	Address	Business activity	2016								
			Ownership interest %		Carrying amount			Investee earnings data (*)			
			Direct	Indirect	Gross	Impairment	Net	Assets	Equity	Income from services/sales	Net profit (loss)
<b><u>Subsidiaries:</u></b>											
Seguros Lagun-Aro Vida, S.A. (a)	Bilbao	Insurance	76%	24%	25,943	-	25,943	530,242	70,410	46,291	3,520
Seguros Lagun-Aro, S.A.	Bilbao	Insurance	49.64%	50.36%	17,649	-	17,649	215,472	59,385	90,119	6,070
Caja Laboral Gestión, S.G.I.I.C., S.A.	Mondragón	Investment fund manager	100%	-	6,281	-	6,281	12,078	8,410	15,039	873
Caja Laboral Pensiones, G.F.P., S.A.	Mondragón	Pension fund manager	100%	-	2,500	-	2,500	3,281	2,616	2,826	18
Caja Laboral Euskadiko Kutxa Cartera, S.L.U.	Mondragón	Holding company	100%	-	59,673	-	59,673	61,171	61,167	-	(10)
Caja Laboral Bancaseguros O.B.S.V., S.L.U.	Bilbao	Bancassurance operator	100%	-	10	-	10	9,022	3,068	33,133	678
Sociedad Gestión Activos Caja Laboral, S.A.U.	Mondragón	Property Asset Manager	100%	-	4,968	(4,000)	968	10,275	8,849	5,806	(1,014)
Credilka, S.A.	Bilbao	Trading company	100%	-	1,620	-	1,620	2,477	2,477	-	(1)
ISGA Inmuebles, S.A.	Mondragón	Property Asset Manager	100%	-	51,431	(33,487)	17,944	243,494	202,930	61,459	(58,697)
					<u>170,075</u>	<u>(37,487)</u>	<u>132,588</u>				

Company	Address	Business activity	2016								
			Ownership interest %		Carrying amount			Investee earnings data (*)			
			Direct	Indirect	Gross	Impairment	Net	Assets	Equity	Income from services/sales	Net profit (loss)
<b><u>Associates</u></b>											
ICR Institutional Investment Management SGIIC, S.A.	Madrid	Investment fund manager	21.43%	-	30	-	30	963	768	1,594	236
					<u>30</u>	<u>-</u>	<u>30</u>				

(a) As at 31 December 2016 the Parent Entity has an uncalled share capital, for the share holdings in Seguros Lagun-Aro Vida, S.A. amounting to 8,565 thousand euros.

(\*) The above figures for equity relate to the standardized financial statements of the investee entities as at 31 December 2016. In certain instances where they relate to prior closings, in no event more than three months previously, the Parent Entity considers that they do not differ significantly from the forecast definitive financial statements at 31 December 2016.

This appendix forms an integrated part of Note 27 to the consolidated annual accounts and should be read together with it.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**

**AGENCY CONTRACTS AT 31 December 2017 AND 2016**

<b>Name</b>	<b>Address</b>	<b>ID Code</b>	<b>Date of grant of powers</b>	<b>Date of finalization of mandate</b>	<b>Geographical scope</b>	<b>Scope of powers</b>
Caja Laboral Banca Seguros O.B.S.V., S.L.U.	Gran Vía Don Diego López de Haro, 2- Bilbao	B 75060988	01/01/2013	Indefinite	Domestic	<ul style="list-style-type: none"> <li>- Handle operations involving current accounts, savings accounts, term deposits, investment funds, pension plans and welfare plans, signing all necessary documents.</li> <li>- Process loans and other risk operations for the Entity.</li> <li>- Correspond with the Entity and keep in contact with the public, organising the work in the timetable and the form it considers appropriate, in accordance with rules and instructions received from the Entity</li> </ul>

**ANNUAL BANKING REPORT**

**Information at 31 December 2017 on the Laboral Kutxa Group in compliance with Law 10/2014 and EU Parliament and Council Directive 2013/36/EU**

The present information has been compiled in compliance with the provisions of Article 87 and Transitional Provision 12 of Law 10/2014 of 26 June 2014 on the organization, supervision and solvency of credit institutions, published in the Official State Gazette of 27 June 2014, which transposed Article 89 of European Parliament and Council Directive 2013/36/EU of 26 June 2013 relating to access to the business of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (commonly known as CRD IV).

In accordance with said regulations, credit institutions are required to report to the Bank of Spain and publish annually, specifying for the countries in which they are established, the following consolidated information for each financial year:

- a) Name, nature and geographical location of the activity.
- b) Business volume.
- c) Number of full time employees.
- d) Gross profit/(loss) before taxes.
- e) Corporate income tax.
- f) Grants or public aid received.

Therefore, the above-mentioned information is set out below:

- a) Name, nature and geographical location of the activity

Caja Laboral Popular Coop. de Crédito (hereinafter the Parent Entity, Laboral Kutxa or Caja Laboral), with registered office in Mondragón (Gipuzkoa), was formed on 2 November 2012 as a new credit cooperative as a result of the merger, through the formation of a new entity, between Caja Laboral Popular Coop. de Crédito and Ipar Kutxa Rural, S.Coop. de Crédito. This entity is a qualified cooperative.

The Articles of Association of the Group's Parent Entity state that its business operations will not be limited to any specific territory and that its corporate purpose is to service the financial needs of its members and third parties by carrying out the activities typical of credit institutions. To this end, it may carry out all kinds of lending, borrowing and servicing operations which financial institutions are permitted to provide, including those relating to the promotion and fulfilment of its cooperative purpose, paying particular attention to its members' financial needs and complying with the legal limits on lending to third parties.

Appendix I to these consolidated Annual Accounts of the Laboral Kutxa Group for the year ended 31 December 2017, lists the companies operating in each jurisdiction, including among other details their names, geographical location and area of activity.

- b) Business volume, number of full-time employees, gross profit before taxes and corporate income tax

	<b>Business Volume (000 Euros)</b>	<b>No. equivalent full time employees</b>	<b>Gross income before taxes</b>	<b>Corporate income tax</b>
<b>Spain</b>	455,490	2,261	125,680	12,831
<b>TOTAL</b>	<b>455,490</b>	<b>2,261</b>	<b>125,680</b>	<b>12,831</b>

For the purposes of this information, “business volume” is considered to be the gross margin disclosed on the consolidated income statement for December 2017. The data for equivalent full time employees has been obtained from information on the workforce of each company/country at the end of 2017.

The return on the Group's assets calculated as net profits attributed to the Parent Entity divided by total assets as at 31 December 2017 stood at 0.51%.

- c) Grants or public aid received

Grants and public aid received by the Laboral Kutxa Group during 2017 were not significant.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**  
**DIRECTORS' CONSOLIDATED REPORT FOR 2017**

The IMF's forecasts of growth in worldwide GDP for 2017 show growth of 3.7% compared to 3.2% at the end of 2016.

2017 was marked by a 23.8% increase in the price of oil, although the average price for the year was 52% below the average price in 2013. The Euro appreciated against the dollar after the depreciations experienced in 2015 and 2016.

In the United States, in relation to monetary policy, in November the FED agreed on a third interest rate hike in 2017, bringing it within the range of 1.25% to 1.5%. The United States is expected to end 2017 with a growth of 2.3% as a result of good financing conditions and high levels of business and consumer confidence.

For the Eurozone, the IMF expects stable and uneven growth in its member countries. The year 2017 is expected to close with a 2.4% increase in GDP. The basis for this growth in 2017 can be attributed to the acceleration of exports in the face of the general upturn in international trade and the continued growth in domestic demand supported by financial conditions. The sturdiness of the growth in Germany is notable, with moderate inflation but with the threat of political instability due to difficulties in reaching a government pact. On the negative side, Italy continues to show poor growth.

During the 2017 financial year the ECB did not change interest rates and continued to apply unconventional monetary measures.

The Spanish economy is projected to grow by 3.1% at the end of 2017, well above the forecasts made by analysts at the beginning of the year, supported by the good performance of the European economy and domestic demand, both in terms of consumption and investment, which have offset the negative effect of political instability. Meanwhile, in 2017 the Basque economy maintained the growth pattern of the Spanish economy with an expected growth rate of 3%, with the progressive improvement in growth in the industrial sector being particularly noteworthy.

The transparency tests published this year by the European Banking Authority (EBA) have shown an improvement in the capitalization of European banks as well as a reduction in the levels of non-productive assets. The improvement in the average profitability of the banks during the year hides a significant dispersion between countries, and was based on the improvement in the rates of doubtful assets and on the increase in fees, but in many cases it is still below the cost of capital.

In the banking sector in Spain, the reduction in credit to the private sector was maintained throughout 2017, although this fall was smoothed out thanks to the sustained growth in consumer finance and SMEs and an improvement in the number of mortgage transactions for the purchase of homes. Nevertheless, the decline in lending to large companies has continued.

The reduction in doubtful assets continued with a 7.85% drop in the doubtful assets ratio of loans and discounts to other resident sectors, with a rise in doubtful assets in consumer finance, probably due to the higher volume of loans and to the entry into this segment of companies with limited experience in this area. However, the reduction in non-performing loans arising from the cycle is noteworthy.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**  
**DIRECTORS' CONSOLIDATED REPORT FOR 2016**

Deposits are stagnating, reflecting a progressive transfer to off-balance-sheet positions in search of profitability (with expected growth of over 12% in 2017) and from time deposits to overnight positions, which are expected to account for 75% of total deposits at the end of 2017.

As for the profitability of the banking business, the net profit expected at the end of 2017 is 80% higher than the 2016 figure, mainly due to lower requirements for impairment provisions which, together with an improvement in operating expenses, offset the reduction in net interest income and net trading income. As a result, the anticipated ROE is 5%, well above the 2.8% in 2016.

With regard to the solvency of the banks, the CET1 stood at 11.57% in phased in and 10.59% in fully loaded as at June 2017.

In this context, the Laboral Kutxa Group has managed to compensate the reduction in financial activity margins, thanks to a containing expenditure policy and to its high quality loan portfolio, reinforcing its high level of solvency.

The key figures of the business are set out below:

Total assets amounted to 22,435.9 million euros, a 5.26% increase on the previous year's figure.

Customer deposits amounted to 18,612.8 million euros, 4.02% more than at the end of 2016, mainly due to the increase of 2,049.9 million euros in demand deposits, 18.10%, due in part to the transfer of funds from time deposits, which reduced their balance by 575.1 million euros.

Loans and advances to customers totalled €13,404.3 million at the 2017 year-end. If we exclude the effect of assets acquired under repo agreements and the fluctuation in other financial assets, the traditional lending activity has declined by 0.95% although there has been a major increase in home loans, consumer loans and lending to companies.

The number of doubtful risk loans to customers fell 12.96% and the non-performing loans ratio under the heading "Other resident sectors" fell to 5.09% at the end of 2017, which is significantly lower than the sector average, which for deposit institutions stands at 7.85%.

Meanwhile, available-for-sale financial assets amounted to 5,081.2 million euros and slightly reduced their share on the balance sheet to 22.65%. As at 31 December 2017, these portfolios reflected net capital gains of 139.9 million euros in other accumulated comprehensive income.

Productivity and liquidity indicators continue on sufficient levels in both absolute and relative terms. The efficiency ratio, measured as administration expenses/gross income pre-FEPC, stood at 55.3% in 2017 and the structural liquidity ratio, calculated in terms of loans/deposits, stood at 79.1%.



**CAJA LABORAL POPULAR COOP. DE CRÉDITO**  
**DIRECTORS' CONSOLIDATED REPORT FOR 2016**

Concerning solvency, the Entity's eligible capital calculated on a consolidated basis as at 31 December 2017 stands at €1,615.9 million. The CET1 (Common Equity Tier 1) ratio is 18.14%, one of the best in the sector and the total solvency ratio stands at 18.50%.

On the income statement, the following income and expense items should be noted:

Profit net of tax was 112.8 million euros in 2017, reaching 121.4 million euros in profit prior to the allocation to welfare projects, exceeding the forecasts in the entity's Management Plan.

Despite an environment of interest rates as low as the current one, which has a direct influence on the first margins, income from interest rose to 247.3 million euros.

The sum of dividends, net commissions, gains on available-for-sale and held-for-trading portfolios, with other operating income and income from the insurance business in 2017 amount to €164.1 million, such that the gross income stands at 411.5 million euros.

In terms of costs, the Entity has continued its policy of containment and rationalization of costs, which has led to a 2.47% reduction in administrative expenses, which stands at € 232.4 million.

The effect on profit and loss of impairment losses, together with the provisions made and the results from non-current assets held for sale, are quantified at 40.9 million. In this respect, the entity has maintained its traditional valuation policy.

As regards the Entity's main risks, a breakdown of these is included in Notes 15 to 21 to the 2017 annual accounts.

The insurance business contributed 37.5 million euros to the Laboral Kutxa Group's overall results, as a result of the good performance in premium renewal and a better than expected claim rate.

In the real estate sector, the process of reducing risk positions continued in 2017 with the real estate development and construction business falling by 84.1 million euros to 933.4 million euros at the end of the year, with associated hedges exceeding 65% of this balance.

Once again, the low interest rates and the reduction in business volume will weigh down the profitability levels of credit institutions in 2018, to which must be added the new accounting criteria that will lead to a lower contribution of financial operations to earnings. Therefore, the lower need for provisions due to the reduction in non-performing loans, such as cost reduction policies and the appropriate management of non-performing assets, will be key.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**  
**DIRECTORS' CONSOLIDATED REPORT FOR 2016**

In this difficult scenario for the next year, the Entity expects that the decrease in financial costs will not compensate the lower contribution to the margin of the credit investment, which will lead to a reduction of the net interest income. The gross margin will also be affected by the lower contribution to net trading income, but the expected reduction in administrative expenses and the lower need for provisions will make it possible to achieve an after-tax result similar to that achieved in 2017.

With regard to business volume and intermediated resources, the reduction of cost of liabilities will continue, although the margin of reduction is lower, which means the transfer from Term deposits to cash balances, that have already taken place during 2017 will be maintained, along with the increase in off-balance sheet resources.

An increase in consumer credit and risk amounts for non-real estate companies is foreseeable. There will be a significant increase in the formalization of housing loans, but not enough to increase the balances, which, with the decrease of credit to the real estate sector, will cause, as in previous years, a slight reduction of credit investment.

The volume of doubtful risk will continue to decline due to the reduction in non-performing assets, although the reduction in the doubtful assets ratio is expected to be more moderate than in previous years.

In a market environment dominated by zero and negative interest rates and difficulties in making the profit and loss account profitable, the priority of the year is to defend the profit and loss account, so that the basic strategic approach remains twofold. First, on the commercial side, the focus will continue to be on optimizing recurrent revenues, combining business growth with strict cost and price controls. Secondly, in structural terms, the search for efficiency, productivity and the adjustment of operating costs will be strengthened by promoting actions to adjust the workforce and, in parallel, by aligning the commercial model and the organizational structure to a business environment that generates lower results, and which requires a proactive adaptation to the accelerated advance of digitalization and the omni-channel nature of the banking business.

The average payment time to suppliers during 2017 was 10 days, below the maximum legal period of 30 days established in Law 15/2010 dated 5 July, which sets out measures to combat late payment in commercial transactions, amended by Law 31/2014 dated 3 December, which amends the Law on Capital Companies to improve corporate governance, and taking into account the Single Additional Provision of the Resolution dated 29 January 2016 by the Institute of Accountants and Auditors. The average payment period has been calculated in accordance with said law.

Royal Decree Law 18/2017 dated 24 November on non-financial information and diversity regulates the disclosure of information on these two aspects. Caja Laboral, as a public interest entity, has published in an additional document, which forms part of the Management Report, the Statement of Non-Financial Information relating to the Caja Laboral Group that responds to the obligations contained in the above-mentioned regulations.

**CAJA LABORAL POPULAR COOP. DE CRÉDITO  
DIRECTORS' CONSOLIDATED REPORT FOR 2016**

In addition, both Laboral Kutxa and the two insurance companies that make up Seguros Lagun Aro publish annual Corporate Responsibility Reports, in accordance with international standards, which can be used to provide more detailed information on these matters.

In accordance with applicable legislation, the Directors' Report and the Annual Corporate Governance Report of Caja Laboral Popular are attached in the following Appendix.



# NON-FINANCIAL INFORMATION STATEMENT

February 2018

**LABORAL**  
kutxa



This Statement belongs to the Management Report and is produced in compliance with RDL 18/2017 dated 24 November on non-financial reporting and diversity, also taking into account the European Commission Communication 2017/C 215/01 on Non-financial reporting guidelines.

It concerns the consolidated Group and, therefore, includes both banking and insurance activities. Both LABORAL Kutxa and the two insurance companies that make up Seguros Lagun Aro publish annual Reports on Corporate Social Responsibility - CSR, in accordance with international standards, in which the information included therein can be consulted in greater detail. In the LABORAL Kutxa CSR Report is also included information relating to Caja Laboral Bancaseguros, OBSV, an investee company dedicated to insurance brokering, whose personnel come from the former network of offices owned by Seguros Lagun Aro and which have been incorporated into the offices of LABORAL Kutxa.

This statement takes a concise approach to the disclosure of the most significant information.

*"Adequate disclosure of non-financial information is an essential element to enable the sustainability of financial activity"*. In relation to the identification and evaluation of risks related to all the activities carried out by LABORAL Kutxa and its disclosure:

- With respect to risks in general, the annual strategic management process reviews the risks and opportunities identified in the various markets and businesses. The annual publication of *Information of Prudential Relevance* describes in detail the policy, objectives and procedures for decision-making and the setting of operational limits that allow the generation of recurring earnings, ensuring the bank's solvency. This risk analysis has a predominantly financial focus. It also describes the activities of the various bodies that participate in these procedures, including the involvement of the highest management body, the Governing Board, which is ultimately responsible for monitoring and supervising the various risks.
- With regard to all the activities and initiatives carried out by the Group in relation to CSR, the CSR Committee is the body delegated by the Board of Directors to propose, coordinate and supervise these activities. Since 2004, LABORAL Kutxa's annual CSR Report has followed the international guidelines for disseminating financial and non-financial information in the *Global Reporting Initiative – GRI*. The Annual Report is verified by Aenor.
- Specifically in relation to the management of environmental risks, since 2001 LABORAL Kutxa has had an Environmental Management System (EMS) in accordance with the ISO 14001 Standard: 2015. This systematic approach provides *"information to senior management to generate long-term success and create options to contribute to sustainable development"*. This system is also audited annually by Aenor.
- With respect to the Health, Safety and Welfare of workers, the Entity also applies a management system, in accordance with the OHSAS 18001:2007 standard, which exceeds legal requirements, seeking to *"achieve and demonstrate a solid performance of Occupational Health and Safety (OHS) by controlling its risks with regard to OHS, in accordance with its OHS policy and objectives"*. This system is audited by Ondoan.

## 1. BRIEF DESCRIPTION OF THE GROUP'S BUSINESS MODEL

### 1.1. BUSINESS MODEL





LABORAL Kutxa, is shown on its corporate website as *a solid and responsible model of cooperative and participative banking.*

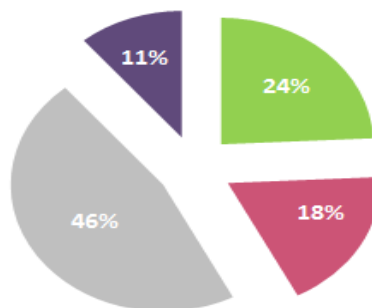
*“LABORAL Kutxa represents a different way of banking, based on cooperation and commitment to our society. Our main objective is the satisfaction of each customer and the generation of wealth and employment in our environment. We are a Cooperative Bank, guided by values and a philosophy that lead us to prioritise the common interest over the individual, to make decisions in a participative and responsible way and to reinvest our profits in society.”*

It is a credit cooperative in which the majority of the capital is held by the cooperatives of the MONDRAGÓN group and by working or retired members (collaborative partners).

**SHARE CAPITAL AT 31/12/2017**  
**727.2 M EUROS**

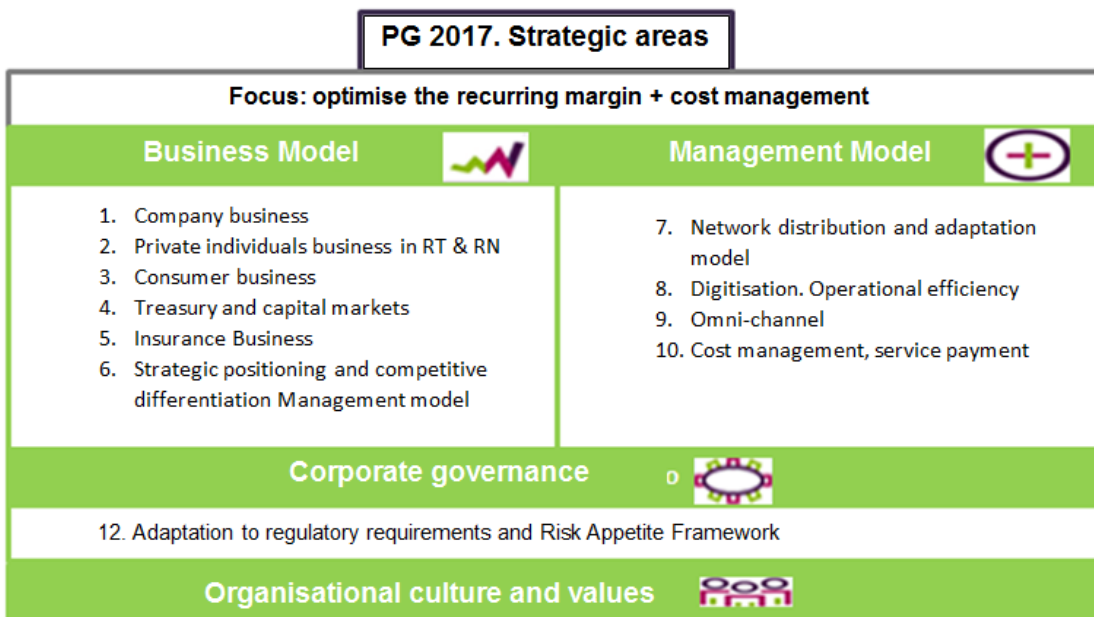
#### Distribution by type:

-  Working partners
-  Collaborative partners
-  Other individuals
-  Associated cooperatives



### PRODUCTS AND MARKETS

The attached graph describes the basic concepts identified in its strategic analysis and which describe the priority products-markets in its activities during the financial year.



LABORAL Kutxa incorporates the insurance activity within a strategy of Banking and Insurance, so that the Group companies (Seguros Lagun Aro SA in the Non-Life areas and Seguros Lagun Aro Vida) market their products for the most part through the offices and the website of LABORAL Kutxa. Seguros Lagun Aro complements these banking channels with a network of selected brokers.

The distribution of its offices by geographical areas where LABORAL Kutxa operates is as follows:

Geographical area	Number of offices for private customers	
	2016	2017
Araba	36	33
Aragon	19	19
Asturias	10	10
Bizkaia	94	92
Cantabria	4	4
Castille and Leon	38	38
Catalonia	1	1
Gipuzkoa	73	69
La Rioja	8	8
Madrid	9	9
Navarra	43	41
<b>Regional Administration 1</b>	<b>178</b>	<b>172</b>
<b>Regional Administration 2</b>	<b>157</b>	<b>152</b>
<b>Total number of offices</b>	<b>335</b>	<b>324</b>

It also has a specialised network of companies (to which must be added the Cooperatives and Large Companies office and the Public Sector office), with the following distribution:

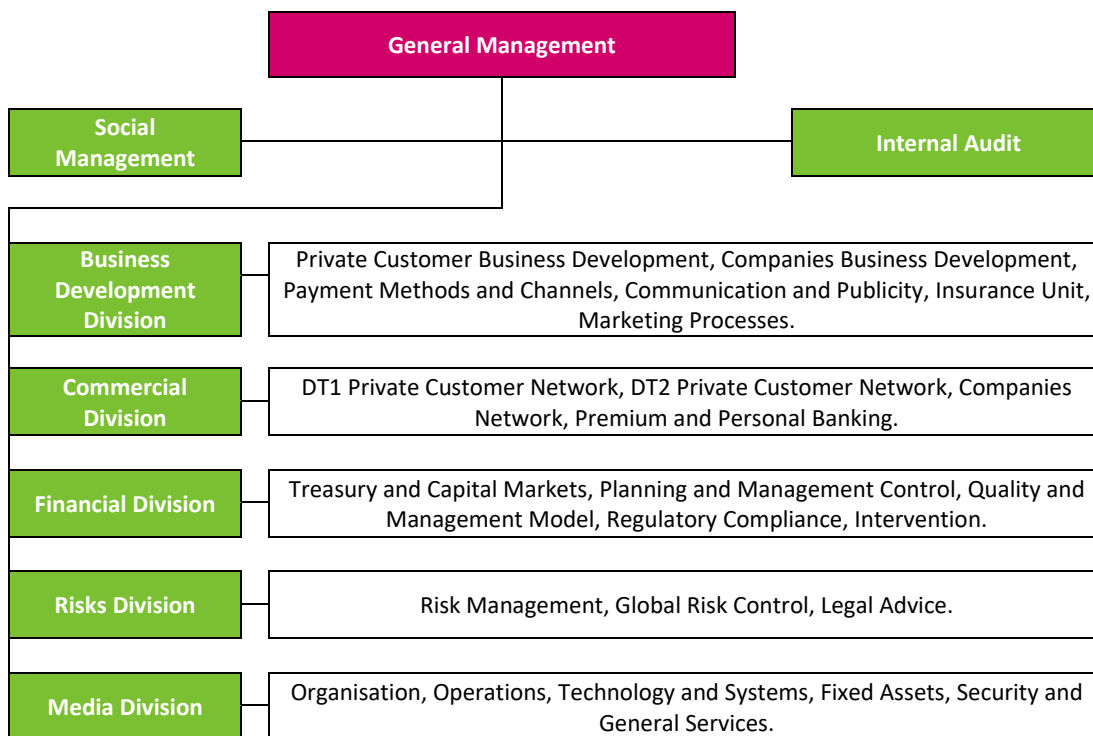
Geographical área	2016	2017
Gipuzkoa	2	2
Navarra	1	1
Madrid	1	1
Castille and Leon	1	1
Bizkaia	3	3
Araba- La Rioja	1	1
<b>Total number of offices</b>	<b>9</b>	<b>9</b>

**Number and geographical distribution of offices for private customers**



**ORGANISATIONAL STRUCTURE**

On 01/01/2017, in the interests of greater efficiency, a new organisational chart was introduced grouping together certain functions. The new structure is basically spread across 5 large functional areas and expanded through the various Departments, Sections, Zones and Network of offices.



In the Private customer offices there are LABORAL Kutxa staff, as well as staff from its subsidiary **Caja Laboral BancaSeguros SLU, associated banking and insurance operator - CLBS**. CLBS incorporated all the people coming from Seguros Lagun Aro who were part of the Sales Network of the "Direct Channel" of Seguros Lagun Aro, and also some other support people, basically in Marketing activities.

**INVESTEES COMPANIES**

Below are the investee companies that make up the LABORAL Kutxa Group:

Dependent Entities	Activity	% Owned
Seguros Lagun Aro Vida, S.A.	Insurance	100%
Seguros Lagun Aro, S.A.	Insurance	100%
Caja Laboral Gestión SGIIC, S.A.	Investment fund manager	100%
Caja Laboral Pensiones GFP, S.A.	Pension fund manager	100%
ISGA Inmuebles, S.A.	Real Estate Developer	100%
Caja Laboral Euskadiko Kutxa Cartera, SLU	Holding company	100%
Sociedad Gestión Activos Caja Laboral, SAU	Property Asset Manager.	100%
Caja Laboral Bancaseguros O.B.S.V., S.L.U.	Banking Insurance Operator	100%
Associated Entities		
ICR Institutional Investment Management SGIIC, SA	Investment fund manager	21.43%



## 1.2. STRATEGY OF THE ENTITY AND RISK MANAGEMENT

### PRIORITY OBJECTIVES: CORE THEMES AND BASIC AREAS, RISKS AND OPPORTUNITIES

The strategic analysis in LABORAL Kutxa follows an annual cycle, within a *Strategic Planning* process that systematises *competitive surveillance* in the various markets and the review of business models and strategic commitments, which are then developed in each Management Plan.

Thus, in 2017 the basic strategic focus was twofold: commercially, the optimisation of recurring margins and structurally, the search for efficiency and cost control.

In this latter area, considerable effort has been devoted to adapting the structures to the new needs. The most relevant actions included in this reorganisation, which began to be implemented on 01/01/2017, are:

- the activation of a Revitalisation Plan 58, seeking to optimise the workforce by making retirement possible for people born in 1958,
- the unification of the Company and Private Customer Division structures, both in the commercial and Business Development areas, and
- integration of the risk management processes.

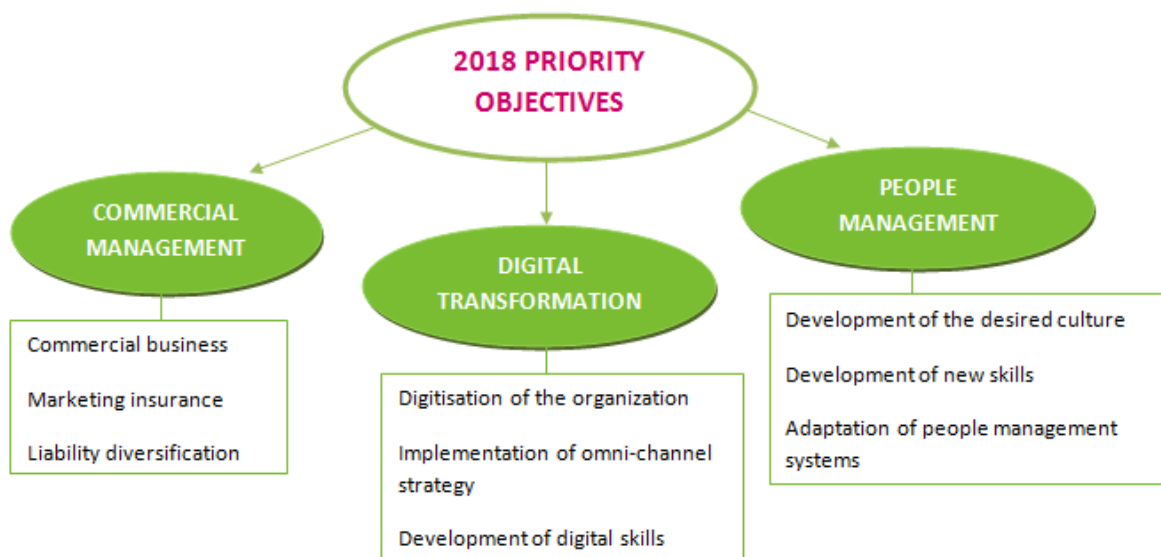
The aim is to substantially improve the efficiency of the organisation by simplifying the organisational chart.

In the review of the strategic analysis carried out in 2017, the greatest risks identified in the market environment remain economic: zero and negative interest rates and difficulties in making the profit and loss account profitable. The greatest opportunities are materialised in the speed of adaptation to the digital transformation of the banking business.

Specifically, the priority for 2018 continues to be defending the income statement, thus, the basic strategic **approach** is twofold.

- Commercially, the **optimisation of recurring margins**, combining business growth with strict cost and price control.
- In terms of structure, the search for **efficiency, productivity and alignment of operating costs**, promoting suitability actions to the workforce. In parallel, aligning the business model and organisational structure to a business environment that generates less profit and requires an anticipatory adaptation to the accelerated advance of **digitisation** and **omni-channels** in the banking business.

Success or failure in these strategies is linked to the speed of adaptation to the digital disruption that is transforming customer behaviour and the banking business model, thus a key priority is digital transformation. Digital transformation of both the relationship with customers and of the internal processes, and in which the challenge of developing the digital skills of our working partners will be a key factor in the quest for excellence in the omni-channel relationship with customers.



As regards risk management, a detailed description of the different basic risks can be found in the annual *Information of Prudential Relevance*, which details the trends and impact on the business of the most important risks: credit, market, operational, interest rate as well as the risk profile and management mechanisms applied.

The opportunities in the commercial activity are identified in income-generating businesses, specifically, commercial business of all segments (SMEs, micro-enterprises, businesses and self-employed), insurance, and (in the area of liabilities) advice and diversification towards the commercialisation of Investment Funds and off-balance sheet items.

- In both the commercial and insurance businesses, the promotion of commercial activity entails the enhancement of the capillarity of our offices and the specialisation of our managers, as well as the development of areas identified in the **Onenak 4.0 project**: commitment to multi-channel customer relations, excellence in business processes and manager empowerment,
- in the management of our customers' savings, we aim to accelerate the transformation of the business model, from the sale by the manager in the office of simple and undifferentiated products such as Term Deposits, to the management of a complex diversification, based on Investment Funds and other long-term savings and investment products, supported by strict protocols to guarantee the customer's knowledge and the suitability of the product offered.

In relation to the **system of advice and interaction**, the adaptation of processes and systems to the MiFID 2 standard, improvements in support systems, the promotion of the remote relationship model and the replacement of the planning tool with a new calendar are particularly relevant. Always maintaining prudence in the preparation of model portfolios.

In terms of **organisation**, in the strategic analysis reviewed in July 2017 we identified opportunities to optimise both the commercial structure and that of the Central Services departments. Along the same lines of improving productivity, we will also adjust the business

model to the **Onenak 4.0 project**, mentioned above, and move towards increasingly integrated insurance management, incorporating the new feature of having a significant number of polyvalent insurance managers.

Relevant decisions have also been taken in the **technological** field in 2017. The *Zabaltek* project involves replacing the *core infrastructure* that supports banking operations by using open systems in order to face with certainty the new challenges arising from the exponential growth of digital banking.

The organisational objective is to substantially improve the **efficiency** and **productivity** of the organisation, simplifying the organisational chart, but also taking advantage of the efficiency improvement possibilities that can be achieved thanks to the digitalisation of processes and customer relations.

Based on shared strategic management planning, Seguros Lagun Aro reviews its annual Management Plan, taking stock of the quantitative indicators of its management *scorecard*, while drawing qualitative conclusions that make it possible to adapt the objectives of the next Plan.

The risks identified in the current insurance market environment relate to the following aspects: the need to increase new production sales, the effect of the car yardstick for calculating compensation for victims of traffic accidents, household claims due to climatic changes, cost containment and changes in financial income in an environment of low interest rates.

The main challenges, which continue into 2018, are customer experience and digital transformation.

- As far as customer experience is concerned, changes will be made to the way we communicate with customers in Service Provision.
- With regard to digital disruption, as in banking, the future of the insurance sector is based on digital transformation. This, in the organisation of Seguros Lagun Aro is specified in the following objectives:
  - Transform the **internal culture** of the organisation to face new challenges.
  - A more flexible **organisation**.
  - **Digitise current processes**, for which we must first make them more efficient.
  - Start **collaborating with other organisations** (*insurtech, start-ups, universities...*).
  - Develop **digital channels** mainly with a clear focus on mobile applications.
  - Begin to implement the **innovative tools** that are emerging every day (*big data, Artificial Intelligence, IOT, chatbots, wearables...*).
  - Do not lose sight of and track the evolution of **new technologies** that may not have an immediate effect in 2018 but that will not be long in coming (autonomous cars, blockchain...).

Digital transformation is unstoppable and it is a priority to tackle it in order to achieve a more efficient, effective and flexible organisation. We revitalise the customer's experience in a market where this not only demands product and service, but also personalisation, experience, agility, transparency...

**TRANSVERSE CONCEPTS AND AREAS**

As part of the Group's strategy, we also devote considerable effort to projects that cut across the various areas of the organisation. These projects are aligned with the **Sustainable Development Goals (SDG)** and the 2030 Agenda. During 2017, LABORAL Kutxa has carried out an analysis of these Objectives, determining which actions have been carried out that are in tune with the SDG, as well as determining which new priority areas should be implemented. The results of this analysis have been shared with the entire workforce.

In the Social Responsibility Report we explain the behaviours which reflect our differentiating values, as summarised in the following table.

**WHAT DIFFERENTIATES US FROM OTHER BANKS AND SAVINGS BANKS?**

<p><b>WE ARE A COOPERATIVE CREDIT UNION</b></p>	<p>The people who serve you at LABORAL Kutxa are members of the organisation, we are committed to the project and believe in it, so we are dedicated to giving each person the best service. Customer satisfaction is the best guarantee for our business plans.</p>
<p><b>GIVING BACK TO SOCIETY. USEFUL BANKING, COMMITTED TO OUR SOCIETY</b></p>	<p>Our dividend is what we give back to society: 25% of our distributable results are used to finance projects of economic and social interest, training and job creation. We reinvest the rest in the entity to strengthen its solvency and its future development.</p>
<p><b>WE ARE WORKERS, PARTNERS AND STAKEHOLDERS</b></p>	<p>-LABORAL Kutxa is not listed on the stock exchange, it is not subject to speculative pressure from the financial markets. All partners participate in the capital and in the decisions of the organisation, with responsibility, assuming the consequences of our management. -The key decisions are validated at the General Meeting with the participation of all partners, guaranteeing an efficient and responsible management that allows us to obtain profits and reinvest them in our society.</p>

In the 2017 Management Plan, with continuity in 2018, we highlight the strategic importance we attach to the following initiatives, all of which are related to Sustainability and Social Responsibility:

- In 2017 we continued to adapt our infrastructures with 14 offices having had their air conditioning replaced, and comprehensive reforms in another 6. Both types of work imply outstanding improvements in the thermal characteristics of our premises.
- Our dedication to emerging initiatives is also significant, such as Socially Responsible Investment, which in our case is aimed at monitoring the social and environmental effects of the projects we finance and the activities of the companies in which we invest.
- With regard to people management, our approach is ambitious in aspects such as:
  - o Occupational Health and Safety.
  - o Encouraging the use of the Basque language as the working language.
  - o The achievement of effective equality between women and men.
- As part of Environmental Management the focus is on continuous improvement, with emphasis on ongoing investments to improve the environmental efficiency of our buildings.

Accordingly, in early 2018 we will complete the renovation of the main building (LK1) of Central Services in Mondragon, which includes the installation of especially environmentally friendly technologies such as geothermal and biomass energy sources. The introduction of renewable energy sources that do not generate CO2 emissions is particularly significant. The investment required has been substantial, as it has required the construction of an additional auxiliary building.

In addition, we have installed state-of-the-art insulation and lighting. As a result, we have achieved the highest energy efficiency rating for the LK1 main building.

At the same time, we would like to highlight the strategic importance of some of the initiatives related to Sustainability and Social Responsibility in the 2017 and 2018 Management Plans of **Seguros Lagun Aro**:

- As far as the people in the organisation are concerned, just as we have commented for LABORAL Kutxa, our management prioritises:
  - o The promotion of health,
  - o encouraging the use of the Basque language as the working language and
  - o the achievement of effective equality between women and men.
- From the point of view of customer relations,
  - o The proposal of new products and services and the search for customer satisfaction, along with
  - o a reduction in written communications, with its consequent environmental impact.

As mentioned above, there is a CSR Committee with participation from the various divisions of the Fund and the insurance companies, whose mission is to govern these activities and which reports to the highest management body, the Governing Board, so that the latter can supervise both environmental and social policies.

#### **DIFFERENCES IN INSURANCE BUSINESS**

The Group's insurance companies, Seguros Lagun Aro and Seguros Lagun Aro Vida, although having a legal status as a joint-stock company and not as a cooperative company, share a large part of the ways of doing business and cooperative values.

Seguros Lagun Aro is part of the *European mutual and cooperative insurance association - EURES*, and shares the values of mutuality and cooperation that this Association defends and is, therefore, committed to:

- applying the guiding principles of the societal economy in all its activities,
- designing products and services that meet the real needs of consumers,
- ensuring that policyholders and shareholders are actively involved in the life of the company, either directly or through their representatives,
- combining the financial picture with ethical conduct, and
- ensuring that its activities are undertaken within the context of a people-centred economy geared towards sustainable and socially responsible development.

### 1.3. MATERIALITY OF THE INFORMATION ON SUSTAINABILITY

Since 2005, the Entity has been producing a Corporate Social Responsibility Report - CSR following the guidelines established by the GRI - Global Reporting Initiative. Since the start it has been verified annually by AENOR.

Since 2014, this Report has included an *analysis of materiality* in order to determine the most relevant issues in these areas, so that the information not only responds to international reporting requirements, but also includes and addresses the risks and opportunities assessed as most relevant by the *Stakeholders* with whom the Entity interacts.

In order to carry out this materiality study on the impacts of its activity, the Fund also analyses the results of the analyses disclosed by other competitors in the banking sector.

For 2017, the conclusions of this analysis, included in the CSR Report for 2016, are as follows:

- The **economic factors** are particularly significant and, in particular, the external and internal Stakeholders give special importance to the elements related to **prudent management focused on excellence** and **responsibility in the contact** with the customer. Indeed, it highlights the importance given to strengthening solvency and liquidity, as well as various elements related to the quality of service and/or transparency and responsibility in multichannel contact with the customer. The main priorities also reflect the demand to contribute to the economic and financial development of the entire business fabric in the areas where the Fund is located.
- **Social factors** are somewhat less material. Nevertheless, the importance of elements such as gender *equality*, *work-life balance* and reducing wage differentials is important in the area of people. In the *area of societal demands*, the most important element is the supply of socially responsible products and services, thus reinforcing the demand for the application of Social Responsibility criteria in the core of the banking business: the commercialisation of financial and insurance products and services in retail markets.
- Finally, with regard to **environmental aspects**, although their relevance is becoming increasingly important in society as a whole, the responses received classify their materiality as average. *“Without a doubt, the activity of a bank is not aggressive towards the environment, but from the conviction that every person and every company has an obligation of care towards our long-suffering planet, it is an area in which we can never reduce our efforts and for which we carry out an analysis of risks and opportunities.”*

In the same way, there are two other elements for which we classify the internal and external relevance as minor but which are considered to be at the heart of our mission and are therefore areas of preferential attention. This concerns the social and business promotion via its support to the *MONDRAGON Corporation* and its contribution to the development of the Basque language. We understand that one reason for the low demand for both elements is that the expectations of the Stakeholders are largely met, so there is no need for additional initiatives beyond those already undertaken.

From the analysis of the demands of the various Stakeholders and their prioritisation, LABORAL Kutxa draws up an annual *Roadmap* with the most important activities it wishes to undertake. The 2017 version, which is described in greater detail in the aforementioned CSR Report, is attached.

## 2017 CSR Roadmap

**After consultation with Stakeholders and comparing it to the sector**

Prioritisation of areas for action		Stakeholder / Area	Actuation levers
1	Strengthen solvency and liquidity	Economic	(N) Strategy approach: optimise recurring margin + cost management Reinvestment of profits. Recovery Plan. (N) Resolution Plan
2	Contribution to the economic and financial development of the business fabric: Financing agreements for companies, support for entrepreneurs, University...	Company	Destination of profits: FEP, FSI Financing agreements and commitments Gaztenpresa Programme
3	Customer management (relations part): transparency, friendliness, etc.	Customers	Integrated Quality Management Process
4	Responsible management towards the customer: explanation and sale of complex savings products	Customers	(N) FFII offer project (N) MiFID II project and management training (N) MIFIR project
5	Development of access through new channels (electronic banking, telephone banking, mobile banking)	Customers	(N) Transformation of On-line Banking
6	People management, gender equality, work-life balance, salary levels and intervals, etc.	People	III Equality Plan-Berdintasuna Personnel development model Remuneration model
7	Review and improvement of internal control mechanisms (management decisions, money laundering, code of ethics, corruption, cost control)	Corporate governance	(N) Market Abuse project (N) Supplier purchase procedures Risk Appetite Framework Ethics Committee
8	Excellence in quality of service, reducing errors and improving operations	Customers	Integrated Quality Management Process
9	Responsible management towards the customer: avoiding over-indebtedness of customers	Customers	Review of acceptance models Update of the Risk Policy and Manual
10	CSR measures: anti-money laundering, arms financing control, gambling, pornography	Corporate governance	Regulatory Compliance Department Socially Responsible Investment Team
11	Socially responsible products and services	Customers	FI ethics and humanitarian aid

(N) New project in 2017 or with a substantial change in focus

In addition, **Seguros Lagun Aro**, since 2014, has been preparing a Corporate Social Responsibility Report - CSR, following the guidelines set by GRI - Global Reporting Initiative. During the process of preparing this Report, the most relevant issues in these areas are identified, so that the aspects managed and the information disseminated include the most relevant risks and opportunities for their Stakeholders.

The strategic objectives in the field of CSR are embodied in commitments relating to each of the priority stakeholders. In this context, the issues that are relevant to the Stakeholders in the **insurance business**, which have been identified as critical, are:

<i>GENERATING VALUE</i>
<ul style="list-style-type: none"> <li>✓ Talent management</li> <li>✓ Responsible management of suppliers and brokers</li> <li>✓ Quality and transparency in service provision</li> <li>✓ Strength and financial stability</li> </ul>
<i>SOCIAL RESPONSIBILITY</i>
<ul style="list-style-type: none"> <li>✓ Good governance</li> <li>✓ Ethics and anti-corruption</li> <li>✓ Stable and good quality employment</li> <li>✓ Equal opportunities and diversity</li> <li>✓ Occupational health and safety</li> <li>✓ Employment practices and Human rights</li> <li>✓ Commitment to the community</li> <li>✓ Discussion with all stakeholders</li> </ul>
<i>ENVIRONMENTAL SUSTAINABILITY</i>
<ul style="list-style-type: none"> <li>✓ Risk and crisis management</li> <li>✓ Management and mitigation of impacts</li> </ul>



## 2. ENVIRONMENTAL ISSUES.

### CURRENT AND FORESEEABLE EFFECTS OF THE COMPANY'S ACTIVITY ON THE ENVIRONMENT

Since 2001, **LABORAL Kutxa** has been implementing an **Environmental Management System – EMS**, in accordance with the ISO 14001 Standard, for all its activities in the three Headquarters buildings. Although it is not part of the certified system, LABORAL Kutxa transfers the majority of its environmental activities from central services to the other work centres.

The Environmental Management System is the responsibility of an Environmental Committee made up of members of the Legal Department, Internal Audit, Risks, Fixed Assets, Security and General Services and Quality, with the latter acting as the Coordinator. In accordance with the precautionary principle of the Rio Declaration, it addresses the possible impacts of the activity with a view to preventing environmental damage.

LABORAL Kutxa is committed to caring for the environment and participates in numerous initiatives in this field. LABORAL Kutxa, one of the founding organisations of Stop CO2 Euskadi, belongs to IZAITE (Basque companies for sustainability) and is a member of the Global Pact.

As stated in the ISO standard followed by the EMS, the success of an environmental management system depends on the commitment of all the functions and levels of the organisation, under the leadership of senior management. Thus:

- LABORAL Kutxa has an Environment Policy, approved by senior management, with access for all its partners and customers, through its publication on the corporate website.
- Every year it carries out planning to determine the risks and opportunities related to its environmental issues.
- On the basis of this, it establishes objectives that are monitored and communicated, both internally and externally.
- It also plans the appropriate actions to achieve these environmental objectives, determining what is to be done, with what resources, who will be responsible, and with what indicators its achievement and compliance with deadlines will be evaluated.

The EMS is audited annually by AENOR. In the report of the last audit, dated 25/09/2017, it identified 3 non-conformities in the system, one of which was the failure to process the notification of the closure of a cooling tower no longer in use. This report mentions, as strengths of the LABORAL Kutxa EMS, such matters as the strengthening of the Management System adapted to the latest version of the Reference Standard, the use of energy from the geothermal heating system and the biomass plant and the A energy rating of the LK1 building (energy certificate 02/05/2017).

**Seguros Lagun Aro** shares the environmental management policies of LABORAL Kutxa although it is not integrated into its Environmental Management System.

Due to the very nature of its activity, the environmental impact caused by the insurance company is minimal. However, its management focuses on the issues related to **paper consumption**.

In this connection, the reduction of paper used in the Organisation has been encouraged, both internally with a new printing strategy and externally with the optimisation of customer document management.

By the end of 2016, all our printers and photocopiers had been refurbished, achieving greater cost efficiency and detailed printing information for print management.

In addition, other internal initiatives have been launched such as: a change in the system of expense notes and tickets that are attached; automated listings; dual screen; double-sided printing; sending monthly print data to each of the teams; and the launch of a tender for paper disposal.

In addition, a project has been launched to issue policies in digital format and provide brokers and customers with a variety of ways to access the applications. In this way, insurance brokers and customers of Lagun Aro are able to send us, in digital format, the documentation in both the underwriting and service provision processes.

This project has a clear impact on the environment as it significantly reduces printing, physical paper transfer and archiving.

Each year, the environmental programme identifies, records and evaluates environmental factors in order to determine their associated environmental impacts and establish their level of significance from a life-cycle perspective. To this end, the scale and degree of danger are determined, obtaining a significance level. Below are the main indicators of the Environmental Management Programme of LABORAL Kutxa and Lagun Aro based on the results of this evaluation.

Paper consumption kg	LABORAL Kutxa		Seguros LA
	2016	2017	2017
Promotional paper	97,089	96,457	80,058
Office paper	283,303	235,538	6,833
<b>Total paper consumption</b>	<b>356,552</b>	<b>331,995</b>	<b>86,891</b>
Promotional paper/customer	0.083	0.082	0.23
Office paper/customer	0.241	0.201	0.02
<b>Total consumption/customer</b>	<b>0.324</b>	<b>0.25</b>	<b>0.25</b>
Total paper consumption/person	162.7	150.2	520.3

In order to reduce the amount of paper used in customer communications, a significant drive has been made in recent years towards the use of new technologies and e-mail communications (Postamail):

Postamail Users	2016	2017
Number of users.	456,229	497,166
% Users from total customer base	38.83%	42.49%
Internet user customers	2016	2017
No. of CLNet contracts	581,507	615,487
Customers active on CLNet	338,954	365,137
% active customers based on contracts	58.29%	59.32%
Mobile Banking (users who have accessed via mobile)	197,137	271,211
Alerts (active contracts)	308,370	346,935

Lagun Aro also has a campaign to control the number of printouts made by workers in order to reduce printing and, therefore, the amount of paper used.

With regard to **toner cartridges**, an attempt is being made to minimise consumption. This is not noticeable in 2017, due to a discontinuity in toner consumption data, because LABORAL Kutxa has carried out a widespread replacement of its printers, scanners and photocopiers and the new models, although more efficient in consumption, use a greater number of cartridges since they are smaller.

Toner consumption in units	LABORAL Kutxa		Seguros LA
	2016	2017	2017
Total toner cartridge consumption	1,877	2,644	44
Cartridge consumption per person	0.80	1.20	0.38

The impacts of the LABORAL Kutxa activity are limited. One of the most important is **electricity consumption**. Mondragón's central services are within the scope of ISO 14001 environmental certification and are actively managed:

Year/Unit	LABORAL Kutxa		Seguros LA
	2016	2017	2017
Electricity consumption in kWh / year CS	3,421,514	3,476,909	247,917
Electricity consumption in kWh / year total LK	14,647,375	13,891,322	

Although water consumption is not relevant in a financial entity, within our environmental system the consumption by central services is controlled. In the reforms being carried out in the buildings, the pipelines are being renovated in order to reduce leaks and water losses.

Water consumption (m3) at Headquarters	2016	2017
Water consumption	11,239	5,786*
Consumption/person - year	26.02	Nd

\*Three quarters, in the same 3 quarters of 2016 consumption was 9,386m3.

One aspect of particular relevance is the calculation of our business's **carbon footprint**. Significant efforts have been made in recent years to reduce it. The following is worth mentioning:

- The introduction of a **geothermal** system to air-condition the central services buildings.
- The construction of a **biomass** plant to meet the biomass heating requirements. Both systems have made it possible to eliminate climate control using fossil fuels (Scope 1).
- Refurbishment of the insulation (low emission glass) and equipment (LED) to increase the efficiency of air conditioning and lighting.

Breakdown of emissions by source. Carbon Footprint	LABORAL Kutxa		Seguros LA
	2016	2017	2017
Scope 1: Direct emissions	144	57	0
Scope 2: Indirect emissions	4,997	4,739	85
Scope 3: Other indirect emissions	794	818	229
<b>Total emissions Tonnes of CO2</b>	<b>5,935</b>	<b>5,613</b>	<b>313</b>

The following is taken into account for obtaining them:

- For **scope 1** consumption of diesel oil and propane.
- For **scope 2** the total electricity consumption (CS, the office network and regional management buildings) has been taken into account.
- For **scope 3**, we have taken into account the emissions due to travel during working time, the kilometres driven by taxi, the emission resulting from paper consumption and the electricity consumption of customers when using our website.

With regard to **environmental safety**, the buildings and premises of the Central Services have emergency plans that include possible effects on the environment in the event of an incident, as well as how to minimise this impact.

There are also emergency plans for all the workplaces, although, in the network of offices, the potential environmental effects of emergencies are much lower.

For managing **waste**, the environmental certification includes the correct management of waste. In addition, the most important waste, paper and toner, are managed centrally for all work centres. The most important aspects of our business activity are listed below:

Indicator	Unit	LABORAL Kutxa		Seguros LA	
		2016	2017	2016	2017
Cardboard and paper waste	Kg	176,760	131,135	6,874	12,437
Recycled toner cartridges	No.	1,338	2,694		
Used vegetable oil	Kg	1,350	1,200		

A distinguishing feature of LABORAL Kutxa's Social Responsibility policy is the implementation of an extensive concept of **Socially Responsible Investment – SRI**, whereby environmental, social and good governance criteria are applied when deciding on the companies in which corporate funds or those from customers are invested through investment or pension funds, but also in relation to credit investment.

In the first domain, investments in markets are analysed in accordance with the *Sustainability ratings* prepared by the specialised company *EIRIS- Vigeo*, which are highly sensitive to environmental requirements. In the area of financing for our company customers, in addition to exclusionary criteria, we also apply inclusive criteria, taking as an example the financing of a fleet of 14 BMW 3i vehicles, 100% electric (zero emissions), for service as chauffeur-driven vehicles for intensive urban use.

### **3. SOCIAL AND PERSONNEL MATTERS**

#### **3.1 IN RELATION TO PERSONNEL**

LABORAL Kutxa, is a cooperative credit union in which working people are members and owners of the company with full rights and responsibilities, both in carrying out their professional duties and in the right to participate in management through the relevant bodies and in the profits from the business.

It therefore applies a people participation model in the company that includes the three areas that are usually distinguished: ownership, management and results. The **Cooperative Education** training programmes reinforce the cooperative identity of the members, and encourage the integration and socio-entrepreneurial involvement of new members.

In the strategic analysis carried out to establish the 2018 Management Plan, the greatest risks and opportunities were identified in relation to the effect on the business model and on people of the disruptive emergence of technology and digital banking.

The main challenge until 2019 is how to adapt to this new scenario and, in doing so, change our behaviour to a behavioural style that promotes strategic challenges without losing our values, which are our hallmark.

The behavioural adjustment is a cultural process and the fundamental measures to implement a strategy with a strong digitisation and omni-channel component are based on identifying the desired culture, in order to compare it with the current cultural profile, having conducted a culture survey in 2017 that reached all the people in the Entity. The next step is to define action plans for cultural development.

A second area of priority in activities relating to people, identified in the Management Plan, is grouped under the concept of Internal Social Responsibility and prioritises:

- Linguistic standardisation, guaranteeing the provision of a high quality service in the Basque language and making progress in ensuring to be our working language.
- Roll-out of the 3rd Equality Plan 2016 - 2018,
- Making progress in the functioning of the Occupational Health and Safety System in accordance with the standards required by OHSAS 18001 for its management system.

Thirdly, during 2017, the training effort undertaken in the area of advice and the sale of complex and non complex savings and investment products for adapting to consumer protection standards was very significant. In particular, the requirements of the MiFID II directive have been met with the approval of practically all the managers in their contact with customers in accordance with these regulations.

Specific focus of Seguros Lagun Aro.

Seguros Lagun Aro is a limited company, 100% owned by LABORAL Kutxa. Thus, even when the employees do not own the company, they participate in the management and business results.

They do this:

- through a universal Individual Variable Remuneration, and
- a Collective Variable Remuneration applicable to people with an indefinite contract (close to 100% of the workforce) voluntarily joining a company formed precisely to enable the participation of workers in the results of the company.

In the analysis carried out to establish the 2018 Management Plan, the greatest risks and opportunities were also identified in relation to the effect on the business model and on people of the emergence of new trends in the insurance market. The main challenge is to update attitudes, behaviours and people's knowledge and skills in the new digital scenario.

The second level of priority includes the following activities:

- Development of leadership in the organisation,
- Linguistic standardisation in order to intensify the use of Basque as a working language,
- Roll-out of the 2nd Equality Plan 2018 - 2020,
- Making progress in the functioning of the Occupational Health and Safety System in accordance with the standards required in its management system.
- Also, development of the Healthy Company Project. Under the slogan "At Seguros Lagun Aro we take care of ourselves" it includes several courses of action (food, physical exercise, ergonomics and psycho-social factors) aimed at Health Promotion. This project, which began in 2017, will continue through 2018 and 2019 with action plans and health promotion activities for all of the Company's personnel.

Regarding the composition of the workforce:

Contractual relationship LK (situation as at 31/12)	2016			2017		
	Total	Men	Women	Total	Men	Women
Active partners	1,925	1,020	905	1,839	943	896
Surpluses	44	9	35	28	6	22
Secondment	16	6	10	15	6	9
Early retirees	104	67	37	134	93	41
<b>Company contracts</b>	<b>2,089</b>	<b>1,020</b>	<b>905</b>	<b>2,016</b>	<b>1,048</b>	<b>968</b>
Temps. Full-time	148	43	105	146	47	99
Temps. Part-time	18	1	17	7	0	7
<b>Temporary Contracts</b>	<b>166</b>	<b>122</b>	<b>44</b>	<b>153</b>	<b>47</b>	<b>106</b>
<b>Indefinite Contracts</b>	<b>8</b>	<b>8</b>	<b>0</b>	<b>7</b>	<b>7</b>	<b>0</b>
<b>Total workforce as at 31/12</b>	<b>2,263</b>	<b>1,154</b>	<b>1,109</b>	<b>2,176</b>	<b>1,102</b>	<b>1,074</b>

All the workers of **BancaSeguros** have an indefinite contract, being distributed between the LABORAL Kutxa Head Office and the commercial network.

Terminations and annual rotation of Working Partners in LABORAL Kutxa	2016	2017
Terminations in the year:	<b>91</b>	<b>144</b>
Voluntary and Public Office Leave	10	0
Leave Caring for children/family	41	41
Retirement	21	16
Death or Disability	0	3
Voluntary Resignation	5	4
On secondment	3	0
Early retirees	11	80
Terminations of Women in the year	57	65
Terminations of Men in the year	34	79
<b>Total departure rate</b>	<b>4.7%</b>	<b>7.5%</b>
Women's departure rate	6.2%	7.3%
Men's departure rate	3.3%	8.4%

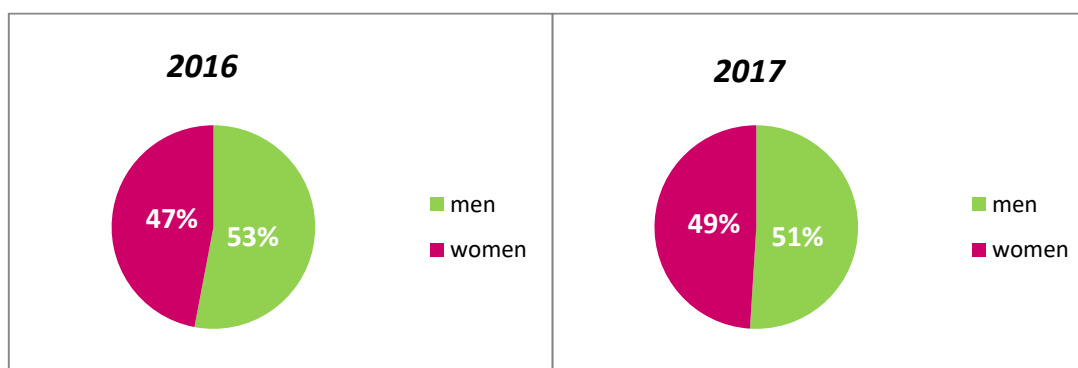
In **Seguros Lagun Aro** the workforce is mainly made up of women.

Contractual relationship SLA (situation as at 31/12)	2016			2017		
	Total	Men	Women	Total	Men	Women
<b>Total workforce as at 31/12</b>	<b>172</b>	<b>63</b>	<b>109</b>	<b>167</b>	<b>59</b>	<b>108</b>

### 3.2. DIVERSITY AND EQUAL OPPORTUNITIES

As part of the LABORAL Kutxa Equality Plan 2016-2018, a very important milestone in the year was the fulfilment of the quantitative objective of gender balance in the co-operative's highest administrative body. After the renewal of positions in the 2017 Assembly of the **12 members of the Governing Board, 6 are women and 6 men.**

Partner workforce of LK by sex and professional category	2016				2017			
	Men		Women		Men		Women	
	No.	%	No.	%	No.	%	No.	%
Directors	32	1.7	3	0.2	25	1.4%	5	0.3%
Managers	282	14.7	118	6.1	263	14.3%	122	6.6%
Technicians	363	18.9	392	20.4	331	18.0%	382	20.8%
Administrative staff	166	8.6	298	15.5	155	8.4%	292	15.9%
Others	177	9.2	94	4.9	169	9.2%	95	5.2%
<b>Total</b>	<b>1,020</b>	<b>53</b>	<b>905</b>	<b>47</b>	<b>943</b>	<b>51%</b>	<b>896</b>	<b>49%</b>
<b>Active partners</b>	<b>1,925</b>				<b>1,839</b>			



3rd PLAN FOR THE EQUALITY OF WOMEN AND MEN OF LABORAL KUTXA		
LINE OF WORK	OBJECTIVES	MEASURES
Communication and awareness raising	OBJECTIVE 1: To demonstrate a commitment to equality and to promote measures favourable to this.	10
Culture of the entity	OBJECTIVE 2: To continue strengthening the culture of equality.	6
Work-life balance and co-responsibility	OBJECTIVE 3: To facilitate the balance between work, family and personal life of the workers of LABORAL Kutxa.	4
Promotion and empowerment	OBJECTIVE 4: To increase the presence of women in decision-making positions.	4
Social responsibility	OBJECTIVE 5: To promote equality in society and inform society of the entity's commitment to equality.	8

During 2017, innovative initiatives have been launched to promote awareness among our partners, our customers and society as a whole. The following are given as examples:

- We have created, with the participation of people from the organisation, some *sketches* that demonstrate some situations of inequality that we experience in our daily work environment. This project, called "Equality is full of small details" was a finalist in the *1. Festival of short films on advanced management* organised by *Euskalit*.



- The display windows of four of our offices (Bilbao, Donostia, Gastez and Iruñea) were decorated with *graffiti* as part of the *International Day Against Violence towards Women*. This activity has had considerable media coverage.
- It is also worth mentioning the actions undertaken to promote the use of non-sexist language and images.

Regarding **BancaSeguros**

Workforce by sex, prof. category and business area	2016				2017			
	Men		Women		Men		Women	
	No.	%	No.	%	No.	%	No.	%
Directors	2	100	0	0	1	100	0	0
Managers	8	80	2	20	8	80	2	20
Technicians	1	14	6	86	1	14	6	86
Commercial Managers	39	20	149	80	34	19	143	81
<b>Total workers</b>	<b>50</b>	<b>24</b>	<b>157</b>	<b>76</b>	<b>44</b>	<b>22</b>	<b>151</b>	<b>78</b>
Central Services	4	36	7	64	4	36	7	64
Commercial Network	46	23	150	77	40	22	144	78
<b>Total workers</b>	<b>50</b>	<b>24</b>	<b>157</b>	<b>76</b>	<b>44</b>	<b>22</b>	<b>151</b>	<b>78</b>

In 2017 **Lagun Aro** carried out a Diagnosis and the 2nd Equality Plan. Elhuyar Aholkularitza collaborated in two phases of the process. In the phase of diagnosing the situation of equality between women and men in the entity, a survey was carried out and documentation and company data were analysed. In the second phase, taking into account the results and conclusions obtained in the diagnosis, the Plan for Equality between women and men was designed and will be implemented in the coming years.

For the preparation of the Plan, an Equality Commission was set up, which will continue to exist throughout the implementation of this Plan (in force from 2018 to 2020). Furthermore, a Coordinator for the Equality Plan has been appointed to promote the Plan, with advice from the aforementioned Consultant.

The main objectives included in the Plan are:

1. To implement the Equality Plan.
2. To involve everyone from the organisation in the implementation of the Plan.
3. To achieve greater parity in all the Management bodies.
4. To ensure that 90% of the workforce is aware that selection and promotion processes are based on equality criteria.
5. To adapt the work-life balance needs to the reality of the organisation.
6. To understand and overcome possible imbalances in remuneration and social benefits.
7. To improve people's knowledge of the actual situation regarding remuneration.
8. To ensure that there are no instances of sexual or gender-based harassment in the organisation.
9. To eliminate the use of language that may encourage inequalities.
10. To ensure an inclusive use of language and images.
11. To obtain public recognition in matters of equality.
12. To raise awareness among the different stakeholders regarding the issue of equality.

### 3.3 HEALTH, SAFETY AND WELFARE AT WORK

With regard to occupational health, safety and welfare, LABORAL Kutxa has the OHSAS certification verified annually by ONDOAN. Maintaining this certification is a sign of the cooperative's commitment to achieving the highest standards of prevention and welfare for its workforce.

The main activities and indicators of the last financial year in this area are identified below:

Management Programme: Proposed actions for 2017.
1. To continue advancing in the integration of H&S within the processes of the Entity, especially those related to works, adaptation of jobs, furniture.
2. In the face of the changes in personnel planned for 2017, to coordinate departure and train new members.
3. To comply with the induction training of 95% of the workforce.
4. To carry out internal audits of the system.
5. To further develop the coordination of business activities.

Absenteeism hours and rate in LABORAL Kutxa	2016	2017
Accident and Illness	98,500	95,744
Maternity	34,686	28,704
Paternity	3,119	3,689
Other*	0	4,971
Absenteeism Total Hours	136,305	133,107
Absenteeism Rate	2.78	3.00
Absenteeism Rate Lagun Aro	4.36	2.44
Absenteeism Rate Bancaseguros	4.27	4.54

\*Caring for sick children.

As has been mentioned, **Seguros Lagun Aro** has decided to work on the Healthy business area, developing the Health Promotion Project *“At Seguros Lagun Aro we take care of ourselves”*. The actions carried out in 2017 included:

- Health assessment for those who want to be part of the Plan:
  - Dietary questionnaire
  - Physical Activity Questionnaire
  - Body assessment (Inbody)
  - Analytical determination assessment
- Promotion of active travel.
- Lunch box: training and recommendations on how to eat in line with the Mediterranean diet, also with lunch box.
- Training on childhood nutrition.
- “Less plastic” campaign (water, cups...).
- Intranet with space reserved for this health topic.
- Fortnightly communications on the Intranet related to the project.

### 3.4 PEOPLE-RELATED INDICATORS

Some of the particularly significant indicators are those relating to training and remuneration levels.

The following table shows the most relevant information regarding training:

Training in LABORAL Kutxa.	2016	2017
Number of courses	568	413
Hours of training	128,017	227,835
Hours of training/person	63.6	99.15
▪ Partner	53.02	108.05
▪ Temporary	230.4	59.2
Directors	240.35	91.13
Office Managers and Directors	58.57	124.4
Technicians	67.64	95.92
Clerical staff	49.83	89.41
Number of courses Lagun Aro	89	95
Training hours Lagun Aro	4,814	2,464.5
Training hours/person Lagun Aro	26.74	14.00

In terms of remuneration levels, wage differentials are substantially narrower than in the rest of the banking sector.

Starting salary	2016	2017
Minimum salary upon entry for partners in € / no. hours worked	14.60	14.83
Minimum salary upon entry for partners in € / Minimum inter-professional salary	2.66	2.50

There is no difference by sex in the range of relationships between the standard starting salary and the local minimum wage, therefore, this data is not broken down by sex.

Salary range	2016	2017
Total pay for best paid person / average total pay	3.60	3.58
Increase in annual pay of the best paid person/average annual pay inc.*	N/A	0.67
Total pay for best paid person / average total pay Lagun Aro	2.44	2.46

\*In LABORAL Kutxa, remuneration is received according to professional category (same job title, same salary, regardless of whether it is male or female), with salary increases being the same for all staff. In 2017, the highest paid person's salary has risen less than the average salary.

### 3.5 SOCIAL DIALOGUE

The Cooperative Credit Union Collective Bargaining Agreement is the general framework of reference, although, in 1996 LABORAL Kutxa adopted a standard for Company Collective Bargaining, through which a specific Collective Bargaining model was established.

Collective bargaining is the process by which the employment and working conditions of all the people in LABORAL Kutxa (partners and employees) and the company guarantees that ensure its application are established. The result of this process is the set of rules and procedures that regulate the general conditions of employment and work of 100% of the people at LABORAL Kutxa and bind the parties (the Board of Directors and the Social Council) and all persons.

In addition to the usual matters relating to expenses compensation, calendars, etc., which are negotiated every year, agreements have been reached in 2017 on the following matters:

- Conditions for the implementation of the training programme based on MiFID II.
- Voluntary measures for adjustment of the workforce (reduced working days with bonuses, negotiated leave, incentivised departures...).

As happens every year, at the end of the annual negotiation process, both parties exchanged the list of matters to be negotiated in 2018.

With regard to the personnel of Caja Laboral **BancaSeguros** S.L.U (a company wholly owned and controlled by LABORAL Kutxa) who are all employees, the working conditions are set out in their own collective agreement, renewed in 2016, as well as general employment legislation. This agreement, which regulates the professional and employment aspects that directly affect the group of workers, has a significant level of convergence with the employment regulations and procedures of LABORAL Kutxa.

**Seguros Lagun Aro** maintains a close relationship with the Legal Representation of Workers (R.L.T.) with whom the Company Statutory Agreement (published in the Official Gazette) is negotiated. 2017 was the second of two years of extensions, signed after the previous agreement expired in 2015.

Within the framework of this agreement, an improvement was established with respect to the conditions set out in the Collective Bargaining Agreement, exceptionally, for the years 2016 and 2017. The company undertook to make extraordinary contributions to E.P.S.V. or Pension Plans. Specifically, extraordinary contributions of €300 per person were made in 2016 and 2017. To be entitled to each of these contributions, the worker had to be a subscriber to the plan as at 31 December of the previous year and make an extraordinary contribution of €300 or more.

This extension has maintained a good company atmosphere throughout the year. At the end of 2017, once the extension had ended, negotiations on a new Agreement for the coming years began.

## 4. SOCIAL ISSUES

### 4.1. DIALOGUE, PROTECTION AND DEVELOPMENT OF LOCAL COMMUNITIES

**LABORAL Kutxa** was founded in the Basque Country as part of a Business Group with a strong commitment to serve society, whose mission includes the creation of associated and participatory cooperative work as an essential way to create wealth and well-being, both among its direct social partners and in the society in which it is immersed.

The criteria and mechanisms for the allocation of social assistance are unique:

- Due to its legal nature and its cooperative vocation, LABORAL Kutxa directs a significant part of its humanitarian aid contributions to the promotion of the cooperative world.
- In the distribution of subsidies under one of the headings of the Education and Promotion Fund, the distribution of which corresponds to the institutional bodies of the cooperative, the section known as "General Distribution", one of the organisations that takes part is the Social Council, which is the representative body of the entity's working members.
- In addition, it also reserves a specific section of the social projects for local assistance (Local Distribution), by means of allocations through the 324 branches of LABORAL Kutxa, which steer the aid towards their own areas (neighbourhood associations, nearby educational centres, parochial social action groups, immigrant social assistance centres, etc.).

The purpose of the Education and Promotion Fund (FEP) is:

- Training and education of the workforce in cooperative principles and values.
- The dissemination of cooperativism, as well as the promotion of inter-cooperative relations.
- The cultural, professional and assistential promotion of the community in general, as well as improving the quality of life and the community development and environmental protection activities.

Item (thousands of euros)	Years of application	
	2016	2017
Charitable contribution to the launch and consolidation of cooperative companies (through MONDRAGON)	11,306	11,750
<b>Inter-cooperative Social Fund - FSI (15% of Profit)</b>	<b>11,306</b>	<b>11,750</b>
Cooperative Promotion through MONDRAGON (68% FEP) and other destinations (UNACC, etc.)	5,280	5,327
FRES, Fund for Restructuring and Company Employment	831	818
Entrepreneurship and Business and vocational training ( <i>Fundación Gaztenpresa</i> )	235	261
Cultural activities in general and others	339	397
Promotion of the Basque-language and Basque Culture	338	428
Welfare and Third World Institutions	398	269
Agri-food sector	117	57
<b>Education and Promotion Fund - FEP (10% of Profit).</b>	<b>7,538</b>	<b>7,557</b>
<b>Sum FSI+FEP</b>	<b>18,844</b>	<b>19,307</b>

In quantitative terms, the Articles of Association of LABORAL Kutxa lay down "return" requirements of funds to the company that are much higher than the requirements established by the regulations for co-operative credit unions. Specifically, this Fund directs **25% of its annual distributable profits** to the promotion of social and business activities in the society where it operates, where it is legally required to dedicate 10%. In addition, all other profits are reinvested in the Fund itself to increase its solvency and sustainability, there being no notion of dividend distribution.

With respect to **Seguros Lagun Aro**, in 2017 the associations with Stop Accidents, Gaztenpresa and the FUNDACION ZEHARO FUNDAZIOA have been continued.

### FUNDACIÓN GAZTENPRESA

One important activity is supporting entrepreneurship through Gaztenpresa. This is an initiative that began in 1994 and is the leader in the Basque Country and Navarre in supporting self-employed people and small businesses that start their entrepreneurial journey.

The Gaztenpresa Foundation is a private, not-for-profit organisation that is part of the social projects of LABORAL Kutxa and its purpose is to support initiatives and develop actions that facilitate the creation and safeguarding of employment, through programmes and services that add value to the business and professional development of its users, as well as to their allies and to society in general. The foundation targets:

- Entrepreneurs, mainly young people.
- Collectives with difficulties in their social and labour insertion.
- Young micro-enterprises with development projects.
- Training institutions that want to encourage the entrepreneurial spirit among their students.

The business creation activity of the **Gaztenpresa Foundation**, financed on the one hand by LABORAL Kutxa and Corporación Mondragon, and on the other hand by the Basque Government (Department of Employment and Social Policies), through Lanbide and the European Social Fund, has been substantial in 2017. Thus, the projects assisted and that go beyond the feasibility phase **have generated 402 micro-enterprises**, creating 703 jobs.

<b>Gaztenpresa Projects</b>	<b>2016</b>	<b>2017</b>
Viable and open the business	386	402
Not viable/ Viable but do not open the business	235	266
Consolidation	84	19
Derivatives	87	160
Consultations	218	201
<b>Total</b>	<b>1,010</b>	<b>1,048</b>

## 4.2. IMTAXES AND DUTIES

LABORAL Kutxa performs its tax obligations in the regions in which it operates. It thus contributes to the sustainability of public services and the progress of Society. The amounts relating to 2017 are as follows:

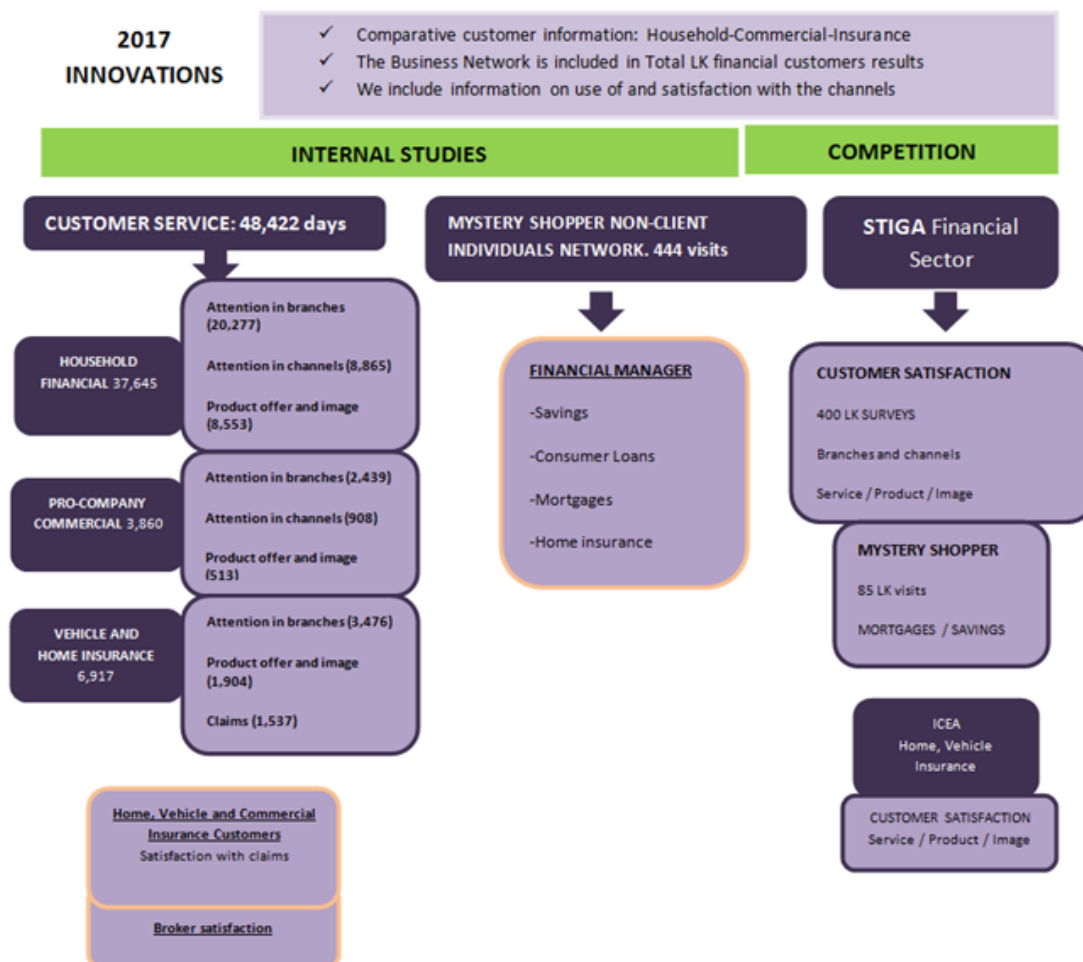
Taxes and duties (thousands of €) LABORAL Kutxa	2016	2017
Corporate income tax	9,779	8,682
Taxes (Property Tax, Self-employed income tax, etc.)	7,085	7,306
V.A.T.	1,790	2,247
<b>Total</b>	<b>18,654</b>	<b>18,235</b>

Taxes and duties (thousands of €) Seguros Lagun Aro	2016	2017
Corporate income tax	4,416	3,135
Taxes (Property Tax, Self-employed income tax, etc.)	93	101
Tax on Insurance Premiums	7,150	7,165
<b>Total</b>	<b>11,660</b>	<b>10,403</b>

### 4.3. CUSTOMER RELATIONS, SATISFACTION, ACCESSIBILITY.

The mechanisms for dialogue with customers are designed to meet the expectations and demands of banking and insurance customers. They are also part of an *Integrated Quality Process* which the permanent objective is that the quality of customer service and attention, in all communication channels that the customer decides to use, is maintained as a distinctive advantage of LABORAL Kutxa compared to its competitors. The following diagram describes the numerous communication mechanisms in place.

Listen to the banking and insurance clientele. Mechanisms in motion.



The results compared to other banking and insurance competitors are favourable. Some of the most representative are included in the following tables.

Satisfaction of banking customers (score 1 to 10)	2016	2017
Satisfaction among preferential customers	7.82	7.67
Recommendation level	7.55	7.48

Source: Tracking study of the image and brand of LABORAL Kutxa. The area is the Basque Country and Navarra. Ikerfel

Satisfaction of banking customers (% of customers who give outstanding ratings)	Basque Country			Navarra		
	LK	Main competitor	Δ	LK	Main competitor	Δ
<b>Most recognised image attributes</b>						
Support Basque language and culture	75%	70%	5%	81%	2%	79%
Good service, close to its customers	60%	44%	16%	53%	35%	18%
Entity committed to society and to local development	58%	63%	-5%	44%	38%	6%
Honest and responsible management, which can be trusted	51%	34%	17%	44%	33%	11%
Professional and specialised advice	48%	37%	11%	41%	37%	4%
Insurance specialist	45%	24%	31%	33%	19%	14%
<b>Least recognised image attributes</b>						
Applies high fees	7%	28%	21%	10%	33%	23%
Distinctive products for professionals and businesses	11%	9%	2%	16%	16%	0%
Most favourable car loans	22%	20%	2%	16%	11%	5%
Entity specialised in companies	23%	15%	8%	17%	27%	-10%
Most favourable mortgages	27%	26%	1%	37%	24%	13%
Distinctive solutions for savings management	28%	21%	7%	19%	11%	8%

Source: Tracking study of the image and brand of LABORAL Kutxa. Ikerfel

Satisfaction of insurance customers (score 1 to 10)	2016	2017
Overall Satisfaction with Service Provision	8.44	8.45
Satisfaction with IP in Cars	8.79	8.86
Satisfaction with IP in Home	8.24	8.28
Satisfaction with IP in Trade	8.22	8.1
Satisfaction with Approved Garages	8.84	8.92
Satisfaction with the Home and Trade Repairers	8.41	8.4

Source: Continuous study of insurance customer satisfaction. Seguros Lagun Aro

Comparative benchmarking with the banking sector. Potential customers (score 1 to 10)	2016	2017	Sector differentiation 2017
Sectoral Objective Quality Study (EQUOS-Stiga)	7.57	7.52	+0.49
Satisfaction of banking customers (BMKS FIN-Stiga)	7.69	7.72	+0.33



Benchmarking in the insurance sector Satisfaction of insurance brokers (score 1 to 10)	Seguros Lagun Aro	Insurance Market
Overall satisfaction with the company	8	7

Source: Continuous study of broker satisfaction. Seguros Lagun Aro e ICEA

In general, the customers recognise the work done by LABORAL Kutxa and Seguros Lagun Aro in important aspects such as:

- Commitment to society and local development and, above all, support for the Basque language and culture,
- the dedication to service quality and honest and responsible handling of customers,
- professionalism and specialisation in advising on banking and insurance products,
- the implementation of reasonable charges, which are lower than those of other competitors.

By contrast, one area for improvement is the differentiation and improvement in the value proposition of some of the mass products such as car loans and mortgages for home purchase, as well as specific products for professionals, businesses and companies.

With regard to accessibility, reference is made throughout this report to the efforts made to improve the new channels with which to maintain and strengthen our relationship with customers via the Internet and mobile phones.

#### **Architectural barriers**

When carrying out any work at offices, the opportunity has been taken, within the possibilities and characteristics of the buildings, to eliminate existing architectural barriers and improve accessibility to the premises, thus complying with the Accessibility Standard. Given that these actions have been carried out for many years, there are currently very few work centres with accessibility problems. During 2017, activities have been carried out in 3 offices.

## 5. HUMAN RIGHTS

In relation to the direct activity of LABORAL Kutxa with respect to its own workers, the legal status of co-operative is an ambitious development of the inspiring principles of the *Universal Declaration of Human Rights*, namely that all human beings are equal in dignity and in rights. This Declaration is based on *the recognition of the inherent dignity and equal and inalienable rights of all members of the human race*.

Indeed, the co-operative method implies that the people who work in the company are partners with equal rights and obligations, regardless of their knowledge or status in the hierarchy. Requiring all people to share rights and obligations, as they all share in the risks and rewards of the business.

The concept of cooperation also extends to a commitment to our society. We are a *Cooperative Bank, guided by values and a philosophy that lead us to prioritise the common interest over the individual, to make decisions in a participative and responsible way and to reinvest our profits in society*.

In our area of activity, we only identify significant risks linked to non-compliance with human rights in relation to corruption risks and with our indirect actions to ensure compliance by companies that supply us. The activities related to these two aspects are described in the following paragraphs.

A second type of risk related to Human Rights concerns *harassment* at work. This is a problem with a low quantitative effect, but a potentially significant effect on the individuals who may be involved in a potential situation of this nature.

In the procedures, there is a *Protocol for action in cases of harassment at work*, updated on 31/01/2015. The organisation incorporates an *Investigation Committee*, which has a *specific complaints channel*. This protocol includes situations of *sexual and gender harassment (known as mobbing)*.

There have been no complaints or enquiries in 2016 and 2017 concerning the aforementioned complaints channel.

**Lagun Aro** has a *procedure for managing conflict, harassment and violence at work*. There have been no complaints under this Procedure. The Protocol against Sexual and Sexist Harassment within the Company (Create, Disseminate, Train) will be defined within the framework of the 2nd Equality Plan. The aim is to integrate this protocol into the current Conflict, Harassment and Violence at Work Management Procedure.

## 6. CORRUPTION AND BRIBERY

The management policies of **LABORAL Kutxa** identify the greatest risks in the areas of corruption and bribery with *the fight against money laundering and the financing of terrorism*. In this regard, it undertakes to establish the necessary bodies and procedures in accordance with current regulations and international standards. For this reason,

- the *Committee for the Prevention of Money Laundering and the Financing of Terrorism* and a *Prevention Unit* have been created within the organisational structure of the Entity, with specific functions in the area of prevention.
- Precise rules and procedures have also been established, which are contained in a "*Money Laundering and Financing of Terrorism Prevention Manual*", the latest version of which was approved on 24/01/2017.

This policy applies to the entire LABORAL Kutxa Group, including the subsidiaries.

The objectives of these rules and procedures, which must be complied with, are:

- To strictly comply with the regulations in force at all times, as well as the recommendations issued by national and international bodies and authorities.
- To introduce rules for action and appropriate control and communication systems to prevent funds of a criminal origin from being channelled through the LABORAL Kutxa Group and to impede access to certain persons.
- To establish customer admission policies.
- To ensure that working partners and other employees adhere to the "know your customer" procedures.

These policies and procedures are primarily preventive in nature. In addition, internal control procedures are subject to an annual review by an *external expert* so that a rationale for continuous improvement in reducing exposure to these money laundering and financing of terrorism risks can be applied.

In addition, LABORAL Kutxa also has a *Criminal Compliance Policy*, with several Regulations and Codes of Conduct including, among others:

- Code of Ethics and Professional Conduct,
- Guide of Good Practices and Professional Secrecy,
- Internal Rules of Conduct specific to the stock market

Organisationally, it has also set up an *Ethics Committee* and a *Regulatory Compliance Department* to prevent irregularities and monitor compliance with rules and procedures.

Below are the business units of LABORAL Kutxa that have been analysed with respect to risks related to corruption:

Offices analysed	2016	2017
Total no. of offices analysed	74	90
% Offices analysed	22%	28%

It should be noted that the controls and remote audit analyses implemented have an effect on 100% of the branches and central organisational units of the Entity.

At **Seguros Lagun Aro** the planning of the *internal audits* carried out in order to oversee the inherent underwriting risks (compliance with regulations and administrative procedures, preservation of documentation, etc.) is carried out at 100% of the branches annually, both in the Banking Insurance and Brokerage channels, based on the warnings and risk groups established for the various annual and daily audits.

There is a “*Complaints Channel*” that allows people to report, guaranteeing the protection of the complainant, irregularities of potential importance linked to the *Code of Ethics* and the *Criminal Compliance Policy* and the “*Ethics Committee*” acts as a supervisory body for these regulations, which is chaired by the Social Management Department and also includes Regulatory Compliance, Legal Advice, the Financial Department and Internal Audit. This body, in addition to monitoring, grants authorisations or exceptions and deals with the complaints received through the Complaints Channel, ensuring the appropriate action. In 2017 there were 4 cases (3 in 2016), two of which were clarified and two other concerns were resolved without the need to initiate proceedings.

Some of the actions taken in the fight against corruption during 2017 are described below:

Actions Undertaken in 2017
<ul style="list-style-type: none"> <li>• The Manual on the Prevention of Money Laundering and Financing of Terrorism has been amended, introducing several improvements.</li> </ul>
<ul style="list-style-type: none"> <li>• The six-monthly reports, Summary of Special Examination Operations and a Risk Self-assessment Report on Money Laundering have been created.</li> </ul>
<ul style="list-style-type: none"> <li>• The alert for inactive accounts has been improved</li> </ul>
<ul style="list-style-type: none"> <li>• A Remediation Plan has been prepared to address deficiencies in the formal identification of customers.</li> </ul>
<ul style="list-style-type: none"> <li>• An Action Plan has been implemented to identify the tax residence of customers in accordance with regulatory requirements derived from the Multilateral Agreement of Competent Authorities on the Automatic Exchange of Financial Account Information signed by Spain.</li> </ul>
<ul style="list-style-type: none"> <li>• A training course has been given to all staff on the Crime Prevention and Response Manual and the Criminal Compliance Policy.</li> </ul>

## 7. SUPPLY CHAINS AND SUBCONTRACTING

In the successive surveys carried out to draw up the materiality study, the various stakeholders have been consulted on the importance they attach to supplier management in their relationship with LABORAL Kutxa. All of them have shown that this aspect is considered to be an element of low materiality. However, in the materiality study carried out in 2017, the two questions relating to vendor management have resulted in an average materiality:

- ✓ Control of the responsible activity of our suppliers: working conditions, occupational risks, payments to the Tax Authorities...
- ✓ Supplier management. Responsible purchasing criteria: purchase locally and take social and environmental criteria into account in addition to price.

When consulting customers, the importance attached to monitoring the responsible behaviour of suppliers is somewhat higher. Workers value the two issues in a similar way, while the CSR Committee members attach greater importance to responsible purchasing criteria.

Without a doubt, the financial activity that we carry out, as well as the local presence in a very specific geographical area, means that the management risks of these companies are not excessively important.

Nevertheless, LABORAL Kutxa, aware of the importance of supply chain management in the area of sustainability, has developed two areas of action regarding suppliers during 2017:

- 1) Firstly, with regard to **occupational risk prevention**, a coordination of business activities has been undertaken. There are more than 350 work centres in LABORAL Kutxa where many people belonging to other companies come to perform professional tasks: subcontractors, works, maintenance... In 2017, priority was given to those activities that involve greater risk, establishing for them the controls and exchanges of information and documentation necessary to ensure that the people who come to our premises to carry out these activities meet all the established requirements.  
The following objectives have been set for 2018:
  - ✓ To select and implement an IT tool to manage the coordination of business activities in an integrated way.
  - ✓ To extend the application of the procedure for coordinating business activities to all contractors who visit our work centres.
- 2) Simultaneously, in 2017, **a project for the management of supplier companies** was initiated to regulate the management of purchases of the different departments. The aim is to contractually comply with certain minimum requirements for sustainability and to establish control filters so that they can be complied with in practice.

**a) Objectives of the project:**

1. To limit the risks that LABORAL Kutxa may assume, from the point of view of the Ethics Committee, in the management of suppliers, updating the policy, establishing commitments to be entered into by suppliers...
2. To organise and rationalise the relationship with suppliers, harmonising contracting procedures in the search for greater efficiency.
3. To improve our relationship with our suppliers from the point of view of sustainability.

**b) Actions undertaken in 2017:**

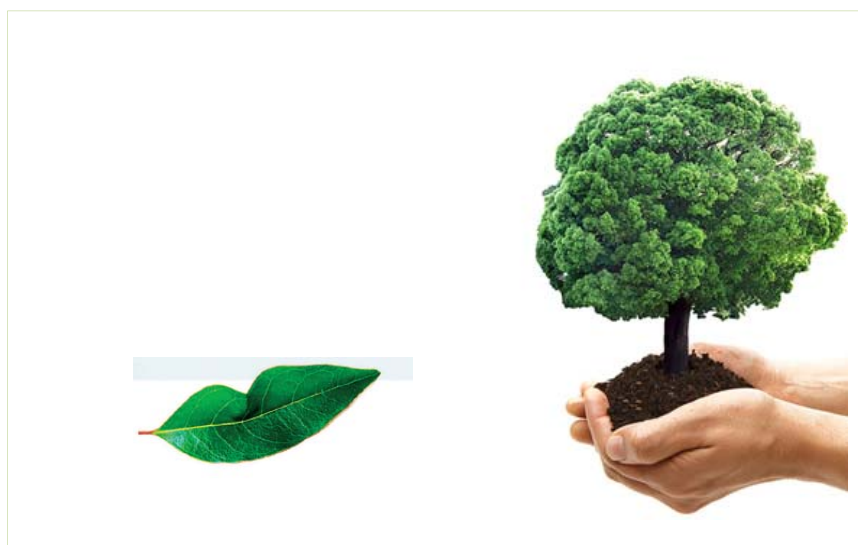
1. Definition of the concept of suppliers.
2. Drafting of the purchasing manual which establishes the procedure to follow when making a purchase, as well as the responsibilities of all parties.
3. Determination of the controls to be established with suppliers to reduce risks.
4. Definition of the *contract awarding body* and of the *approval process*.

This supplier management project is also in line with LABORAL Kutxa's commitment to the *Sustainable Development Goals (SDGs)* of the United Nations.

With regard to the origin of the purchases, LABORAL Kutxa makes the majority of its acquisitions in places where it operates.

	2016	2017
Purchase volume (thousands of euros)	198,797	173,690 (1)
% of goods and services purchased from local businesses	94.9%	96.3%
% of local suppliers of total	94.5%	95.0%
% of domestic purchases, not imported (1)	99%	100%

(1) Since 2017, only those suppliers that are legal entities have been considered.



## APPENDIX II

### ANNUAL REPORT ON THE CORPORATE GOVERNMENT OF OTHER ENTITIES -OTHER THAN SAVINGS BANKS- WHICH ISSUE SHARES TRADED IN OFFICIAL MARKETS

#### DATA IDENTIFYING THE ISSUER

<b>END DATE OF THE YEAR IN QUESTION</b>	31/12/2017
---	------------

<b>C.I.F.</b>	F75076935
---------------	-----------

<b>CORPORATE NAME</b>
CAJA LABORAL POPULAR COOP. DE CRÉDITO

<b>BUSINESS ADDRESS</b>
PS. JOSE MARIA ARIZMENDIARRIETA S/N, (MONDRAGON) GIPUZKOA

**ANNUAL REPORT ON THE CORPORATE GOVERNMENT OF  
OTHER ENTITIES -OTHER THAN SAVINGS BANKS- WHICH  
ISSUE SHARES TRADED IN OFFICIAL MARKETS**

**A OWNERSHIP STRUCTURE**

A.1 Details of the most significant shareholders or participants in your entity at year-end:

Name or company name of the shareholder or participant	% of share capital
LAGUNARO EPSV	15.26%

A.2. Indicate, where appropriate, any family, commercial, contractual or company relationships that exist between the significant shareholders or participants, as far as they are known by the entity, unless they are barely relevant or only arise in the ordinary course of business:

A.3 Indicate, where appropriate, any commercial, contractual or company relationships that exist between the significant shareholders or participants and the entity, unless they are barely relevant or only arise in the ordinary course of business:

A.4 Indicate, where appropriate, any restrictions in the exercise of the right to vote, and any restrictions in the acquisition or transfer of shares in the capital:

Yes

No

**Description of the restrictions**

In compliance with that established by cooperative law, no legal entity member may have a capital share and/or vote of more than 20% and no natural person member may have a capital share and/or vote of more than 2.5%.

**B GENERAL COUNCIL OR EQUIVALENT BODY**

B.1 List the constitution quorum for the general council or equivalent body established in the articles of association. Describe how it differs from the minimum member system stated in the Spanish Companies Act (LSC) or the regulations that apply to it.

In accordance with what appears in cooperative legislation, the General Meeting, regardless of the agreement to be adopted, is considered to be validly constituted, on first call, when more than half of the shareholders are present or represented and on second call when at least 5% of the shareholders or 100 shareholders attend.



**B.2 Explain the system for adopting company resolutions. Describe how it differs from the system stated in the LSC or the regulations that apply to it.**

Applying cooperative legislation, the motions must be adopted, as a general rule, by more than half of the validly cast votes. In the event of mergers, divisions, issue of debentures and other securities, and for amendment of the articles of association, a favourable majority is required of no less than two thirds of the votes present or represented.

**B.3 Indicate briefly the motions adopted at meetings of the General Council or equivalent bodies held during the year corresponding to this report and the percentage of votes with which these motions were adopted.**

During the year the motions adopted by the General Meeting held on 1 April 2017, with their respective voting percentages, were as follows:

- Designating three shareholders to approve the minutes of the respective meeting (unanimous).
- Approving the annual accounts and the management report referring to the entity and its consolidated group (unanimous).
- Paying interest on share capital (unanimous).
- Distributing the net surpluses from the year, allocating 10% to the Education and Promotion Fund, 15% to the Inter-cooperative Social Fund, 25% to Cooperative Returns and 50% to the Mandatory Reserve Fund (unanimous).
- From the Education and Promotion Fund, allocating 10.11% for local distribution, 11.45% for general distribution and 78.44% for financing Mondragon's cooperative institutions and contributions to the Inter-cooperative Education and Promotion Fund (unanimous).
- Approving income quotas and contributions to registered capital from new shareholders (unanimous).
- Establishing that the 2018 General Meeting will set the interest to be paid on the contributions to registered capital corresponding to 2017 and, nonetheless, authorizing the Governing Board to make payments on account (unanimous).
- Extending the appointment of Price Waterhouse Cooper as auditors of the entity for the 2017 financial year (unanimous).
- Partially renewing the members of the Governing Board (unanimous).
- Renewal of the inspectors (unanimous)
- Election of the Resources Committee (unanimous)

**B.4 Indicate the address and how to access the entity website containing information on corporate governance.**

The Corporate Governance content can be accessed from the home page of the general website ([www.laboralkutxa.com](http://www.laboralkutxa.com)) or from the entity's corporate website (<http://corporativa.laboralkutxa.com>) by clicking on the section "Corporate Governance and Remuneration Policy".

**B.5 State whether meetings have been held for the different unions that might exist for holders of shares issued by the entity, the subject of the meetings held during the year referred to in this report and the main motions adopted.**

There are no unions for holders of shares issued by the entity.

## **C STRUCTURE OF THE ENTITY'S ADMINISTRATION**

### C.1 Administrative body or board

C.1.1 Give details of the maximum and minimum number of board members or members of the administrative body set forth in the articles of association:

<b>Maximum number of board/body members</b>	13
<b>Minimum number of board/body members</b>	12

C.1.2 Complete the following table for the board/administrative body members and their different statuses:

#### **BOARD / ADMINISTRATIVE BODY MEMBERS**

<b>Name or company name of the board /administrative body member</b>	<b>Representative</b>	<b>Date of last appointment</b>
TXOMIN GARCIA HERNANDEZ		29/07/2015
MARIA CARMEN IÑURRIA LANDERAS		29/07/2015
ELENA ZARRAGA BILBAO		29/07/2015
JAVIER OLEAGA MENDIARACH		29/07/2015
AINHOA GALLASTEGUI MARTINEZ		29/07/2015
ADOLFO PLAZA IZAGUIRRE		29/07/2015
LUIS MARIA UGARTE AZPIRI		27/07/2017
PABLO LUIS BRINGAS VELEZ		27/07/2017
FRANCISCO JOSE DEAN PUEYO		27/07/2017
ITZIAR ELGARRESTA IBARRONDO		27/07/2017
MARIA ESTHER KORTA ERRAZKIN		27/07/2017
NAGORE LARRABEITI LIBANO		27/07/2017

C.1.3 Identify, when appropriate, the board/administrative body members who take on administrative or management roles in other entities within the entity's group:

<b>Name or company name of the board/administrative body member</b>	<b>Corporate name of the group's entity</b>	<b>Position</b>
TXOMIN GARCIA HERNANDEZ	SEGUROS LAGUN ARO, S.A.	CHAIR
TXOMIN GARCIA HERNANDEZ	SEGUROS LAGUN ARO VIDA, S.A.	CHAIR

C.1.4 Complete the following table regarding the number of female members of the board of directors and its committees, as well as its evolution over the last four financial years:

	Number of members							
	2017		2016		2015		2014	
	Number	%	Number	%	Number	%	Number	%
ADMINISTRATIVE BOARD	6	50.00%	3	21.00%	3	21.00%	3	21.00%
AUDIT COMMITTEE	2	67.00%	2	67.00%	2	67.00%	2	67.00%
APPOINTMENTS COMMITTEE	2	40.00%	0	0.00%	0	0.00%	0	0.00%
REMUNERATIONS COMMITTEE	2	40.00%	0	0.00%	0	0.00%	0	0.00%
RISKS COMMITTEE	3	60.00%	2	40.00%	2	40.00%	1	20.00%

C.1.5 Complete the following table regarding the aggregate salary of the board/administrative body members paid over the financial year:

Salary item	Thousands of Euro	
	Individual	Group
Fixed salary	135	0
Variable salary	26	0
Expenses	0	0
Other remuneration	0	0
<b>Total</b>	<b>161</b>	<b>0</b>

C.1.6 Identify the senior management members that are not members of the board or administrative body and indicate the total payment made to them during the financial year:

Name or corporate name	Position
JULIO GALLASTEGUI ZUBIZARRETA	Managing Director
CARLOS OSES IRULEGUI	Commercial Director and Deputy General Manager
OSCAR EGUSKIZA SIERRASESUMAGA	Risks Director
JOSU ARRAIZA MARTÍNEZ DE LAGRAN	Media Director
XABIER EGUIBAR GAINZA	Business Development Director
JOSÉ ANTONIO UNANUE ETXEBERRIA	Financial Director
NURIA AGUIRRE UNZUETA	Corporate Management Director

<b>Total senior management payments (in thousands of euros)</b>	<b>1,013</b>
---	--------------

C.1.7 Indicate whether the board's articles of association or regulations establish a limited mandate for the members of the board/administrative body:

Yes

No

C.1.8 Indicate whether the individual and consolidated annual accounts that are presented for approval to the board/administrative body have been previously certified:

Yes

No

Identify, when appropriate, the person or persons that have certified the individual and consolidated annual accounts for the entity, for their formulation by the board or administrative body:

C.1.9 Explain, if they exist, the mechanisms established by the board or administrative body to prevent the individual and consolidated accounts they have formulated being presented at the general council or equivalent body with exceptions in the audit report.

The regulations of the Governing Board regulate an Audit Committee which is assigned, among its other functions, the supervision of the preparation and presentation of the regulated financial information and the supervision of the effectiveness of the internal control systems.

C.1.10 Is the secretary of the board or administrative body also a member of the board?

Yes

No

C.1.11 Indicate, if they exist, the mechanisms established to maintain the independence of the external auditor, the financial analysts, the investment banks and the classification agencies.

The regulations of the Governing Board regulate an Audit Committee which is assigned, among its other functions, the task of establishing the suitable relationships with the account auditors or audit companies in order to receive information regarding matters which may present a risk to their independence, requiring annual written confirmation of this independence.

## C.2 Committees of the board or administrative body

C.2.1 List the committees of the board or administrative body:

Name of the committee	No. of members
AUDIT COMMITTEE	3
APPOINTMENTS COMMITTEE	5
REMUNERATIONS COMMITTEE	5
RISKS COMMITTEE	5

C.2.2 Describe all the committees of the board or administrative body, their members and the proportion of executive, shareholding, independent and other external board members of which they are comprised (the entities which do not have the legal form of a limited company will not fill in the category of the board member in the corresponding fields and will explain the category of each board member in the text section according to its legal regime and the way in which they meet the constitution requirements of the audit committee and of the appointments and remunerations committee):

### Audit Committee

Name	Position	Category
MARIA CARMEN IÑURRIA LANDERAS	Chair	
ADOLFO PLAZA IZAGUIRRE	Member	
ELENA ZARRAGA BILBAO	Member	

<b>% of shareholding board members</b>	
<b>% of independent board members</b>	
<b>% of other external members</b>	
<b>Number of meetings</b>	10

Explain the duties attributed to this committee, describe its procedures and organisation and operational rules and summarise its most notable actions during the financial year.

The Audit Committee's specific duties are those set out in the Articles of Association (art. 36.9), that is to say:

- a) To inform the General Meeting about the issues raised there by shareholders on matters within their competence.
- b) To propose to the Governing Board, for submission to the General Meeting, the appointment, extension or termination of the external account auditors.
- c) To supervise the internal audit services.
- d) To be aware of the financial information process and the company's internal control systems.
- e) To communicate with the external auditors to receive information about matters that could compromise their independence and any other information related to the accounts audit process, plus any other communication required by account auditing legislation and the technical audit standards.
- f) To issue an annual report, prior to the publication of the accounts audit report, expressing an opinion on the independence of the account auditors or audit companies. This report shall, in all events, give an opinion on the provision of the additional services, referred to in the previous paragraph.

Similarly, pursuant to Article 10.3 of the Regulations of the Governing Board, it is also responsible for supervising the process of preparing and presenting regulated financial information and supervising the compliance with codes of conduct and corporate governance rules.

The Articles of Association of the Company establish that the audit committee will meet whenever it is considered appropriate when called by its Chair or at the request of any of its members. Each of them has one vote and motions are adopted by simple majority and the vote of the Chair resolves ties.

With regard to the category of the board members which make up the committee, Maria Carmen Inurria (Committee Chairperson) and Elena Zagarra are "independent board members" (67% of the total) and Adolfo Plaza is a "working partner board member" (33% of the total). There are no shareholding or executive directors on the Committee.

The "working partner board member" is a board member who works in the role of working partner in the entity and does not perform senior management duties.

With regard to the most significant actions of the Audit Committee in 2017, the following are highlighted:

- It has supervised the process of preparing and presenting the financial information published by Caja Laboral, through the Internal Audit Department's releases, highlighting the following verifications:
  - Review of the individual and consolidated financial accounts prepared by the entity and the corresponding management reports.
  - Review of the quarterly consolidated public financial statements submitted to the Bank of Spain.
  - Review of the information on market transparency published twice a year by the entity.
  - Six-monthly review of the statement of equity submitted to the Bank of Spain.
  - Review of the prudential information published by the entity.
- It has supervised the Financial Information Internal Control System (FIICS) through the review procedure established by the Internal Audit Department.
- It has supervised the capital self-assessment process carried out by the entity.
- It has supervised the internal audit function, ensuring its independence and effectiveness, receiving regular information on the activities carried out by the Internal Audit Department.
- It has adopted the resolution to propose to the Governing Board, for submission to the General Meeting, the extension of the external audit contract.
- It has monitored the result of the external audit, holding joint meetings with the external auditor, analysing and reviewing the aspects considered to be especially relevant.
- It has expressed an opinion, confirming the independence of the external auditors, prior to the accounts audit report being issued.
- It has evaluated and approved, where appropriate, those services additional to the audit services that the entity proposed to outsource to the external auditor.

Identify the board member on the audit committee who has been appointed, taking into account his/her knowledge and experience in accounting and/or auditing, and report on the number of years that the Chair of this committee has been in office.

<b>Name of the board member with experience</b>	ELENA ZARRAGA BILBAO
<b>No. of years the chairperson has held the position</b>	2

## Appointments Committee

Name	Position	Category
ITZIAR ELGARRESTA IBARRONDO	Chair	
TXOMIN GARCIA HERNANDEZ	Member	
MARIA ESTHER KORTA ERRAZKIN	Member	
PABLO LUIS BRINGAS VELEZ	Member	
FRANCISCO JOSE DEAN PUEYO	Member	

<b>% of shareholding board members</b>	
<b>% of independent board members</b>	
<b>% of other external members</b>	
<b>Number of meetings</b>	4

Explain the duties attributed to this committee, describe its procedures and organisation and operational rules and summarise its most notable actions during the financial year.

The Governing Board agreed, on 29 April 2016, to formally establish the Appointments Committee and the Remuneration Committee as separate Committees, modifying Article 11 of the Governing Board Regulations.

The specific duties of the Appointments Committee are those set out in the Governing Board's regulations (art. 11. b), i.e:

- To identify and recommend, with a view to their approval by the Governing Board or the General Meeting, candidates to fill vacancies on the Governing Board.
- To evaluate the balance of expertise, ability, diversity and experience of the Governing Board and to develop a description of the duties and aptitudes required for a specific appointment, evaluating the expected time commitment for the post.
- To regularly evaluate, at least once a year, the structure, size, composition and performance of the Governing Board, making recommendations to it regarding potential changes.
- To regularly evaluate, at least once a year, the suitability of the various members of the Governing Board and of the latter as a whole, and to report to the Governing Board accordingly.
- To regularly review the Governing Board's policy on the selection and appointment of senior management members and make recommendations.
- The functions assigned in the Selection and Suitability Assessment Procedure Manual for board members and key staff.
- To establish a target for the representation of the least represented sex in the Governing Board and develop guidance on how to increase the number of people of the least represented sex with a view to achieving this target.

The Regulations establish that the Appointments Committee shall meet as many times as it is deemed appropriate at the call of its Chair, on their own initiative or at the request of any of its members. Each of them has one vote and motions are adopted by simple majority and the vote of the Chair resolves ties.

With regard to the category of the board members which make up the Committee, Itziar Elgarresta (Committee Chair) and Esther Korta are "independent board members" (40% of the total), Pablo Luis Bringas and Francisco Jose Dean are "working partner board members" (40% of the total) and Txomin Garcia is "other external board member" (20% of the total). There are no shareholding or executive directors on the Committee.

The "working partner board member" is a board member who works in the role of working partner in the entity and does not perform senior management duties.

The "other external board member" is a board member who does not meet the requirements to be included in the other categories.

With respect to the most important actions in 2017 of the Appointments Committee, the following are noteworthy:

- Presentation of the Report on recommendations to the Governing Board regarding the evaluation and analysis of the candidates to become members of the Governing Board.
- The continued evaluation of the suitability of the members of the Governing Board, General Management and Key Personnel and the assessment of the balance of knowledge, ability, diversity and experience on the Governing Board.

Presentation of the report evaluating the structure, size, composition and performance of the Governing Board

- Review of the proposal for the Governing Board policy on the selection, appointment and succession of the members of Senior Management.
- Proposal for amending the Selection and Suitability Assessment Procedure Manual for board members and key staff of Caja Laboral.

### **Remunerations Committee**

Name	Position	Category
ITZIAR ELGARRESTA IBARRONDO	Chair	
TXOMIN GARCIA HERNANDEZ	Member	
MARIA ESTHER KORTA ERRAZKIN	Member	
PABLO LUIS BRINGAS VELEZ	Member	
FRANCISCO JOSE DEAN PUEYO	Member	

<b>% of shareholding board members</b>	
<b>% of independent board members</b>	
<b>% of other external members</b>	
<b>Number of meetings</b>	4

Explain the duties attributed to this committee, describe its procedures and organisation and operational rules and summarise its most notable actions during the financial year.

The Governing Board agreed, on 29 April 2016, to formally establish the Appointments Committee and the Remuneration Committee as separate Committees, modifying Article 11 of the Governing Board Regulations.

The specific duties of the Remuneration Committee are those set out in the Governing Board's regulations (art. 11. c), i.e:

- To propose to the Governing Board the general remuneration policy applicable in the entity and prepare the decisions to be taken by the Governing Board regarding remuneration, including those that have an impact on the risk and risk management of the entity.
- To report to the Governing Board on the remuneration policy for directorates included in the "identified group" as well as general remuneration of directors when they are remunerated for this position and for the General Manager and assimilated directors, as well as individual remuneration and other contractual conditions for members of the Governing Board who perform executive functions.
- To ensure that an independent, internal or external, annual evaluation of the implementation of the remuneration policy is carried out.
- To ensure compliance with the remuneration policy established in the company and to periodically review the remuneration policy applied to directorates included in the "identified group" when they are remunerated for such status and to the General Manager and those assimilated.



- To perform the other duties established by current legislation, the Articles of Association, as well as those assigned by the decision of the Governing Board.

The Regulations establish that the Remuneration Committee shall meet as many times as it is deemed appropriate at the call of its Chair, on their own initiative or at the request of any of its members. Each of them has one vote and motions are adopted by simple majority and the vote of the Chair resolves ties.

With regard to the category of the board members which make up the Committee, Itziar Elgarresta (Committee Chair) and Esther Korta are "independent board members" (40% of the total), Pablo Luis Bringas and Francisco Jose Dean are "working partner board members" (40% of the total) and Txomin García is "other external board member" (20% of the total). There are no shareholding or executive directors on the Committee.

The "working partner board member" is a board member who works in the role of working partner in the entity and does not perform senior management duties.

The "other external board member" is a board member who does not meet the requirements to be included in the other categories.

With respect to the most important actions in 2017 of the Remuneration Committee, the following are noteworthy:

- Update of the "Remunerations policy of Caja Laboral Popular Coop.de Crédito", proposing modifications in the identified group.
- Proposal of a Governing Board remuneration policy for the General Meeting.
- Proposal for formulating objectives and applying individual variable remuneration to the members of the identified group.
- Presentation of the internal evaluation report on Caja Laboral's remuneration policy.

### **Risks committee**

Name	Position	Category
ELENA ZARRAGA BILBAO	Chair	
TXOMIN GARCIA HERNANDEZ	Member	
LUIS MARIA UGARTE AZPIRI	Member	
AINHOA GALLASTEGUI MARTINEZ	Member	
NAGORE LARRABEITI LIBANO	Member	

<b>% of shareholding board members</b>	
<b>% of independent board members</b>	
<b>% of other external members</b>	
<b>Number of meetings</b>	9

Explain the duties attributed to this committee, describe its procedures and organisation and operational rules and summarise its most notable actions during the financial year.

The Risks Committee has the specific duties described in the Governing Board's regulations (art 11 bis) i.e.:

- To advise the Governing Board with regard to global risk propensity, current and future, of the entity and its strategy on this matter, assisting it in the monitoring of the application of this strategy and the specific policies of management, supervision and reduction of risks to which the entity is or may be exposed.
- To ensure that the assets and liabilities pricing policy offered to clients takes into account the business model and the risk strategy of the entity. Otherwise, to present the governing board with a plan to resolve it.

- To advise the Governing Board on the management and supervision of all the relevant risks of the entity.
- To advise the Governing Board regarding stress tests and capital planning in relation to risks.
- To ensure that suitable resources are assigned to risk management and the efficiency of the internal organisation.
- To ensure that there are efficient channels of information in terms of risks from the Governing Board to the organisation and vice versa, defining, together with the Governing Board, the nature, quantity, format and frequency of the information on risks which must be received by the committee and the Governing Board.
- To supervise the valuation of assets, the use of external credit classifications and the internal models regarding risks.
- To help establish rational remuneration practices and policies. To examine whether the incentives policy planned in the remuneration system takes into account the risk, capital, liquidity and probability and opportunity of profit.

The Regulations establish that the Risks Committee shall meet as many times as it is deemed appropriate at the call of its Chair, on their own initiative or at the request of any of its members. Each of them has one vote and motions are adopted by simple majority and the vote of the Chair resolves ties.

With regard to the category of the board members which make up the committee, Elena Zarraga (Committee Chair) and Nagore Larrabeiti are "independent board members" (40% of the total), Ainhoa Gallastegui is a "working partner board member" (20% of the total), Txomin García is an "other external board member" (20% of the total) and Luis Maria Ugarte is a "shareholding board member" (20% of the total). There are no executive board members on the committee.

The "working partner board member" is a board member who works in the role of working partner in the entity and does not perform senior management duties.

The "other external board member" is a board member who does not meet the requirements to be included in the other categories.

In relation to the work carried out in 2017, the Risk Committee in the performance of its duties has carried out:

- The monitoring and control of all risks through quarterly COAP releases.
- It has analysed and validated the modifications of the various risk policies and manuals.
- It has analysed and validated the update of limitations and competences for the various types of risks.
- It has analysed and validated the 2016 IAC.
- It has analysed and validated the Recovery Plan.

It has analysed and validated the risk appetite framework (RAF), the annual risk appetite statement (RAS) and performed its monitoring, and the stress testing methodology and scenario.

- It has analysed and validated the control of the fact that the prices of the formalised transactions exceed the cost of the transaction, in accordance with Annex IX.
- It has analysed and validated the proposed remuneration policy.
- It has analysed and validated the classification of fixed-income and equity portfolios, with IFRS 9.

## **D** LINKED OPERATIONS AND INTERGROUP OPERATIONS

D.1 Give details of the operations performed between the entity or entities in your group, and the shareholders, cooperative participants, holders of property rights or any other equivalent party of the entity.

D.2 Give details of the operations performed between the entity or entities in your group, and the entity's administrators or members of the administrative body or directors.

D.3 Give details of the intergroup operations.

D.4 Give details of the mechanisms established to detect, determine and resolve possible conflicts of interest between the entity or its group, and its board/administrative body members or directors.

In addition to the legally established possibility of challenging the motions agreed by the General Meeting and the Governing Board that harm the interests of Caja Laboral, to the benefit of one or more shareholders or third parties, the following specific regulations can be applied, regarding any possible conflicts of interest:

a) In compliance with article 7 of the Risks Policy Manual, and as a general criterion, all the risk operations proposed by the members of the Governing Board, General Manager, their family members up to second degree consanguinity and related companies will require centralised approval and must be submitted for the approval or ratification of the Governing Board, requesting authorisation from the Bank of Spain when exceeding the limits and terms established in standard 35 of the Bank of Spain Circular No. 2/2016 regarding supervision and solvency or otherwise being the object of immediate notification.

b) The need to meet the requirements, which are indicated below, for agreements of the Governing Board regarding risk operations specified in letter a) above. The requirements are as follows:

- The agreement must be adopted by secret ballot, with prior inclusion of the matter on the agenda with due clarity.

- The motion must be adopted by a majority of at least two-thirds of the total number of board members. If the beneficiary of the operation or service is a board member or a member of their family as indicated above, they will be considered as having a conflict of interest and will not be able to take part in the voting.

- Once the secret ballot has been held and the result announced, it will be appropriate to officially record any reservations or discrepancies with respect to the motion adopted.

These same requirements must be met when it comes to establishing, suspending, modifying, renewing or terminating obligations or rights of Caja Laboral with entities in which those persons or their aforementioned relatives are employers, directors, administrators, senior managers, advisers or basic members with a stake in the capital equal to or greater than 5%.

The appointment of board members is subject to a suitability manual which requires a signed declaration stating the absence of continued or structural conflicts with the interests of Caja Laboral as a necessary requirement to prove the suitability of the board member. Similarly, this situation is verified on an annual basis, without prejudice to the fact that the Board Member is responsible for immediately notifying Caja Laboral of any circumstances that could affect his or her suitability and is responsible for any damage that may be caused to the company as a result of the absence or delay of such notification.

## **E RISK MANAGEMENT AND CONTROL SYSTEMS**

### **E.1 Explain the scope of the entity's Risk Management System.**

The Risk Management System works as a whole, with the responsibility for acceptance, monitoring and recoveries of traditional credit risk and the measurement and control of risks regarding interest rates, liquidity, market and operations being centralised in the Risks Division. The monitoring of the different risks are reported monthly, except operational risk, to the Assets and Liability Committee (COAP) and the monitoring of operational risks is reported quarterly to the Operational Risk Committee (CORO).

The management of all the risks is centralised, with the Assets and Liabilities Committee, and the Operational Risk Committee in the case of operational risk, being responsible for this task. Except for the treasury and capitals market risks, which are expressly delegated to the Treasury Department, and the credit risk for that related to attributions corresponding to branches or the Risk Division.

### **E.2 Identify the bodies of the entity responsible for the development and execution of the Risk Management System.**

Governing Board: highest administrative body. It has the ultimate responsibility for monitoring and supervising the risks incurred by the entity. In order to carry out its functions, it relies on the Risk Committee, which is made up of members of the Governing Board, and on its direct presence in the COAP and the Principal Risk Committee. It requires rigorous risk control and systematic risk management from the ORC (Director of the Global Risk Control Department).

The Principal Risk Committee has the highest powers for all amounts and types of risk. It may authorise any type of operation except those aimed at financing electoral campaigns, which are matters for the Governing Board.

General Management: responsible for the implementation of risk policies, through delegation by the governing body. It has organised the risk function on the premise of separation of roles between sales management and assumption of risks.

The Risks Division, specifically the ORC, reports quarterly on the monitoring and control of all risks to the Risks Committee and the Governing Board, specifying the level of compliance with the different limits and procedures established.

Assets And Liabilities Committee: the body which controls the interest rate, liquidity, market and credit risks. The ORC reports monthly on risk monitoring, and this committee makes the relevant management decisions in relation to liquidity, interest rate and market risks.

Operational Risk Committee: operational risk control body. The ORC submits a quarterly report on the monitoring of operational risk.

Risk Division: centralises responsibility for the admission, monitoring and recovery of individual and company credit risk and for the construction and maintenance of credit risk internal models, as well as the measurement and control of liquidity, interest rate, market and operational risks.

Global Risk Control Department: reports hierarchically to the Risks division and functionally to the Risk Committee. It provides an overview of all the risks by measuring and controlling all the risks. As such, it is responsible for the preparation of credit risk monitoring and internal admissions models, as well as the measurement and control of liquidity, interest rate, market and operational risks. Reports to the COAP, the Risk Committee and the Governing Board.

Risk Management Department: answerable to the Risk Division. It is responsible for managing both domestic and commercial credit risk, both in terms of acceptance and the monitoring and recovery of irregular situations in its friendly and pre-litigation phase. It intervenes in the penalisation of failures and has powers up to a certain level.

Legal Advice Department: answerable to the Risk Division. It provides legal documentary cover and support for risk operations as well as for the management of disputes within the company network.

Treasury Department: answerable to the Finance Division, it manages the credit risk with financial institutions and private fixed income, market risks, short-term liquidity risk and positions arising from the decisions made in the COAP.

Regulatory Compliance Department: internal control organisation and monitoring of the various areas of regulatory compliance. It coordinates the different divisions and departments of the entity.

Branch office network: first phase in the individuals and companies credit risk acceptance process, up to the limit of their scope in which they have delegated functions due to scoring/rating levels, alerts and competences which make up the entity's risk policy. If the risk admission exceeds the powers of the retail network, the approval is raised to the Risk Area.

Internal Audit: independent and objective role of assurance and advice, providing a systematic and disciplined approach to assess and improve the efficiency of risk management, control and governance processes.

### E.3 Indicate the main risks which could affect the attainment of the business goals.

The credit risk of the traditional business with individuals and companies (including concentration risk), structural interest rate risk, liquidity risk, treasury and capital market risks (counterpart, country, concentration and market risks), operational risk, reputational risk and business risk.

### E.4 Identify whether the entity has a risk tolerance level.

The Risk Appetite Framework (RAF) is the main tool used by the Governing Board to establish, manage and control the types and levels of risk that it is prepared to assume in order to achieve its strategic objectives. The RAF allows the people who determine the Entity's strategy to consciously accept the risks that correspond to such a strategy.

In relation to Governance, the Global Risk Control Department is responsible for managing all issues related to the RAF, identifying needs, coordinating all the areas involved and presenting the different proposals to the COAP/Risks Committee/Governing Board. The COAP and the Risk Committee have a leading role in the analysis and supervision of the proposals, prior to their submission to the Governing Board for approval.

In order to establish the risk appetite, the Entity takes into account its capacity to assume risks, mainly by taking into account:

- The financial capacity (capital and liquidity) of the Entity to assume risks
- The business environment: macroeconomic situation, regulatory risks...

- The risk culture in the Entity
- The inherent risk in each type of risk
- The degree of preparation and ability to take on each type of risk: the quality of the risk processes, knowledge and preparation of the personnel involved in each risk, the ability of the technological infrastructure to support the management and control of each type of risk...

The RAF incorporates a structure of indicators or metrics relating to the profitability, solvency, liquidity and different types of risk that the Entity manages. There is a first level, with the core indicators, and a second level with indicators that develop or complement those of the first level. The profitability, solvency and liquidity are considered to be priority dimensions, being established within the first level of CORE indicators related to these dimensions. All of the above metrics are assigned objectives and observation and tolerance thresholds, which allow us to specify the level of risk that the Entity is willing to assume, i.e. its level of risk aversion.

To achieve its strategic objectives, the Entity wishes to maintain a medium-low risk profile, which is specified in its Risk Appetite Statement (RAS). The RAS establishes observation and tolerance thresholds consistent with a prudent risk policy aimed at keeping the Entity within comfortable levels of capitalisation and liquidity, even in stress scenarios. The Entity monitors these indicators, having established an action procedure if the thresholds are exceeded.

## E.5 Indicate which risks have materialised during the financial year.

Regarding the interest rate risk, the limit set by the governing body and controlled by the COAP has never been exceeded.

For market risks, the excesses are supervened, i.e., motivated by the reduction of limits and not by increases of the position. In these cases the control systems have worked properly, with the COAP having been informed of the mentioned excesses and having decided whether or not to maintain the position.

As regards liquidity risk, there has not been any stress situation. The systematic monitoring of the entity's liquidity and the analysis of its deviations from the forecasts and the monthly finance plans allow sufficient time to anticipate possible unfavourable mid-term impacts, generating the necessary corrective actions in enough time.

Relating to the credit risk and regarding operations with the individuals and company segments, when the risk with a creditor exceeds the attributions in an organisation, the ruling is implemented in the organisation with the next higher level of attributions. In operations with financial institutions and large corporations, the activity has been carried out within the Entity's risk management framework, which sets limits significantly lower than the levels set by the regulations for large risks.

As for operational risk, the operational losses that inevitably occur as a result of the activity of the entity are reduced as a result of the controls established in the qualitative section. The entity has made provisions in anticipation of future needs.

With regard to reputational risk, the situations arising from business with clientèle which have generated negative publicity continues to be managed.

## E.1 Explain the response and supervision plans for the main risks of the entity.

Internal supervision of the risks of the entity is determined by the activities of Internal Audit, which are aimed at assessing and improving the efficiency of the risk control and management processes.

## **F INTERNAL RISK CONTROL AND MANAGEMENT SYSTEMS RELATED TO THE PROCESS OF ISSUING FINANCIAL INFORMATION (FIICS)**

Describe the mechanisms which form the risk control and management systems related to the process of issuing financial information (FIICS) of the entity.

### **F.1 Entity control environment**

Give details, highlighting the main characteristics of, at least:

**F.1.1. Which bodies and/or functions are responsible for: (i) the existence and maintenance of a suitable and effective FIICS; (ii) its implementation; and (iii) its supervision.**

Caja Laboral has implemented internal control mechanisms in order to guarantee that the financial information published in the markets, concerning both the entity and the group, is complete, reliable and appropriate. This process has been reinforced with the completion during 2014 of the Financial Information Internal Control System (hereinafter, FIICS).

Section 3.6. "reliability of the information" of the Code of Ethics and Professional Conduct of Caja Laboral defines both the governing bodies and the roles assigned to each of them, in relation to FIICS:

"The Caja Laboral Governing Board is the body ultimately responsible for establishing, maintaining and guaranteeing a suitable and efficient FIICS, which controls and ensures that the financial information published in the markets, concerning both the Entity itself and the Group, is complete, reliable and suitable."

"The Management Board and the Internal Audit Department are responsible for designing and implementing effective control procedures to permanently guarantee the reliability of the financial information supplied to the market. To this end, it will supply the entity with sufficient human and material resources, providing the people involved in the preparation of the financial information with the necessary training for them to perform their tasks."

The Audit Committee is responsible for overseeing the proper functioning of the FIICS through monitoring the preparation and presentation process of the regulated financial information and, especially, the legal requirements and the correct application of the generally accepted accounting principles. For this task, it is supported by the Internal Audit Department which assists the audit committee in reporting on the supervision of the correct design and implementation of the risk control and management systems, including the FIICS, and supervises their correct and efficient working order.

Lastly, the Management Control and Planning Department, under the direction of the Finance Division, cooperates in the design and implementation of risk control and management systems, especially regarding the process of preparation, presentation and integrity of financial information which is disseminated in the markets.

**F.1.2. If they exist, especially regarding the process of preparing financial information, the following elements:**

- Departments and/or mechanisms responsible: (i) For the design and review of the organisational structure; (ii) for clearly defining the lines of responsibility and authority, with appropriate distribution of tasks and roles; and (iii) for there being sufficient procedures for their correct dissemination within the company.

Design and review of the organisational structure is the responsibility of the Organisation Department, which analyses and reviews the need for resources of each Division so that it can be met. This review, which is carried out at the divisions and departments level of central services when the need arises to adapt their organisational structure, not only decides the staffing required but also validates the organisational structure of each unit.

Thus, within the scope of the commercial branch network, using a computer application designed for the purpose, the work load of each branch is measured each month. This information is transferred to the general management, the HR management and the commercial network management in order to apply the adjustments that need to be made to resources.

The Organisation Department is also responsible for defining the lines of responsibility and authority in each area of activity, and for the duties and tasks carried out therein, publishing them in the directory of each division.

In 2015, the Organisation Manual was approved, a single repository for the tasks performed in the organisation, and in 2016 it was published on the corporate Intranet to which all staff have access, together with the entity's general organisational chart.

- Code of conduct, approving body, level of dissemination and instruction, principles and values included (indicating whether there are specific mentions in the register of operations and preparation of financial information), body responsible for analysing non-compliance and for proposing corrective actions and disciplinary measures.

The entity has a code of ethics and professional conduct, the last update of which was approved by its Governing Board in June 2015.

The Code of Ethics and Professional Conduct establishes, in section 3.6, aspects to be taken into account regarding reliability of financial information, of which the following are noteworthy:

"Caja Laboral is responsible for providing reliable, accurate, complete and timely information on its financial statements and on events which may have a significant impact on these.

In addition to the procedures established in the Group to ensure that the financial information is prepared in compliance with the valuation regulations and principles in force, all the work associates and employees have the obligation to diligently comply with their tasks regarding the recording and treatment of the information, which constitutes the basis of the Group's public financial information preparation process.

The application of this responsibility is especially important with regard to the data and reports which are required for preparing the Group's financial statements, as its adequate recording and interpretation are essential in order to ensure a correct application of the relevant valuation criteria for each accounting balance, transaction or contingency".

In June 2015 a Manual on prevention and the response to crime and the corresponding policy of criminal compliance was approved, thereby ratifying the firm stance of Caja Laboral to maintain conduct that respects both the regulations and ethical standards and establishing its framework of principles of compliance in criminal matters. By virtue of this manual, the ethics committee assumes the role of ensuring compliance with the principles of the code of ethics and professional conduct, in general, and the monitoring of potentially illicit conduct from a criminal perspective.

Furthermore, Caja Laboral also has an internal code of conduct in the area of the securities market, which applies to the members of the Governing Board of Caja Laboral, members of the Boards of Directors of the group's companies and to all those people, whether or not they are managers, whose work is directly or mainly related to the activities and services of the entity in the securities market area or who frequently or usually have access to relevant information about Caja Laboral.

- Complaints procedure, which allows the Audit Committee to be notified of any financial or accounting irregularities, as well as any breaches of the code of conduct and any irregular activities in the organisation, informing where applicable if it is of a confidential nature.

As a result of the approval of the Manual on Prevention and Response to Crimes, the complaints channel is managed by the Ethics Committee, which includes the Director of Internal Audit.

This complaints channel is available to all partners, employees and administrators of the different companies which are part of the group. Its operating system is part of the entity's Manual on Prevention and Response to Crimes.

Through this channel, the Ethics Committee is informed of any potential non-compliance with the code of ethics and professional conduct, of operations and behaviour contrary to the legislation in force and the internal regulations and any potentially significant irregularities, especially financial and accounting irregularities.

The entity's Manual on Prevention and Response to Crimes describes the scope, content and use of the channel, ensuring the confidentiality of the complaint.

In addition, the Audit Committee is regularly informed of the work carried out by Internal Audit, including that related to any irregular actions within the organisation.

- Regular training and refresher programmes for personnel involved in the preparation and review of financial information, as well as in the evaluation of the FIICS, to cover at least accounting standards, audit, internal control and risk management.

The entity has a training plan which ensures that the personnel directly involved in the drafting and preparation of the financial information, and in its review, have the training and professional skills necessary to carry out their duties. In this respect, these members of staff are permanently informed about the regulatory requirements in force.

The training programmes and activities are managed by the training section of the entity, which also keeps an up-to-date record of all the courses carried out and their characteristics. Some of the aspects covered in the fields of FIICS during 2017 are described below: risk analysis and management, regulatory compliance, analysis of consolidated financial statements, implementation of IFRS 9...

The training sessions are in person and on-line through internal and external trainers.

## F.2 Financial information risk assessment

Give details of at least:

### F.2.1. The main characteristics of the risk identification process, including those of error or fraud, in terms of:

- Whether the process exists and is documented.

The FIICS has been developed by the entity management in accordance with the international standards established by the "Committee of Sponsoring Organizations of the Treadway Commission" (hereinafter, "COSO"); which establishes five components on which to base the efficiency of the internal control systems:

- To establish a suitable control environment for monitoring all these activities.
- To evaluate all the risks which an entity could incur during the preparation of its financial information.
- To design the controls required to mitigate the most critical risks.
- To establish the appropriate information circuits in order to detect and communicate the weaknesses or inefficiencies of the system.
- To monitor these controls to ensure their effectiveness and the validity of their efficiency over time.

Thus, the process for identifying risks with a potential impact on the financial statements is significant, focusing on identifying the critical management processes related to the generation of financial information and the areas or headings of the financial statements where the mentioned risks materialise. In the process of analysing processes and areas, both quantitative (balance and granularity) and qualitative factors (degree of automation of the processes, operation standardisation, level of accounting complexity, changes with regard to the previous financial year, identified weaknesses in control, etc.) are considered.

The financial information internal control risks evaluation and identification is dynamic, it continuously evolves over time, reflecting the reality of the business of the group, the risks which affect it and the controls which mitigate it, at each moment in time. The evaluation of the effectiveness of the FCIIS controls is performed based on the indicated risks identification process, taking into account the changes in the organisation and business of the group and considering the level of materiality, probability of occurrence or possible financial impact of the risk which include the mentioned controls.

- If the process covers all objectives of the financial information (existence and occurrence; integrity; valuation; presentation; breakdown and comparability; and rights and obligations), whether it is updated and with what frequency.

The process has been designed taking into account all objectives of the financial information considered in the Internal Control Document on financial information in the listed entities issued by the CNMV (existence and occurrence, integrity, valuation, presentation, breakdown and comparability, and rights and obligations).



As indicated above, the criteria to be followed for all types of identifiable risks and which are included in the design of the FIICS are both quantitative and qualitative, as well as considering the identification of error and fraud risks related to published financial information.

The foreseen frequency of the identification process of the relevant material areas and processes is at least annually, using the most recent financial information. Furthermore, this evaluation will also be performed whenever circumstances arise which have not been previously identified and which show possible errors in the financial information or when substantial changes are made in the operations which may lead to the identification of new risks, including situations which entail changes in the structure of the Group, such as: modifications to the scope of consolidation or in the business lines, or other relevant events, among other aspects.

- The existence of a process for identifying the scope of consolidation, taking into account, amongst other aspects, the possible existence of complex company structures, instrumental or special purpose entities.

The entity has a procedure for identifying and updating the scope of consolidation, which is the responsibility of the Inspection Department. Every quarter, this department reviews the inventory of investee companies in order to detect any variation that may be included in the systems to obtain the consolidated financial information.

- If the process takes account of the effects of other types of risks (operational, technological, financial, legal, reputational, environmental, etc.) insofar as they affect the financial statements.

As mentioned above, and due to the control standards and methodology implemented, the effects of other types of risks (market, credit, operational, technological, financial, legal, reputational, of any other nature) are taken into account insofar as they may affect the financial statements.

Regarding operational risk, Caja Laboral has a model for managing operational risk, which includes a risk identification process (map showing the risks of internal and external fraud, and technological, operative, business practices and loss risks) and the controls that mitigate them, as well as a quantitative assessment of them. The model is directly monitored by the Operational Risk Committee and contained in a computer application and in various policy, procedure and user manuals. Responsibility for monitoring assessment of the operational risks and the controls allocated to them falls on the internal audit department.

- Which governing body of the entity supervises the process.

The execution of the risk identification and controls procedure is the responsibility of the Planning and Management Control Department, which reports to the management of the Financial Division, while its supervision is entrusted to the Audit Committee, through the Internal Audit Department.

### F.3 Control activities

State, highlighting the main characteristics, whether you have at least:

F.3.1. Procedures for reviewing and authorising the financial information and description of the FIICS, to be published in the securities markets, indicating the persons responsible for this, as well as documentation describing the flows of activities and controls (including those relating to fraud risk) of the different types of transactions that could materially affect the financial statements, including the accounting closing procedure and the specific review of the relevant judgements, estimates, valuations and projections.

The procedures for the review and authorisation of financial information of the group which is published in the markets begins with the review by the Finance Division management. The individual and consolidated annual accounts are reviewed by the Internal Audit Department as the preceding step to their formulation by the Governing Board. The Audit Committee then reads the information and discusses it with the managers from the Finance Division, Internal Audit and with the external auditors, before it is sent to the Governing Board.

Regarding activities and controls directly related to transactions that could materially affect the financial statements, the entity has procedure manuals specific to the divisions and departments and to the financial information control divisions. These manuals are drafted by the areas and approved by the Governing Board.

The procedures include the organisation chart and the functions involved in the process, the systems involved and the description of the process. Additionally, the risk and control matrices include, among others, the following fields:

- Description of the risk.
- Control activities.
- Control classification: key/standard.
- Control category: preventive/detective.
- Method: manual/mixed/automatic.
- System which supports the control.
- Control manager and executor.
- Control frequency.
- Control evidence.

The significant processes (distinguishing between transversal and business processes) associated with the entity's Finance Divisions for which the aforementioned documentation is available are listed below:

Transversal processes:

- Accounting closure.
- Consolidation.
- Legal and tax management.
- General computer controls.
- Judgements and estimations.

Business processes:

- Lending
  - concession.
  - monitoring and recovery.
- Financial instruments.
- Real estate assets received as payment of debt.

The descriptive documentation described above includes:

- A description of the divisions and departments involved in each of the identified processes.
- The description focused on the preparation of financial information of the procedures, controls and verifications of the activities related to the process from the beginning.
- The identification of the computer systems involved in each process.
- The identification of relevant risks with a material impact on the entity's financial statements.

- The identification of the controls and their description, as well as their association with the previously identified risks.

The Caja Laboral accounting closure procedure is automated and the accounting takes place automatically through the entity's various applications. After this initial process has taken place, the Inspection Department reviews the information, comparing it to both the data from the previous month and the forecast figures, in order to validate the closure of the balance sheet and profit and loss account for the month.

Accounting closure of the subsidiaries is carried out by their corresponding entity, except in the case of the real estate promotion companies, which are sub-contracted to a third party. Once the information has been received from the subsidiaries, a review is performed by the Caja Laboral Inspection Department in order to carry out the consolidation process.

As mentioned in the annual accounts, estimations have been used, as appropriate, for the valuation of certain assets, liabilities, income, expenditure and commitments performed by the Senior Management of the Parent Entity and of the Investee Entities and ratified by their Administrators. In these financial accounts, the entity reports on the most relevant areas in which there are judgement or estimation parameters, as well as the key assumptions included by the group with respect to them. In this respect, the main estimations made make reference to:

- Impairment losses on certain assets.
- The useful life applied to the elements of the tangible and intangible assets.
- Valuation of goodwill for consolidation.
- The fair value of certain unquoted assets.
- The expected cost and evolution of contingent liabilities and provisions.
- Hypotheses used for calculating insurance liabilities.
- The actuarial hypotheses used for calculating the post-employment remuneration liabilities and commitments.
- The recoverability evaluation of activated tax credits

In addition, Caja Laboral has, within the FIICS, a general policy for giving judgements and estimations, covering all the aspects to be considered and the responsibilities in its preparations and review.

### F.3.2. Policies and procedures for internal control regarding the information systems (amongst others, secure access, monitoring of changes, their implementation, operational continuity and separation of roles) that support the relevant company processes in relation to the preparation and publication of financial information.

The 2017 financial year saw the continuation of the development of the Master Plan for Comprehensive Security, a plan that arose from the security diagnosis that was carried out in order to conduct a comprehensive security analysis and detect improvements in the areas of governance, surveillance, protection and resilience.

In line with the area of governance, following the former approval of the comprehensive security policy, the new Security Regulatory Unit has been approved. This is the document unit where the mandatory corporate security requirements are compiled. It is made up of policies that detail at a high level the objective of each Division and corporate standards that define the specific controls to be implemented for each of the security areas. The Security Regulatory Unit is applicable to the entire entity and the functions and responsibilities for executing the tasks detailed therein have been defined. At the moment it is in the dissemination phase.

With regard to the area of protection, the identity management initiative has been launched. Although policies and procedures are already in place for the management of registration, cancellation and modification of users, the objective of this initiative is to further improve the management of provisioning, the processes of registration and cancellation, role management and the blocking and monitoring of these, with special emphasis on the management of privileged users.

In relation to the area of resilience, the development of the business continuity management system continues, with the finalisation of new recovery strategies, crisis management plans and recovery plans.

The entity has two duplicate data processing centres, separated from each other, with their corresponding access controls, surveillance and other additional security measures, established after analysing the potential risks.

F.3.3. Internal control policies and procedures designed to supervise the management of activities outsourced to third parties, as well as those aspects of assessment, calculation and valuation entrusted to independent experts, which could materially affect the financial statements.

The entity periodically reviews which activities performed by third parties are relevant to the financial reporting process or could indirectly affect its reliability. To date, the entity has not outsourced processes that have a significant impact on financial reporting. Nevertheless, the entity uses independent expert valuation reports for operational valuations that could potentially materially affect the financial statements.

In 2017, the activities entrusted to third parties related to valuations and calculations by independent experts were those relating to appraisals of foreclosed properties and properties used as collateral for Caja Laboral's loan portfolio operations.

The entity has controls in place to mitigate the risks associated with the activity carried out by valuation companies, which are implemented by the departments responsible for the operation, aimed at guaranteeing the independence of the valuers and the quality of the valuations. It is also supported by the Internal Audit Department for checking the effectiveness of the established procedures.

## F.4 Information and communication

State, highlighting the main characteristics, whether you have at least:

F.4.1. A specific function responsible for defining, maintaining up-to-date accounting policies (accounting policy division or department) and resolving any questions or conflicts arising from their interpretation, maintaining fluid communication with those responsible for operations in the organisation, as well as an up-to-date accounting policy manual, communicated to the units through which the entity operates.

The Inspection Department is responsible for identifying, defining and communicating accounting policies to the Entity, including to the subsidiaries, and for answering any accounting queries that may be presented by the subsidiary companies or business units of the Entity.

The Entity has an Accounting Manual, which determines and explains the regulations for preparing the financial information and how these regulations should be applied to the operations specific to the Entity, such as, for example, consolidation packages for the subsidiary companies. These documents not only refer explicitly to the standards that apply to each type of transaction, but they also develop and explain their interpretation so that they can be adapted precisely to each type of transaction.

These documents are regularly updated and therefore any significant amendments or updates are notified to the companies to which they apply.

The consolidation packages are prepared by each affiliated company of the Financial Group and it is the Inspection Department that supervises the compliance of these investee companies with the accounting policies established by the Group. This Department analyses and reviews the information from the subsidiaries and makes any corrections that may be necessary.

If there are no regulatory changes concerning the financial information that have an impact on the financial statements, the Inspection Department is responsible for revising, analysing and updating the accounting standards. This department is also responsible for communicating changes or updates to the entity's business units and subsidiaries.

The financial accounting information framework applied by the entity and its group includes: (i) the international financial reporting standards adopted by the European Union, and (ii) Bank of Spain Circular 4/2004 dated 22 December 2004 (repealed on 1 January 2018 by Circular 4/2017).

#### F.4.2. Mechanisms for capturing and preparing the financial information with standard formats for application and use by all units of the institution or group, which support the main financial statements and the notes, as well as the information detailed about the FIICS.

There are control measures in place to ensure that the back-up data for the financial information is collected in full, and in an accurate and timely manner, being also notified in a timely manner. The process of consolidation and preparation of the financial information is centralised and carried out by the Entity.

This process uses as input the consolidation packages from the financial statements reported by the subsidiaries, following the guidelines and formats in place, as well as the rest of the financial information required, both in the account standardisation process and to cover the information requirements in place. The Inspection Department is responsible for reviewing the financial information reported by the subsidiary companies.

The Inspection Department performs a series of controls to ensure the reliability and correct processing of the financial information received from the subsidiaries and the business units, among which are checks on the correct implementation of the various consolidation entries, variations in the results obtained on the budget and the checks specific to Banco de España, where the various balance sheet and profit and loss account entries are interlinked.

### F.5 Supervising the system's operation

Give details, highlighting the main characteristics, of at least:

#### F.5.1. Activities for supervising the FIICS carried out by the Audit Committee, and whether the institution has an internal audit system whose responsibilities include supporting the committee in its task of supervising the internal control system, including the FIICS.

Furthermore, information shall be provided about the scope of the evaluation of the FIICS made during the financial year and the procedure used by the person responsible for carrying out the evaluation to report their findings, whether the institution has an action plan containing details of any corrective measures and whether their impact on the financial information has been considered.

Among the competences assigned to the audit committee, as well as that of supervising the internal audit services, are those regarding the supervision of the process of development and presentation of financial information and the internal control systems of the company and delegating the development of these activities to the internal audit department.

To perform its role, the Internal Audit Department is divided into four functions: Financial Units Audit, Customer Management Units Audit, Remote Audit and Information Technology Audit, and their main task is to establish the internal control measures necessary to guarantee the reliability of the financial information, operational efficiency (of both procedures and management), compliance with the internal and external regulations that apply, and protection of the Entity's assets.

Furthermore, the entity's Code of Ethics and Professional Conduct establishes that the Governing Body and the Internal Audit Department are responsible for designing and implementing effective control procedures to permanently guarantee the reliability of the financial information supplied to the market.

To achieve its objective, Internal Audit carries out scheduled reviews of the systems implemented for controlling risks, internal operating procedures and compliance with the internal and external regulations that apply at any time.

The Internal Audit Department includes in its annual action plan revisions on the processes considered to be relevant, with the aim of reviewing all of them over a three-year period, with the exception of certain areas or processes considered to be of special relevance, among which are the accounting closure procedure, the review of judgements and estimates and general controls over information systems, for which the evaluation is carried out annually.

The scope of the monitoring and evaluation of FIICS carried out during the 2017 financial year included the following reviews:

- Review of the transversal accounting closure process. In addition, the process of preparing and presenting the financial information published by Caja Laboral was supervised.

- Review of the judgements and estimates used in the calculation of the relevant contingent liabilities and provisions.
- Review of the transversal process of general computer controls.
- Review of the transversal process of fiscal and legal management.

The result of the review and evaluation of FIICS in 2017 has been regularly presented to the Audit Committee by the Director of the Internal Audit Department.

F.5.2. Whether there is a procedure for discussion through which the account auditor (in accordance with what is stated in the Technical Auditing Standards), the internal audit team and other experts can report to senior management and to the Audit Committee or the entity's directors any significant control weaknesses detected during the annual account review processes or any others assigned to them. Furthermore, whether there is an action plan to correct or mitigate any weaknesses observed.

The Audit Committee meets the External Auditor at least twice during the financial year:

- The first meeting is held at the end of the preliminary work for the interim visit that forms part of the annual audit, where the external auditor presents the preliminary findings obtained from the work carried out to date.
- The second meeting takes place prior to the formulation of the annual accounts. At this meeting the external auditor presents the final findings of the audit.

Moreover, the account auditor has direct access to senior management and to the Internal Audit Division, holding regular meetings with them both to obtain the information necessary for this work and also to discuss any weaknesses detected.

The Internal Control memorandum of suggestions and recommendations issued by the External Auditor is presented to the Audit Committee and subsequently sent for approval to the Entity's Governing Board. This document contains comments from the general management for each recommendation and, where applicable, the action plans or measures adopted to resolve any weaknesses.

Lastly, depending on the importance of the recommendations issued by the External Auditor, the Annual Internal Audit Plan usually includes work for monitoring the measures that have been adopted.

With regard to the result of the work carried out by internal audit, the reports issued are presented by the manager of the department to those responsible for the centre audited and, depending on their relevance, to the Board of Directors and the Audit Committee, and the degree of implementation of the recommendations proposed in the reports is monitored.

Furthermore, at least quarterly, the Audit Committee meets at the request of the management of the Internal Audit Department, in order to receive information on the main work carried out by it, thereby fulfilling one of the responsibilities entrusted to the committee.

## F.6 Other relevant information

### F.7 External auditor's report

Give details of:

F.7.1. Whether the FIICS information sent to the markets has been subject to review by the external auditor, in which case the entity should include the corresponding report as an Appendix. Otherwise, explain the reasons for this.

The entity has not considered it necessary to submit the FIICS information sent to the markets for review by the external auditor.

## **G** OTHER INFORMATION OF INTEREST

If there is any relevant aspect of corporate governance in the entity or in the group companies that has not been included in the other sections of this Report, but that it is necessary to include in order to provide more complete and reasoned information on the structure and practices of governance in the entity or its group, describe it briefly.

Any other information, clarification or nuance relating to the previous sections of the report can also be included in this section as long as it is relevant and does not repeat what has already been stated.

Specifically, indicate whether the entity is subject to any legislation other than Spanish law on matters of corporate governance and, if so, include any information that you are obliged to provide that is not included in this report.

The entity may also indicate whether it has voluntarily adhered to other codes of ethics or good practices, either international, sectoral or of another scope. When applicable, the entity will identify the code in question and the date of adhesion.

1.- This information complements section A. Property structure:

The majority of the cooperatives and their trading companies which are partners of Caja Laboral, in turn form part of Mondragón Corporación Cooperativa. This corporation, which Caja Laboral is part of, is a group of freely associated cooperatives which share a set of cooperative values and which seek to achieve competitive advantages from their joint cooperative action.

Caja Laboral contributes, in the form of a subsidy, to MONDRAGÓN Inversiones S. Coop. and to Fundación MONDRAGÓN (entities belonging to or formed by the cooperatives associated with Corporación MONDRAGÓN), an annual amount equivalent to 15% of the surplus available from the previous year (after taxes and interest on capital) that is deducted from the Inter-cooperative Social Fund.

2.- This information complements section C.1.5. on the remuneration of directors:

The working partner board members do not receive any remuneration for belonging to the Governing Board other than that received for the work they perform in the entity as workers. The rest of the members of the Governing Board do not receive remuneration for belonging to the Board either.

Caja Laboral compensates the dedication of the Chairperson and, through the established procedures, pays the corresponding remuneration by applying the remuneration criteria established by Caja Laboral within the framework of the regulations established for credit institutions.

This annual corporate governance report has been approved by the board or administrative body of the entity at its meeting held on 28/02/2018.

Indicate the directors or members of the administrative body who voted against or abstained in relation to the approval of this report.

This report was approved unanimously

**CAJA LABORAL POPULAR COOP. DE CRÉDITO**

**PREPARATION OF THE CONSOLIDATED ANNUAL ACCOUNTS AND DIRECTORS' REPORT FOR 2017**

The Members of the Parent Entity's Governing Board declare that to the best of their knowledge the attached financial statements have been prepared in accordance with applicable accounting principles and provide a true and fair view of the consolidated equity and consolidated results of the Parent Entity and its investee companies, and that the attached Directors' report includes an accurate analysis of the development and results obtained by the Group during the year ended 31 December 2017.

As a result, the members of the Governing Board of Caja Laboral Popular Coop. de Crédito (Parent Entity) hereby prepare the Consolidated Directors' Report and consolidated financial statements on 28 February 2018 including the notes to the consolidated annual accounts, Consolidated balance sheet, Consolidated income statement, Consolidated statement of recognised income and expenses, Consolidated statement of total changes in equity and Consolidated cash flows statement for the year ended 31 December 2017. All members have signed this page in witness of their agreement and the Secretary to the Governing Board has signed each page of the documents mentioned above for the purposes of their identification.

Txomin García Hernández (Chairman)	Luis María Ugarte Azpiri (Vice-Chairman)	Adolfo Plaza Izaguirre (Secretary)
Ms Elena Zarraga Bilbao (Member)	Ms Ainhoa Gallastegui Martínez (Member)	Javier Oleaga Mendiach (Member)
Francisco José Dean Pueyo (Member)	Ms María Carmen Iñurria Landeras (Member) (*)	Ms Nagore Larrabeiti Libano (Member)
Ms María Esther Korta Errazkin (Member)	D. Pablo Luis Bringas Velez (Member)	Ms Itziar Elgarresta Ibarrondo (Member)

(\*) Ms María Carmen Iñurria Landeras has not signed the annual accounts for the financial year 2017, due to the fact that at the date of the Governing Board meeting she was travelling for professional reasons.