# Kutxabank, S.A. and Subsidiaries (Consolidated Group)

Consolidated Financial Statements for the year ended 31 December 2017 and Directors' Report, together with Independent Auditor's Report

*Translation of a report originally issued in Spanish based on our work performed in accordance with the audit regulations in force in Spain and of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 67). In the event of a discrepancy, the Spanish-language version prevails.*

Deloitte.

Deloitte, S.L.
Ercilla, 24
48011 Bilbao
España

Tel: +34 944 44 70 00
www.deloitte.es

# INDEPENDENT AUDITOR'S REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

To the Shareholders of Kutxabank, S.A.,

## Report on the Consolidated Financial Statements

### Opinion

We have audited the consolidated financial statements of Kutxabank, S.A. ("the Parent") and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2017, and the consolidated statement of profit or loss, consolidated statement of comprehensive income, consolidated statement of changes in equity, consolidated statement of cash flows and notes to the consolidated financial statements for the year then ended.

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

### Basis for Opinion

We conducted our audit in accordance with the audit regulations in force in Spain. Our responsibilities under those regulations are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those pertaining to independence, that are relevant to our audit of the consolidated financial statements in Spain pursuant to the audit regulations in force. In this regard, we have not provided any services other than those relating to the audit of financial statements and there have not been any situations or circumstances that, in accordance with the aforementioned audit regulations, might have affected the requisite independence in such a way as to compromise our independence.

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

### Key Audit Matters

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

## Estimation of impairment losses on loans and receivables

### Description

As indicated in Note 16 to the accompanying consolidated financial statements as at 31 December 2017, the credit risk of loans and receivables constitutes a risk of the highest significance in the Group's business activity. Note 14-h to the aforementioned consolidated financial statements includes an explanation of how the Group estimates, both individually and collectively, the impairment losses due to credit risk of loans and receivables.

This estimation, which, in accordance with the regulations applicable to the Group, is based on incurred losses, involves a high level of judgement, complexity and technical difficulty, since it takes into consideration, among other factors: (i) the use of significant assumptions and hypotheses, such as estimates of the market value of the collateral for loans and receivables, (ii) the correct accounting classification of transactions and the appropriate segmentation of credit risk, and (iii) the performance of complex calculations that require mass data processing in order to calculate the impairment losses that are collectively assessed using statistical procedures.

As a result of all the foregoing, we considered this area to be one of most significance in our audit.

### Procedures applied in the audit

In order to address this key audit matter, our work included the performance of audit procedures to evaluate the operating effectiveness of the relevant controls established by the Parent in this area, as well as the conduct of substantive procedures on the estimates of impairment losses calculated both individually and collectively.

In this regard, among other procedures, we obtained an understanding of the phases of the process for estimating impairment losses and identifying the risks associated therewith, analysed the adequacy of the design and implementation of the relevant controls established by the Parent in this area, and performed audit procedures thereon in order to test the operating effectiveness of those controls.

We conducted, among others, the following substantive procedures in relation to the impairment losses estimated collectively: (i) tests aimed at verifying the completeness of the information used as a basis for estimating impairment, (ii) analysis of classification criteria and reasonableness of the segmentation variables, and (iii) replication of the calculation to determine impairment, including a review of the reasonableness of the calculation methodology.

In addition, with regard to the impairment losses estimated individually, we reviewed individual loan files, on a selective basis, in order to evaluate whether they have been properly classified and adjusted for impairment, considering, among other information, the cash flow discounting model used, the existing financial information on the debtor and, where applicable, the value of any collateral provided.

## Recoverability of deferred tax assets

### Description

The consolidated balance sheet as at 31 December 2017 includes deferred tax assets amounting to EUR 1,926,107 that can be recovered within the Kutxabank and CajaSur tax groups, which are headed by the Parent and CajaSur Banco, S.A.U., respectively.

At the end of the year Group management prepares financial models to assess the recoverability of the tax losses recognised, taking into consideration new legislative developments and the most recently approved business plans.

We identified this matter as key in our audit, since the preparation of these models requires a significant level of judgement, largely in connection with the projections of business performance, which affect the estimate made of the recoverability of the tax assets.

### Procedures applied in the audit

Our audit procedures included, among others, reviewing the aforementioned financial models -including analysis of the consistency of the actual results obtained by the various divisions compared with the results projected in the previous year's models-, obtaining evidence of the approval of the budgeted results included in the current year's models and the tax legislation applicable where the deferred tax assets are recognised, and evaluating the reasonableness of the projections for future years and the consistency of these projections with those used in other estimate-based areas, such as those used in the assessment of impairment of financial investments relating to Group companies and associates, in the assessment of the use of the going concern basis of accounting or in the impairment test performed on assets.

We also involved our internal experts from the tax area in the analysis of the reasonableness of the tax assumptions considered on the basis of the applicable legislation.

Lastly, we assessed whether Note 40 to the accompanying consolidated financial statements contains the disclosures required in this connection by the regulatory financial reporting framework applicable to the Group.

| Estimation of the provision for litigation, claims and labour-related agreements | |
|---|---|
| **Description** | **Procedures applied in the audit** |
| As indicated in Notes 14-s and 35 to the accompanying consolidated financial statements, at 31 December 2017 the Group was involved in various legal and labour-related court proceedings, as well as claims arising in the ordinary course of its business activities.<br><br>In this regard, the estimation of the provisions necessary to cover the costs expected to arise from the aforementioned litigation and claims in process is one of the areas that requires the highest level of judgement in view of the uncertainty inherent in the obligations giving rise to those provisions. As a result, this area was considered to be one of most significance in our audit. | In order to address this matter, our audit procedures consisted, among others, of: (i) understanding and reviewing the process performed by the Group's management and directors to estimate provisions, including, if appropriate, the approval of the assumptions used in calculating them, (ii) obtaining confirmation letters from lawyers working with the Parent in order to check their assessment of the expected outcome of the litigation, as well as the correct recognition of the provision, and identifying any potential liabilities omitted, (iii) analysing the reasonableness of the estimation of the expected outcome of the most significant legal and labour-related proceedings, (iv) analysing the claims, (v) understanding the response established by the Parent to cater for potential claims and complaints, (vi) understanding and reviewing the various claim scenarios established by the Parent, and (vii) analysing the recognition and reasonableness of the accounting provisions recorded in this connection, and the changes in those provisions. |

## Other Information: Consolidated Directors' Report

The other information comprises only the consolidated directors' report for 2017, the preparation of which is the responsibility of the Parent's directors and which does not form part of the consolidated financial statements.

Our audit opinion on the consolidated financial statements does not cover the consolidated directors' report. Our responsibility relating to the consolidated directors' report, in accordance with the applicable audit regulations, consists of evaluating and reporting on whether the consolidated directors' report is consistent with the consolidated financial statements, based on our knowledge of the Group obtained in the audit of those consolidated financial statements and excluding any information other than that obtained as evidence during the audit. Also, our responsibility consists of evaluating and reporting on whether the content and presentation of the consolidated directors' report are in conformity with the applicable regulations. If, based on the work we have performed, we conclude that there are material misstatements, we are required to report that fact.

Based on the work performed, as described in the preceding paragraph, the information in the consolidated directors' report is consistent with that contained in the consolidated financial statements for 2017 and its content and presentation are in conformity with the applicable regulations.

## Responsibilities of the Directors and of the Audit Committee of the Parent for the Consolidated Financial Statements

The Parent's directors are responsible for preparing the accompanying consolidated financial statements so that they present fairly the Group's consolidated equity, consolidated financial position and consolidated results in accordance with EU-IFRSs and the other provisions of the regulatory 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 financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, the Parent'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's audit committee is responsible for overseeing the process involved in the preparation and presentation of the consolidated financial statements.

## Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements 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 the audit regulations in force 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 financial statements.

A further description of our responsibilities for the audit of the consolidated financial statements is included in Appendix I to this auditor's report. This description, which is on page 8, forms part of our auditor's report.

# Report on Other Legal and Regulatory Requirements

## Additional Report to the Parent's Audit Committee

The opinion expressed in this report is consistent with the content of our additional report to the Parent's audit committee dated 23 February 2018.

## Engagement Period

The Annual General Meeting held on 3 May 2017 appointed us as auditors for a period of one year from the year ended 31 December 2016.

Previously, we were designated pursuant to a resolution of the General Meeting for the period of one year and have been auditing the consolidated financial statements uninterruptedly since the year ended 31 December 2011.

DELOITTE, S.L.
Registered in ROAC under no. S0692

Pablo Mugica
Registered in ROAC under no. 18694

23 February 2018

# Appendix I to our auditor's report

Further to the information contained in our auditor's report, in this Appendix we include our responsibilities in relation to the audit of the consolidated financial statements.

## Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

As part of an audit in accordance with the audit regulations in force in Spain, we exercise professional judgement and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, 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's directors.
- Conclude on the appropriateness of the use by the Parent's directors 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 financial statements 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 financial statements, including the disclosures, and whether the consolidated financial statements 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 financial statements. 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'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's audit committee with a statement that we have complied with relevant ethical requirements, including those regarding independence, and we have communicated with it to report on all matters that may reasonably be thought to jeopardise our independence, and where applicable, on the related safeguards.

From the matters communicated with the Parent's audit committee, we determine those matters that were of most significance in the audit of the consolidated financial statements 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.

# KUTXABANK, S.A.
# AND SUBSIDIARIES (CONSOLIDATED GROUP)
# CONSOLIDATED BALANCE SHEETS AS AT 31 DECEMBER 2017 AND 2016 (*)

(Thousands of euros)

| ASSETS | 2017 | 2016 (*) |
|---|---|---|
| **Cash, cash balances at central banks and deposits (Note 21) other demand** | **4,407,638** | **1,481,508** |
| **Financial assets held for trading (Note 22)** | **83,770** | **142,345** |
| Derivatives | 83,770 | 142,345 |
| Equity instruments | - | - |
| Debt securities | - | - |
| Loans and advances | - | - |
| Central banks | - | - |
| Credit institutions | - | - |
| Customers | - | - |
| *Memorandum item: loaned or advanced as collateral with right to sell or pledge (Note 42)* | - | - |
| **Financial assets designated at fair value through profit or loss (Note 23)** | **35,239** | **34,994** |
| Equity instruments | 6,103 | 6,249 |
| Debt securities | 29,136 | 28,745 |
| Loans and advances | - | - |
| Central banks | - | - |
| Credit institutions | - | - |
| Customers | - | - |
| *Memorandum item: loaned or advanced as collateral with right to sell or pledge (Note 42)* | - | - |
| **Available-for-sale financial assets (Note 24)** | **4,896,559** | **5,236,490** |
| Equity instruments | 1,372,566 | 2,206,658 |
| Debt securities | 3,523,993 | 3,029,832 |
| *Memorandum item: loaned or advanced as collateral with right to sell or pledge (Note 42)* | *1,180,526* | *333,058* |
| **Loans and receivables (Note 25)** | **42,559,033** | **44,269,735** |
| Debt securities | - | - |
| Loans and advances | 42,559,033 | 44,269,735 |
| Central banks | - | - |
| Credit institutions | 552,660 | 1,696,602 |
| Customers | 42,006,373 | 42,573,133 |
| *Memorandum item: loaned or advanced as collateral with right to sell or pledge (Note 42)* | *5,028,953* | *5,407,162* |
| **Held-to-maturity investments (Note 26)** | **248,761** | **44,246** |
| *Memorandum item: loaned or advanced as collateral with right to sell or pledge (Note 42)* | *44,349* | *44,246* |
| **Derivatives – hedge accounting (Note 27)** | **174,079** | **254,855** |
| **Fair value changes of the hedged items in portfolio hedge of interest rate risk** | - | - |
| **Investments in joint ventures and associates (Note 28)** | **514,522** | **503,118** |
| Jointly controlled entities | - | 2 |
| Associates | 514,522 | 503,116 |
| **Assets under reinsurance and insurance contracts (Note 36)** | **48,635** | **49,323** |
| **Tangible assets (Note 29)** | **1,015,286** | **1,065,463** |
| **Property, plant and equipment-** | **844,019** | **905,612** |
| For own use | 724,686 | 771,531 |
| Leased out under an operating lease | 119,333 | 134,081 |
| **Investment property-** | **171,267** | **159,851** |
| *Of which: leased out under an operating lease* | *111,095* | *94,657* |
| *Memorandum item: acquired under a finance lease* | - | - |
| **Intangible assets (Note 30)** | **357,158** | **347,759** |
| Goodwill | 301,457 | 301,457 |
| Other intangible assets | 55,701 | 46,302 |
| **Tax assets (Note 31)** | **1,960,893** | **1,931,433** |
| Current tax assets | 34,786 | 36,033 |
| Deferred tax assets | 1,926,107 | 1,895,400 |
| **Other assets (Note 32)** | **252,760** | **295,950** |
| Insurance contracts linked to pensions | - | - |
| Inventories | 178,889 | 221,432 |
| Other | 73,871 | 74,518 |
| **Non-current assets and disposal groups classified as held for sale (Note 33)** | **887,408** | **858,697** |
| **TOTAL ASSETS** | **57,441,741** | **56,515,916** |

| LIABILITIES AND EQUITY | 2017 | 2016 (*) |
|---|---|---|
| **Financial liabilities held for trading (Note 22)** | **83,364** | **140,109** |
| Derivatives | 83,364 | 140,109 |
| Short positions | - | - |
| Deposits | - | - |
| Central banks | - | - |
| Credit institutions | - | - |
| Customers | - | - |
| Debt securities issued | - | - |
| Other financial liabilities | - | - |
| **Financial liabilities designated at fair value through profit or loss** | **-** | **-** |
| Deposits | - | - |
| Central banks | - | - |
| Credit institutions | - | - |
| Customers | - | - |
| Debt securities issued | - | - |
| Other financial liabilities | - | - |
| *Memorandum item: subordinated liabilities* | - | - |
| **Financial liabilities at amortised cost (Note 34)** | **50,063,009** | **49,157,493** |
| Deposits | 46,271,964 | 44,590,584 |
| Central banks | 3,980,155 | 2,620,000 |
| Credit institutions | 479,257 | 743,131 |
| Customers | 41,812,552 | 41,227,453 |
| Debt securities issued | 3,138,943 | 4,035,099 |
| Other financial liabilities | 652,102 | 531,810 |
| *Memorandum item: subordinated liabilities* | - | - |
| **Derivatives – hedge accounting (Note 27)** | **148,846** | **168,972** |
| **Fair value changes of the hedged items in portfolio hedge of interest rate risk** | - | - |
| **Liabilities under insurance and reinsurance contracts (Note 36)** | **626,854** | **635,350** |
| **Provisions (Note 35)** | **566,240** | **558,420** |
| Pensions and other post-employment defined benefit obligations | 328,314 | 253,150 |
| Other long-term employee benefits | 52,595 | 57,381 |
| Pending legal issues and tax litigation | 679 | 690 |
| Commitments and guarantees given | 34,816 | 39,840 |
| Other provisions | 149,836 | 207,359 |
| **Tax liabilities (Note 31)** | **269,110** | **285,140** |
| Current tax liabilities | 20,055 | 23,129 |
| Deferred tax liabilities | 249,055 | 262,011 |
| **Share capital repayable on demand** | - | - |
| **Other liabilities (Note 32)** | **214,983** | **174,629** |
| **Liabilities included in disposal groups classified as held for sale** | **-** | **-** |
| **TOTAL LIABILITIES** | **51,972,406** | **51,120,113** |
| **EQUITY** | | |
| **Shareholders' equity (Note 37)** | **5,031,608** | **4,875,516** |
| **Share capital** | **2,060,000** | **2,060,000** |
| Paid up capital | 2,060,000 | 2,060,000 |
| Unpaid capital which has been called up | - | - |
| *Memorandum item: uncalled capital* | - | - |
| **Share premium** | **-** | **-** |
| **Equity instruments issued other than capital** | - | - |
| Equity component of compound financial instruments | - | - |
| Other equity instruments issued | - | - |
| **Other equity items** | **-** | **-** |
| **Retained earnings** | **420,891** | **296,780** |
| **Revaluation reserves** | **-** | **-** |
| **Other reserves** | **2,364,185** | **2,369,642** |
| Reserves or accumulated losses of investments in joint ventures and associates | 25,852 | 27,842 |
| Other | 2,338,333 | 2,341,800 |
| **(-) Treasury shares** | **-** | **-** |
| **Profit attributable to owners of the Parent** | **301,954** | **244,248** |
| **(-) Interim dividends** | **(115,422)** | **(95,154)** |
| **Accumulated other comprehensive income (Note 38)** | **429,121** | **507,460** |
| **Items that will not be reclassified to profit or loss** | **(48,491)** | **(49,153)** |
| Actuarial gains or (-) losses on defined benefit pension plans | (48,491) | (49,153) |
| Non-current assets and disposal groups classified as held for sale | - | - |
| Share of other recognised income and expense of investments in joint ventures and associates | - | - |
| Other valuation adjustments | - | - |
| **Items that may be reclassified to profit or loss** | **477,612** | **556,613** |
| Hedge of net investments in foreign operations (effective portion) | - | - |
| Foreign currency translation | - | - |
| Hedging derivatives. Cash flow hedges (effective portion) (Note 27) | (7,001) | (2,293) |
| Available-for-sale financial assets | 484,022 | 558,558 |
| Debt instruments | 138,110 | 92,667 |
| Equity instruments | 345,912 | 465,891 |
| Non-current assets and disposal groups classified as held for sale | - | - |
| Share of other recognised income and expense of investments in joint ventures and associates | 591 | 348 |
| **Minority interests (non-controlling interests) (Note 39)** | **8,606** | **12,827** |
| Accumulated other comprehensive income | 1,157 | 1,392 |
| Other items | 7,449 | 11,435 |
| **TOTAL EQUITY** | **5,469,335** | **5,395,803** |
| **TOTAL LIABILITIES AND EQUITY** | **57,441,741** | **56,515,916** |
| **MEMORANDUM ITEMS: OFF-BALANCE-SHEET EXPOSURES** | | |
| **Guarantees given (Note 42)** | **1,916,147** | **1,803,010** |
| **Contingent commitments given (Note 43)** | **6,272,176** | **5,452,249** |

The accompanying Notes 1 to 67 and Appendices I to IV are an integral part of the consolidated balance sheet as at 31 December 2017.

(*) Presented for comparison purposes only.

# KUTXABANK, S.A.
# AND SUBSIDIARIES (CONSOLIDATED GROUP)
## CONSOLIDATED STATEMENTS OF PROFIT OR LOSS
## FOR THE YEARS ENDED 31 DECEMBER 2017 AND 2016 (*)
(Thousands of euros)

| | 2017 | 2016 (*) |
|---|---|---|
| **Interest income (Note 44)** | **650,982** | **728,656** |
| **Interest expenses (Note 45)** | **(92,250)** | **(170,658)** |
| **Expenses on share capital repayable on demand** | - | - |
| **NET INTEREST INCOME** | **558,732** | **557,998** |
| **Dividend income (Note 46)** | **49,681** | **94,779** |
| **Share of the profit or loss of entities accounted for using the equity method (Note 37)** | **17,555** | **43,838** |
| **Fee and commission income (Note 47)** | **422,884** | **382,617** |
| **Fee and commission expenses (Note 48)** | **(43,322)** | **(38,792)** |
| **Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net (Note 49)** | **271,013** | **168,602** |
| **Gains or losses on financial assets and liabilities held for trading, net (Notes 22 & 50)** | **1,953** | **(1,754)** |
| **Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net (Note 51)** | **397** | **(9)** |
| **Gains or losses from hedge accounting, net (Note 27)** | **290** | **230** |
| **Exchange differences (gain or loss), net (Note 52)** | **2,538** | **3,705** |
| **Other operating income (Note 53)** | **73,610** | **64,870** |
| **Other operating expenses (Note 54)** | **(122,172)** | **(107,218)** |
| **Income from assets under insurance and reinsurance contracts (Note 55)** | **190,558** | **172,558** |
| **Expenses of liabilities under insurance and reinsurance contracts (Note 55)** | **(92,019)** | **(85,000)** |
| **GROSS INCOME** | **1,331,698** | **1,256,424** |
| **Administrative expenses:** | **(626,596)** | **(648,505)** |
| Staff costs (Note 56) | (434,393) | (452,866) |
| Other administrative expenses (Note 57) | (192,203) | (195,639) |
| **Depreciation and amortisation charge (Note 58)** | **(54,997)** | **(56,086)** |
| **Provisions or reversal of provisions (Note 59)** | **(138,248)** | **(117,585)** |
| **Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss (Note 60):** | **(86,262)** | **(89,363)** |
| Financial assets measured at cost | - | - |
| Available-for-sale financial assets (Note 24) | (57,850) | (39,431) |
| Loans and receivables (Note 25) | (28,412) | (49,932) |
| Held-to-maturity investments | - | - |
| **PROFIT FROM OPERATIONS** | **425,595** | **344,885** |
| **Impairment or reversal of impairment of investments in joint ventures and associates (Note 28)** | **(4,123)** | **(687)** |
| **Impairment or reversal of impairment on non-financial assets (Note 61):** | **(44,565)** | **(14,946)** |
| Tangible assets | (19,660) | (10,974) |
| Intangible assets | - | - |
| Other | (24,905) | (3,972) |
| **Gains or losses on derecognition of non-financial assets and investments, net (Note 62)** | **36,704** | **25,476** |
| *Of which: investments in subsidiaries, joint ventures and associates* | *20,186* | *17,337* |
| **Negative goodwill recognised in profit or loss** | **-** | **-** |
| **Profit or loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations (Note 63)** | **(131,742)** | **(40,999)** |
| **PROFIT OR LOSS BEFORE TAX FROM CONTINUING OPERATIONS** | **281,869** | **313,729** |
| **Tax expense or income related to profit or loss from continuing operations (Note 40)** | **21,362** | **(68,803)** |
| **PROFIT OR LOSS AFTER TAX FROM CONTINUING OPERATIONS** | **303,231** | **244,926** |
| **Profit or loss after tax from discontinued operations** | **-** | **-** |
| **PROFIT FOR THE YEAR** | **303,231** | **244,926** |
| **Attributable to minority interests (non-controlling interests) (Note 64)** | **1,277** | **678** |
| **Attributable to owners of the Parent** | **301,954** | **244,248** |

The accompanying Notes 1 to 67 and Appendices I to IV are an integral part of the consolidated statement of profit or loss for 2017.

(*) Presented for comparison purposes only.

**KUTXABANK, S.A.**
**AND SUBSIDIARIES (CONSOLIDATED GROUP)**
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**
**FOR THE YEARS ENDED 31 DECEMBER 2017 AND 2016 (*)**
(Thousands of euros)

| | 2017 | 2016 (*) |
|---|---|---|
| **PROFIT FOR THE YEAR** | **303,231** | **244,926** |
| **OTHER COMPREHENSIVE INCOME** | **(78,574)** | **(60,678)** |
| **Items that will not be reclassified to profit or loss** | **662** | **(7,723)** |
| Actuarial gains or losses on defined benefit pension plans | 913 | (10,726) |
| Non-current assets and disposal groups held for sale | - | - |
| Share of other recognised income and expense of investments in joint ventures and associates | - | - |
| Other valuation adjustments | - | - |
| Income tax relating to items that will not be reclassified | (251) | 3,003 |
| **Items that may be reclassified to profit or loss** | **(79,236)** | **(52,955)** |
| Hedge of net investments in foreign operations (effective portion) | - | - |
| Valuation gains or (-) losses taken to equity | - | - |
| Transferred to profit or loss | - | - |
| Other reclassifications | - | - |
| Foreign currency translation | - | - |
| Translation gains or (-) losses taken to equity | - | - |
| Transferred to profit or loss | - | - |
| Other reclassifications | - | - |
| Cash flow hedges (effective portion) | (6,636) | 2,928 |
| Valuation gains or (-) losses taken to equity | (7,437) | 2,106 |
| Transferred to profit or loss | 801 | 822 |
| Transferred to initial carrying amount of hedged items | - | - |
| Other reclassifications | - | - |
| Available-for-sale financial assets | (94,309) | (77,098) |
| Valuation gains or (-) losses taken to equity | 163,417 | 50,272 |
| Transferred to profit or loss | (257,726) | (127,370) |
| Other reclassifications | | |
| Non-current assets and disposal groups held for sale | - | - |
| Valuation gains or (-) losses taken to equity | - | - |
| Transferred to profit or loss | - | - |
| Other reclassifications | - | - |
| Share of other recognised income and expense of investments in joint ventures and associates | 243 | (14) |
| Income tax relating to items that may be reclassified to profit or loss | 21,466 | 21,229 |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | **224,657** | **184,248** |
| Attributable to minority interests (non-controlling interests) | 1,042 | 899 |
| Attributable to owners of the Parent | 223,615 | 183,349 |

The accompanying Notes 1 to 67 and Appendices I to IV are an integral part of the consolidated statement of comprehensive income for the year ended 31 December 2017.

(*) Presented for comparison purposes only.

# KUTXABANK, S.A. AND SUBSIDIARIES (CONSOLIDATED GROUP)
# CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
# FOR THE YEARS ENDED 31 December 2017 AND 2016 (*)
(Thousands of euros)

| | | | | | | | | | | | | Non-controlling interests | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Equity instruments issued other than capital | Other equity items | Retained earnings | Revaluation reserves | Other reserves | (-) Treasury shares | Profit attributable to owners of the Parent | (-) Interim dividends | Accumulated other comprehensive income | Accumulated other comprehensive income | Other items | Total |
| **Opening balance (before restatement)** | **2,060,000** | **-** | **-** | **-** | **296,780** | **-** | **2,369,642** | **-** | **244,248** | **(95,154)** | **507,460** | **1,392** | **11,435** | **5,395,803** |
| Effects of corrections of errors | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Effects of changes in accounting policies | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| **Opening balance at 31 December 2016** | **2,060,000** | **-** | **-** | **-** | **296,780** | **-** | **2,369,642** | **-** | **244,248** | **(95,154)** | **507,460** | **1,392** | **11,435** | **5,395,803** |
| **Total comprehensive income for the year** | **-** | **-** | **-** | - | **-** | - | **-** | **-** | **301,954** | **-** | **(78,339)** | **(235)** | **1,277** | **224,657** |
| **Other changes in equity** | - | - | - | - | **124,111** | - | **(5,457)** | **-** | **(244,248)** | **(20,268)** | - | - | **(5,263)** | **(151,125)** |
| Issuance of ordinary shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Issuance of preference shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Issuance of other equity instruments | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Exercise or expiration of other equity instruments issued | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Conversion of debt to equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Capital reduction | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Dividends (or remuneration of members) | - | - | - | - | (26,970) | - | - | - | - | (115,422) | - | - | (189) | (142,581) |
| Purchase of treasury shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Sale or cancellation of treasury shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Reclassification of financial instruments from equity to liability | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Reclassification of financial instruments from liability to equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Transfers among components of equity | - | - | - | - | 151,081 | - | (1,987) | - | (244,248) | 95,154 | - | - | - | - |
| Equity increase or (-) decrease resulting from business combinations | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Share-based payments | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Other increase or (-) decrease in equity | - | - | - | - | - | - | (3,470) | - | - | - | - | - | (5,074) | (8,544) |
| **Ending balance at 31 December 2017** | **2,060,000** | **-** | **-** | **-** | **420,891** | **-** | **2,364,185** | **-** | **301,954** | **(115,422)** | **429,121** | **1,157** | **7,449** | **5,469,335** |

| | Share capital | Share premium | Equity instruments issued other than capital | Other equity items | Retained earnings | Revaluation reserves | Other reserves | (-) Treasury shares | Profit attributable to owners of the Parent | (-) Interim dividends | Accumulated other comprehensive income | Non-controlling interests: Accumulated other comprehensive income | Non-controlling interests: Other items | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Opening balance (before restatement)** | **2,060,000** | **-** | **-** | **-** | **208,856** | **-** | **2,349,160** | **-** | **218,782** | **(78,814)** | **568,359** | **1,171** | **10,091** | **5,337,605** |
| Effects of corrections of errors | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Effects of changes in accounting policies | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| **Opening balance at 31 December 2015** | **2,060,000** | **-** | **-** | **-** | **208,856** | **-** | **2,349,160** | **-** | **218,782** | **(78,814)** | **568,359** | **1,171** | **10,091** | **5,337,605** |
| **Total comprehensive income for the year** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **244,248** | **-** | **(60,899)** | **221** | 678 | **184,248** |
| **Other changes in equity** | **-** | **-** | **-** | **-** | **87,924** | **-** | **20,482** | **-** | **(218,782)** | **(16,340)** | **-** | **-** | **666** | **(126,050)** |
| Issuance of ordinary shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Issuance of preference shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Issuance of other equity instruments | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Exercise or expiration of other equity instruments issued | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Conversion of debt to equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Capital reduction | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Dividends (or remuneration of members) | - | - | - | - | (30,577) | - | - | - | - | (95,154) | - | - | (214) | (125,945) |
| Purchase of treasury shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Sale or cancellation of treasury shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Reclassification of financial instruments from equity to liability | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Reclassification of financial instruments from liability to equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Transfers among components of equity | - | - | - | - | 118,501 | - | 21,467 | - | (218,782) | 78,814 | - | - | - | - |
| Equity increase or (-) decrease resulting from business combinations | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Share-based payments | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Other increase or (-) decrease in equity | - | - | - | - | - | - | (985) | - | - | - | - | - | 880 | (105) |
| **Ending balance at 31 December 2016** | **2,060,000** | **-** | **-** | **-** | **296,780** | **-** | **2,369,642** | **-** | **244,248** | **(95,154)** | **507,460** | **1,392** | **11,435** | **5,395,803** |

The accompanying Notes 1 to 67 and Appendices I to IV are an integral part of the consolidated balance sheet as at 31 December 2017.
(*) Presented for comparison purposes only.

**KUTXABANK, S.A.**
**AND SUBSIDIARIES (CONSOLIDATED GROUP)**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**FOR THE YEARS ENDED 31 DECEMBER 2017 AND 2016 (*)**
(Thousands of euros)

| | 2017 | 2016 (*) |
|---|---|---|
| **A) CASH FLOWS FROM OPERATING ACTIVITIES** | **3,992,528** | **1,328,678** |
| **Profit for the year** | **303,231** | **244,926** |
| **Adjustments made to obtain the cash flows from operating activities** | | |
| Depreciation and amortisation charge (+) | 54,997 | 56,086 |
| Other adjustments (+/-) | 62,544 | 101,099 |
| | **117,541** | **157,185** |
| **Net increase/decrease in operating assets:** | | |
| Financial assets held for trading | 60,528 | (8,081) |
| Financial assets designated at fair value through profit or loss | 152 | 3,377 |
| Available-for-sale financial assets | 448,595 | 1,076,554 |
| Loans and receivables | 1,443,451 | 931,983 |
| Other operating assets | 93,567 | 197,391 |
| | **2,046,293** | **2,201,224** |
| **Net increase/decrease in operating liabilities:** | | |
| Financial liabilities held for trading | (56,745) | 8,306 |
| Financial liabilities designated at fair value through profit or loss | - | - |
| Financial liabilities at amortised cost | 1,725,342 | (1,145,148) |
| Other operating liabilities | (151,780) | (124,303) |
| | **1,506,923** | **(1,261,145)** |
| **Income tax recovered/paid** | **18,540** | **(13,298)** |
| **B) CASH FLOWS FROM INVESTING ACTIVITIES** | **(103,991)** | **144,499** |
| **Payments:** | | |
| Tangible assets | (15,929) | (31,728) |
| Intangible assets | (23,016) | (19,634) |
| Investments in subsidiaries, joint ventures and associates | (270) | (4,428) |
| Other business units | - | - |
| Non-current assets and liabilities classified as held for sale | (36,107) | (40,457) |
| Held-to-maturity investments | (204,515) | - |
| Other payments related to investing activities | - | - |
| | **(279,837)** | **(96,247)** |
| **Proceeds:** | | |
| Tangible assets | 41,300 | 40,846 |
| Intangible assets | - | - |
| Investments in subsidiaries, joint ventures and associates | 21,615 | 59,783 |
| Other business units | - | - |
| Non-current assets and liabilities classified as held for sale | 112,931 | 140,117 |
| Held-to-maturity investments | - | - |
| Other proceeds related to investing activities | - | - |
| | **175,846** | **240,746** |
| **C) CASH FLOWS FROM FINANCING ACTIVITIES** | **(962,407)** | **(947,666)** |
| **Payments:** | | |
| Dividends | (142,581) | (125,945) |
| Subordinated liabilities | | (55,000) |
| Redemption of own equity instruments | - | - |
| Acquisition of own equity instruments | - | - |
| Other payments related to financing activities | (819,826) | (766,721) |
| | **(962,407)** | **(947,666)** |
| **Proceeds:** | | |
| Subordinated liabilities | - | - |
| Issuance of own equity instruments | - | - |
| Disposal of own equity instruments | - | - |
| Other proceeds related to financing activities | - | - |
| | - | - |
| **D) EFFECT OF FOREIGN EXCHANGE RATE CHANGES** | **-** | **-** |
| **E) NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS (A+B+C+D)** | **2,926,130** | **525,725** |
| **F) CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR** | **1,481,508** | **955,783** |
| **G) CASH AND CASH EQUIVALENTS AT END OF YEAR** | **4,407,638** | **1,481,508** |
| **COMPONENTS OF CASH AND CASH EQUIVALENTS AT END OF YEAR** | | |
| *Of which: held by Group entities but not available for use by the Group* | | |
| Cash | 257,891 | 260,969 |
| Cash equivalents at central banks | 3,893,673 | 874,158 |
| Other financial assets | 256,074 | 346,381 |
| Less: Bank overdrafts refundable on demand | - | - |
| **TOTAL CASH AND CASH EQUIVALENTS AT END OF YEAR** | **4,407,638** | **1,481,508** |

The accompanying Notes 1 to 67 and Appendices I to IV are an integral part of the consolidated statement of cash flows for 2017.
(*) Presented for comparison purposes only.

*Translation of consolidated financial statements originally issued in Spanish and prepared in accordance with the regulatory financial reporting framework applicable to the Group in Spain (see Notes 2 and 67). In the event of a discrepancy, the Spanish-language version prevails.*

# Kutxabank, S.A. and Subsidiaries (Consolidated Group)

Explanatory Notes to the Consolidated Financial Statements

for the year ended 31 December 2017

## 1. Description of the Institution

### 1.1. Description of the Institution

Kutxabank, S.A. ("the Bank", "Kutxabank" or "the Parent") was incorporated in a public deed dated 14 June 2011 under the name of Banco Bilbao Bizkaia Kutxa, S.A. (Sole-Shareholder Company), as a private-law entity subject to the rules and regulations applicable to banks operating in Spain. Subsequently, on 22 December 2011, the Bank changed its corporate name to its current name. Kutxabank, S.A. is the Parent of the Kutxabank Group, which arose from the integration of the three Basque savings banks – Bilbao Bizkaia Kutxa, Aurrezki Kutxa eta Bahitetxea ("BBK"), Caja de Ahorros y Monte de Piedad de Gipuzkoa y San Sebastián ("Kutxa") and Caja de Ahorros de Vitoria y Álava ("Caja Vital") (see Note 1.2). Its registered office is at Gran Vía, 30 (Bilbao).

The Bank is governed by its bylaws; by Law 10/2014, of 26 June, on the regulation, supervision and capital adequacy of credit institutions, implemented by Royal Decree 84/2015, of 13 February; by Legislative Royal Decree 4/2015, of 23 October, on the Securities Market; by Royal Decree 217/2008, of 15 February, on the legal regime for investment services companies and other entities providing investment services; by the Consolidated Spanish Limited Liability Companies Law, approved by Legislative Royal Decree 1/2010, of 3 July; and by all other applicable legislation in force.

Kutxabank, S.A. commenced operations on 1 January 2012 and is registered with code number 2095, which had previously corresponded to BBK, in the Spanish Banks and Bankers Register. Its company object encompasses all manner of activities, transactions and services inherent to the banking business in general and which it is permitted to perform under current legislation, including the provision of investment and ancillary services provided for in Articles 140 and 141 of Legislative Royal Decree 4/2015, of 23 October, on the Securities Market, and the acquisition, ownership, use and disposal of all manner of marketable securities.

The Group operated through 931 branches at 31 December 2017 (31 December 2016: 958 branches). The distribution, by geographical area, of the Group's branch network at 31 December 2017 and 2016 is as follows:

| | Branches | |
|---|---|---|
| | 2017 | 2016 |
| Basque Country Autonomous Community | 368 | 388 |
| Andalusia | 331 | 337 |
| Expansion network | 228 | 229 |
| France | 4 | 4 |
| | **931** | **958** |

On 18 December 2015, the Group entered into an agreement to transfer and sell the assets and liabilities assigned to each of the ten branches owned by the Group in the Autonomous Community of Extremadura and to transfer the lease and services agreements for the branches and the personnel assigned thereto. Completion of this transfer agreement was subject to fulfilment of the conditions precedent included therein, including most notably the authorisation of the transaction by the competition authorities and authorisation by the Spanish Ministry of Economy and Competitiveness. On 17 June 2016, the transfer agreement became effective, resulting in a gain of EUR 3,916 thousand for the Bank, which is recognised under "Gains or (-) Losses on Derecognition of Non-Financial Assets and Investments, Net" in the consolidated statement of profit or loss for 2016 (see Note 62).

The Bank is the Parent of a group of investees composing the Kutxabank Group ("the Group"). Therefore, the Parent is required to prepare, in addition to its own separate financial statements, which are also subject to statutory audit, consolidated financial statements for the Group which include the corresponding investments in subsidiaries, jointly controlled entities and associates. The entities in the Group engage in various activities, as disclosed in Appendices I and II. Also, Bilbao Bizkaia Kutxa Fundación Bancaria, Kutxabank's majority shareholder, prepares the consolidated financial statements of the Bilbao Bizkaia Kutxa Fundación Bancaria Group, which includes Kutxabank and its Subsidiaries.

At 31 December 2017, the Parent's total assets, equity and profit for the year represented 81.15%, 88.31% and 61.07%, respectively, of the related Group figures (31 December 2016: 81.76%, 87.36% and 60.93%, respectively).

Set forth below are the condensed separate balance sheets, condensed separate statements of profit or loss, condensed separate statements of changes in equity, condensed separate statements of comprehensive income and condensed separate statements of cash flows of the Parent for the years ended 31 December 2017 and 2016, prepared in accordance with the accounting principles and rules and measurement bases established by Bank of Spain Circular 4/2004 and subsequent amendments thereto (see Note 2-a):

## a) Condensed separate balance sheets as at 31 December 2017 and 2016:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Cash, cash balances at central banks and other demand deposits | 3,689,919 | 1,076,299 |
| Financial assets held for trading | 88,451 | 148,948 |
| Financial assets designated at fair value through profit or loss | - | - |
| Available-for-sale financial assets | 2,789,960 | 2,384,119 |
| Loans and receivables | 34,988,760 | 36,813,505 |
| Held-to-maturity investments | 44,349 | 44,246 |
| Derivatives – hedge accounting | 33,449 | 83,045 |
| Investments in subsidiaries, joint ventures and associates | 2,932,891 | 3,644,010 |
| Tangible assets | 624,115 | 663,851 |
| Intangible assets | 35,812 | 24,106 |
| Tax assets | 1,268,192 | 1,211,239 |
| Other assets | 42,750 | 32,918 |
| Non-current assets and disposal groups classified as held for sale | 75,965 | 80,008 |
| **Total assets** | **46,614,613** | **46,206,294** |
| Financial liabilities held for trading | 88,488 | 146,185 |
| Financial liabilities at amortised cost | 40,801,070 | 40,524,311 |
| Derivatives – hedge accounting | 125,642 | 145,294 |
| Provisions | 516,910 | 449,013 |
| Tax liabilities | 120,197 | 107,498 |
| Other liabilities | 132,461 | 120,242 |
| **Total liabilities** | **41,784,768** | **41,492,543** |
| Shareholders' equity: | 4,635,968 | 4,548,163 |
| Share capital | 2,060,000 | 2,060,000 |
| Share premium | - | - |
| Retained earnings | 79,775 | 53,075 |
| Other reserves | 2,427,198 | 2,381,418 |
| Profit for the year | 184,417 | 148,824 |
| Interim dividends | (115,422) | (95,154) |
| Accumulated other comprehensive income | 193,877 | 165,588 |
| **Total equity** | **4,829,845** | **4,713,751** |
| **Total liabilities and equity** | **46,614,613** | **46,206,294** |
| Guarantees given | 2,018,390 | 1,939,808 |
| Contingent commitments given | 6,203,402 | 4,731,660 |

## b) *Condensed separate statements of profit or loss for the years ended 31 December 2017 and 2016:*

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Interest income | 462,386 | 521,240 |
| Interest expenses | (81,173) | (149,414) |
| **Net interest income** | **381,213** | **371,826** |
| Dividend income | 258,462 | 145,891 |
| Fee and commission income | 347,740 | 327,808 |
| Fee and commission expenses | (11,423) | (11,884) |
| Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net | 27,447 | 116,387 |
| Gains or losses on financial assets and liabilities held for trading, net | 2,091 | (1,034) |
| Gains or losses from hedge accounting, net | 180 | 230 |
| Exchange differences (gain or loss), net | 2,203 | 3,384 |
| Other operating income | 10,007 | 11,860 |
| Other operating expenses | (69,551) | (61,951) |
| **Gross income** | **948,369** | **902,517** |
| Administrative expenses | (450,756) | (471,747) |
| Depreciation and amortisation charge | (32,276) | (32,866) |
| Provisions or reversal of provisions | (122,344) | (5,126) |
| Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | (50,392) | (91,073) |
| **Profit from operations** | **292,601** | **301,705** |
| Impairment or reversal of impairment of investments in subsidiaries, joint ventures and associates | (154,573) | (189,476) |
| Impairment or reversal of impairment on non-financial assets | (15,610) | (8,663) |
| Gains or losses on derecognition of non-financial assets and investments, net | 13,963 | 4,733 |
| Profit or loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations | (5,233) | 2,985 |
| **Profit or loss before tax from continuing operations** | **131,148** | **111,284** |
| Tax expense or income related to profit or loss from continuing operations | 53,269 | 37,540 |
| **Profit or loss after tax from continuing operations** | **184,417** | **148,824** |
| **Profit for the year** | **184,417** | **148,824** |

## c) *Condensed separate statements of comprehensive income for the years ended 31 December 2017 and 2016:*

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Profit for the year** | **184,417** | **148,824** |
| **Other comprehensive income:** | **28,289** | **(21,953)** |
| Items that will not be reclassified to profit or loss | | |
| Actuarial gains or (-) losses on defined benefit pension plans | 490 | (4,376) |
| Income tax relating to items that will not be reclassified | (137) | 1,225 |
| | 353 | (3,151) |
| Items that may be reclassified to profit or loss | | |
| Hedge of net investments in foreign operations (effective portion) | - | - |
| Foreign currency translation | - | - |
| Cash flow hedges (effective portion) | (4,585) | (750) |
| Available-for-sale financial assets | | |
| Valuation gains or (-) losses taken to equity | 61,114 | 70,363 |
| Transferred to profit or loss | (17,727) | (95,590) |
| | 43,387 | (25,227) |
| Non-current assets and disposal groups held for sale | - | - |
| Share of other recognised income and expense of investments in joint ventures and associates | - | - |
| Income tax relating to items that may be reclassified to profit or loss | (10,866) | 7,175 |
| **Total comprehensive income for the year** | **212,706** | **126,871** |

## d) Condensed separate statements of changes in equity for the years ended 31 December 2017 and 2016:

| | Thousands of euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Retained earnings | Other reserves | Profit for the year | Interim dividends | Total shareholders' equity | Other comprehensive income | Total equity |
| Ending balance at 31/12/16 | 2,060,000 | - | 53,075 | 2,381,418 | 148,824 | (95,154) | 4,548,163 | 165,588 | 4,713,751 |
| Adjustments | - | - | - | - | - | - | - | - | - |
| Adjusted beginning balance | 2,060,000 | - | 53,075 | 2,381,418 | 148,824 | (95,154) | 4,548,163 | 165,588 | 4,713,751 |
| Total comprehensive income for the year | - | - | - | - | 184,417 | - | 184,417 | 28,289 | 212,706 |
| Other changes | - | - | 26,700 | 45,780 | (148,824) | (20,268) | (96,612) | - | (96,612) |
| Ending balance at 31/12/17 | 2,060,000 | - | 79,775 | 2,427,198 | 184,417 | (115,422) | 4,635,968 | 193,877 | 4,829,845 |

| | Thousands of euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Share capital | Share premium | Retained earnings | Other reserves | Profit for the year | Interim dividends | Total shareholders' equity | Other comprehensive income | Total equity |
| Ending balance at 31/12/15 | 2,060,000 | - | 36,958 | 2,381,418 | 125,508 | (78,814) | 4,525,070 | 187,541 | 4,712,611 |
| Adjustments | - | - | - | - | - | - | - | - | - |
| Adjusted beginning balance | 2,060,000 | - | 36,958 | 2,381,418 | 125,508 | (78,814) | 4,525,070 | 187,541 | 4,712,611 |
| Total comprehensive income for the year | - | - | - | - | 148,824 | | 148,824 | (21,953) | 126,871 |
| Other changes | - | - | 16,117 | - | (125,508) | (16,340) | (125,731) | - | (125,731) |
| Ending balance at 31/12/16 | 2,060,000 | - | 53,075 | 2,381,418 | 148,824 | (95,154) | 4,548,163 | 165,588 | 4,713,751 |

## e) Condensed separate statements of cash flows for the years ended 31 December 2017 and 2016:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Cash flows from operating activities:** | | |
| Profit for the year | 184,417 | 148,824 |
| Adjustments made to obtain the cash flows from operating activities | 230,487 | 158,259 |
| Net increase/(decrease) in operating assets | 1,593,798 | 1,861,821 |
| Net increase/(decrease) in operating liabilities | 1,898,699 | (2,183,985) |
| Income tax recovered/(paid) | (56) | (239) |
| | 3,907,345 | (15,320) |
| **Cash flows from investing activities:** | | |
| Payments | (43,617) | (344,960) |
| Proceeds | 462,110 | 1,240,610 |
| | 418,493 | 895,650 |
| **Cash flows from financing activities:** | | |
| Payments | (1,712,218) | (587,031) |
| Proceeds | - | - |
| | (1,712,218) | (587,031) |
| **Effect of foreign exchange rate changes** | - | - |
| **Net increase/(decrease) in cash and cash equivalents** | **2,613,620** | **293,299** |
| Cash and cash equivalents at beginning of year | 1,076,299 | 783,000 |
| Cash and cash equivalents at end of year | 3,689,919 | 1,076,299 |

## 1.2. Integration of Bilbao Bizkaia Kutxa, Aurrezki Kutxa eta Bahitetxea (BBK), Caja de Ahorros y Monte de Piedad de Gipuzkoa y San Sebastián - Gipuzkoa eta Donostiako Aurrezki Kutxa (Kutxa), Caja de Ahorros de Vitoria y Álava - Araba eta Gasteizko Aurrezki Kutxa (Caja Vital) and Kutxabank, S.A.

On 30 June 2011, the Boards of Directors of BBK, Kutxa, Caja Vital and the Bank approved the integration agreement for the formation of a contractual consolidable group of credit institutions (Institutional Protection Scheme ("SIP")), the head of which would be the Bank, and which would also comprise BBK, Kutxa and Caja Vital (referred to collectively as "the Savings Banks"). This integration agreement governed the elements configuring the new group, the group's and the Bank's governance, and the group's stability mechanisms.

Also, the Boards of Directors of the Savings Banks and the Bank (the latter as the beneficiary) approved, pursuant to Title III and Additional Provision Three of Law 3/2009, of 3 April, on structural changes to companies formed under the Spanish Commercial Code, the corresponding spin-off plans under which all the assets and liabilities associated with the financial activity of BBK, Kutxa and Caja Vital would be contributed to the Bank, and the Savings Banks would pursue their objects as credit institutions indirectly through the Bank.

The purpose of the spin-off was the transfer en bloc, by universal succession, of the items composing the economic unit consisting of the spun-off assets and liabilities, which were all the assets and liabilities of the respective Savings Banks, except for the excluded assets and liabilities not directly related to the Savings Banks' financial activities (including BBK's ownership interest in the Bank), which were identified in the respective spin-off plans.

These spin-off plans, together with the integration agreement and the subsequent novation thereof, were approved by the corresponding General Assemblies of the Savings Banks and the Bank's then sole shareholder on 23 September and 20 October 2011, respectively.

Therefore, once the relevant administrative authorisations had been obtained, on 22 December 2011, BBK, Kutxa and Caja Vital, together with the Bank, executed the related public deeds for the spin-off of the Savings Banks' financial businesses and the contribution thereof to Kutxabank, S.A.

For the purposes of Article 31.7 of Law 3/2009, of 3 April, on structural changes to companies formed under the Spanish Commercial Code, the spin-off of the Savings Banks' businesses and the contribution thereof to the Bank and, consequently, the SIP, became effective when the spin-off was registered in the Bizkaia Mercantile Register, on 1 January 2012.

The registration of the spin-offs fulfilled the last of the conditions precedent for the integration agreement entered into by the Savings Banks to come into force. Consequently, on 1 January 2012, the integration agreement constituting an Institutional Protection Scheme whereby the Savings Banks approved the indirect exercise of their activity and span off their financial businesses to the Bank became effective. The Bank, as the beneficiary of the spin-off, was subrogated to all the rights, actions, obligations, liability and charges relating to the spun-off assets and liabilities. Also, the Bank took on the human and material resources related to the operation of the spun-off businesses of the respective Savings Banks.

In exchange for the spun-off assets and liabilities, the Bank increased share capital by a total of EUR 1,981,950 thousand, represented by 1,981,950 registered shares of EUR 1,000 par value each, plus a share premium, so that each Savings Bank received newly issued shares of the Bank for a value equal to the value of the assets and liabilities spun off by each Savings Bank. The shares issued were registered shares, like the existing outstanding shares, and all of them belonged to the same class and ranked pari passu with the shares existing at the time of the capital increase. After the capital increase, the ownership interest of each Savings Bank (under their current names as banking foundations) in the Bank is as follows:

| | % of ownership |
|---|---|
| Bilbao Bizkaia Kutxa Fundación Bancaria - Bilbao Bizkaia Kutxa Banku Fundazioa | 57% |
| Fundación Bancaria Kutxa - Kutxa Banku Fundazioa | 32% |
| Caja de Ahorros de Vitoria y Álava - Araba eta Gasteizko Aurrezki Kutxa, Fundación Bancaria | 11% |

Pursuant to Law 26/2013, of 27 December, on savings banks and banking foundations, the Ordinary General Assemblies of BBK and Caja Vital at their meetings held on 30 June 2014 and the Extraordinary General Assembly of Kutxa held on 24 October 2014 approved the reregistration of the Savings Banks as banking foundations. BBK, Kutxa and Caja Vital were subsequently registered in the Basque Country Register of Foundations on 24 November 2014, 22 December 2014 and 29 July 2014, respectively.

The registration of the three former Savings Banks in the Register of Foundations resulted, de facto, in the loss of their credit institution status and as a result the SIP formed by the Savings Banks and Kutxabank was terminated. In this connection, the Board of Trustees of Bilbao Bizkaia Kutxa Fundación Bancaria and the Board of Trustees of Caja de Ahorros de Vitoria y Álava-Araba eta Gasteizko Aurrezki Kutxa, Fundación Bancaria, unanimously resolved, on 23 January 2015 and 10 February 2015, respectively, to terminate the SIP and the integration agreement entered into by the former Savings Banks and Kutxabank. In addition, the Board of Trustees of Fundación Bancaria Kutxa- Kutxa Banku Fundazioa unanimously resolved, on 17 March 2015, to terminate the integration agreement entered into by the former Savings Banks and Kutxabank, to sign for this purpose, at an undetermined date, the termination document of the aforementioned agreement and authorise, at the same time, a new "Shareholders Agreement" between the banking foundation shareholders of Kutxabank, S.A. Lastly, on 17 March 2016, Fundación Bancaria Kutxa - Kutxa Banku Fundazioa entered into the agreement which expressly provides for its inclusion in the termination document of the integration agreement entered into by Kutxabank, S.A., Bilbao Bizkaia Kutxa Fundación Bancaria and Caja de Ahorros de Vitoria y Álava, Fundación Bancaria - Araba eta Gasteizko Aurrezki Kutxa, Banku Fundazioa, on 24 March 2015.

Also, as a result of the termination of the SIP, Bilbao Bizkaia Kutxa Fundación Bancaria, with registered office at Gran Vía 19-21, Bilbao, has the power to exercise control over Kutxabank. Accordingly, Kutxabank and its subsidiaries form part of the Bilbao Bizkaia Kutxa Fundación Bancaria Group. The consolidated financial statements for 2016 of the Bilbao Bizkaia Kutxa Fundación Bancaria Group were approved by the Board of Trustees on 22 June 2017 and filed at the Basque Country Registry of Foundations.

### 1.3. Most significant changes in the scope of consolidation

Set forth below are the most significant changes in the scope of consolidation in 2017:

- On 26 December 2016, the date of the related deed, Cascada Beach, S.L., in which the Group held a 100% ownership interest, was liquidated, resulting in no gains or losses for the Group.

- On 20 December 2016, the date of the related deed, Peri 3 Gestión, S.L., in which the Group held a 50% ownership interest, was liquidated, resulting in a loss of EUR 1 thousand for the Group.

- On 9 January 2017, the date of the related deed, Promega Residencial, S.L., in which the Group held a 35% ownership interest, was liquidated, resulting in a loss of EUR 1 thousand for the Group.

- On 10 February 2017, the date of the related deed, Promociones Ames Bertan, S.L., in which the Group held a 100% ownership interest, was liquidated, resulting in a loss of EUR 2 thousand for the Group.

- On 24 April 2017, the date of the related deed, the Group sold 25% of its ownership interest in Ibérico de Bellota, S.A., resulting in a gain of EUR 62 thousand for the Group.

- On 15 June 2017, the date of the related deed, the Group sold 0.06% of its ownership interest in Viacajas, S.A., decreasing its ownership interest in that company to 46.64%, resulting in no gains or losses for the Group.

- On 26 July 2017, the date of the related deed, a capital increase was performed at Euskaltel, S.A., through the issue of 26,800,000 new shares with pre-emption rights of the current shareholders. The Group did not subscribe to the capital increase and, therefore, its ownership interest in that company fell from 25.11% to 21.35%. This transaction gave rise to a gain of EUR 20,818 thousand for the Group.

- On 10 November 2017, the date of the related deed, Columba 2.010, S.L.U., in which the Group held a 100% ownership interest, was liquidated, resulting in no gains or losses for the Group.

- On 11 December 2017, Grupo de Empresas Cajasur, S.A., in which the Group held a 100% ownership interest, was liquidated, resulting in no gains or losses for the Group.

- On 14 December 2017, the Group sold 33.33% of its ownership interest in Aparcamientos de Getxo en Romo y Las Arenas (Las Mercedes) Sociedad Concesionaria, S.L., resulting in no gains or losses for the Group.

- On 20 December 2017, the merger by absorption by Kutxabank, S.A. ("absorbing company") of Kartera 2, S.L.U. and Kartera 4, S.A.U. ("absorbed companies"), wholly owned by Kutxabank, S.A., took place.

- On 26 December 2017, the Group acquired 18.22% of Fineco Sociedad de Valores, S.A., as a result of which it held a 98.22% ownership interest in this company. The indirect interest held by Kutxabank, S.A., through Fineco Sociedad de Valores, S.A., in Fineco Previsión Entidad Gestora de Fondos de Pensiones, S.A., GIIC Fineco Sociedad Gestora de Instituciones de Inversión Colectiva, S.A. and Fineco Patrimonios Sociedad Gestora de Instituciones de Inversión Colectiva, S.A. was increased to 98.22% of those entities. This transaction gave rise to a decrease in other reserves of EUR 3,470 thousand.

In addition, there were other less significant changes due to changes in treasury shares and capital increases not subscribed by the Group, which gave rise to changes in the ownership interests in certain associates, such as Ingeteam, S.A., Inversiones Zubiatzu, S.A., Talde Promoción y Desarrollo S.C.R., S.A., Zierbena Bizkaia 2002, A.I.E., and Araba Logística, S.A. (Appendix II) and a total loss of EUR 643 thousand.

## 2. Basis of presentation of the consolidated financial statements

### *a) Basis of presentation*

The consolidated financial statements were prepared from the Group entities' accounting records in accordance with EU-IFRSs, taking into account Bank of Spain Circular 4/2004, of 22 December, and subsequent amendments thereto, which implements and adapts for the Spanish credit institution sector the International Financial Reporting Standards adopted by the European Union and, accordingly, they present fairly the Group's consolidated equity and consolidated financial position as at 31 December 2017 and the consolidated results of its operations, the changes in the consolidated equity and the consolidated cash flows for the year then ended. All obligatory accounting principles and standards and measurement bases with a significant effect on the consolidated financial statements were applied in preparing them. The principal accounting policies and measurement bases applied in preparing these consolidated financial statements are summarised in Note 14.

The information in these consolidated financial statements is the responsibility of the directors of the Parent.

The Group's consolidated financial statements for 2017 were authorised for issue by the Parent's directors at the Board meeting held on 22 February 2018. They have not yet been approved by the Annual General Meeting, but are expected to be approved by it without any material changes. These consolidated financial statements are presented in thousands of euros, unless stated otherwise.

### *b) Basis of consolidation*

The Group was defined in accordance with International Financial Reporting Standards (IFRSs) adopted by the European Union. Investees include subsidiaries, jointly controlled entities and associates. Inclusions and changes in the scope of consolidation are detailed in Notes 1 and 28.

Subsidiaries are defined as investees that, together with the Parent, constitute a decision-making unit, i.e. entities over which the Parent has, directly or indirectly through other investees, the capacity to exercise control. Control is, in general but not exclusively, presumed to exist when the Parent owns directly or indirectly through other investees more than half of the voting power of the investee. Control is defined as the power to govern the financial and operating policies of an investee so as to obtain benefits from its activities and it can be exercised even if the aforementioned percentage of ownership is not held.

Appendix I contains relevant information on the investments in subsidiaries at 31 December 2017 and 2016.

The financial statements of the subsidiaries were consolidated using the full consolidation method. Accordingly, all material balances and transactions between consolidated entities were eliminated on consolidation. Also, the share of third parties of the Group's equity is presented under "Minority Interests (Non-Controlling Interests)" in the consolidated balance sheet and their share of the profit for the year is presented under "Profit for the Year - Attributable to Minority Interests (Non-Controlling Interests)" in the consolidated statement of profit or loss.

The results of subsidiaries acquired by the Group during the year are included in the consolidated statement of profit or loss from the date of acquisition to year-end. Similarly, the results of subsidiaries disposed of by the Group during the year are included in the consolidated statement of profit or loss from the beginning of the year to the date of disposal.

Jointly controlled entities are defined as joint ventures and investees that are not subsidiaries but which are jointly controlled by the Group and by one or more entities not related to the Group. A joint venture is a contractual arrangement whereby two or more entities or venturers undertake operations or hold assets so that strategic financial and operating decisions affecting the joint venture require the unanimous consent of the venturers, provided that these operations or assets are not integrated in financial structures other than those of the venturers.

Appendix II contains relevant information on the investments in jointly controlled entities at 31 December 2017 and 2016.

Associates are investees over which the Group exercises significant influence. Significant influence is, in general but not exclusively, presumed to exist when the investor holds, directly or indirectly through other investees, 20% or more of the voting power of the investee. There are no entities in which the Group owns 20% or more of the voting power that were not considered to be associates in 2017. Also, at 31 December 2017, there were no significant investees in which the Group held less than 20% of the voting power that were included in the Group's scope of consolidation.

Appendix II contains relevant information on the investments in associates at 31 December 2017 and 2016.

The associates and jointly controlled entities were accounted for using the equity method. Consequently, the investments in associates and jointly controlled entities were measured at the Group's share of net assets of the investee, after taking into account the dividends received therefrom and other equity eliminations. The profits and losses resulting from transactions with an associate or a jointly controlled entity are eliminated to the extent of the Group’s interest therein. If as a result of losses incurred by an associate its equity were negative, the investment would be presented in the Group's consolidated balance sheet with a zero value, unless the Group is obliged to give it financial support.

Since the accounting policies and measurement bases used in preparing the Group’s consolidated financial statements for 2017 and 2016 may differ from those used by certain subsidiaries, jointly controlled entities and associates, the required adjustments and reclassifications, if material, were made on consolidation to unify such policies and bases.

### *c) Adoption of new standards and interpretations issued*

*Standards and interpretations effective in 2017*

On 1 January 2017, the following standards, amendments and interpretations came into force, which did not have a significant impact on the Group's consolidated financial statements:

| Standards, amendments and interpretations | Content of the standard, amendment or interpretation | Obligatory application in annual reporting periods beginning on or after: |
|---|---|---|
| **Approved for use in the EU:** | | |
| Amendments to IAS 7 | Disclosure Initiative | 1 January 2017 |
| Amendments to IAS 12 | Recognition of Deferred Tax Assets for Unrealised Losses | 1 January 2017 |
| **Not yet approved for use in the EU (1):** | | |
| Improvements to IFRSs, 2014-2016 cycle | Clarification in relation to the scope of IFRS 12 and its interaction with IFRS 5. | 1 January 2017 |

*Standards and interpretations issued but not yet in force*

At the date of preparation of these consolidated financial statements, the most significant standards and interpretations that had been published by the IASB but which had not yet come into force, either because their effective date is subsequent to the date of the consolidated financial statements or because they had not yet been adopted by the European Union, were as follows:

| Standards, amendments and interpretations | Content of the standard, amendment or interpretation | Obligatory application in annual reporting periods beginning on or after: |
|---|---|---|
| **Approved for use in the EU:** | | |
| IFRS 15 | Revenue from Contracts with Customers | 1 January 2018 |
| IFRS 9 | Financial Instruments. Replaces the requirements in IAS 39 relating to the classification, measurement, recognition and derecognition of financial assets and financial liabilities, hedge accounting and impairment. | 1 January 2018 |
| Amendments to IFRS 4 | Applying IFRS 9 or temporary exemption for entities with IFRS 4, Insurance Contracts | 1 January 2018 |
| IFRS 16 | Inclusion of a single lessee accounting model | 1 January 2019 |
| **Not yet approved for use in the EU (1):** | | |
| Amendments to IFRS 2 | Clarifications of the vesting conditions in share-based payments | 1 January 2018 |
| Amendments to IAS 40 | Transfers of investment property | 1 January 2018 |
| Improvements to IFRSs, 2014-2016 cycle | Minor amendments to a series of standards | 1 January 2018 |
| IFRIC 22 | Determining the exchange rate in foreign currency transactions | 1 January 2018 |
| IFRIC 23 | Clarification of the recognition and measurement criteria in IAS 12 | 1 January 2019 |
| Amendments to IFRS 9 | Prepayment Features with Negative Compensation | 1 January 2019 |
| Amendments to IAS 28 | Long-term Interests in Associates and Joint Ventures | 1 January 2019 |
| Improvements to IFRSs, 2015-2017 cycle | Application of IFRS 9, Long-term Interests in Associates | 1 January 2019 |
| IFRS 17 | The recognition, measurement, presentation and disclosure of insurance contracts | 1 January 2021 |
| Amendments to IFRS 10 and IAS 28 | Clarification in relation to the gain or loss from transactions involving a business or assets | Not yet determined |

(1) Standards and interpretations not yet adopted by the European Union at the date of preparation of these consolidated financial statements.

The entry into force of these standards might have a significant impact on the consolidated financial statements of future years in the following cases:

- IFRS 9, Financial Instruments: IFRS 9 supersedes IAS 39 effective from the year beginning 1 January 2018. It has been issued in several phases (classification and measurement of financial assets and liabilities, hedge accounting and impairment) and there are very significant differences with respect to the standard applicable at 31 December 2017:

    - In relation to financial assets, the new standard includes the approval of a new classification model based on only two categories, namely instruments measured at amortised cost and those measured at fair value, the disappearance of the current "held-to-maturity investments" and "available-for-sale financial assets" categories, and the non-separation of derivatives embedded in financial asset contracts.

      With respect to the criteria for classification in the categories indicated above, the approach under IFRS 9 is based on assessing on a joint basis the characteristics of the cash flows from the instruments and the business model for managing the instruments. Therefore, financial assets the cash flows of which are solely payments of principal and interest and which are held with the objective of collecting such cash flows may be measured at amortised cost, whereas if the objective is to collect cash flows and sell the financial assets they must be measured at fair value through equity. All other financial assets must be measured at fair value through profit or loss. However, there is the option to recognise in equity changes in the fair value of equity instruments, in which case neither the gains or losses on the sale thereof, nor impairment losses may be recognised in profit or loss.

    - In relation to financial liabilities, the classification categories proposed by IFRS 9 are similar to those currently contained in IAS 39 and, therefore, there are no significant differences, except, in the case of the fair value option for financial liabilities, for the requirement to recognise changes in fair value attributable to own credit risk as a component of equity.

    - The new standard also includes changes in relation to hedge accounting compared to the current IAS 39 aimed in general at aligning hedge accounting with economic risk management by changing aspects relating to hedged items, hedging instruments and the measurement of effectiveness.

    - With respect to impairment recognition, a new impairment model is introduced based on expected credit losses, unlike the incurred loss-based model of IAS 39, and which applies to all financial assets not measured at fair value through profit or loss. This expected loss model must reflect the historical performance of the instruments assessed and include estimates of how foreseeable changes in the economic cycle (under certain scenarios) affect the measurement parameters used.

      In addition to the measurement model, the scope with which impairment is recognised is also different, and it is structured though three phases at which a financial instrument may be after its initial recognition, based on the degree of credit risk and on whether there has been a significant increase in credit risk since its origination. Therefore, the expected loss is initially recognised in a time horizon of twelve months (Phase 1) unless the existence of a significant increase in the risk relating to the transaction is identified. However, for transactions for which there has been a significant increase in the risk since origination (Phase 2), or which have been classified as non-performing (Phase 3), the expected loss is calculated until the transaction expires.

The Group has developed a Master Plan in 2017 made up of various operating working groups to analyse the impact of each of the areas introduced by IFRS 9, coordinated by a management committee which, in turn, has reported the progress of the project to the governing bodies on a systematic basis, to enable them to adopt the pertinent resolutions.

The most significant lines of work undertaken in relation to the Master Plan for the implementation of IFRS 9 are as follows:

- *Classification of impairment*: the criteria for segmenting the transactions into uniform groups have been defined and the indicators for classifying the financial assets into the three phases according to their credit risk have been identified.

- *Methodology and monitoring*: based on the segmentation, a map of models has been defined and the parameters to estimate the expected losses in the segments have been modelled using internal methods, validated in full at the date of preparation of these consolidated financial statements.

- *Databases and systems*: the information required to construct the models has been extracted. In addition, the tools used for automated segmentation, classification into phases according to credit risk and calculation of expected loss, estimated on a collective and an individual basis, have been modified. Also, parallel calculations were performed of the expected loss in accordance with the new criteria in the second half of 2017.

- *Classification of instruments*: the business models for determining the classification of the financial instruments have been defined. Also, the studies required to determine whether the cash flows from these instruments relate solely to payments of principal and interest have been carried out. In addition, the calculation methodology and the processes to be applied from 1 January 2018 to perform this analysis in the new transactions have been documented and defined, respectively.

The main impacts on the measurement and classification of the financial assets as a result of the changes described above are as follows:

- The effect of the classification of the financial assets and liabilities in the categories defined in the new standard which determine whether they are measured at fair value or amortised cost is not significant in relation to the accompanying consolidated financial statements.

- Impairment losses: The new impairment model results in an increase in provisions, particularly in relation to the unimpaired assets; this increase is concentrated mainly on financial assets where the risk of default has increased since their initial recognition, but in relation to which the Group expects to recover its investment. The increase in provisions for this reason, with respect to those reflected in the consolidated financial statements at 31 December 2017 totals EUR 103.5 million.

- The Group does not expect the implementation of IFRS 9 to have any impact on its hedge accounting transactions.

The overall effect of the various aspects of the new standard from 1 January 2018 will be a reduction in the Group's capital adequacy ratio of 27 bp compared to the ratio at 31 December 2017 (see Note 6).

Other standards approved for use in the EU:

- IFRS 15, Revenue from Contracts with Customers: comprehensive new standard on the recognition of revenue from customers which will supersede the standards and interpretations currently in force (IAS 18, IAS 11, IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31). the new IFRS 15 model is much more restrictive than the standards which it supersedes and is based on rules and, therefore, the application of the new requirements might give rise to changes in the revenue profile. These changes in the revenue profile are due to the fact that the revenue must be recognised in such a way as to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Specifically, the standard establishes a revenue recognition approach based on five steps: Identify the contract(s) with a customer; identify the performance obligations in the contract; determine the transaction price; allocate the transaction price to the performance obligations in the contract; and recognise revenue when (or as) the entity satisfies a performance obligation.

- IFRS 16, Leases: IFRS 16 will supersede the current IAS 17 and the associated interpretations from the year beginning 1 January 2019. The most significant differences with respect to the current standard are as follows:

    - There will be a single accounting model for lessees, removing the distinction between operating and finance leases. All leases are therefore recognised in the balance sheet as if they were financed purchases, with limited exceptions.

    - Entities must measure the lease liabilities at the present value of their lease payments. These liabilities will include fixed payments as well as variable payments that depend on an index or interest rate.

    - In practice, it is somewhat simplified, and allows short-term leases and leases of low-value assets to be accounted for directly as an expense, normally on straight-line basis over the term of the lease.

The Parent's directors consider that these standards will not have a significant effect on the consolidated financial statements.

Standards and interpretations not yet adopted by the European Union at the date of preparation of these consolidated financial statements.

- Amendments to IFRS 4, Insurance Contracts: these amendments provide entities within the scope of IFRS 4 with the option of applying IFRS 9 (“overlay approach”) to financial assets related to insurance contracts, or the temporary exemption therefrom ("deferral approach"). This deferral approach has not been adopted by the Group as its core activity is not insurance.

- Amendments to IFRS 2, Classification and Measurement of Share-based Payment Transactions: these amendments clarify specific issues such as the effects of vesting conditions on cash-settled share-based payments, the classification of share-based payment transactions with net settlement features and accounting for a modification to the terms and conditions of a share-based payment that changes the classification of the transaction from cash-settled to equity-settled.

- Amendments to IAS 40, Transfers of Investment Property: the amendments clarify that transfers to, or from, investment property will only be possible when there is evidence of a change in use.

- IFRIC 22, Foreign Currency Transactions and Advance Consideration: this interpretation establishes "the date of the transaction" for the purpose of determining the exchange rate to use in transactions with advance consideration in a foreign currency.

- IFRIC 23, Uncertainty Over Income Tax Treatments: this interpretation clarifies how to apply the recognition and measurement requirements in IAS 12 when there is uncertainty over whether the relevant taxation authority will accept a tax treatment used by an entity.

- Amendments to IFRS 9 - this amendment introduces changes to the SPPI (solely payments of principal and interest) test to, under certain circumstances, make it possible for assets that can be amortised early by the borrower and involve the payment of compensation reflecting changes in interest rates to be measured at amortised cost, subject to other IFRS 9 criteria.

- Amendments to IAS 28 - this amendment clarifies that IFRS 9, including its requirements for impairment, must be applied to long-term loans to associates and joint ventures that are part of the entity's net investment therein.

- Amendments to IFRS 10 and IAS 28, Sale or Contribution of Assets between an Investor and its Associate or Joint Venture: these amendments introduce highly significant clarification of the result of such transactions, since there is currently a conflict between the requirements in IFRS 10 and IAS 28. A full gain or loss should be recognised on the loss of control of a business and a partial gain or loss is recognised in accounting for the loss of control of a subsidiary that does not constitute a business as a result of a transaction between an investor and its associate or joint venture (based on the percentage realised with third parties).

- IFRS 17, Insurance Contracts: IFRS 17, which will supersede IFRS 4 from the year beginning 1 January 2021, establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued to ensure that entities provide relevant and reliable information that gives a basis for users of the financial information to assess the effect that insurance contracts have on the entity's financial statements.

### *d) Information relating to 2016*

As required by IAS 1, the information relating to 2016 contained in these consolidated financial statements is presented with the information relating to 2017 for comparison purposes only and, accordingly, it does not form part of the Group’s statutory consolidated financial statements for 2017.

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

The information in the Group's consolidated financial statements is the responsibility of the Parent's directors.

In these consolidated financial statements estimates were made by management of the Parent and of the investees, in order to measure certain assets, liabilities, income, expenses and obligations. These estimates relate to the following:

- The impairment losses on certain assets (see Notes 14-h, 14-p, 14-q, 14-r, 14-t and 14-u).
- The actuarial assumptions used in the calculation of the post-employment benefit liabilities and obligations and other long-term benefits (see Note 14-o).
- The useful life of the tangible and intangible assets (see Notes 14-q and 14-r).
- The fair value of certain unquoted assets (see Note 14-e).
- The expected cost of and changes in provisions and contingent liabilities (see Note 14-s).

Since these estimates were made on the basis of the best information available at the date of preparation of these consolidated financial statements on the items analysed, future events might make it necessary to change these estimates (upwards or downwards) in coming years. Changes in accounting estimates would be applied prospectively, recognising the effects of the change in estimates in the consolidated statements of profit or loss of the future years affected.

### *a) Changes in accounting policies*

There were no changes in accounting policies with respect to the consolidated balance sheet as at 1 January 2016 affecting the consolidated financial statements for 2017 and 2016, other than those arising from the standards in force described in Note 2-c.

### *b) Errors and changes in accounting estimates*

No corrections of material errors relating to prior years were made in 2017 and 2016 and there were no significant changes in accounting estimates affecting those years or which might have an impact on future years.

## 4. Distribution of profit for the year

The proposed distribution of the profit for 2017 that the Board of Directors of the Parent will submit for approval at the Annual General Meeting is as follows:

| | Thousands of euros |
|---|---|
| | 2017 |
| **Distribution:** | |
| To legal reserve | - |
| To voluntary reserves | 33,440 |
| Interim dividend | 115,422 |
| Final dividend | 35,555 |
| Distributed profit | 184,417 |
| **Profit for the year** | **184,417** |

At the General Meeting held on 28 December 2017, the shareholders resolved to distribute an interim dividend of EUR 115,422 thousand out of 2017 profit, which was paid on 28 December 2017.

The Parent's accounting statements prepared in accordance with legal requirements evidencing the existence of sufficient liquidity for the distribution of the aforementioned interim dividend were as follows:

| | Thousands of euros |
|---|---|
| | Accounting statement prepared as at 30 November 2017 |
| Net profit at the date indicated | 163,916 |
| Estimated appropriation to legal reserve | - |
| Interim dividends paid | - |
| **Maximum distributable profit** | **163,916** |
| **Liquidity available** | **2,996,000** |
| Liquidity available in Bank of Spain facility | 601,000 |
| Unrestricted assets | 1,666,000 |
| **Additional liquidity** | **2,267,000** |

At the General Meeting held on 25 November 2016, the shareholders resolved to distribute an interim dividend of EUR 95,154 thousand out of 2016 profit, which was paid on 30 November 2016.

Also, at the proposal of the Parent's Board of Directors, the Annual General Meeting held on 3 May 2017 resolved to distribute a final dividend of EUR 26,970 thousand out of 2016 profit, which was paid on the same day.

The profits or losses of the subsidiaries composing the Group will be allocated as approved at their respective Annual General Meetings.

## 5. Business segment reporting

IFRS 8 requires information about the financial performance of the business segments to be reported on the basis of the information used by management internally to evaluate the performance of these segments.

In addition, IFRS 8 requires an entity to report separately information about an operating segment whose reported revenue is 10% or more of the combined revenue of all operating segments or whose reported profit or loss is 10% or more of the greater, in absolute amount, of (i) the combined reported profit of all operating segments that did not report a loss, and (ii) the combined reported loss of all operating segments that reported a loss. Also, an entity shall report separately information about an operating segment if its assets are 10% or more of the combined assets of all operating segments. Moreover, reportable operating segments include, irrespective of their size, segments which in aggregate represent 75% or more of the Group's revenue.

### *a) Basis of segmentation*

Segment information is presented based on the various business lines of the Kutxabank Group, in accordance with its organisational structure at 2017 year-end. The following business segments are distinguished, taking into account mainly the subgroup from which the information originates:

- Kutxabank subgroup.
- CajaSur Banco subgroup.
- Insurance companies.
- Other business activities.

The Kutxabank subgroup segment includes the business activities of Kutxabank, which are carried on through its branch network and comprise the business with individual customers, SMEs and developers and its investments in businesses. The range of products and services offered includes mortgage loans, consumer loans, financing for businesses and developers, demand and time savings products, guarantees and debit and credit cards. In addition, this segment includes the business activities carried on by certain companies that are considered to be a direct prolongation of the activity carried on by the Parent. Kutxabank's Board of Directors is ultimately responsible for operational decisions in this area.

The CajaSur Banco subgroup segment includes the business activities of CajaSur Banco and its subsidiaries, which are carried on through the CajaSur Banco branch network and comprise the business with individual customers, SMEs and developers. The catalogue of products and services offered is similar to that of the Kutxabank subgroup. The Board of Directors of CajaSur Banco is ultimately responsible for operational decisions in this area.

The insurance companies segment includes the business activities carried on by the Group through Kutxabank Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.U. and Kutxabank Aseguradora Compañía de Seguros y Reaseguros, S.A.U. The Boards of Directors of the two subsidiaries are ultimately responsible for operational decisions in this area.

The other business activities segment includes all the business activities not allocated to the aforementioned segments. Ultimate responsibility for operational decisions in this area lies with the Boards of Directors of each of the subsidiaries, on which the relevant Area Management of the Parent (depending on the business activity of each subsidiary) is represented.

However, the decisions of the Group's various businesses are taken in the context of control arising from their belonging to the Kutxabank Group.

### *b) Basis and methodology for business segment reporting*

The operating segments are formed by aggregating the business entities in which each activity is performed and, therefore, each segment's information was prepared by consolidating the accounting information of the companies making up the segment. Accordingly, no internal transfer prices needed to be used. All segment financial statements have been prepared on a basis consistent with the accounting policies used by the Group.

The adjustments and eliminations relate mainly to the elimination of inter-segment results.

The sum of the operating segments' statements of profit or loss plus the adjustments and eliminations is equal to the total in the consolidated statement of profit or loss.

### *c) Business segment information*

The following tables show the consolidated statements of profit or loss, broken down by business segment, for the years ended 31 December 2017 and 2016, together with other segment information:

| | 2017 (Thousands of euros) | | | | | |
|---|---|---|---|---|---|---|
| | Kutxabank subgroup | CajaSur Banco subgroup | Insurance companies | Other business activities | Adjustments and eliminations | Total Group |
| **Statement of profit or loss** | | | | | | |
| **Net interest income (expense)** | **381,014** | **166,066** | **17,178** | **(5,537)** | **11** | **558,732** |
| Dividend income | 47,933 | 497 | 131 | 1,120 | - | 49,681 |
| Share of the profit or loss of entities accounted for using the equity method | - | (7) | - | 17,562 | - | 17,555 |
| Net fee and commission income (expenses) | 337,765 | 57,459 | (59,803) | 44,157 | (16) | 379,562 |
| Gains or losses on derecognition or measurement of financial assets and liabilities | 269,846 | 2,958 | 536 | 313 | - | 273,653 |
| Exchange differences, net | 2,202 | 336 | - | - | - | 2,538 |
| Other operating income, other operating expenses and income and expenses under insurance contracts | (60,519) | (14,210) | 98,770 | 29,463 | (3,527) | 49,977 |
| **Gross income** | **978,241** | **213,099** | **56,812** | **87,078** | **(3,532)** | **1,331,698** |
| Staff costs | (312,496) | (103,311) | (5,453) | (13,133) | - | (434,393) |
| Other administrative expenses | (138,505) | (43,053) | (6,944) | (7,233) | 3,532 | (192,203) |
| Depreciation and amortisation charge | (32,605) | (7,008) | (2,655) | (12,729) | - | (54,997) |
| Provisions or reversal of provisions | (122,343) | (12,411) | - | (3,494) | - | (138,248) |
| Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | (51,125) | (6,147) | - | (28,990) | - | (86,262) |
| **Profit from operations** | **321,167** | **41,169** | **41,760** | **21,499** | **-** | **425,595** |
| Impairment or reversal of impairment on non-financial assets | (16,677) | (5,928) | (83) | (26,000) | - | (48,688) |
| Other income and expenses | 28,886 | (12,583) | - | (111,341) | - | (95,038) |
| **Profit (Loss) before tax** | **333,376** | **22,658** | **41,677** | **(115,842)** | **-** | **281,869** |

| 2017 (Thousands of euros) | | | | | | |
|---|---|---|---|---|---|---|
| | Kutxabank subgroup | CajaSur Banco subgroup | Insurance companies | Other business activities | Adjustments and eliminations | Total Group |
| Total assets | 44,439,439 | 11,461,196 | 1,024,358 | 2,691,056 | (2,174,308) | 57,441,741 |
| Customers | 34,717,309 | 8,209,753 | 12,440 | 279,845 | (1,212,974) | 42,006,373 |
| Investment securities (*) | 3,778,949 | 762,186 | 791,061 | 34,716 | (186,353) | 5,180,559 |
| Investments in joint ventures and associates | 507,837 | 6,685 | - | - | - | 514,522 |
| Non-current assets and disposal groups classified as held for sale | 75,966 | 91,817 | - | 719,625 | - | 887,408 |
| Financial liabilities at amortised cost | 40,861,085 | 9,959,873 | 93,426 | 1,163,789 | (2,015,164) | 50,063,009 |

(*) Including balances of "Debt Securities" and "Other Equity Instruments".

| | 2016 (Thousands of euros) | | | | | |
|---|---|---|---|---|---|---|
| | Kutxabank subgroup | CajaSur Banco subgroup | Insurance companies | Other business activities | Adjustments and eliminations | Total Group |
| **Statement of profit or loss** | | | | | | |
| **Net interest income (expense)** | **372,181** | **178,906** | **16,701** | **(10,189)** | **399** | **557,998** |
| Dividend income | 93,056 | 502 | 27 | 1,194 | - | 94,779 |
| Share of the profit or loss of entities accounted for using the equity method | - | 74 | - | 43,764 | - | 43,838 |
| Net fee and commission income (expenses) | 309,171 | 50,686 | (53,665) | 37,651 | (18) | 343,825 |
| Gains or losses on derecognition or measurement of financial assets and liabilities | 166,554 | 430 | (9) | 481 | (387) | 167,069 |
| Exchange differences, net | 3,383 | 322 | - | - | - | 3,705 |
| Other operating income, other operating expenses and income and expenses under insurance contracts | (47,353) | (15,265) | 87,769 | 23,462 | (3,403) | 45,210 |
| **Gross income** | **896,992** | **215,655** | **50,823** | **96,363** | **(3,409)** | **1,256,424** |
| Staff costs | (330,124) | (104,954) | (5,102) | (12,686) | - | (452,866) |
| Other administrative expenses | (141,905) | (42,910) | (6,860) | (7,373) | 3,409 | (195,639) |
| Depreciation and amortisation charge | (33,217) | (7,195) | (2,740) | (12,934) | - | (56,086) |
| Provisions or reversal of provisions | (5,125) | (108,390) | - | (4,070) | - | (117,585) |
| Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss | (107,379) | 40,062 | - | (22,046) | - | (89,363) |
| **Profit (Loss) from operations** | **279,242** | **(7,732)** | **36,121** | **37,254** | - | **344,885** |
| Impairment or reversal of impairment on non-financial assets | (9,090) | (974) | - | (5,569) | - | (15,633) |
| Other income and expenses | 22,426 | 8,573 | - | (46,522) | - | (15,523) |
| **Profit (Loss) before tax** | **292,578** | **(133)** | **36,121** | **(14,837)** | - | **313,729** |

| 2016 (Thousands of euros) | | | | | | |
|---|---|---|---|---|---|---|
| | Kutxabank subgroup | CajaSur Banco subgroup | Insurance companies | Other business activities | Adjustments and eliminations | Total Group |
| Total assets | 44,179,600 | 11,739,950 | 999,343 | 2,467,656 | (2,870,633) | 56,515,916 |
| Customers | 35,020,788 | 8,255,052 | 10,589 | 276,245 | (989,541) | 42,573,133 |
| Investment securities (*) | 4,141,250 | 1,139,902 | 774,066 | 34,606 | (774,094) | 5,315,730 |
| Investments in joint ventures and associates | 479,385 | 23,733 | - | - | - | 503,118 |
| Non-current assets and disposal groups classified as held for sale | 80,008 | 100,788 | - | 677,901 | - | 858,697 |
| Financial liabilities at amortised cost | 40,693,030 | 10,225,506 | 70,147 | 845,396 | (2,676,586) | 49,157,493 |

(*) Including balances of "Debt Securities" and "Other Equity Instruments".

The Group carries on its business activities mainly in Spain, through a network comprising 931 branches at 31 December 2017, of which 368 were located in the Basque Country Autonomous Community, 331 in Andalusia, 228 in the rest of Spain and 4 in France (31 December 2016: 958 branches, of which 388 were located in the Basque Country, 337 in Andalusia, 229 in the rest of Spain and 4 in France).

The geographical distribution of the Group's financial assets and loans and receivables is detailed in Notes 22 to 26 to these consolidated financial statements. Substantially all the Group's income is generated in Spain.

## 6. Minimum ratios

### Capital management objectives, policies and processes

The main legislation regulating the capital requirements for credit institutions, both as stand-alone entities and as consolidated groups, is that published by the European Union on 27 June 2013: Directive 2013/36/EU ("CRD IV") and Regulation (EU) No 575/2013 ("CRR"). Both CRD IV and the CRR, which adapt Basel III for the European Union, entered into force on 1 January 2014.

In spite of the significant progress brought by the entry into force of these regulations, the European Commission continued to work to mitigate the weaknesses identified in the current regulatory framework. As a result, it submitted two proposals for amendment (known as CRD V and CRR II).

The proposed amendments cover a broad range of areas (requirements for own funds and eligible liabilities, leverage ratio, liquidity ratios, counterparty risk and market risk), and final approval thereof will finalise the regulatory reforms undertaken against the backdrop of the economic and financial crisis that began in 2008.

In addition, in December 2017 the Basel Committee on Banking Supervision published a document which completed the reforms taking place in the global regulatory framework (Basel III) and set the international standards on the capital adequacy and liquidity requirements applicable to financial institutions around the world. These principles will be directly applicable to European financial institutions once they have been explicitly brought into EU legislation.

As regards Spain, the most significant regulations are Royal Decree-Law 14/2013, of 29 November, on urgent measures to adapt Spanish law to European Union legislation in relation to the supervision and capital adequacy of financial institutions, Law 10/2014, of 26 June, on the regulation, supervision and capital adequacy of credit institutions, Royal Decree 84/2015, of 13 February, implementing the aforementioned law, and Bank of Spain Circular 2/2016, of 2 February, completing the adaptation of the Spanish legal system to CRR and CRD IV.

These regulations govern the minimum capital requirements for Spanish credit institutions - both as stand-alone entities and as consolidated groups- and the criteria for calculating them, as well as the various internal capital adequacy assessment processes they should have in place and the public information they should disclose to the market.

The minimum capital requirements established by this legislation are calculated on the basis of the Group's exposure to credit risk, to counterparty, position and settlement risk in relation to the financial assets held for trading, to foreign currency and gold position risk, and to operational risk. Additionally, the Group is subject to compliance with the established risk concentration limits and the requirements concerning internal corporate governance, internal capital adequacy assessment, interest rate risk measurement and disclosure of public information to the market. With a view to ensuring that the aforementioned objectives are met, the Group performs an integrated management of these risks in accordance with the policies outlined above.

In addition to strict compliance with current capital adequacy regulations, the Group has strategic guidelines in place for the management of its global risk profile; these guidelines, which are contained in its Risk Appetite Framework, include the establishment of corporate targets and observation and alert thresholds for the main capital ratios. The formal identification of the capital adequacy levels pursued, combined with the analysis of the risk the Group assumes in the performance of its business and the evaluation of the appropriateness of the infrastructure used to manage and control that risk, make it possible to determine its global risk profile.

Putting this policy into practice involves two different types of action: firstly, managing eligible capital and its various sources and, secondly, including the level of capital requirement as a consideration in the acceptance criteria for the various types of risk.

The implementation of this policy is overseen by monitoring the Group’s solvency position on an ongoing basis and by forecasting future trends in the position using a base scenario that includes the assumptions most likely to be met over the next three years, and various stress scenarios designed to evaluate the Group’s financial capacity to overcome particularly adverse situations of different kinds.

The main area of capital adequacy management is the consolidated Group of credit institutions.

Following is a detail of the Group’s capital at 31 December 2017 and 2016, calculated in accordance with current regulations:

| | 2017 | 2016 |
|---|---|---|
| Eligible common equity Tier 1 (thousands of euros) (a) | 4,679,898 | 4,612,708 |
| Eligible additional Tier 1 capital (thousands of euros) (b) | - | - |
| Eligible Tier 2 capital (thousands of euros) (c) | - | - |
| Risk (thousands of euros) (d) | 29,789,553 | 30,352,743 |
| Common equity Tier 1 (CET 1) ratio (A)=(a)/(d) | 15.71% | 15.20% |
| Additional Tier 1 capital (AT 1) ratio (B)=(b)/(d) | - | - |
| Tier 1 capital (Tier 1) ratio (A)+(B) | 15.71% | 15.20% |
| Tier 2 capital (Tier 2) ratio (C)=(c)/(d) | - | - |
| **Total capital ratio (A)+(B)+(C)** | **15.71%** | **15.20%** |
| Tier 1 capital (thousands of euros) (a) | 4,679,898 | 4,612,708 |
| Exposure (thousands of euros) (b) | 57,968,617 | 57,029,254 |
| **Leverage ratio (a)/(b)** | **8.07%** | **8.09%** |

In addition to complying with the capital requirements stemming from the capital adequacy regulations in force, European banks are required to meet the additional capital requirements laid down by the supervisory bodies, in the exercise of the powers established in Regulation (EU) 1024/2013. These supervisory requirements differ for each entity, as they depend on the conclusions drawn in each case during the supervisory review and evaluation process (SREP).

Accordingly, the capital requirements applicable to the Kutxabank Group in 2017 were 7.00% (in terms of the Common Equity Tier 1 (CET 1) ratio, and 10.50% (in terms of the Total Capital Adequacy Ratio). The Group's capital adequacy amply exceeded these requirements throughout the year.

On 7 December 2017, the ECB notified Kutxabank of its new decision regarding the supervisory capital requirements applicable to it from 1 January 2018 onwards, and established minimum thresholds, on a consolidated basis, of 7.575% for the CET1 Ratio and 11.075% for the Total Capital Adequacy Ratio. These thresholds encompass, in addition to the regulatory requirements under Pillar 1, a Pillar 2 supervisory requirement of 1.20% and a capital conservation buffer of 1.875%.

At 31 December 2017 and 2016, the Group's eligible capital exceeded comfortably the minimum capital requirements under the regulations in force at those dates.

### Minimum reserve ratio

In accordance with Monetary Circular 1/1998, of 29 September, the Group is subject to the minimum reserve ratio (which requires minimum balances to be held at the Bank of Spain).

Under Regulation 1358/2011 of the European Central Bank, of 14 December, financial institutions subject thereto must maintain a minimum reserve ratio of 1%. At 31 December 2017 and 2016, and throughout 2017 and 2016, the Group entities subject thereto met the minimum reserve ratio required by the applicable Spanish legislation.

The cash held by the Group in the Bank of Spain reserve account for these purposes amounted to EUR 3,893,085 thousand at 31 December 2017 (31 December 2016: EUR 873,568 thousand) (see Note 21). However, the Group entities' compliance with the obligation to hold the balance required by the applicable legislation in order to achieve the aforementioned minimum reserve ratio is calculated based on the average end-of-day balance held by each Group company in the reserve account over the maintenance period.

## 7. Remuneration of directors and senior executives of the Parent and Detail of investments held by directors in companies with similar activities

### *a) Remuneration of directors*

The aggregate remuneration earned in 2017 by the members of the Parent's Board of Directors, including directors with executive functions, amounted to EUR 2,254 thousand (2016: EUR 2,247 thousand), the detail being as follows:

| Type of remuneration | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Fixed remuneration | 1,336 | 1,299 |
| Variable remuneration | 357 | 345 |
| Attendance fees | 561 | 603 |
| **Total** | **2,254** | **2,247** |

In accordance with current legislation, a portion of the variable remuneration earned in 2017 and 2016 was paid through replacement equity instruments.

Also, EUR 35 thousand earned in years prior to 2016 which had already been included in the total remuneration for that year were paid in 2017 (no amounts earned in years prior to 2015 were paid in 2016).

The members of the Board of Directors did not earn any remuneration for discharging duties within the governing bodies of Group companies in 2017 (2016: EUR 36.7 thousand) in addition to the remuneration disclosed above, which was earned at the Parent.

Certain members of the Bank's Board of Directors are entitled to post-employment benefits due to their status as directors and earned EUR 24 thousand in this connection in 2017 (2016: EUR 19 thousand). In addition, certain members of the Board of Directors have pension rights which were earned in years in which they held positions at the Bank. No amounts were earned in this connection in 2017, nor were any amounts paid in this connection in 2016.

These two rights are externalised through insurance policies with non-Group companies.

Appendix III to these notes contains an itemised detail of this remuneration.

### *b) Remuneration of senior executives of the Parent*

For the purpose of preparing these consolidated financial statements and in keeping with the detail provided in the Annual Corporate Governance Report, at 31 December 2017 and 2016 there were five senior executives, comprising the Corporate General Managers and similar executives who discharge their management duties under direct supervision of the Managing Bodies, the Executive Committees or the CEO.

The following table shows the remuneration earned by the senior executives of the Parent:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Remuneration | 1,441 | 1,378 |
| Post-employment benefits | 119 | 81 |
| | **1,560** | **1,459** |

Also, EUR 88.7 thousand earned in years prior to 2016 which had already been included in the total remuneration for that year were paid in 2017 (EUR 249.2 thousand earned in years prior to 2015 and included in the remuneration for those years were paid in 2016).

Also, in 2017 and 2016 no senior executives received benefits as a result of the termination of their employment relationship.

### *c) Information regarding situations of conflict of interest involving the directors*

Pursuant to Article 229 of the Spanish Limited Liability Companies Law, amended by Law 31/2014, of 3 December 2014, it is indicated that, at 31 December 2017, neither the members of the Board of Directors nor persons related to them as defined in Article 231 of the Consolidated Spanish Limited Liability Companies Law had notified the Board of Directors of any direct or indirect conflict of interest they might have with respect to the Bank, without prejudice to one-off conflicts, which were dealt with in accordance with applicable law and internal regulations.

The Board of Directors had 16 members at 31 December 2017 and 2016.

## 8. Agency agreements

No agency agreements, as defined in Article 21 of Royal Decree 84/2015, of 13 February, were in force in 2017 or 2016.

## 9. Investments in the share capital of credit institutions

Pursuant to Article 28 of Royal Decree 84/2015, of 13 February, it is stated that the Group did not hold any ownership interests of more than 5% in the share capital or voting power of Spanish or foreign credit institutions at 31 December 2017 and 2016, in addition to those detailed in Appendices I and II.

## 10. Environmental impact

The Group's global operations are governed, inter alia, by laws on environmental protection (environmental laws) and on worker safety and health (occupational safety laws). The Group considers that it substantially complies with these laws and that it has procedures in place designed to encourage and ensure compliance therewith.

The Group has adopted the appropriate measures relating to environmental protection and improvement and the minimisation, where appropriate, of the environmental impact and complies with current legislation in this respect. In 2017 and 2016, the Group did not deem it necessary to recognise any provision for environmental risks and charges as, in the opinion of the Parent's Board of Directors, there are no contingencies in this connection that might have a significant effect on these consolidated financial statements.

## 11. Deposit Guarantee Fund for Credit Institutions and Single Resolution Fund

### Deposit Guarantee Fund for Credit Institutions

Both the Parent and its subsidiary CajaSur Banco belong to the Deposit Guarantee Fund for Credit Institutions (FGDEC).

Royal Decree-Law 19/2011, of 2 December, expressly repealed the Ministerial Orders which, pursuant to legislation then in force, established optional ad hoc reductions to the contributions to be made by credit institutions, and stipulated an actual contribution of 2 per mil, with a ceiling on the contributions of 3 per mil, of guaranteed deposits. Also, at its meeting on 30 July 2012 -in which it approved the financial statements for 2011, which presented an equity deficit at 31 December 2011-, the Managing Committee of the FGDEC, in order to restore the equity position of the FGDEC, resolved that an extraordinary contribution was to be made, which would be paid in ten annual payments from 2013 to 2022. The amounts paid each year in this connection can be deducted from, up to a limit of, the ordinary annual contribution. "Financial Liabilities at Amortised Cost - Other Financial Liabilities" in the accompanying consolidated balance sheet as at 31 December 2017 includes EUR 43,129 thousand (31 December 2016: EUR 51,005 thousand) of annual payments payable at that date (see Note 34-e).

Bank of Spain Circular 5/2016, of 27 May, modified the calculation of the contribution to the FGDEC, which is proportional to the Bank's risk profile taking into consideration risk indicators established therein.

As a result of the foregoing, the expense for 2017 arising from the ordinary contribution to be made in 2018 to the Deposit Guarantee Fund due to its positions at 31 December 2017 was estimated at EUR 46,681 thousand (2016: EUR 39,192 thousand), which are included under "Other Operating Expenses" in the accompanying consolidated statement of profit or loss (see Note 54) and recognised under "Other Liabilities" in the accompanying consolidated balance sheet (see Note 32).

In order to strengthen the assets of the Deposit Guarantee Fund for Credit Institutions, Royal Decree-Law 6/2013, of 22 March, increased the annual contribution to be made by the member entities on deposits at 31 December 2012, provided for in Article 3 of Royal Decree 2606/1996, of 20 December, on Deposit Guarantee Funds for Credit Institutions, on an exceptional, one-off basis, by an additional 3 per mil. Taking into account the deductions discussed below, the amount payable by the Group of this extraordinary contribution was EUR 69,846 thousand, which were recognised in full in the Group's consolidated statement of profit or loss for 2013.

The aforementioned Royal Decree-Law established that the extraordinary contribution be made in two tranches:

- A first tranche equal to two-fifths of the total increase paid within 20 working days from 31 December 2013, with a deduction of up to 30% of the amounts invested by the entities prior to 31 December 2013 in the subscription or acquisition of shares or subordinated debt instruments issued by the Spanish Bank Restructuring Asset Management Company (SAREB).

- A second tranche equal to the remaining three-fifths to be paid as from 1 January 2014, in accordance with the payment schedule set by the Managing Committee, within a maximum period of seven years.

The first tranche of the contribution was paid by member credit institutions on 22 January 2014 and the first payment of the second tranche, equal to one-seventh of this tranche, was settled on 30 September 2014. At its meeting held on 17 December 2014, the Management Committee of the Deposit Guarantee Fund for Credit Institutions, within the powers conferred on it by the aforementioned Royal Decree-Law, resolved that the remaining payment of the second tranche of the contribution be made through two equal payments on 30 June 2015 and 30 June 2016. Accordingly, since the last payments were made on 30 June 2016, there was no amount payable in this connection at 31 December 2017.

**Single Resolution Fund**

Both the Parent and its subsidiary CajaSur Banco belong to the Single Resolution Fund (SRF). Regulation (EU) No 806/2014 of 15 July 2014 establishes the criteria for calculating contributions to the SRF, which will be based on two types of contribution:

- A flat contribution, which is pro-rata based on the amount of an institution's liabilities.

- A risk-adjusted contribution, which is based on the criteria laid down in Directive 2014/59/EU.

As a result of the foregoing, the 2017 expense for the contribution to the SRF amounted to EUR 11,776 thousand (2016: EUR 12,671 thousand), which were recognised under "Other Operating Expenses" in the accompanying consolidated statement of profit or loss (see Note 54) and paid in 2017.

## 12. Audit fees

In 2017 and 2016 the fees for the audit of the separate and consolidated financial statements of the Group companies and other services provided by the auditor of the Parent, Deloitte, S.L., or by firms in the Deloitte organisation, were as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Services provided by the auditor or by companies related thereto | | Services provided by other auditors or by companies related thereto | |
| | 2017 | 2016 | 2017 | 2016 |
| Audit services | 976 | 1,056 | 151 | 120 |
| Other attest services | 192 | 176 | 157 | 218 |
| **Total audit and related services** | **1,168** | **1,232** | **308** | **338** |
| Tax counselling services | 405 | 444 | - | 23 |
| Other services | 181 | 99 | 14 | 90 |
| **Total other professional services** | **586** | **543** | **14** | **113** |

## 13. Events after the reporting period

In the period from 31 December 2017 to the date when these consolidated financial statements were authorised for issue, no events took place having a material effect on the Group.

## 14. Accounting policies and measurement bases

The principal accounting policies and measurement bases applied in preparing these consolidated financial statements were as follows:

### *a) Going concern basis*

The consolidated financial statements were prepared on the assumption that the Group entities will continue as going concerns in the foreseeable future. Therefore, the application of the accounting policies is not aimed at determining the value of consolidated equity with a view to its full or partial transfer or the amount that would result in the event of liquidation.

### *b) Accrual basis of accounting*

These consolidated financial statements, except the consolidated statements of cash flows, where appropriate, were prepared on the basis of the actual flow of the related goods and services, regardless of the payment or collection date.

### c) *Other general principles*

The consolidated financial statements were prepared on a historical cost basis, albeit adjusted as a result of the integration transaction described in Note 1.2 and by the revaluation of land and structures made on 1 January 2004, as discussed in Note 14-q, and except for the measurement of available-for-sale financial assets and financial assets and liabilities (including derivatives) at fair value.

The preparation of consolidated financial statements requires the use of certain accounting estimates. It also requires management to make judgements in the application of the Group's accounting policies. These estimates may affect the amount of assets and liabilities, the contingent asset and liability disclosures at the reporting date and the amount of income and expenses during the reporting period. Although these estimates are based on management's best knowledge of the current and foreseeable circumstances, the final results might differ from these estimates.

### d) *Financial derivatives*

Financial derivatives are instruments which, in addition to providing a profit or loss, may permit the offset, under certain conditions, of all or a portion of the credit and/or market risks associated with balances and transactions, using interest rates, certain indices, equity prices, cross-currency exchange rates or other similar benchmarks as underlyings. The Group uses financial derivatives traded on organised markets or traded bilaterally with the counterparty outside organised markets (OTC).

Financial derivatives are used for trading with customers who request these instruments, for managing the risks of the Group's own positions (hedging derivatives) or for obtaining gains from changes in the prices of these derivatives. Any financial derivative not qualifying for hedge accounting is treated for accounting purposes as a derivative held for trading. A derivative qualifies for hedge accounting if the following conditions are met:

1. The financial derivative hedges the exposure to changes in the fair value of assets and liabilities due to fluctuations in interest rates, exchange rates and/or securities prices (fair value hedge); the exposure to changes in the estimated cash flows arising from financial assets and liabilities, commitments and highly probable forecast transactions (cash flow hedge); or the exposure of a net investment in a foreign operation (hedge of a net investment in a foreign operation).

2. The financial derivative is effective in offsetting exposure inherent in the hedged item or position throughout the expected term of the hedge, which means that the hedge is prospectively effective (i.e. effective at the time of arrangement of the hedge under normal conditions) and retrospectively effective (i.e. there is sufficient evidence that the hedge will have been actually effective during the whole life of the hedged item or position).

   The analysis performed by the Group to ascertain the effectiveness of a hedge is based on various calculations included in the Group's risk monitoring computer applications. These applications keep record, on a systematic and daily basis, of the calculations made to value the hedged items and the hedging instruments. The resulting data, in conjunction with the particular characteristics of these items, enable historical calculations of values and sensitivity analyses to be performed. These estimates serve as the basis for the effectiveness tests of fair value and cash flow hedges. Recording this information enables the Group to re-perform all the analyses at the required frequency and at any given date.

3. There must be adequate documentation evidencing the specific designation of the financial derivative to hedge certain balances or transactions and how this effective hedge was expected to be achieved and measured, provided that this is consistent with the Group's management of own risks.

Hedges can be applied to individual items or balances or to portfolios of financial assets and liabilities. In the latter case, the group of financial assets or liabilities to be hedged must share a common risk exposure, which is deemed to occur when the sensitivity of the individual hedged items to changes in the risk being hedged is similar.

The hedging policies are part of the Group's global risk management strategy and hedges are arranged, by decision of the Parent's Asset-Liability Committee, mainly in the form of "micro-hedges" relating to:

1. The management of the Group's on-balance-sheet interest rate risk exposure, and

2. The mitigation of undesired risks arising from the Group's operations.

In general, the hedge is designed at the very moment the risk arises to achieve an effective (partial or full) hedge of the related risk on the basis of the analysis of the sensitivity of the known flows or changes in value of the hedged items to changes in the risk factors (mainly interest rates). As a result, derivative instruments are arranged on organised or OTC markets to offset the effects of changes in market conditions on the fair values and cash flows of the hedged items.

The Group classifies its hedges based on the type of risk they hedge: fair value hedges, cash flow hedges and hedges of net investments in foreign operations. At 31 December 2017 and 2016, most of the Group's hedges were fair value hedges and there were no hedges of net investments in foreign operations.

The fair value hedges are instrumented in interest rate or equity swaps arranged with financial institutions, the purpose of which is to hedge the exposure to changes in fair value, attributable to the risk being hedged, of certain asset and liability transactions.

Financial derivatives embedded in other financial instruments or in other host contracts are accounted for separately as derivatives if their risks and characteristics are not closely related to those of the host contracts, provided that the host contracts are not classified as "Financial Assets/Liabilities Held for Trading" or as "Financial Assets/Liabilities Designated at Fair Value through Profit or Loss" in the consolidated balance sheet.

The financial derivative measurement bases are described in Note 14-e (Financial assets) below.

### *e) Financial assets*

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

1. "Cash, Cash Balances at Central Banks and Other Demand Deposits", which comprises cash balances and demand deposits held with central banks and credit institutions.

2. "Financial Assets Held for Trading", which includes financial assets acquired for the purpose of selling them in the near term, financial assets which are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking and derivatives not designated as hedging instruments.

3. "Financial Assets Designated at Fair Value through Profit or Loss", which includes financial assets not held for trading that are hybrid financial assets and are measured entirely at fair value, and financial assets which are managed jointly with liabilities under insurance contracts measured at fair value, with derivative financial instruments whose purpose and effect is to significantly reduce exposure to variations in fair value, or with financial liabilities and derivatives in order to significantly reduce overall exposure to interest rate risk.

4. "Available-for-Sale Financial Assets", which includes debt securities not classified as held-to-maturity investments, as financial assets designated at fair value through profit or loss, as loans and receivables or as financial assets held for trading, and equity instruments of entities other than subsidiaries, associates and jointly controlled entities that have not been classified as financial assets held for trading or as financial assets designated at fair value through profit or loss.

5. "Loans and Receivables", which includes financial assets that are not quoted in an active market, that do not have to be measured at fair value and that have fixed or determinable cash flows, with respect to which the Group will recover all of its initial investment, other than losses because of credit deterioration. This category includes the investment arising from ordinary lending activities, such as the cash amounts of loans drawn down and not yet repaid by customers, the deposits placed with other institutions, whatever the legal instrument, unquoted debt securities and the debt incurred by the purchasers of goods, or the users of services, constituting part of the Group's business.

6. "Held-to-Maturity Investments", which includes debt securities with fixed maturity and with fixed cash flows that the Group has decided to hold to maturity because it has, basically, the financial capacity to do so or because it has the related financing.

7. "Derivatives – Hedge Accounting", which includes the financial derivatives acquired or issued by the Group which qualify for hedge accounting.

8. "Assets under Reinsurance and Insurance Contracts" includes the amounts that the Group is entitled to receive for reinsurance contracts with third parties and, specifically, the reinsurer's share of the technical provisions recorded.

9. "Insurance Contracts Linked to Pensions", which includes the reimbursement rights claimable from insurers relating to part or all of the expenditure required to settle a defined benefit obligation when the insurance policies do not qualify as a plan asset. At 31 December 2017 and 2016, the Group had not recognised any amount in this asset category.

10. "Non-Current Assets and Disposal Groups Classified as Held for Sale", which includes the carrying amount of individual items, disposal groups or items forming part of a business unit earmarked for disposal ("discontinued operations"), whose sale in their present condition is highly likely to be completed within one year from the reporting date. Therefore, the carrying amount of the items that are of a financial nature will foreseeably be recovered through the proceeds from their disposal. There are other non-current assets and disposal groups classified as held for sale of a non-financial nature whose accounting treatment is described in Note 14-t.

In 2017 and 2016 no assets were reclassified among the "Financial Assets Held for Trading", "Financial Assets Designated at Fair Value through Profit or Loss", "Available-for-Sale Financial Assets" and "Held-to-Maturity Investments" categories in the consolidated balance sheet.

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

In general, financial assets are initially recognised at acquisition cost and are subsequently measured at each period-end as follows:

1. Financial assets are measured at fair value except for loans and receivables, held-to-maturity investments, equity instruments whose fair value cannot be determined in a sufficiently objective manner, and financial derivatives that have those equity instruments as their underlying and are settled by delivery of those instruments.

   The fair value of a financial asset on a given date is taken to be the amount for which it could be transferred between knowledgeable, willing parties in an arm's length transaction. The best evidence of the fair value is the quoted price on an organised, transparent and deep market.

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

   The fair value of financial derivatives quoted in an active market is their daily quoted price and if, for exceptional reasons, the quoted price at a given date cannot be determined, these financial derivatives are measured using methods similar to those used to measure OTC financial derivatives.

   The fair value of OTC derivatives is taken to be the sum of the future cash flows arising from the instrument, discounted to present value at the date of measurement ("present value" or "theoretical close") using valuation techniques accepted in the financial markets ("Net Present Value" (NPV), option pricing models, etc.).

2. Loans and receivables and held-to-maturity investments are measured at amortised cost using the effective interest method. Amortised cost is understood to be the acquisition cost of a financial asset adjusted by principal repayments and the amortisation taken to the consolidated statement of profit or loss using the effective interest method, less any reduction for impairment recognised directly as a deduction from the carrying amount of the asset or through an allowance account. In the case of loans and receivables hedged in fair value hedges, the changes in the fair value of these assets related to the risk or risks being hedged are recognised.

   The effective interest rate is the discount rate that exactly matches the initial carrying amount of a financial instrument to all its estimated cash flows of all kinds over its remaining life. For fixed rate financial instruments, the effective interest rate coincides with the contractual interest rate established on the acquisition date adjusted by the fees that, because of their nature, can be equated with a rate of interest. In the case of floating rate financial instruments, the effective interest rate coincides with the rate of return prevailing in all connections until the next benchmark interest reset date.

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

At 31 December 2017 and 2016, the impact of the use of assumptions other than those employed in measuring financial instruments using internal models is not material.

As a general rule, changes in the carrying amount of financial assets are recognised in the consolidated statement of profit or loss. A distinction is made between the changes resulting from the accrual of interest and similar items, which are recognised under "Interest Income", and those arising for other reasons, which are recognised at their net amount under "Gains or Losses on Derecognition of Financial Assets and Liabilities Not Measured at Fair Value Through Profit or Loss, Net", "Gains or Losses on Financial Assets and Liabilities Held for Trading, Net", "Gains or Losses on Financial Assets and Liabilities Designated at Fair Value through Profit or Loss, Net" and "Gains or Losses from Hedge Accounting, Net" in the consolidated statement of profit or loss.

However, changes in the carrying amount of instruments included under "Available-for-Sale Financial Assets" are recognised temporarily in consolidated equity under "Accumulated Other Comprehensive Income", unless they relate to exchange differences on monetary financial assets. Amounts included under "Accumulated Other Comprehensive Income" remain in consolidated equity until the asset giving rise to them is derecognised or impairment losses are recognised on that asset, at which time they are reclassified to profit or loss.

Exchange differences on securities included in this portfolio denominated in currencies other than the euro are recognised as explained in Note 14-i. Any impairment losses on these securities are recognised as described in Note 14-h.

In the case of financial assets designated as hedged items or qualifying for hedge accounting, gains and losses are recognised as follows:

1. In fair value hedges, the gains or losses arising on both the hedging instruments and the hedged items attributable to the type of risk being hedged are recognised directly in the consolidated statement of profit or loss.

2. In cash flow hedges and hedges of a net investment in a foreign operation, the ineffective portion of the gains or losses on the hedging instruments is recognised directly in the consolidated statement of profit or loss.

3. In cash flow hedges and hedges of a net investment in a foreign operation, the gains or losses attributable to the portion of the hedging instruments qualifying as an effective hedge are recognised temporarily in consolidated equity under "Accumulated Other Comprehensive Income".

The gains or losses on the hedging instrument are not recognised in profit or loss until the gains or losses on the hedged item are recognised in the consolidated statement of profit or loss or until the date of maturity of the hedged item.

### *f) Financial liabilities*

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

1. "Financial Liabilities Held for Trading", which includes financial liabilities issued for the purpose of repurchasing them in the near term, financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit taking, derivatives not designated as hedging instruments, and financial liabilities arising from the outright sale of financial assets acquired under reverse repurchase agreements or borrowed.

2. "Financial Liabilities Designated at Fair Value through Profit or Loss", which includes the financial liabilities not held for trading that are hybrid financial instruments and contain an embedded derivative whose fair value cannot be reliably measured. At 31 December 2017 and 2016, the Group did not have any financial liabilities of this kind on its balance sheet.

3. "Financial Liabilities at Amortised Cost", which includes, irrespective of their instrumentation and maturity, the financial liabilities not included under any other item in the consolidated balance sheet which arise from the ordinary borrowing activities carried on by financial institutions.

4. "Derivatives – Hedge Accounting", which includes the financial derivatives acquired or issued by the Group which qualify for hedge accounting.

5. "Liabilities included in Disposal Groups classified as Held for Sale", which includes the balances payable arising from the non-current assets and disposal groups classified as held for sale. At 31 December 2017 and 2016, the Group did not have any financial liabilities of this kind on its consolidated balance sheet.

Financial liabilities are measured at amortised cost, as defined for financial assets in Note 14-e, except as follows:

1. Financial liabilities included under "Financial Liabilities Held for Trading" and "Financial Liabilities Designated at Fair Value through Profit or Loss" are measured at fair value as defined for financial assets in Note 14-e. Financial liabilities hedged in fair value hedges are adjusted and the changes in fair value related to the risk being hedged are recognised.

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

As a general rule, changes in the carrying amount of financial liabilities are recognised in the consolidated statement of profit or loss. A distinction is made between the changes resulting from the accrual of interest and similar items, which are recognised under "Interest Expenses", and those arising for other reasons, which are recognised at their net amount under "Gains or Losses on Derecognition of Financial Assets and Liabilities Not Measured at Fair Value Through Profit or Loss, Net", "Gains or Losses on Financial Assets and Liabilities Held for Trading, Net", "Gains or Losses on Financial Assets and Liabilities Designated at Fair Value through Profit or Loss, Net" and "Gains or Losses from Hedge Accounting, Net" in the consolidated statement of profit or loss.

In the case of financial liabilities designated as hedged items or qualifying for hedge accounting, gains and losses are recognised as described for financial assets in Note 14-e.

### *g) Transfer and derecognition of financial instruments*

Transfers of financial instruments are accounted for taking into account the extent to which the risks and rewards associated with the transferred financial instruments are transferred to third parties, as follows:

1. If the Group transfers substantially all the risks and rewards to third parties, the transferred financial instrument is derecognised and any rights or obligations retained or created in the transfer are recognised simultaneously.

2. If the Group retains substantially all the risks and rewards associated with the transferred financial instrument, the transferred financial instrument is not derecognised and continues to be measured by the same criteria as those used before the transfer. However, the associated financial liability is recognised for an amount equal to the consideration received, and this liability is subsequently measured at amortised cost. The income from the transferred financial asset not derecognised and any expense incurred on the new financial liability are also recognised.

3. If the Group neither transfers nor retains substantially all the risks and rewards associated with the transferred financial instrument, the following distinction is made:

    a. If the Group does not retain control of the transferred financial instrument, the instrument is derecognised and any rights or obligations retained or created in the transfer are recognised.

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

Accordingly, financial assets are only derecognised when the cash flows they generate have been extinguished or when substantially all the inherent risks and rewards have been transferred to third parties. Similarly, financial liabilities are only derecognised when the obligations they generate have been extinguished or when they are acquired, albeit with the intention either to cancel them or to resell them.

However, in accordance with International Financial Reporting Standards as adopted by the European Union, the Group did not recognise, unless they had to be recognised as a result of a subsequent transaction or event, any non-derivative financial assets and liabilities relating to transactions performed before 1 January 2004 that had been derecognised as a result of the formerly applicable accounting standards. Specifically, at 31 December 2017 the Group held securitised assets amounting to EUR 12,381 thousand (31 December 2016: EUR 14,683 thousand) which were derecognised before 1 January 2004 as a result of the formerly applicable accounting standards (see Note 25).

***h) Impairment of financial assets***

The carrying amount of a financial asset is generally adjusted with a charge to the consolidated statement of profit or loss when there is objective evidence that an impairment loss has occurred. This evidence exists:

1. In the case of debt instruments, i.e. loans, advances other than loans and debt securities, when, after their initial recognition, a single event or the combined effect of several events causes an adverse impact on their future cash flows.

2. In the case of equity instruments, when, as a result of a single event or the combined effect of several events after initial recognition, their carrying amount cannot be recovered.

In the case of debt instruments carried at amortised cost, the amount of the impairment losses incurred is equal to the negative difference between their carrying amount and the present value of their estimated future cash flows. For quoted debt instruments, market value may be used instead of the present value of future cash flows, provided that the market is sufficiently deep for the value to be considered as representative of the amount that could be recovered by the Group.

The estimated future cash flows of debt instruments are all the amounts (principal and interest) that the Group considers will flow to it over the remaining life of the instrument. This estimate takes into account all relevant information available on the reporting date about the likelihood of collecting the contractual cash flows in the future. The future cash flows of a collateralised instrument are estimated by taking into account the flows that would result from foreclosure less costs for obtaining and subsequently selling the collateral, whether or not foreclosure is probable.

The discount rate used to calculate the present value of estimated future cash flows is the instrument's original effective interest rate, if its contractual rate is fixed, or the effective interest rate determined under the contract at the reporting date, if it is variable.

Debt instruments and off-balance-sheet exposures, whoever the obligor and whatever the instrument or guarantee, are analysed to determine the Group's credit risk exposure and to consider whether an impairment allowance is required. In the preparation of the consolidated financial statements, the Group classifies its transactions based on their credit risk and assesses separately the insolvency risk attributable to the customer and the country risk to which these transactions are exposed.

Objective evidence of impairment is determined individually for all debt instruments classified as non-performing that are significant and collectively for groups of debt instruments that are not individually significant. When a specific instrument cannot be included in any group of assets with similar credit risk characteristics, it is analysed solely on an individual basis to determine whether it is impaired and, if so, to estimate the impairment loss. Accordingly, impairment is broken down, on the basis of the calculation method, into:

1. *Specific allowances for individually assessed financial assets*: cumulative amount of the allowances recognised for non-performing assets which have been assessed individually.

2. *Specific allowances for collectively assessed financial assets:* cumulative amount of collective impairment calculated for debt instruments of insignificant amounts classified as non-performing that have become individually impaired and for which the Bank uses a statistical approach, i.e. it calculates the specific allowance by applying collective allowance percentages based on the age of the amounts past due.

3. *Collective allowances for incurred but not reported losses*: cumulative amount of collective impairment of debt instruments that have not become individually impaired.

A group of financial assets is collectively assessed to estimate the impairment losses thereon as follows:

1. Debt instruments are included in groups with similar credit risk characteristics indicative of the debtors' ability to pay all principal and interest amounts in accordance with the contractual terms. The credit risk characteristics considered for the purpose of grouping the assets are, inter alia, instrument type, debtor's industry and geographical location, type of guarantee or collateral, age of past-due amounts and any other relevant factor for the estimation of future cash flows.

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

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

Debt instruments not classified as financial assets held for trading or off-balance-sheet exposures are classified on the basis of the insolvency risk attributable to the customer or to the transaction, in the following categories: standard risk, standard risk under special monitoring, non-performing due to customer arrears, non-performing for reasons other than customer arrears and write-offs. For debt instruments not classified as standard risk or standard risk under special monitoring that are individually significant, the specific individually assessed impairment allowances are estimated, based on the past experience of the Bank and the industry, taking into consideration the age of the past-due amounts, the guarantees provided and the financial situation of the customer and, where appropriate, of the guarantors. For the remaining debt instruments, the collectively assessed specific and general allowances are estimated on the basis of the parameters established in Bank of Spain Circular 4/2016.

In accordance with Circular 4/2016, debt instruments under special monitoring are those which do not meet the criteria for classification as non-performing due to customer arrears or non-performing for reasons other than customer arrears, and which show weaknesses that may entail the Bank assuming losses higher than those on transactions classified as standard risk.

Refinanced or restructured transactions are classified taking into consideration the payment pattern over a prolonged period, the granting of grace periods, the provision of additional effective collateral and the capacity to generate funds, among other factors.

The refinancing or restructuring of transactions that are not current in their payments does not interrupt their classification as doubtful, unless there is reasonable certainty that the customer will be able to meet its payment obligations within the established time frame or new effective collateral is provided, and, in both cases, unless at least the ordinary outstanding interest is received.

The amount of the financial assets that would have been deemed to be impaired had the conditions thereof not been renegotiated is not material with respect to the consolidated financial statements taken as a whole. In general, the Bank's refinancing transactions do not lead to the derecognition of existing assets and the recognition of new assets, the main objective being to improve the coverage of these transactions through additional collateral. In the case of these transactions, there were no material differences between the carrying amount of the assets derecognised and the fair value of the new assets in 2017 and 2016. Also, the aforementioned transactions do not entail a delay or reduction in the recognition of impairment losses that would have been required if they had not been modified, since at the date of modification, were it necessary, these transactions were already impaired and the Group had recognised the related credit loss allowance prior to the arrangement of this type of transaction.

When there is objective evidence that the decline in fair value of debt securities and equity instruments included under "Available-for-Sale Financial Assets" is due to impairment, the unrealised losses recognised directly in consolidated equity under "Accumulated Other Comprehensive Income" are recognised immediately in the consolidated statement of profit or loss. If all or part of the impairment losses are subsequently reversed, the reversed amount is recognised, for debt securities, in the consolidated statement of profit or loss for the period in which the reversal occurred and, for equity instruments, in consolidated equity under "Accumulated Other Comprehensive Income". The amount of the impairment losses incurred is the positive difference between acquisition cost, net of any principal repayment, and fair value.

Interest accrual on the basis of the contractual terms is suspended for all debt instruments individually classified as impaired and for those for which impairment losses have been assessed collectively because they have amounts more than three months past due.

To estimate the impairment of equity instruments included in the available-for-sale financial asset portfolio, the Bank conducts a case-by-case analysis of the impairment of each relevant security. However, the Group's accounting policies establish that, in any case, a prolonged or significant decline in their fair value below their cost is objective evidence of impairment and, therefore, an impairment loss is recognised for the difference between the cost and the fair value of the instrument affected. Specifically, for listed equity instruments, the accounting policy considers that a decline in value is prolonged when the fair value of the instrument has remained below its cost for more than 18 months, and considers that the decline in value is significant when it exceeds 40% of the cost of the instrument.

The amount of the impairment losses on equity instruments carried at cost is the difference between their carrying amount and the present value of the expected future cash flows discounted at the market rate of return for similar securities. These impairment losses are recognised in the consolidated statement of profit or loss for the period in which they arise as a direct reduction of the cost of the financial asset, and the amount of the losses cannot be reversed subsequently, except in the case of sale of the asset.

The Group estimates impairment losses on equity instruments that are investments in jointly controlled entities and associates by comparing their recoverable amount with their carrying amount. These impairment losses are recognised in the consolidated statement of profit or loss for the period in which they arise and subsequent reversals are recognised in the consolidated statement of profit or loss for the period in which the reversal occurs.

In the case of debt and equity instruments classified under "Non-Current Assets and Disposal Groups Classified as Held for Sale", losses previously recognised in consolidated equity are considered to be realised and are recognised in the consolidated statement of profit or loss on the date the assets are so classified.

### *i) Foreign currency accounts*

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

The detail of the equivalent euro value of the total foreign currency assets and liabilities held by the Group at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Assets | Liabilities | Assets | Liabilities |
| US dollar | 251,502 | 122,841 | 209,000 | 192,991 |
| Pound sterling | 3,745 | 4,927 | 4,594 | 5,744 |
| Japanese yen | 50,964 | 12,490 | 53,960 | 4,546 |
| Swiss franc | 19,401 | 953 | 23,361 | 973 |
| Mexican peso | 17,634 | 9,837 | 20,873 | 10,100 |
| Other currencies | 1,297 | 1,922 | 2,778 | 1,979 |
| | **344,543** | **152,970** | **314,566** | **216,333** |

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

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Assets | Liabilities | Assets | Liabilities |
| Financial assets/liabilities held for trading | 2,253 | 2,271 | 678 | 680 |
| Loans and receivables/Financial liabilities at amortised cost | 337,205 | 140,099 | 306,952 | 205,403 |
| Derivatives – hedge accounting | - | 9,837 | - | 10,100 |
| Other | 5,085 | 763 | 6,936 | 150 |
| | **344,543** | **152,970** | **314,566** | **216,333** |

Upon initial recognition, balances receivable and payable denominated in foreign currencies are translated to the functional currency using the spot exchange rate at the recognition date, which is defined as the exchange rate for immediate delivery. Subsequent to initial recognition, foreign currency balances are translated to the functional currency as follows:

1. Monetary assets and liabilities are translated at the closing rate, defined as the average spot exchange rate at the reporting date.

2. Non-monetary items measured at historical cost are translated at the exchange rate at the date of acquisition.

3. Non-monetary items measured at fair value are translated at the exchange rate at the date when the fair value was determined.

4. Income and expenses are translated at the exchange rate at the transaction date. However, an average exchange rate is used for all the transactions carried out in the period, unless there have been significant exchange rate fluctuations. Depreciation and amortisation charges are translated at the exchange rate applied to the related asset.

The exchange differences arising on the translation of balances receivable and payable denominated in foreign currencies are generally recognised in the consolidated statement of profit or loss.

### *j) Recognition of income and expenses*

Interest income, interest expenses and similar items are generally recognised on an accrual basis using the effective interest method (see Note 14-e). Dividends received from other entities are recognised as income when the right to receive them arises.

Fee and commission income and expenses for financial services, however denoted contractually, are classified in the following categories, which determine their recognition in the consolidated statement of profit or loss:

1. Financial fees and commissions, which are those that are an integral part of the effective yield or cost of a financial transaction, are recognised in the consolidated statement of profit or loss over the expected life of the transaction as an adjustment to the effective yield or cost thereof. These fees and commissions are recognised under "Interest Income" in the consolidated statement of profit or loss. They include most notably origination fees and commissions on means of payment deferrals. The fees and commissions earned in 2017 and 2016 were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Origination fees | 8,938 | 9,692 |
| Means of payment deferral commissions | 11,398 | 12,313 |
| Other fees and commissions | 7,138 | 803 |
| | **27,474** | **22,808** |

2. Non-financial fees and commissions, which are those deriving from the provision of services and may arise from a service provided over a period of time or from a service provided in a single act (see Notes 47 and 48). They are generally recognised in the consolidated statement of profit or loss using the following criteria:

    1. Those relating to financial assets and liabilities measured at fair value through profit or loss are recognised when collected or paid.

    2. Those arising from transactions or services that are performed over a period of time are recognised over the life of these transactions or services.

    3. Those relating to a transaction or service performed in a single act are recognised when the single act is carried out.

Non-finance income and expenses are recognised for accounting purposes on an accrual basis. Deferred collections and payments are recognised for accounting purposes at the amount resulting from discounting the expected cash flows at market rates.

### *k) Offsetting*

Asset and liability balances are reported in the consolidated balance sheet at their net amount when they arise from transactions in which a contractual or legal right of set-off exists and the Group intends to settle them on a net basis, or to realise the asset and settle the liability simultaneously.

### *l) Guarantees given*

Guarantees given are defined as contracts whereby the Group undertakes to make specific payments on behalf of a third party if the latter fails to do so, irrespective of the various legal forms they may have, such as guarantees and irrevocable documentary credits issued or confirmed by the Group.

Guarantees are recognised under "Financial Liabilities at Amortised Cost - Other Financial Liabilities" in the consolidated balance sheet at their fair value which, on initial recognition and in the absence of evidence to the contrary, is the present value of the cash flows to be received, and, simultaneously, the present value of the future cash flows receivable is recognised in assets under "Loans and Receivables" using an interest rate similar to that of the financial assets granted by the Bank with a similar term and risk. Subsequent to initial recognition, the value of the contracts recognised under "Loans and Receivables" is discounted and the differences are recorded as finance income in the consolidated statement of profit or loss, and the fair value of the guarantees recognised under "Financial Liabilities at Amortised Cost" is allocated to the consolidated statement of profit or loss as fee and commission income on a straight-line basis over the expected life of the guarantee.

Guarantees given are classified on the basis of the insolvency risk attributable to the customer or to the transaction and, if appropriate, the Group considers whether provisions for these guarantees should be made, using criteria similar to those described in Note 14-h for debt instruments carried at amortised cost.

The provisions made for guarantees given are recognised under "Provisions - Commitments and Guarantees Given" on the liability side of the consolidated balance sheet (see Note 35). The additions to these provisions and the provisions reversed are recognised under "Provisions or Reversal of Provisions" in the consolidated statement of profit or loss.

If a provision is required for these guarantees given, the unearned commissions recognised under "Financial Liabilities at Amortised Cost - Other Financial Liabilities" on the liability side of the consolidated balance sheet are reclassified to the appropriate provision.

### *m) Leases*

Lease agreements are presented in the consolidated financial statements on the basis of the economic substance of the transaction, regardless of its legal form, and are classified from inception as finance or operating leases.

1. A lease is classified as a finance lease when it transfers substantially all the risks and rewards incidental to ownership of the leased asset.

   When the Group acts as the lessor of an asset, the sum of the present value of the lease payments receivable from the lessee and the guaranteed residual value (which is generally the exercise price of the lessee's purchase option at the end of the lease term) is recognised as lending to third parties and is therefore included under "Loans and Receivables" in the consolidated balance sheet based on the type of lessee.

   When the Group acts as the lessee, it presents the cost of the leased assets in the consolidated balance sheet, based on the nature of the leased asset, and, simultaneously, recognises a liability for the same amount (which is the lower of the fair value of the leased asset and the sum of the present value of the lease payments payable to the lessor plus, if appropriate, the exercise price of the purchase option). The depreciation policy for these assets is consistent with that for property, plant and equipment for own use.

   The finance income and finance charges arising under finance lease agreements are credited and debited, respectively, to "Interest Income" and "Interest Expenses", respectively, in the consolidated statement of profit or loss so as to reflect a constant periodic rate of return over the lease term.

2. Leases other than finance leases are classified as operating leases.

   When the Group acts as the lessor, it recognises the acquisition cost of the leased assets under “Tangible Assets” in the consolidated balance sheet. The depreciation policy for these assets is consistent with that for similar items of property, plant and equipment for own use, and income from operating leases is recognised in the consolidated statement of profit or loss on a straight-line basis.

   When the Group acts as the lessee, lease expenses, including any incentives granted by the lessor, are charged to “Other Administrative Expenses” in the consolidated statement of profit or loss on a straight-line basis.

***n) Assets under management***

The Group includes in memorandum items the fair value of funds entrusted by third parties for investment in investment companies, investment funds, pension funds, savings insurance contracts and discretionary portfolio management contracts, and it makes a distinction between the funds managed by the Group and those marketed by the Group but managed by third parties.

These investment and pension funds managed by the consolidated entities are not presented on the face of the Group's consolidated balance sheet since the related assets are owned by third parties.

The Group also recognises in memorandum items, at fair value or at cost if there is no reliable estimate of fair value, the assets acquired in the name of the Group for the account of third parties and the debt securities, equity instruments, derivatives and other financial instruments held on deposit, as collateral or on consignment at the Group for which it is liable to third parties.

Management fees are included under “Fee and Commission Income” in the consolidated statement of profit or loss (see Note 47). Information on third-party assets managed by the Group at 31 December 2017 and 2016 is disclosed in Note 66.

***o) Staff costs and post-employment benefits***

*o.1) Post-employment benefits*

Post-employment benefits are employee benefits that are payable after the completion of employment. Post-employment benefits are classified as defined contribution plans when the Group pays predetermined contributions into a separate entity and will have no legal or constructive obligation to pay further contributions if the separate entity cannot pay the employee benefits relating to the service rendered in the current and prior periods. Post-employment obligations that do not meet the aforementioned conditions are classified as defined benefit plans.

<u>Defined benefit plans</u>

The Group recognises under “Provisions - Pensions and Other Post-Employment Defined Benefit Obligations” on the liability side of the consolidated balance sheet (or under “Other Assets - Other” on the asset side, based on whether the resulting difference is positive or negative) the present value of its defined benefit pension obligations, net, as explained below, of the fair value of the assets qualifying as “plan assets”. If the fair value of the plan assets is higher than the present value of the obligations, the Group measures the asset recognised at the lower of the absolute value of the aforementioned difference and the present value of the cash flows available to the entity in the form of refunds from the plan or reductions in future contributions to the plan.

"Plan assets" are defined as those that are related to certain defined benefit obligations that will be used directly to settle these obligations, and that meet the following conditions: they are not owned by the consolidated entities, but by a legally separate third party that is not a party related to the Group; they are only available to pay or fund post-employment benefits for employees; they cannot be returned to the consolidated entities unless the assets remaining in the plan are sufficient to meet all the benefit obligations of the plan or of the entity to current and former employees, or they are returned to reimburse employee benefits already paid by the Group; and when the assets are held by a post-employment employee benefit entity (or fund), such as a pension fund, they cannot be non-transferable financial instruments issued by the Group.

All the changes in the provision recognised (or the asset, depending on whether the aforementioned difference is positive or negative) are recognised when they occur, as follows:

1. In the consolidated statement of profit or loss: the service cost relating to employee service in the current year and that in prior years not recognised in those years, the net interest on the liability (asset), and any gain or loss on settlement.

2. In the consolidated statement of changes in equity: the remeasurements of the liability (asset) as a result of actuarial gains and losses, the return on plan assets excluding amounts included in net interest on the liability (asset), and changes in the present value of the asset as a result of changes in the present value of the cash flows available to the entity, excluding amounts included in net interest on the liability (asset). The amounts recognised in the consolidated statement of changes in equity are not reclassified to the consolidated statement of profit or loss in future years.

   The net interest on the liability (or on the asset, as appropriate) is determined by multiplying the net liability (asset) by the discount rate used to estimate the present value of the benefit obligations determined at the start of the annual reporting period, taking account of any changes in the net liability (asset). Net interest comprises interest income on plan assets, interest cost on the obligation and interest resulting from measuring, as the case may be, the plan assets at the present value of the cash flows available to the entity in the form of refunds from the plan or reductions in future contributions to the plan.

Defined benefit plans are recognised as follows:

a) Service cost is recognised in the consolidated statement of profit or loss and includes the following items:

   - Current service cost, which is the increase in the present value of the obligation resulting from employee service in the current period, is recognised under "Staff Costs".
   - Past service cost, which arises from changes to existing post-employment benefits or from the introduction of new benefits and includes the cost of curtailments, is recognised under "Provisions or Reversal of Provisions".
   - Any gain or loss on settlement of the plan is recognised under "Provisions or Reversal of Provisions".

b) Net interest on the net defined benefit liability (asset), i.e. the change during the period in the net defined benefit liability (asset) that arises from the passage of time, is recognised under "Interest Expenses" ("Interest Income" if it is income) in the consolidated statement of profit or loss.

Following is a summary, by originating entity, of the defined benefit obligations assumed by the Group. By virtue of the Parent’s collective agreement in force, each group of employees from BBK, Kutxa and Caja Vital maintains the coverage regime that was in force at their original entity on this matter before this collective agreement was entered into.

*Obligations to employees from BBK*

Under the collective agreement in force, the Group has undertaken to supplement the social security benefits accruing to employees retired at 31 July 1996 and, from that date, to the possible beneficiaries of disability benefits and of surviving spouse or surviving child benefits in the event of death of current employees.

In order to externalise its obligations in this connection, in 1990 BBK fostered the formation of Voluntary Community Welfare Entities (EPSVs), governed by Law 25/1983, of 27 October, of the Basque Parliament, and by Decree 87/1984, of 20 February, of the Basque Government, so that these entities would settle the employee benefit obligations in the future.

*Obligations to employees from Kutxa*

Under the collective agreement in force, the Group has a defined benefit obligation in the event of disability or death of current employees (surviving spouse and surviving child benefits), and defined benefit obligations for the employees who had retired at 18 October 1994. These obligations are covered by various Voluntary Community Welfare Entities (EPSVs).

*Obligations to employees from Caja Vital*

Under the collective agreement in force, amended in matters relating to the social welfare scheme by the agreement entered into by Caja Vital with its Works Council on 25 October 1996, the Group has undertaken to supplement the social security benefits accruing to the Group's employees who had taken retirement, early retirement or pre-retirement at 25 October 1996 and, from that date, to the possible beneficiaries of disability benefits and of surviving spouse or surviving child benefits in the event of death of current employees.

In order to externalise its pension obligations to current and retired employees, Caja Vital fostered the formation of four Voluntary Community Welfare Entities (EPSVs), each with a separate group of employees.

*Obligations to employees from CajaSur Banco*

In October 2000 the former CajaSur offered certain employees the possibility of retiring before reaching the age stipulated in the collective agreement in force, and externalised the obligations generated.

In addition, the former CajaSur externalised its vested pension obligations to the majority of its retired employees at the end of 2000, and its vested pension obligations to certain retired employees at the end of 2001.

These three obligations were externalised by taking out three insurance policies with CajaSur Entidad de Seguros y Reaseguros, S.A., which take the form of a defined benefit plan. Since 30 June 2011, this plan has been managed by Kutxabank Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.

Additional information on these obligations is detailed in Note 35.

Defined contribution plans

The Group has an obligation vis-à-vis certain employees to make annual contributions to various defined contribution plans, implemented through various EPSVs and pensions funds. The amount of these obligations is established as a percentage of certain remuneration items and/or a pre-determined fixed amount. The contributions made by the Group in each period to cover these obligations are recognised with a charge to "Staff Costs - Contributions to External Defined Contribution Pension Plans" in the consolidated statements of profit or loss (see Note 56).

Other post-employment obligations

The Group has assumed certain obligations to its employees, relating to remuneration in kind of various types, which will be settled after the completion of their employment. These obligations are covered by internal provisions which are recognised under "Provisions - Pensions and Other Post-Employment Defined Benefit Obligations" in the accompanying consolidated balance sheet. Additional information on these obligations is detailed in Note 35.

*o.2) Other long-term employee benefits*

These obligations are accounted for, as applicable, using the same criteria as those explained above for defined benefit obligations, except that changes in the value of the liability (asset) resulting from actuarial gains or losses are recognised in the consolidated statement of profit or loss for the year.

Following is a summary, by originating entity, of these obligations assumed by the Group.

*Obligations to employees from Kutxabank*

Early retirements

A labour agreement with the main trade union representatives, which took effect on 1 January 2012, provides for a partial retirement or pre-retirement plan, on a voluntary basis, for all serving Kutxabank employees at 31 December 2011 who meet the conditions included in the agreement, provided that their length of service is at least ten years on the date of taking pre-retirement. On 13 May 2013 and 4 November 2015, following two new agreements between a majority of the employees' representatives and the Group, the number of employees entitled to participate in the aforementioned pre-retirement plan was increased and the condition that participating employees' length of service must be at least ten years on the date of taking pre-retirement was maintained. Also, on 24 January and 1 December 2017 it was decided to extend the group of eligible plan employees, with the conditions mentioned above being maintained. The Group recognised the total estimated cost of these agreements, amounting to EUR 119,858 thousand (2016: EUR 42,557 thousand), under "Provisions - Pensions and Other Post-Employment Defined Benefit Obligations" on the liability side of the consolidated balance sheet (see Note 35).

Other long-term obligations

The Group has recognised certain provisions to cover potential welfare benefit obligations to current employees. The related provisions, amounting to EUR 45,700 thousand at 31 December 2017 (31 December 2016: EUR 50,659 thousand), are included under "Provisions - Other Long-Term Employee Benefits" in the consolidated balance sheet (see Note 35).

*Obligations to employees from BBK*

The Group has obligations arising from agreements which may be classified as other long-term benefits. Accordingly, the Group has recognised provisions to cover these obligations (see Note 35).

Death and disability

The cost of the Group's obligations in the event of death or disability of current employees was quantified by an independent actuary. These obligations, which were externalised to EPSVs, amounted to EUR 5,626 thousand in 2017 (2016: EUR 6,785 thousand).

Early retirements

These provisions, for which no amount was recognised at 31 December 2017 (31 December 2016: EUR 48 thousand), are included under "Provisions - Pensions and Other Post-Employment Defined Benefit Obligations" in the consolidated balance sheet (see Note 35).

*Obligations to employees from Kutxa*

Death and disability

The cost of the Group's obligations in the event of death or disability of current employees was quantified by an independent actuary. These obligations, which were externalised to EPSVs, amounted to EUR 4,308 thousand in 2017 (2016: EUR 5,176 thousand).

Early retirements

In order to reduce the average age of the workforce, the Group has an indefinite leave and partial retirement plan for employees aged over 57. Each indefinite leave or partial retirement agreement must be requested by the employee and approved by the Group. The Group is only obliged to pay employees who have availed themselves of the partial retirement plan a percentage of their salary in proportion to the hours actually worked. In the case of employees who have availed themselves of the "paid leave of absence" plan, the Group has undertaken to pay the agreed amounts until the date of retirement or partial retirement, as appropriate.

The Group recognised the present value of its obligations to these employees until their date of retirement, amounting to EUR 442 thousand at 31 December 2017 (31 December 2016: EUR 3,838 thousand) under "Provisions - Pensions and Other Post-Employment Defined Benefit Obligations" in the accompanying consolidated balance sheet.

*Obligations to employees from Caja Vital*

Obligations in the event of death or disability of current employees

The cost of the Group's obligations in the event of death or disability of current employees was quantified by an independent actuary. These obligations, which were externalised to EPSVs, amounted to EUR 1,021 thousand in 2017 (2016: EUR 1,303 thousand).

*Obligations to employees from CajaSur Banco*

Pre-retirements

On 18 March 2016, a labour agreement was entered into whereby CajaSur Banco offered some of its employees, among other measures, the possibility of voluntarily suspending their employment contract for a period of two years, or participating in a pre-retirement agreement up to the date on which the employee can take early retirement.

Also, on 14 July 2017 CajaSur Banco decided to offer pre-retirement to current employees with ten or more years of service at the bank at that date who were born in 1960 and had not received a pre-retirement offer previously. This offer was also extended to the members of the employee group whose employment contracts had been temporarily suspended at that date by virtue of the temporary workforce restructuring agreement entered into on 18 March 2016 (see Note 14-o.4). This offer was accepted by a total of 40 employees.

The Group recognised the present value of the obligations assumed, amounting to EUR 42,449 thousand at 31 December 2017 (31 December 2016: EUR 35,596 thousand) under "Provisions - Pensions and Other Post-Employment Defined Benefit Obligations" in the accompanying consolidated balance sheet.

Additionally, the Group has insured a portion of the contributions to the defined contribution plans for pre-retired employees through the arrangement or renewal of an insurance policy with Caser, Seguros y Reaseguros, S.A. The related obligations totalled EUR 1,140 thousand at 31 December 2017 (31 December 2016: EUR 1,416 thousand). The following actuarial assumptions were used to calculate the amount of the policy: PERM/F-2000P mortality tables; a discount rate based on the return on the plan assets; and a policy salary increase rate of 2%, reviewable each year based on the CPI.

Death and disability

The Group's obligations in the event of death or disability of current employees of CajaSur Banco, which are covered by insurance policies taken out with Kutxabank Seguros, are recognised in the consolidated statement of profit or loss at the amount of the related insurance policy premiums accrued in each year.

The amount accrued in connection with these insurance policies in 2017, which is recognised under "Staff Costs" in the consolidated statement of profit or loss, was EUR 161 thousand (2016: EUR 179 thousand).

Long-service bonuses

The Group recognised the present value of these obligations, amounting to EUR 6,692 thousand (2016: EUR 6,533 thousand), under "Provisions - Other Long-Term Employee Benefits" on the liability side of the consolidated balance sheet.

*o.3) Termination benefits*

Under current legislation, the Group is required to pay termination benefits to employees terminated without just cause. With regard to senior executive employment contracts, the amount of the agreed termination benefit is charged to the consolidated statement of profit or loss when the decision to terminate the contract is taken and notified to the person concerned. No amount was recognised in connection with termination benefits to senior executives in 2017 or 2016.

The State Aid Procedure for the Restructuring of CajaSur Banco approved by the European Commission establishes as a necessary condition for receiving the promised aid that CajaSur Banco must undertake a restructuring process involving the reduction of the installed capacity and, accordingly, an adjustment of operating costs to ensure the viability of the business plan.

The agreement relating to the workforce of the financial business was formalised at the beginning of January 2011 through the signing thereof by CajaSur Banco and all of this entity's trade union representatives. The aim of the agreement was to be able to undertake the workforce adjustments required to make the aforementioned entity viable and meet the requirements of the State Aid Procedure mentioned above. This agreement affected the workforce of the financial business and has been implemented using various measures to rightsize the workforce: termination programmes, temporary layoff measures and geographical mobility. The maximum number of employees that could participate in these measures was 668. This agreement expired on 31 December 2015 and 649 people availed themselves of it.

*o.4) Temporary workforce restructuring at CajaSur Banco*

2013 agreement:

On 27 December 2013, an agreement was entered into between CajaSur Banco and all the trade union representatives which, affecting all of the financial institution's workforce, and completed on 31 December 2015, established the following measures:

Voluntary measures:

Voluntary redundancies, temporary layoffs and a 50% reduction of working hours, with the establishment of a maximum limit on the number of employees that could avail themselves of these measures (10% of the workforce) and a mandatory acceptance rate for the Bank (5%).

The employees who participate in the voluntary redundancies will receive a termination benefit of 60 days per year worked, with a minimum amount of 12 months' salary and a maximum amount of 45 months' salary. In the case of termination benefits the amount of which exceeds 24 months' salary, acceptance by the Bank would be required. 16 employees availed themselves of this measure.

The temporary layoffs will have a duration of two years, in which participating employees will receive a voluntary improvement in unemployment benefit equal to 30% of their gross fixed salary remuneration, to be paid in twelve payments per year. On completion of the temporary layoff period, participating employees will be entitled to return to the Bank and take up posts of a similar level to those held by them when they availed themselves of this layoff measure. Eight employees availed themselves of this measure at the end of 2015, of whom seven did so voluntarily and one was terminated for disciplinary reasons.

The voluntary 50% reduction in working hours has a duration of two years, and participating employees receive 50% of their annual gross fixed salary remuneration plus an improvement in unemployment benefit equal to 10% of this amount. 4 employees availed themselves of this measure in 2013.

Universal measures:

10% collective reduction in working hours for a maximum of 1,848 employees with the corresponding 10% reduction in the annual gross fixed salary remuneration over a period of two years.

A group of 299 employees was excluded from this measure, and their working hours were not reduced, due to their specific characteristics and the importance of the functions they perform. The salary of this group of employees will be reduced over a period of two years by between 5% and 7% depending on the annual gross fixed salary of each employee, based on a sliding scale. Also, the agreement established a mechanism applicable as from 2016 permitting the recovery of salary reductions if certain conditions are met.

In 2015, 253 employees excluded themselves from the reduction in working hours measure in order to avail themselves of the salary reduction measure.

Lastly, contributions to the defined contribution retirement pension plan were suspended for the entire workforce in 2015 and 2016. As from 2018 employees would be able to recover these contributions provided that certain conditions are satisfied.

2016 agreement:

Also, on 18 March 2016, an agreement was entered into between CajaSur Banco and all the trade union representatives which, affecting all of the financial institution's workforce, establishes the following measures:

Voluntary measures:

Voluntary redundancies, temporary layoffs and a 50% reduction of working hours, with the establishment of a maximum limit on the number of employees that could avail themselves of these measures (10% of the workforce) and a mandatory acceptance rate for CajaSur Banco (5%).

The employees who participate in the voluntary redundancies will receive a termination benefit of 60 days per year worked, with a minimum amount of 12 months' salary and a maximum amount of 45 months' salary. In the case of termination benefits the amount of which exceeds 24 months' salary, approval by CajaSur Banco will be required. 13 employees availed themselves of this measure.

The temporary layoffs will have a duration of two years, in which participating employees will receive a voluntary improvement in unemployment benefit equal to 30% of their gross fixed salary remuneration, to be paid in twelve payments per year. On completion of the temporary layoff period, participating employees will be entitled to return to CajaSur Banco and take up posts of a similar level to those held by them when they availed themselves of this layoff measure. 37 employees had availed themselves of this measure at the end of 2016.

The voluntary 50% reduction in working hours has a duration of two years, and participating employees receive 50% of their annual gross fixed salary remuneration plus an improvement in unemployment benefit equal to 10% of this amount. Nine employees availed themselves of this measure in 2016.

Universal measures:

Temporary layoffs for 22 working days in 2016 and 20 working days in 2017 for a maximum of 1,400 employees with the corresponding reduction in the annual gross fixed salary remuneration over a period of two years.

A group of 650 employees is excluded from this measure, and their working hours will not be reduced, due to their specific characteristics and the importance of the functions they perform. The salary of this group of employees will be reduced over a period of two years by between 3.5% and 6.5% depending on the annual gross fixed salary of each employee, based on a sliding scale.

Also, the agreement establishes a mechanism applicable as from 2016 permitting the recovery of salary reductions if certain conditions are met.

Lastly, contributions to the defined contribution retirement pension plan were suspended for the entire workforce in 2017. As from 2019 employees will be able to recover these contributions provided that certain conditions are satisfied.

*o.5) Equity-instrument-based employee remuneration*

The Group does not have any equity-instrument-based remuneration systems for its employees.

***p) Income tax***

Income tax is deemed to be an expense and is recognised under "Income Tax" in the consolidated statement of profit or loss, except when it results from a transaction recognised directly in equity, in which case the income tax is recognised directly in equity, or from a business combination in which the deferred tax is recognised as one of its assets or liabilities.

The income tax expense is determined as the tax payable on the taxable profit for the year, after taking account of any changes in that year due to temporary differences and to tax credit and tax loss carryforwards. The taxable profit for the year may differ from the consolidated net profit for the year reported in the consolidated statement of profit or loss due to differences between the criteria established in tax and accounting rules.

Deferred tax assets and liabilities are taxes expected to be recoverable or payable on differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases. Deferred tax assets and liabilities are recognised in the consolidated balance sheet and are measured by applying to the related temporary difference or tax credit the tax rate that is expected to apply in the period when the asset is realised or the liability is settled.

A deferred tax asset, such as prepaid tax, a tax credit carryforward or a tax loss carryforward, is recognised to the extent that it is probable that the Group will obtain sufficient future taxable profit against which the deferred tax asset can be utilised. It is considered probable that the Group will obtain sufficient taxable profit in the future in the following cases, among others:

1. There are deferred tax liabilities settleable in the same year as that in which the deferred tax asset is expected to be realised, or in a subsequent year in which the existing tax loss or that arising from the deferred tax asset can be offset.

2. The tax losses resulted from identifiable causes which are unlikely to recur.

However, deferred tax assets are not recognised if they arise from the initial recognition of an asset or liability, other than in a business combination, that at the time of recognition affects neither accounting profit nor taxable profit (tax loss).

Deferred tax liabilities are always recognised except when they arise from the initial recognition of goodwill. Furthermore, a deferred tax liability is not recognised if it arises from the initial recognition of an asset or liability, other than in a business combination, that at the time of recognition affects neither accounting profit nor taxable profit (tax loss).

The deferred tax assets and liabilities recognised are reassessed at each reporting date in order to ascertain whether they still exist, and the appropriate adjustments are made.

***q) Tangible assets***

Tangible assets for own use relate to the property, plant and equipment which are intended to be held for continuing use by the Group and the property, plant and equipment acquired under finance leases. They are measured at acquisition cost less the related accumulated depreciation and any estimated impairment losses (carrying amount higher than recoverable amount). The acquisition cost of certain unrestricted items of tangible assets for own use includes their fair value at 1 January 2004, which was determined on the basis of appraisals performed by independent experts.

Depreciation is systematically calculated using the straight-line method by applying the years of estimated useful life of the various items to the acquisition cost of the assets less their residual value. The land on which the buildings and other structures stand is deemed to have an indefinite life and, therefore, is not depreciated. The Parent's period tangible asset depreciation charge is recognised in the consolidated statement of profit or loss and is calculated on the basis of the following average years of estimated useful life of the various classes of assets:

| | Years of estimated useful life |
|---|---|
| Property for own use | 33 to 50 |
| IT equipment | 4 |
| Furniture, fixtures and other | 5 to 7 |

The Group assesses at each reporting date whether there is any internal or external indication that its tangible assets may be impaired (i.e. their carrying amount exceeds their recoverable amount). If this is the case, the Group reduces the carrying amount of the asset to its recoverable amount and adjusts the future depreciation charges in proportion to the revised carrying amount and to the new remaining useful life (if the useful life has to be re-estimated). Also, if there is an indication of a recovery in the value of a tangible asset, the Group recognises the reversal of the impairment loss recognised in prior periods and adjusts the future depreciation charges accordingly. In no circumstances may the reversal of an impairment loss on an asset raise its carrying amount above that which it would have if no impairment losses had been recognised in prior years. This reduction of the carrying amount of tangible assets for own use and the related reversal are recognised, if necessary, with a charge or credit, respectively, to "Impairment or Reversal of Impairment on Non-Financial Assets - Tangible Assets" in the consolidated statement of profit or loss.

The Group reviews the estimated useful lives of the tangible assets for own use at least at the end of each reporting period with a view to detecting significant changes therein. If changes are detected, the useful lives of the assets are adjusted by correcting the depreciation charge to be recognised in the consolidated statement of profit or loss in future years on the basis of the new useful lives.

Upkeep and maintenance expenses relating to the tangible assets for own use are recognised in the consolidated statement of profit or loss for the period in which they are incurred.

Tangible assets that necessarily take a period of more than twelve months to get ready for their intended use include as part of their acquisition or production cost such borrowing costs as might have been incurred before the assets are ready for their intended use and which have been charged by the supplier or relate to loans or other types of borrowings directly attributable to their acquisition, production or construction. Capitalisation of borrowing costs is suspended, if appropriate, during periods in which the development of the assets is interrupted, and ceases when substantially all the activities necessary to prepare the asset for its intended use are complete.

Investment property under "Tangible Assets" reflects the net values of the land, buildings and other structures held by the Group either to earn rentals or for capital appreciation.

The criteria used to recognise the acquisition cost of investment property, to calculate its depreciation and its estimated useful life and to recognise any impairment losses thereon are consistent with those described above in relation to the tangible assets for own use.

"Tangible Assets - Property, Plant and Equipment - Leased Out under an Operating Lease" relates to the net values of the tangible assets, other than land and buildings, leased out by the Group under an operating lease.

The criteria used to recognise the acquisition cost of the leased-out assets, to calculate their depreciation and their respective estimated useful lives and to recognise any impairment losses thereon are consistent with those described in relation to the tangible assets for own use.

Bizkaia Regulatory Decree 11/2012, of 18 December, on asset revaluation was published on 28 December 2012. Under this tax legislation, companies may revalue their assets for tax purposes. Pursuant to this legislation, the Parent revalued the tax base of a portion of its assets following the approval of its adoption of this measure, granted by the General Meeting of the Parent on 27 June 2013. Accordingly, in conformity with the aforementioned regulatory decree, the Parent created the "Revaluation Reserve Bizkaia Regulatory Decree 11/2012", effective from 1 January 2013, amounting to EUR 51,685 thousand (see Note 37).

The implications of this regulatory decree are that the increase in the tax base of the revalued assets has a maximum limit of the fair value of these assets and it will be deductible in the annual reporting periods beginning after 1 January 2015. As a result of the aforementioned revaluation, in July 2013 the Parent paid a single levy of EUR 2,720 thousand, i.e. 5% of the revalued amount, without changing the value of the non-current assets.

Note 40 to these consolidated financial statements includes additional information on the aforementioned asset revaluation.

### r) *Intangible assets*

Intangible assets are identifiable non-monetary assets without physical substance. Intangible assets are deemed to be identifiable when they are separable from other assets because they can be sold, rented or disposed of individually or when they arise from a contractual or other legal right. An intangible asset is recognised when, in addition to meeting the aforementioned definition, the Group considers it probable that the economic benefits attributable to the asset will flow to the Group and its cost can be measured reliably.

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

Goodwill represents a payment made by the Group in anticipation of future economic benefits from assets of the acquired entity that are not capable of being individually identified and separately recognised and is only recognised when it has been acquired for consideration in a business combination.

Any excess of the cost of the investments in subsidiaries, jointly controlled entities and associates over the corresponding underlying carrying amounts acquired, adjusted at the date of first-time consolidation, is allocated as follows:

1. If it is attributable to specific assets and liabilities of the entities acquired, by increasing the value of the assets or reducing the value of the liabilities whose market values were higher or lower, respectively, than the carrying amounts at which they had been recognised in their balance sheets and whose accounting treatment was similar to that of the same assets or liabilities, respectively, of the Group.

2. If it is attributable to specific intangible assets, by recognising it explicitly in the consolidated balance sheet provided that the fair value of these assets at the date of acquisition can be measured reliably.

3. The remaining unallocable amount is recognised as goodwill, which is allocated to one or more specific cash-generating units.

Goodwill is measured at acquisition cost. At the end of each reporting period, the Group reviews goodwill for impairment (i.e. a reduction in its recoverable amount to below its carrying amount) and, if there is any impairment, the goodwill is written down with a charge to “Impairment or Reversal of Impairment on Non-Financial Assets - Intangible Assets” in the consolidated statement of profit or loss. An impairment loss recognised for goodwill cannot be reversed in a subsequent period.

Goodwill is allocated to one or more cash-generating units that are expected to benefit from the synergies of the business combinations. Cash-generating units are the smallest identifiable groups of assets that generate cash inflows for the Group that are largely independent of the cash inflows from the Group's other assets or groups of assets. Each unit to which goodwill is allocated:

- Represents the lowest level within the entity at which goodwill is monitored for internal management purposes.
- Is not larger than a business segment.

The cash-generating units to which goodwill has been allocated are tested for impairment (the allocated portion of goodwill is included in their carrying amount). This test is performed at least annually or whenever there is an indication of impairment.

For the purposes of performing the impairment test, the carrying amount of the cash-generating unit is compared with its recoverable amount. Recoverable amount is calculated as the sum of a static valuation and a dynamic valuation. The static valuation quantifies the entity's value based on its equity position and existing gains and losses while the dynamic valuation quantifies the discounted value of the Group's estimated cash flow projections for a projection period of five years (until 2022) plus a calculation of the residual value using a perpetuity growth rate. The variables on which these projections are based are a reduction in the asset and liability margins in the banking industry and the distribution of a portion of earnings to strengthen capital adequacy levels.

The goodwill recognised at 31 December 2017 was allocated to the Retail and Corporate Banking cash-generating unit of CajaSur Banco, which includes retail and business banking and excludes the property business. The capital requirement of the cash-generating unit was considered to be 11.70% (10.5% in 2016). The discount rate used to discount cash flows is the cost of capital allocated to the cash-generating unit, which is around 6.48% (8% for Tier 1 capital and between 2% and 4% for the hybrid instruments required to meet the capital requirements), and is composed of a risk-free rate plus a premium that reflects the inherent risks of the business unit assessed (a discount rate of 6.75% in 2016 - 8% for Tier 1 capital and between 4% and 8% for the hybrid instruments). The sustainable growth rate used to extrapolate cash flows to perpetuity is around 1% (2016: 1.0%).

Using these assumptions, the excess of the recoverable amount over the carrying amount of goodwill would be EUR 881 million (2016: EUR 425 million). If the discount rate had been increased or decreased by 50 basis points, the excess of the recoverable amount over the carrying amount would have decreased or increased by EUR 151 million or EUR 182 million, respectively (2016: EUR 93 million or EUR 111 million, respectively). If the growth rate had been increased or decreased by 50 basis points, the excess of the recoverable amount over the carrying amount would have increased or decreased by EUR 144 million or EUR 120 million, respectively (2016: EUR 87 million or EUR 73 million, respectively). The Group conducts an additional sensitivity analysis which addresses the convergence of the levels of its public debt portfolio with those of comparable financial institutions, which would increase the excess of the recoverable amount by EUR 501 million.

Any deficiency of the cost of investments in subsidiaries, jointly controlled entities and associates below the related underlying carrying amounts acquired, adjusted at the date of first-time consolidation, is allocated as follows:

1. If it is attributable to specific assets and liabilities of the entities acquired, by increasing the value of the liabilities or reducing the value of the assets whose market values were higher or lower, respectively, than the carrying amounts at which they had been recognised in their balance sheets and whose accounting treatment was similar to that of the same assets or liabilities, respectively, of the Group.

2. The remaining unallocable amount is recognised under "Negative Goodwill Recognised in Profit or Loss" in the consolidated statement of profit or loss for the year in which the share capital is acquired.

Other intangible assets can have an indefinite useful life -when, based on an analysis of all the relevant factors, it is concluded that there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group- or a finite useful life. Intangible assets with indefinite useful lives are not amortised, but rather at the end of each reporting period the Group reviews the remaining useful lives of the assets. Intangible assets with finite useful lives are amortised over those useful lives, which range from three to four years, using methods similar to those used to depreciate tangible assets.

In either case the Group recognises any impairment loss on the carrying amount of these assets with a charge to the consolidated statement of profit or loss. The criteria used to recognise the impairment losses on these assets and, where applicable, the reversal of impairment losses recognised in prior years are similar to those used for tangible assets.

### *s) Provisions and contingent liabilities*

Provisions are present obligations of the Group arising from past events whose nature is clearly specified at the reporting date but whose amount or timing is uncertain and that the Group expects to settle on maturity through an outflow of resources embodying economic benefits. These obligations may arise from:

1. A legal or contractual requirement.

2. An implicit or tacit obligation arising from valid expectations created by the Group on the part of third parties that it will discharge certain responsibilities. Such expectations are created when the Group publicly accepts responsibilities, or derive from a pattern of past practice or from published business policies.

3. Virtual certainty as to the future course of regulation in particular respects, especially proposed new legislation that the Group cannot avoid.

Contingent liabilities are possible obligations of the Group that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more future events not wholly within the control of the Group. Contingent liabilities include present obligations of the Group when it is not probable that an outflow of resources embodying economic benefits will be required to settle them or when, in extremely rare cases, their amount cannot be measured with sufficient reliability.

Provisions and contingent liabilities are classified as probable when it is more likely than not that a present obligation exists; as possible when it is more likely than not that no present obligation exists; and as remote when it is extremely unlikely that a present obligation will exist.

The Group’s consolidated financial statements include all the material provisions and contingent liabilities with respect to which it is considered that it is more likely than not that the obligation will have to be settled. Contingent liabilities classified as possible are not recognised in the consolidated financial statements, but rather are disclosed, unless the possibility of an outflow of resources embodying economic benefits is considered to be remote.

Provisions are quantified on the basis of the best information available on the consequences of the event giving rise to them and are reviewed at the end of each reporting period. Provisions are used to cater for the specific obligations for which they were recognised and they are fully or partially reversed when such obligations cease to exist or are reduced (see Note 35).

The additions to and release of provisions considered necessary pursuant to the foregoing criteria are recognised with a charge or credit, respectively, to “Provisions or Reversal of Provisions” in the consolidated statement of profit or loss (see Note 59).

### t) *Non-current assets and disposal groups classified as held for sale and Liabilities included in disposal groups classified as held for sale*

"Non-Current Assets and Disposal Groups Classified as Held for Sale" in the consolidated balance sheet includes the carrying amount of individual items, items included in disposal groups or items forming part of a business unit earmarked for disposal ("discontinued operations"), whose sale in their present condition is highly likely to be completed within one year from the reporting date. Investments in jointly controlled entities or associates that meet the aforementioned requirements are also considered to be non-current assets and disposal groups classified as held for sale.

Therefore, the carrying amount of these items -which can be of a financial nature or otherwise- will foreseeably be recovered through the proceeds from their disposal rather than through their continuing use.

Also, property or other non-current assets received by the consolidated entities as total or partial settlement of their debtors' payment obligations to the Group, which are deemed to be "Non-Current Assets and Disposal Groups Classified as Held for Sale", unless the consolidated entities have decided to classify these assets, on the basis of their nature and intended use, as tangible assets for own use, investment property or inventories. Accordingly, at consolidated level the Group recognises the assets received in full or partial satisfaction of payment obligations uniformly under "Non-Current Assets and Disposal Groups Classified as Held for Sale" in the accompanying consolidated balance sheet.

In general, non-current assets and disposal groups classified as held for sale are measured at the lower of their carrying amount calculated as at the classification date, once foreclosed assets and assets received in payment of debts have been treated as collateral, and their fair value less estimated costs to sell. Tangible and intangible assets that are depreciable and amortisable by nature are not depreciated or amortised during the time they remain classified as non-current assets and disposal groups classified as held for sale.

Following foreclosure the asset must be revalued, and this amount will be the basis for the fair value measurement. In measuring the fair value of the asset foreclosed or received in payment of debts the entity will assess whether it is necessary to reduce the value of the asset due to the specific conditions of the asset itself, such as its location or state of repair, or of the market for similar assets, such as decreases in the volume or level of activity. In this assessment the entity will take into consideration its experience of sales and the average time similar assets have remained on the balance sheet.

If the carrying amount of the assets exceeds their fair value less costs to sell, the Group adjusts the carrying amount of the assets by the amount of the excess with a charge to "Profit or Loss from Non-Current Assets and Disposal Groups Classified as Held for Sale Not Qualifying as Discontinued Operations" in the consolidated statement of profit or loss. If the fair value of such assets subsequently increases, the Group reverses the losses previously recognised and increases the carrying amount of the assets without exceeding the carrying amount prior to the impairment, with a credit to "Profit or Loss from Non-Current Assets and Disposal Groups Classified as Held for Sale Not Qualifying as Discontinued Operations" in the consolidated statement of profit or loss.

Gains or losses on the sale of non-current assets and disposal groups classified as held for sale are recognised under "Profit or Loss from Non-Current Assets and Disposal Groups Classified as Held for Sale Not Qualifying as Discontinued Operations" in the consolidated statement of profit or loss.

"Liabilities Included in Disposal Groups Classified as Held for Sale" includes the balances payable associated with disposal groups and with the Group's discontinued operations. At 31 December 2017 and 2016, no amounts had been recognised under "Liabilities Included in Disposal Groups Classified as Held for Sale".

## u) Inventories

Inventories are non-financial assets held for sale in the ordinary course of business, in the process of production, construction or development for such sale, or to be consumed in the production process or in the rendering of services. Consequently, inventories include the land and other property held for sale in the Group's property development activity.

Inventories are measured at the lower of cost and net realisable value. Cost comprises all the costs of purchase, costs of conversion and other direct and indirect costs incurred in bringing the inventories to their present location and condition, as well as the borrowing costs that are directly attributable to them, provided the inventories require more than one year to be sold, taking into account the criteria described above for capitalising borrowing costs of property, plant and equipment for own use. Net realisable value is the estimated selling price of the inventories in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

The cost of inventories that are not ordinarily interchangeable and of goods or services produced and segregated for specific projects is determined by identifying their individual costs, and the cost of other inventories is assigned by using the weighted average cost formula.

The amount of any write-downs of inventories to net realisable value -such as those due to damage, obsolescence or reduction of the selling price- and other losses are recognised as an expense in the consolidated statement of profit or loss for the year in which the write-down or loss occurs. Subsequent reversals are recognised in the consolidated statement of profit or loss for the year in which they occur. Any write-downs of the carrying amount of inventories to net realisable value and any subsequent reversals of write-downs are recognised under "Impairment or Reversal of Impairment on Non-Financial Assets - Other" in the consolidated statement of profit or loss.

Income from sales is recognised under "Other Operating Income" when the significant risks and rewards inherent to ownership of the asset sold have been transferred to the buyer, and the Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the asset sold.

The carrying amount of inventories is derecognised, and recognised as an expense in the consolidated statement of profit or loss, in the year in which the revenue from their sale is recognised. This expense is included under "Other Operating Expenses" in the consolidated statement of profit or loss.

## v) Insurance transactions

In accordance with standard accounting practice in the insurance industry, the consolidated insurance entities credit the amounts of premiums to income when the related insurance policies are issued and charge to income the cost of claims on settlement thereof. Insurance entities are therefore required to accrue at period-end the unearned revenues credited to their statements of profit or loss and the accrued costs not charged to income.

The most significant accruals recorded by the consolidated entities in relation to direct insurance contracts arranged by them are included in the following technical provisions:

- **Provision for unearned premiums**: this provision reflects the gross premium written in a year allocable to future years, less the loading for contingencies.

- **Provision for unexpired risks**: this provision supplements the provision for unearned premiums by the amount by which that provision is not sufficient to reflect the assessed risks and expenses to be covered in the policy period not elapsed at the reporting date.

- **Provision for claims outstanding**: this provision reflects the estimated obligations outstanding arising from claims incurred prior to the reporting date -both unsettled or unpaid claims and claims not yet reported-, less payments made on account, taking into consideration the internal and external claim settlement expenses and, where appropriate, any additional provisions required for variances in assessments of claims involving long handling periods.

- **Life insurance provision**: in life insurance policies whose coverage period is one year or less, the provision for unearned premiums reflects the gross premium written in the year which is allocable to future years. If this provision is insufficient, a supplemental provision is calculated for unexpired risks which covers the assessed risks and expenses expected to arise in the policy period not elapsed at the reporting date.

- In life insurance policies whose coverage period is more than one year, the mathematical provision is calculated as the difference between the present actuarial value of the future obligations of the consolidated entities operating in this line of insurance and those of the policyholder or the insured, taking as a basis for calculation the "inventory" premium accrued during the year (i.e. pure premium plus a loading for administrative expenses per the technical bases).

- **Provision for life insurance policies where the investment risk is borne by the policyholder**: this provision is determined on the basis of the assets specifically assigned to determine the value of the rights.

- **Provision for bonuses and rebates:** this provision includes the amount of the bonuses accruing to policyholders, insureds or beneficiaries and the premiums to be returned to policyholders or insureds, based on the behaviour of the risk insured, to the extent that such amounts have not been individually assigned to each of them.

<u>Elimination of accounting mismatches</u>

In insurance transactions that are financially immunised, i.e. whose surrender value is linked to the value of specifically assigned assets, and which are expected to share in the profits generated by an associated asset portfolio, or in the case of insurance transactions in which the policyholder assumes the investment risk or similar risks, the insurance companies recognised symmetrically, through equity or the consolidated statement of profit or loss, the changes in fair value of the assets classified under "Available-for-Sale Financial Assets" and "Financial Assets Designated at Fair Value through Profit or Loss".

The balancing entry for such changes was the provision for life insurance, where required by the private insurance regulations and other applicable legislation, and a liability item (with a positive or negative balance) for the portion not recognised as a life insurance provision.

The technical provisions for reinsurance assumed are determined using criteria similar to those applied for direct insurance and are generally calculated on the basis of the information provided by the cedants.

The technical provisions for direct insurance and reinsurance assumed are recognised in the consolidated balance sheet under "Liabilities under Reinsurance and Insurance Contracts".

The technical provisions for reinsurance ceded -which are calculated on the basis of the reinsurance contracts entered into and by applying the same criteria as those used for direct insurance- are presented in the consolidated balance sheet under "Assets under Insurance and Reinsurance Contracts".

### *w) Business combinations*

A business combination is the bringing together of two or more separate entities or economic units into one single entity or group of entities.

Business combinations performed on or after 1 January 2004 whereby the Group obtains control over an entity or economic unit are recognised for accounting purposes as follows:

- The Group measures the cost of the business combination, defined as the fair value of the assets transferred, the liabilities incurred and the equity instruments issued, if any, by the acquirer.

- The fair values of the assets, liabilities and contingent liabilities of the acquired entity or business, including any intangible assets which might not have been recognised by the acquiree, are estimated and recognised in the consolidated balance sheet.

- Any difference between the net fair value of the assets, liabilities and contingent liabilities of the acquired entity or business and the cost of the business combination is recognised as discussed in Note 14-r.

When shares of a given entity are purchased in stages, until as a result of one such purchase the Group obtains control over the investee ("successive purchases" or "step acquisitions"), the following criteria are applied:

- The cost of the business combination is the aggregate cost of the individual transactions.

- For each of the share purchase transactions performed until control over the acquiree is obtained, goodwill or a gain from a bargain purchase is calculated separately using the criteria described earlier in this Note.

- Any difference between the fair value of the asset and liability items of the acquiree on each of the successive purchase dates and their fair value on the date that control is obtained over the acquiree is recognised as a revaluation of those items under "Revaluation Reserves" in consolidated equity.

The Group did not take part in any significant business combinations in 2017 or 2016.

### *x) Consolidated statement of changes in equity*

The consolidated statement of changes in equity presented in these consolidated financial statements shows the total changes in consolidated equity in the year. This information is in turn presented in two statements: the consolidated statement of comprehensive income and the consolidated statement of changes in equity. The main characteristics of the information contained in the two parts of the statement are explained below:

Consolidated statement of comprehensive income

As indicated above, in accordance with the options provided for by IAS 1, the Group opted to present two separate statements, i.e. a first statement displaying the components of consolidated profit or loss ("consolidated statement of profit or loss") and a second statement which, beginning with consolidated profit or loss for the year, discloses the components of other comprehensive income for the year ("consolidated statement of comprehensive income", using the name contained in Bank of Spain Circular 4/2004).

The consolidated statement of comprehensive income presents the income and expenses generated by the Group as a result of its business activity in the year, and a distinction is made between the income and expenses recognised in the consolidated statement of profit or loss for the year and the other income and expenses recognised, in accordance with current regulations, directly in consolidated equity.

Accordingly, this statement presents:

a) Consolidated profit for the year.

b) The net amount of the income and expenses recognised directly in equity as "Items that Will Not Be Reclassified to Profit or Loss".

c) The net amount of the income and expenses recognised directly in equity as "Items that May Be Reclassified to Profit or Loss".

d) Comprehensive income for the year calculated as the sum of letters a) to c) above.

The amount of the income and expenses relating to entities accounted for using the equity method recognised directly in consolidated equity is presented in this statement, irrespective of the nature of the related items, under "Share of Other Recognised Income and Expense of Investments in Joint Ventures and Associates".

The changes in income and expenses recognised in consolidated equity under "Accumulated Other Comprehensive Income" are broken down as follows:

**a) Gains or (-) losses:** includes the amount of the income, net of the expenses incurred in the year, recognised directly in consolidated equity. The amounts recognised in this line item in the year remain there, even if in the same year they are transferred to the consolidated statement of profit or loss, to the initial carrying amount of other assets or liabilities, or are reclassified to another line item.

**b) Transferred to profit or loss**: includes the amount of the revaluation gains and losses previously recognised in consolidated equity, albeit in the same year, which are recognised in the consolidated statement of profit or loss.

**c) Transferred to initial carrying amount of hedged items**: includes the amount of the revaluation gains and losses previously recognised in consolidated equity, albeit in the same year, which are recognised in the initial carrying amount of the assets or liabilities as a result of cash flow hedges.

**d) Other reclassifications**: includes the amount of the transfers made in the year between valuation adjustment items in accordance with current regulations.

The amounts of these items are presented gross and, except as indicated above for the items relating to valuation adjustments of entities accounted for using the equity method, the related tax effect is recognised under "Income Tax" in this statement.

Consolidated statement of changes in equity

The consolidated statement of changes in equity presents all the changes in consolidated equity, including those arising from changes in accounting policies and from the correction of errors. Accordingly, this statement presents a reconciliation of the carrying amount at the beginning and end of the year of all the consolidated equity items, and the changes are grouped together on the basis of their nature into the following items:

**a) Effects of corrections of errors and of changes in accounting policies**: include the changes in consolidated equity arising as a result of the retrospective restatement of the balances in the consolidated financial statements due to changes in accounting policies or to the correction of errors.

**b) Total comprehensive income for the year**: includes, in aggregate form, the total of the aforementioned items recognised in the consolidated statement of comprehensive income.

c) **Other changes in equity**: includes the remaining items recognised in consolidated equity, including, inter alia, increases and decreases in share capital, distribution of profit, transactions involving own equity instruments, equity-instrument-based payments, transfers between consolidated equity items and any other increases or decreases in consolidated equity.

***y) Consolidated statement of cash flows***

The following terms are used in the consolidated statement of cash flows with the meanings specified:

1. **Cash flows**: inflows and outflows of cash and cash equivalents. Cash equivalents are deemed to be short-term, highly liquid investments that are subject to an insignificant risk of changes in value, irrespective of the portfolio in which they are classified -such as balances with central banks, short-term treasury bills and demand balances with other credit institutions-, and, only when they form an integral part of cash management, bank overdrafts repayable on demand, which will reduce the amount of cash and cash equivalents.

2. **Operating activities**: the principal revenue-producing activities of the Group and other activities that are not investing or financing activities. Operating activities also include interest paid on any financing received, even if this financing is considered to be a financing activity. Activities performed with the various financial instrument categories detailed in Notes 14-e and 14-f above are classified, for the purposes of this statement, as operating activities, except for held-to-maturity investments, subordinated financial liabilities and investments in equity instruments classified as available for sale which are strategic investments. For these purposes, a strategic investment is that made with the intention of establishing or maintaining a long-term operating relationship with the investee, since, among other things, one of the circumstances that could determine the existence of significant influence prevails, even though significant influence does not actually exist.

3. **Investing activities:** the acquisition and disposal of non-current assets and other investments not included in cash and cash equivalents, such as tangible assets, intangible assets, investments in jointly controlled entities and associates, non-current assets and disposal groups classified as held for sale, equity instruments classified as available for sale which are strategic investments and financial assets included in held-to-maturity investments.

4. **Financing activities:** activities that result in changes in the size and composition of the consolidated equity and liabilities and which are not operating activities, such as subordinated liabilities.

For the purposes of preparing the consolidated statement of cash flows, "cash and cash equivalents" were considered to be short-term, highly liquid investments that are subject to an insignificant risk of changes in value. Accordingly, the Group considers the items recognised under "Cash, Cash Balances at Central Banks and Other Demand Deposits" in the consolidated balance sheet to be cash and cash equivalents. The cash held by the Group at 31 December 2017 amounted to EUR 4,407,638 thousand (31 December 2016: EUR 1,481,508 thousand).

## 15. Customer care

Article 17 of Ministry of Economy Order ECO/734/2004, of 11 March, on Customer Care Departments and Services and the Customer Ombudsmen of Financial Institutions ("Order ECO/734/2004") requires customer care departments and services and, where appropriate, customer ombudsmen to submit to the Board of Directors or equivalent governing body, within the first quarter of each year, a report explaining the functions performed by them in the previous year.

In conformity with Article 17 of the aforementioned Order, the Annual Report on the Group's Customer Care Service ("SAC") was prepared, a summary of which is presented below:

**Quantitative summary of the claims and complaints filed with the Service**

10,367 claims and complaints relating to the Kutxabank Group were filed by customers with the SAC in 2017 (2016: 6,696), of which 10,305 (2016: 6,666) were admitted for consideration, of which 6,835 (2016: 3,784) were resolved in favour of the Bank and 2,000 (2016: 1,871) were resolved in favour of customers.

The detail, by reason, of the claims and complaints filed is as follows:

| | 2017 | 2016 |
|---|---|---|
| Quality, ex-ante dissatisfaction with the service (information and advice) | 2.36% | 4.80% |
| Quality, ex-post dissatisfaction with the service (lack of diligence) | 15.66% | 22.55% |
| Fees/commissions and expenses | 37.76% | 26.39% |
| Discrepancy in account entries | 4.70% | 6.08% |
| Exercise of rights under the Personal Data Protection Law | 0.31% | 0.36% |
| Interest | 12.75% | 25.91% |
| Other contractual conditions/documentation | 9.27% | 1.01% |
| Data protection | 0.11% | 0.27% |
| Insurance policies, claims | 2.61% | 2.30% |
| Other | 14.47% | 10.33% |
| | **100.00%** | **100.00%** |

(*) The above data exclude:

- Claims relating to mortgaged land that were analysed under Royal Decree-Law 1/2017 (40,898 claims in 2017). 30,968 claims admitted for consideration, of which 9,146 were resolved in favour of the Bank, 21,066 were in favour of customers and 747 were yet to be analysed at 31 December 2017.
- Claims relating to mortgage loan arrangement expenses (33,838 claims in 2017), all of which were dismissed.

**Performance of the Service and improvement measures adopted to meet customer requirements**

The Kutxabank Group's SAC is attached to the Legal Advisory Department and the Chairman's Office. The SAC receives, analyses, handles and responds to the complaints and claims filed by users, in conformity with certain procedures which comply with the requirements of Ministerial Order ECO/734/2004 and the Kutxabank Group's Customer Ombudsman Regulations.

The SAC prepares the Annual Report using information on the complaints and claims received and on their evolution and reasons, and submits it to the competent governing bodies.

2017 saw the number of complaints and claims increase substantially, particularly for those relating to clauses in mortgage loan agreements.

The Group's main objective is to reduce the complaints and claims by studying the cases handled by the Department, communicating any relevant incidents and proposing the necessary improvements to achieve this aim. To this end, among other measures, management of the Parent is furnished with information on all aspects which, in the SAC's opinion, bolster the good relations and mutual confidence that must exist between the Kutxabank Group entities and their customers.

The actions taken to improve all aspects of customer service quality are communicated to the Areas concerned and the related follow-up work is performed in conjunction with them.

## 16. Credit risk

Credit risk is defined as the possibility of the Group incurring a financial loss stemming from the failure of third parties to meet their contractual obligations to the Group due to insolvency or for other reasons.

This category includes counterparty risk, which is linked to treasury operations and is generally assumed vis-à-vis other financial institutions, and country risk, which refers to defaults caused by specific circumstances relating to the country and/or currency of the borrower which are beyond the borrower's control and are unrelated to its creditworthiness.

Ultimate responsibility for credit risk at the Group lies with the senior executive bodies, i.e. the Executive Committee and the Board of Directors of the Parent, which are charged with the approval of large transactions and the policies and criteria to be applied.

These bodies receive proposals from the Risk Committee, which comprises the CEO, the Corporate Financial and Group Deputy General Manager, the Wholesale Business Deputy General Manager and the Risk Manager as permanent members.

The design and implementation of the credit risk policies and procedures are the responsibility of the Risk Policy Area, which forms part of the Risk Division.

The management and control systems established to assess, mitigate and reduce credit risk are generally based on the procedures set forth below and on prudent policies relating to risk diversification, reduction of counterparty risk concentration and acceptance of guarantees.

### Loan analysis and approval

In order to optimise business opportunities with each customer and guarantee an adequate degree of security, responsibility for loan approval and risk monitoring is shared between the business manager and the risk analyst, thus permitting, through efficient communication, an integrated view of each customer's situation and a coordinated management of risk.

The branch and specialised managers have different levels of powers assigned to them on a personal basis, based on the type of customer and the type of risk and guarantee involved. These powers are specified in terms of risk limits which, in turn, vary on the basis of the guarantees received and of the reports issued by the various scoring models in place; models which provide an overall limit by customer. If transactions exceed the powers assigned to the business and branch managers, they are analysed by the central risk approval area, which either approves the transactions, if appropriate, on the basis of its powers, or instead conveys the related proposals to higher authority for authorisation: i.e. to the Corporate Financial and Group Deputy General Manager, the CEO and, following review by the Risk Committee, to the ultimate decision-making bodies, i.e. the Executive Committee/Board of Directors.

The Credit Risk Policy document approved by the Parent's Board of Directors on 27 October 2016 includes the basic principles to be observed in the responsible granting of loan transactions to customers. This policy is implemented throughout the general loan approval process for our individual customers, in the form of the scoring models in place and the rules that must be observed by managers in exercising the powers delegated to them to grant transactions involving credit risk.

As an essential resource in credit risk management, the Group seeks to ensure that loan assets acquired or arranged by the Group have collateral and other types of credit enhancement in addition to the debtor’s personal guarantee. Based on the particular characteristics of the transactions, the Group's risk analysis and loan approval policies establish the collateral or credit enhancements that are required, in addition to the debtor’s personal guarantee, before the transactions can be authorised.

The collateral received is valued on the basis of its nature. Generally, collateral in the form of real estate is valued at its appraisal value, calculated by independent entities in accordance with Bank of Spain regulations at the transaction date. This collateral is subject to periodic valuation in the form of complete re-appraisals, statistical revisions or indexing the value thereof to public industry indices; collateral in the form of securities listed in active markets is valued at the quoted price of these securities, adjusted by a percentage to protect against possible fluctuations in the market value that might jeopardise the risk cover; and lastly, collateral in the form of pledged deposits is measured at the value of these deposits and, in the case of foreign currency deposits, is translated using the exchange rate at the date of measurement. Where effective personal guarantees are received, direct debtors may be replaced by guarantors for the purpose of calculating the related allowance. Non-performing transactions subject to collective estimates of the allowances for which effective personal guarantees are provided by guarantors identified as being of negligible risk or with significant transactions may be subject to individual estimates of the allowances taking those guarantees into account. Also, non-performing transactions subject to collective estimates of the allowances for which effective personal guarantees other than those mentioned above are provided and ordinary transactions for which effective personal guarantees are provided may be subject to collective estimates of the allowances by attributing the guaranteed amount to the guarantor for the purposes of calculating the allowance covering the transaction.

When considering whether personal guarantees are acceptable for the approval of credit transactions, the Bank takes into account the borrower's solvency adequately supported by the relevant documentation and, in particular, the extent to which it considers the guarantees provided by guarantors identified as being of negligible risk or the guarantors are considered to be significant customers. Personal guarantees considered acceptable are included in the calculation, both on an individual and collective basis, of the required allowance for non-performing transactions.

### Instrumentation

Transaction instrumentation and legal support procedures are specialised so that they can respond to the various customer segments. They include a process featuring customised risk management and advisory services for large transactions, and another process, involving the preparation and supervision of various model agreements for the arrangement of standard transactions, which is decentralised across the network.

### Risk monitoring and policies

Managers monitor operations through direct contact with customers and the management of their daily transactions, as well as through the alerts generated automatically by the monitoring system implemented at the Group. Risk analysts also have access to customer and centre monitoring through the automatic alert system in place.

The risk monitoring procedures enable the Group to perform both an individual control by customer, customer group or large exposure, and a general control by segment, through the use of different alert signals.

The Credit Risk Modelling and Policy Unit is responsible for developing and implementing the credit risk classification.

The Group has a specialised unit for the monitoring of risk associated with the property industry which controls and assesses the smooth progress of the property projects it finances in order to anticipate any problems concerning their execution.

The Group also has a specialised unit for monitoring significant customers and for estimating on an individual basis the allowances required to cover the impairment of non-performing loans to these customers.

### Loan recovery

The establishment of efficient management procedures for loans outstanding facilitates the management of past-due loans by making it possible to adopt a proactive approach based on the early identification of loans with a tendency to become delinquent and the transfer thereof to recovery management specialists who determine the types of recovery procedures that should be applied.

Information systems provide daily information on the individual and global situation of managed risks, supported by various indicators and alerts that facilitate efficient management.

The Recovery Unit has managers who specialise in monitoring and supporting the decentralised recovery management function at branches, which includes pre-delinquency measures and support from specialised external companies and lawyers specialising in the recovery of delinquent loans through the courts.

### Refinancing

Without prejudice to the above, the Group has been applying measures to mitigate the impact of the crisis on borrowers experiencing temporary difficulties in repaying their debts. The main principle is that debtors who are clearly willing to meet their obligations should be aided in doing so.

The basic objectives of the debt refinancing and restructuring policy are to adapt the repayment schedule to the actual capacity of the debtor and to strengthen the guarantees in the transactions handled.

The analysis and handling of these transactions are tailored to suit each type of debtor, with the powers to resolve the transactions being centralised to a high degree in the Risk and Loan Recovery areas, depending on the segment to which they belong.

The instruments used are the lengthening of terms and the introduction of cure periods in mortgage transactions, as well as the obtainment of new collateral to secure repayment of the mortgages or of other previously unsecured loans.

The Group has also established for this portfolio a specific system to monitor it on an individual basis and classify it for accounting purposes.

**Policies and procedures relating to mortgage market activities**

With respect to the mortgage market, as required by Mortgage Market Law 2/1981, amended by Law 41/2007, Royal Decree 716/2009, Bank of Spain Circular 7/2010 and Law 1/2013, of 14 May, on measures to reinforce the protection of mortgagors, debt restructuring and social rent, the Parent has the necessary controls in place, as part of its processes, in order to guarantee compliance with regulatory requirements in the various mortgage loan approval, instrumentation, monitoring and control phases.

The Parent's directors are responsible for ensuring the compliance of the policies and procedures approved in relation to the mortgage market. These procedures place particular emphasis on the following points, inter alia:

- A viability analysis must be performed of any authorised or proposed transactions and of the related guarantees. The file for all transactions must contain the documentation and information required to support the transaction and, particularly, to assess the customer's ability to pay (evidence of recurring income for individuals and statements of profit or loss in the case of companies) and the guarantees relating to the transaction (statement of assets for individuals, balance sheets for companies and up-to-date appraisals for mortgage transactions).

- Loan approval powers are delegated taking into consideration the relationship between the loan amount and the appraisal value of the mortgaged property, together with all the additional collateral that might exist to secure the transaction. Based on the type of collateral provided, the policies establish lending limits on the basis of the loan-to-value (LTV) ratio of the transactions.

The Group authorises appraisals performed by the leading valuers within the area of operations of its branch network. The main valuers used are Servicios Vascos de Tasaciones, S.A., Tasaciones Inmobiliarias, S.A. and occasionally Tecnitasa, S.A. and Krata, S.A.

**Counterparty risk**

With respect to its treasury activities, the Parent has exposure limits per counterparty which avoid a high level of concentration vis-à-vis any single financial institution. In the case of derivative instruments, the portion of the limit used is calculated on the basis of both the value of present claims (positive replacement value) and a measure of the potential risk that might arise from the favourable performance of this replacement value in the future.

The Group uses netting and collateral arrangements entered into with counterparties as a risk mitigation policy in this connection. At 31 December 2017, the deposits received and advanced as collateral amounted to EUR 116,315 thousand and EUR 213,065 thousand, respectively, and these amounts are recognised under "Financial Liabilities at Amortised Cost - Deposits - Credit Institutions" and "Loans and Receivables - Loans and Advances - Credit Institutions", respectively, in the consolidated balance sheet (31 December 2016: EUR 176,343 thousand and EUR 224,694 thousand, respectively) (see Notes 34-b and 25-a).

**Risk control**

The lines of action described are developments aimed at aligning the Group's risk processes with the legislation and regulations in force at any given time. Accordingly, the Group is committed to continuously improving the design and implementation of the tools and procedures for a more efficient treatment of customer credit risk in all its processes, which will guarantee certain standards in the quality of service and rigour in the criteria used, with the ultimate aim of preserving the Bank's solvency and contributing value to it.

The Risk Control Committee is responsible for systematically reviewing exposure to the main types of risk, controlling and supervising the risk management system and analysing and evaluating proposals relating to risk management strategy and policies.

The Internal Audit Department checks effective compliance with the aforementioned management policies and procedures and assesses the adequacy and efficiency of the management and control activities of each functional and executive unit. To this end, it performs periodic audits of the centres related to credit risk, which include an analysis of loan recoverability and of the appropriate loan classification for accounting purposes. The information obtained from these audits is sent to the related executive bodies and to the Parent's Audit and Regulatory Compliance Committee.

At 31 December 2017 and 2016, more than 99% of the loans and receivables outstanding were with counterparties resident in Spain.

The information on the guarantees and collateral associated with customer transactions is included in Note 25.

Following is a detail of the maximum level of credit risk exposure assumed by the Group at 31 December 2017 and 2016, by type of financial instrument, without deducting collateral or any other credit enhancements received to ensure the compliance of debtors with their obligations:

## At 31 December 2017

| | Thousands of euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Asset balances | | | | | | | | |
| | Financial assets held for trading | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets | Loans and receivables | Held-to-maturity investments | Derivatives – hedge accounting | Investments in joint ventures and associates | Memorandum items | Total |
| Loans and advances to credit institutions | - | - | - | 552,660 | - | - | - | - | 552,660 |
| Debt securities | - | 29,136 | 3,523,993 | - | 248,761 | - | - | - | 3,801,890 |
| Equity instruments | - | 6,103 | 1,372,566 | - | - | - | 514,522 | - | 1,893,191 |
| Customers | - | - | - | 42,006,373 | - | - | - | - | 42,006,373 |
| Derivatives | 83,770 | - | - | - | - | 174,079 | - | - | 257,849 |
| **Total** | **83,770** | **35,239** | **4,896,559** | **42,559,033** | **248,761** | **174,079** | **514,522** | **-** | **48,511,963** |
| **Guarantees given:** | | | | | | | | | |
| Financial bank guarantees | - | - | - | - | - | - | - | 408,447 | 408,447 |
| Other guarantees provided | - | - | - | - | - | - | - | 1,507,700 | 1,507,700 |
| **Total guarantees given** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **1,916,147** | **1,916,147** |
| **MAXIMUM LEVEL OF CREDIT RISK EXPOSURE** | **83,770** | **35,239** | **4,896,559** | **42,559,033** | **248,761** | **174,079** | **514,522** | **1,916,147** | **50,428,110** |

## At 31 December 2016

| | Thousands of euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Asset balances | | | | | | | | |
| | Financial assets held for trading | Financial assets designated at fair value through profit or loss | Available-for-sale financial assets | Loans and receivables | Held-to-maturity investments | Derivatives – hedge accounting | Investments in joint ventures and associates | Memorandum items | Total |
| Loans and advances to credit institutions | - | - | - | 1,696,602 | - | - | - | - | 1,696,602 |
| Debt securities | - | 28,745 | 3,029,832 | - | 44,246 | - | - | - | 3,102,823 |
| Equity instruments | - | 6,249 | 2,206,658 | - | - | - | 503,118 | - | 2,716,025 |
| Customers | - | - | - | 42,573,133 | - | - | - | - | 42,573,133 |
| Derivatives | 142,345 | - | - | - | - | 254,855 | - | - | 397,200 |
| **Total** | **142,345** | **34,994** | **5,236,490** | **44,269,735** | **44,246** | **254,855** | **503,118** | **-** | **50,485,783** |
| **Guarantees given:** | | | | | | | | | |
| Financial bank guarantees | - | - | - | - | - | - | - | 458,796 | 458,796 |
| Other guarantees provided | - | - | - | - | - | - | - | 1,344,214 | 1,344,214 |
| **Total guarantees given** | **-** | **-** | **-** | **-** | **-** | **-** | **-** | **1,803,010** | **1,803,010** |
| **MAXIMUM LEVEL OF CREDIT RISK EXPOSURE** | **142,345** | **34,994** | **5,236,490** | **44,269,735** | **44,246** | **254,855** | **503,118** | **1,803,010** | **52,288,793** |

Following is a detail, for the financial instruments relating to “Customers” classified as standard risk, of the credit risk exposure covered by each of the main classes of collateral and other credit enhancements held by the Group at 31 December 2017 and 2016:

**At 31 December 2017:**

| | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | Property mortgage guarantee | Secured by cash deposits and fixed-income securities | Other collateral | Guaranteed by financial institutions | Guaranteed by other entities | Total |
| Customers | 31,330,598 | 48,545 | 139,239 | 177,197 | 875,802 | 32,571,380 |

**At 31 December 2016:**

| | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | Property mortgage guarantee | Secured by cash deposits and fixed-income securities | Other collateral | Guaranteed by financial institutions | Guaranteed by other entities | Total |
| Customers | 31,877,263 | 353,803 | 175,936 | 179,882 | 859,616 | 33,446,500 |

Also, following is a detail, for the financial instruments relating to "Customers", of the credit risk exposure covered by collateral, based on the activity sector to which they belong and on the loan-to-value (LTV) ratio calculated using the value of the Group's collateral at 31 December 2017 and 2016:

| (Thousands of euros) | TOTAL | Of which: Property mortgage guarantee | Of which: Other collateral | Secured loans. Loan to value ratio | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Less than or equal to 40% | More than 40% and less than or equal to 60% | More than 60% and less than or equal to 80% | More than 80% and less than or equal to 100% | More than 100% |
| **31/12/17** | | | | | | | | |
| Public sector | 2,510,955 | 207,478 | 4,535 | 21,170 | 34,355 | 71,852 | 37,872 | 46,764 |
| Other financial companies and individual traders | 545,700 | 10,168 | 92 | 2,723 | 3,804 | 2,389 | 632 | 712 |
| Non-financial companies and individual traders | 8,086,339 | 3,426,341 | 126,482 | 1,124,811 | 887,574 | 729,841 | 277,041 | 533,556 |
| *Construction and property development* | *1,018,764* | *1,009,918* | *1,514* | *195,862* | *208,374* | *223,507* | *112,000* | *271,689* |
| *Civil engineering construction* | *281,212* | *22,165* | *145* | *11,008* | *4,425* | *2,252* | *578* | *4,047* |
| *Other purposes* | *6,786,363* | *2,394,258* | *124,823* | *917,941* | *674,775* | *504,082* | *164,463* | *257,820* |
| *Large companies* | *3,328,778* | *281,778* | *25,245* | *59,218* | *75,201* | *56,115* | *39,883* | *76,606* |
| *SMEs and individual traders* | *3,457,585* | *2,112,480* | *99,578* | *858,723* | *599,574* | *447,967* | *124,580* | *181,214* |
| Other households | 30,731,695 | 28,965,095 | 79,454 | 5,022,135 | 7,020,435 | 10,442,517 | 4,245,575 | 2,313,887 |
| *Residential* | *28,214,511* | *27,884,622* | *53,949* | *4,590,808* | *6,742,337* | *10,242,351* | *4,161,869* | *2,201,206* |
| *Consumer loans* | *979,436* | *174,686* | *17,558* | *63,411* | *36,841* | *34,266* | *26,481* | *31,245* |
| *Other purposes* | *1,537,748* | *905,787* | *7,947* | *367,916* | *241,257* | *165,900* | *57,225* | *81,436* |
| **TOTAL (*)** | **41,874,689** | **32,609,082** | **210,563** | **6,170,839** | **7,946,168** | **11,246,599** | **4,561,120** | **2,894,919** |
| Refinancing, refinanced and restructured transactions | 1,636,283 | 1,385,878 | 11,384 | 194,744 | 235,467 | 280,388 | 208,367 | 478,296 |

(*) Total balance excluding "Other Financial Assets" for a net amount of EUR 131,684 thousand.

| (Thousands of euros) | TOTAL | Of which: Property mortgage guarantee | Of which: Other collateral | Secured loans. Loan to value ratio | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | Less than or equal to 40% | More than 40% and less than or equal to 60% | More than 60% and less than or equal to 80% | More than 80% and less than or equal to 100% | More than 100% |
| **31/12/16** | | | | | | | | |
| Public sector | 2,660,726 | 223,118 | 4,614 | 14,589 | 34,662 | 55,243 | 32,684 | 90,554 |
| Other financial companies and individual traders | 443,092 | 25,672 | 250,582 | 3,244 | 5,292 | 3,657 | 7,739 | 256,322 |
| Non-financial companies and individual traders | 8,272,254 | 3,758,967 | 226,415 | 1,366,378 | 984,277 | 753,183 | 327,921 | 553,623 |
| *Construction and property development* | *1,174,417* | *1,161,507* | *2,934* | *254,412* | *265,102* | *260,813* | *113,241* | *270,873* |
| *Civil engineering construction* | *242,610* | *21,881* | *903* | *10,972* | *5,036* | *3,907* | *616* | *2,253* |
| *Other purposes* | *6,855,227* | *2,575,579* | *222,578* | *1,100,994* | *714,139* | *488,463* | *214,064* | *280,497* |
| *Large companies* | *3,204,688* | *295,897* | *35,459* | *55,840* | *72,741* | *40,967* | *43,441* | *118,367* |
| *SMEs and individual traders* | *3,650,539* | *2,279,682* | *187,119* | *1,045,154* | *641,398* | *447,496* | *170,623* | *162,130* |
| Other households | 31,043,764 | 29,382,140 | 80,581 | 4,769,838 | 6,634,569 | 9,813,686 | 5,193,766 | 3,050,862 |
| *Residential* | *28,527,747* | *28,203,822* | *42,959* | *4,323,449* | *6,320,783* | *9,586,936* | *5,093,300* | *2,922,313* |
| *Consumer loans* | *899,993* | *193,615* | *20,370* | *67,322* | *42,060* | *34,228* | *19,432* | *50,943* |
| *Other purposes* | *1,616,024* | *984,703* | *17,252* | *379,067* | *271,726* | *192,522* | *81,034* | *77,606* |
| **TOTAL (*)** | **42,419,836** | **33,389,897** | **562,192** | **6,154,049** | **7,658,800** | **10,625,769** | **5,562,110** | **3,951,361** |
| Refinancing, refinanced and restructured transactions | 1,965,994 | 1,644,382 | 18,241 | 266,978 | 303,927 | 385,055 | 265,481 | 441,182 |

(*) Total balance excluding "Other Financial Assets" for a net amount of EUR 153,297 thousand.

The Parent has been implementing various models and tools to support the assessment and management of credit risk exposure to customers.

Since most of these assets relate to lending to individuals and SMEs, only a small portion of the loan portfolio has external ratings. The following table provides a detail of "Loans and Advances – Customers", without considering valuation adjustments, based on the credit ratings granted by the various recognised external rating agencies (using the standard nomenclature of Standard & Poor's and Fitch):

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Thousands of euros | % | Thousands of euros | % |
| **Investment grade** | | | | |
| AAA to AA- | 9,874 | 0.02% | 11,114 | 0.03% |
| A+ to A- | 885,637 | 2.06% | 994,411 | 2.26% |
| BBB+ to BBB- | 1,810,516 | 4.22% | 1,570,536 | 3.57% |
| **Non-investment grade** | | | | |
| Below BBB- | 143,358 | 0.33% | 163,490 | 0.37% |
| **Unrated** | 40,060,966 | 93.36% | 41,255,377 | 93.77% |
| **Total** | **42,910,351** | **100.00%** | **43,994,928** | **100.00%** |

The Group performs sensitivity analyses to estimate the effects of potential changes in the non-performing loans ratio, both on an overall basis through the study of loans and receivables segments, and on an individual basis through the study of individual economic groups or customers.

Also, following is the detail, by activity sector and geographical area, of the Group's credit risk exposure at 31 December 2017 and 2016, which comprises "Cash, Cash Balances at Central Banks and Other Demand Deposits" (excluding cash balances), "Financial Assets Held for Trading", "Financial Assets Designated at Fair Value through Profit or Loss", "Available-for-Sale Financial Assets", "Loans and Receivables", "Held-to-Maturity Investments", "Derivatives – Hedge Accounting", "Investments in Joint Ventures and Associates" and "Guarantees Given".

| (Thousands of euros) | TOTAL | Spain | Other EU countries | Americas | Rest of the world |
|---|---|---|---|---|---|
| **31/12/17** | | | | | |
| Central banks and credit institutions | 5,360,133 | 4,812,925 | 291,647 | 35,103 | 220,458 |
| Public sector | 5,822,532 | 5,769,662 | 52,870 | - | - |
| *Central government* | *3,015,836* | *2,962,997* | *52,839* | - | - |
| *Public sector - other* | *2,806,696* | *2,806,665* | *31* | - | - |
| Other financial companies and individual traders | 1,028,461 | 978,701 | 36,005 | 8,823 | 4,932 |
| Non-financial companies and individual traders | 11,564,807 | 11,432,731 | 110,644 | 21,164 | 268 |
| *Construction and property development* | *1,348,279* | *1,347,963* | *316* | - | - |
| *Civil engineering construction* | *475,665* | *475,665* | - | - | - |
| *Other purposes* | *9,740,863* | *9,609,103* | *110,328* | *21,164* | *268* |
| *Large companies* | *5,827,013* | *5,721,091* | *91,606* | *14,220* | *96* |
| *SMEs and individual traders* | *3,913,850* | *3,888,012* | *18,722* | *6,944* | *172* |
| Other households | 30,801,924 | 30,542,025 | 203,118 | 22,776 | 34,005 |
| *Residential* | *28,215,562* | *27,960,223* | *199,530* | *22,203* | *33,606* |
| *Consumer loans* | *979,436* | *978,478* | *726* | *108* | *124* |
| *Other purposes* | *1,606,926* | *1,603,324* | *2,862* | *465* | *275* |
| **TOTAL** | **54,577,857** | **53,536,044** | **694,284** | **87,866** | **259,663** |

| (Thousands of euros) | TOTAL | Spain | Other EU countries | Americas | Rest of the world |
|---|---|---|---|---|---|
| **31/12/16** | | | | | |
| Central banks and credit institutions | 3,668,631 | 3,049,081 | 351,549 | 42,270 | 225,731 |
| Public sector | 5,245,929 | 5,231,327 | 14,602 | - | - |
| *Central government* | *2,390,517* | *2,377,894* | *12,623* | - | - |
| *Public sector - other* | *2,855,412* | *2,853,433* | *1,979* | - | - |
| Other financial companies and individual traders | 949,021 | 892,149 | 41,091 | 9,345 | 6,436 |
| Non-financial companies and individual traders | 12,553,805 | 12,443,063 | 84,516 | 25,967 | 259 |
| *Construction and property development* | *1,473,790* | *1,473,474* | *316* | - | - |
| *Civil engineering construction* | *377,375* | *377,375* | - | - | - |
| *Other purposes* | *10,702,640* | *10,592,214* | *84,200* | *25,967* | *259* |
| *Large companies* | *6,274,579* | *6,193,446* | *63,402* | *17,682* | *49* |
| *SMEs and individual traders* | *4,428,061* | *4,398,768* | *20,798* | *8,285* | *210* |
| Other households | 31,111,506 | 30,849,313 | 211,159 | 19,307 | 31,727 |
| *Residential* | *28,529,256* | *28,271,611* | *207,642* | *18,736* | *31,267* |
| *Consumer loans* | *899,993* | *899,183* | *647* | *75* | *88* |
| *Other purposes* | *1,682,257* | *1,678,519* | *2,870* | *496* | *372* |
| **TOTAL** | **53,528,892** | **52,464,933** | **702,917** | **96,889** | **264,153** |

The detail, by autonomous community, of the Group's financial instruments in the foregoing table located in Spain at 31 December 2017 and 2016 is as follows:

| (Thousands of euros) | | Autonomous community | | | | | |
|---|---|---|---|---|---|---|---|
| **31/12/17** | TOTAL | Basque Country | Andalusia | Madrid | Catalonia | Valencia | Other |
| Central banks and credit institutions | 4,812,925 | 123,790 | 6,827 | 4,391,772 | 215,537 | 16 | 74,983 |
| Public sector | 5,769,662 | 2,469,045 | 239,035 | 34,433 | 3,592 | - | 60,560 |
| *Central government* | 2,962,997 | - | - | - | - | - | - |
| *Public sector - other* | 2,806,665 | 2,469,045 | 239,035 | 34,433 | 3,592 | - | 60,560 |
| Other financial companies and individual traders | 978,701 | 153,681 | 8,261 | 505,021 | 310,981 | 144 | 613 |
| Non-financial companies and individual traders | 11,432,731 | 5,952,802 | 1,567,614 | 3,034,886 | 313,272 | 67,554 | 496,603 |
| *Construction and property development* | 1,347,963 | 747,103 | 238,948 | 201,949 | 52,819 | *12,709* | *94,435* |
| *Civil engineering construction* | 475,665 | 88,083 | 27,864 | 356,304 | 205 | *856* | *2,353* |
| *Other purposes* | 9,609,103 | 5,117,616 | 1,300,802 | 2,476,633 | 260,248 | *53,989* | *399,815* |
| *Large companies* | 5,721,091 | 3,056,031 | 248,992 | 2,090,203 | 141,292 | *9,057* | *175,516* |
| *SMEs and individual traders* | 3,888,012 | 2,061,585 | 1,051,810 | 386,430 | 118,956 | *44,932* | *224,299* |
| Other households | 30,542,025 | 13,458,271 | 5,927,330 | 4,818,415 | 1,761,782 | 1,267,228 | 3,308,999 |
| *Residential* | 27,960,223 | 12,058,167 | 5,178,557 | 4,629,474 | 1,714,833 | *1,212,396* | *3,166,796* |
| *Consumer loans* | 978,478 | 541,627 | 198,374 | 96,556 | 31,640 | *33,341* | *76,940* |
| *Other purposes* | 1,603,324 | 858,477 | 550,399 | 92,385 | 15,309 | *21,491* | *65,263* |
| **TOTAL** | **53,536,044** | **22,157,589** | **7,749,067** | **12,784,527** | **2,605,164** | **1,334,942** | **3,941,758** |

| (Thousands of euros) | | Autonomous community | | | | | |
|---|---|---|---|---|---|---|---|
| **31/12/16** | TOTAL | Basque Country | Andalusia | Madrid | Catalonia | Valencia | Other |
| Central banks and credit institutions | 3,049,081 | 1,130,019 | 306,858 | 920,225 | 446,987 | 154,455 | 90,537 |
| Public sector | 5,231,327 | 2,540,918 | 280,007 | 13,562 | 7,476 | 228 | 11,242 |
| *Central government* | 2,377,894 | - | - | - | - | - | - |
| *Public sector - other* | 2,853,433 | 2,540,918 | 280,007 | 13,562 | 7,476 | *228* | *11,242* |
| Other financial companies and individual traders | 892,149 | 53,550 | 12,199 | 822,024 | 3,465 | 138 | 773 |
| Non-financial companies and individual traders | 12,443,063 | 6,658,553 | 1,666,419 | 3,116,950 | 430,706 | 67,086 | 503,349 |
| *Construction and property development* | 1,473,474 | 838,081 | 258,516 | 172,870 | 60,130 | *12,423* | *131,454* |
| *Civil engineering construction* | 377,375 | 94,469 | 28,048 | 251,570 | 80 | *510* | *2,698* |
| *Other purposes* | 10,592,214 | 5,726,003 | 1,379,855 | 2,692,510 | 370,496 | *54,153* | *369,197* |
| *Large companies* | 6,193,446 | 3,436,889 | 240,026 | 2,106,558 | 251,446 | *10,049* | *148,478* |
| *SMEs and individual traders* | 4,398,768 | 2,289,114 | 1,139,829 | 585,952 | 119,050 | *44,104* | *220,719* |
| Other households | 30,849,313 | 13,798,717 | 5,860,000 | 4,841,784 | 1,732,645 | 1,277,569 | 3,338,598 |
| *Residential* | 28,271,611 | 12,354,064 | 5,139,920 | 4,660,582 | 1,689,742 | *1,226,386* | *3,200,917* |
| *Consumer loans* | 899,183 | 531,297 | 152,862 | 87,392 | 28,014 | *29,226* | *70,392* |
| *Other purposes* | 1,678,519 | 913,356 | 567,218 | 93,810 | 14,889 | *21,957* | *67,289* |
| **TOTAL** | **52,464,933** | **24,181,757** | **8,125,483** | **9,714,545** | **2,621,279** | **1,499,476** | **3,944,499** |

The detail at 31 December 2017 and 2016 of the Group's current refinancing and restructuring balances, classified on the basis of their accounting status, counterparty and collateral, is as follows:

| | 31/12/17 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | TOTAL | | | | | | | Of which: NON-PERFORMING | | | | | | |
| | Total without collateral | | Total with collateral | | | | Total accumulated impairment or accumulated fair value losses due to credit risk | Without collateral | | With collateral | | | | Accumulated impairment or accumulated fair value losses due to credit risk |
| | No. of transactions | Gross amount | No. of transactions | Gross amount | Maximum amount of the collateral or guarantee that can be considered | | | No. of transactions | Gross amount | No. of transactions | Gross amount | Maximum amount of the collateral or guarantee that can be considered | | |
| | | | | | Property mortgage guarantee | Other collateral | | | | | | Property mortgage guarantee | Other collateral | |
| Credit institutions | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Public sector | 10 | 15,322 | 59 | 8,129 | 7,828 | - | (302) | - | - | 9 | 765 | 463 | - | (302) |
| Other financial companies and individual traders | 6 | 2,613 | 16 | 2,636 | 1,881 | - | (2,750) | 3 | 2,027 | 9 | 2,073 | 1,355 | - | (2,745) |
| Non-financial companies and individual traders | 496 | 244,098 | 4,008 | 979,978 | 734,266 | 5,371 | (249,533) | 201 | 19,457 | 2,596 | 583,699 | 391,508 | 3,695 | (194,497) |
| *Of which: Financing for construction and property development* | *1* | *12* | *1,526* | *469,013* | *328,709* | *1,514* | *(128,767)* | *1* | *12* | *1,316* | *291,688* | *191,045* | - | *(100,241)* |
| Other households | 1,948 | 20,572 | 7,998 | 749,920 | 592,249 | 504 | (134,400) | 945 | 9,725 | 4,251 | 420,688 | 289,264 | 137 | (127,475) |
| **Total** | **2,460** | **282,605** | **12,081** | **1,740,663** | **1,336,224** | **5,875** | **(386,985)** | **1,149** | **31,209** | **6,865** | **1,007,225** | **682,590** | **3,832** | **(325,019)** |
| Financing classified as non-current assets and disposal groups classified as held for sale | - | - | - | - | - | - | - | - | - | - | - | - | - | - |

| | 31/12/2016 | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | TOTAL | | | | | | | Of which: NON-PERFORMING | | | | | | |
| | Total without collateral | | Total with collateral | | | | Total accumulated impairment or accumulated fair value losses due to credit risk | Without collateral | | With collateral | | | | Accumulated impairment or accumulated fair value losses due to credit risk |
| | No. of transactions | Gross amount | No. of transactions | Gross amount | Maximum amount of the collateral or guarantee that can be considered | | | No. of transactions | Gross amount | No. of transactions | Gross amount | Maximum amount of the collateral or guarantee that can be considered | | |
| | | | | | Property mortgage guarantee | Other collateral | | | | | | Property mortgage guarantee | Other collateral | |
| Credit institutions | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Public sector | 5 | 11,010 | 1 | 122 | 98 | - | (64) | 1 | 2,113 | 1 | 122 | 98 | - | (64) |
| Other financial companies and individual traders | 6 | 3,784 | 18 | 11,687 | 6,009 | - | (6,920) | 3 | 3,183 | 10 | 10,994 | 5,361 | - | (6,909) |
| Non-financial companies and individual traders | 513 | 326,788 | 5,410 | 1,475,525 | 957,581 | 7,187 | (532,369) | 215 | 44,979 | 3,836 | 972,427 | 521,388 | 2,213 | (466,286) |
| *Of which: Financing for construction and property development* | *3* | *534* | *2,761* | *844,957* | *487,942* | *1,855* | *(348,521)* | *3* | *534* | *2,421* | *608,414* | *296,417* | - | *(311,230)* |
| Other households | 1,721 | 17,051 | 8,445 | 806,370 | 639,296 | 562 | (146,990) | 949 | 8,191 | 4,627 | 452,553 | 309,364 | 170 | (140,592) |
| **Total** | **2,245** | **358,633** | **13,874** | **2,293,704** | **1,602,984** | **7,749** | **(686,343)** | **1,168** | **58,466** | **8,474** | **1,436,096** | **836,211** | **2,383** | **(613,851)** |
| Financing classified as non-current assets and disposal groups classified as held for sale | - | - | - | - | - | - | - | - | - | - | - | - | - | - |

## 17. Liquidity risk

Liquidity risk, in its most significant version, structural liquidity risk, is the possibility that, because of the maturity gap between its assets and liabilities, the Group will be unable to meet its payment commitments at a reasonable cost or will not have a stable funding structure to support its business plans for the future.

The Board of Directors has ultimate responsibility for liquidity risk and delegates to the Asset-Liability Committee (ALCO), comprising executives of the Parent, as the competent decision-making body in this respect.

Liquidity risk management involves close monitoring of maturity gaps on the Group's balance sheet, the analysis of their foreseeable future trend, the inclusion of the liquidity factor in the business decision-making process, the use of financial markets to complete a stable funding base, and the arrangement of liquidity channels that can be used immediately in unforeseen extreme scenarios.

The ALCO is responsible for assessing the Group's future liquidity needs. To this end, management of the Parent defines the three-year Financing Plan, which is used to prepare the specific annual Liquidity Plan. The annual Liquidity Plan defines the strategy for wholesale funding issues, based on the projected liquidity needs arising from the performance of the business, issue maturities and planned asset investments and disposals. The volume and type of assets in these transactions are determined based on the Group's balance sheet performance and liquidity position, and market conditions and expectations. The Board of Directors of the Parent is responsible for authorising all issues to be launched.

The ALCO monitors the liquidity budget on a fortnightly basis. Among other controls, each month the Parent monitors the liquidity indicators and limits, the eligible liquid assets available at the European Central Bank and its mortgage-backed bond issue capacity.

The Treasury and Capital Markets Department is responsible for seeking stable sources of external funding for the Group in the financial markets, at a reasonable cost, to offset the disintermediation process undergone by customers in their investment decisions and the growth in their demand for financing.

Also, the Group endeavours to maintain access to additional sources of funding (institutional or otherwise) to be used in extremely adverse liquidity scenarios, so that all its payment commitments can be met even in such circumstances.

The need to closely monitor the performance of financial institutions in this regard as a result of the financial crisis that erupted in 2007, which triggered a complex liquidity management scenario, gave rise to a proliferation of regulatory reports on financial institutions' liquidity positions and the development of standardised, industry-wide indicators. For the most part, the new regulatory reports replaced the management information that had been prepared until recently, and became part of the set of liquidity risk management indicators.

In this regard, in 2010 the Basel Committee amended its principles to produce the recommendations known as Basel III, which are currently in effect. This latest improvement was driven by the recent major international crisis and, unlike its predecessors, addressed the areas of leverage and liquidity, since the financial crisis had shown that the inability to meet obligations on time and at a reasonable cost was the main trigger of numerous problems for various entities, and it had not been previously regulated. Now aware of the importance of liquidity to financial stability, European authorities began to take concrete steps, through new, binding regulatory standards, to create a more orderly and uniform liquidity management framework. Accordingly, Basel III, which was transposed at European level through Directive 2013/36/EU (CRD IV) and Regulation (EU) No 575/2013 (CRR), included for the first time on a quantitative basis two minimum liquidity standards, namely the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR), and established compliance with these ratios as being mandatory from 2015 and 2018, respectively. The Basel Committee on Banking Supervision published the final LCR standard in January 2013 and that of the NSFR in October 2014. In Europe, the Commission Delegated Regulation of 10 October 2014 on the LCR (the LCR Delegated Act) gives legal force to the LCR ratio, implements its content and is the European Union's first detailed regulation on liquidity.

In addition, the achievement of adequate levels in the aforementioned LCR and NSFR indicators is included among the strategic liquidity objectives defining the Group's Risk Appetite Framework, in which certain thresholds are established linked to specified action guidelines.

Also, in terms of liquidity risk management, there is a set of additional liquidity indicators used to monitor changes in the various aggregates that affect the defined risk tolerance.

In addition, with the entry into force of the supervisory review and evaluation process (SREP), since 2015 the Parent has undergone an internal liquidity adequacy assessment process (ILAAP) on a yearly basis in order to evaluate its capacity to meet liquidity requirements, both in normal and adverse scenarios, in the short, medium and long term.

The detail of the assets and liabilities, by term to maturity (i.e. the period remaining from the reporting date to the contractual maturity date), is as follows:

| | Thousands of euros | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 2017 | On demand | Less than 1 month | 1 to 3 months | 3 months to 1 year | 1 to 2 years | 2 to 3 years | 3 to 4 years | More than 4 years | No maturity | Total |
| Cash, cash balances at central banks and other demand deposits | 4,034,206 | - | - | - | - | 9,893 | - | - | 363,539 | 4,407,638 |
| Credit institutions | 66,731 | - | - | 235,837 | - | - | - | - | 250,092 | 552,660 |
| Customers | - | 779,497 | 970,350 | 3,009,218 | 2,793,417 | 2,761,410 | 2,637,133 | 27,787,350 | 1,267,998 | 42,006,373 |
| Debt securities: | | | | | | | | | | |
| Available-for-sale financial assets | - | 12,833 | 2,178 | 79,346 | 197,543 | 199,348 | 86,584 | 1,987,272 | 958,889 | 3,523,993 |
| Held-to-maturity investments | - | - | - | - | - | - | - | 248,761 | - | 248,761 |
| Other financial assets at fair value | - | - | - | - | - | - | - | - | 29,136 | 29,136 |
| Equity instruments: | | | | | | | | | | |
| Available-for-sale financial assets | - | - | - | - | - | - | - | - | 1,372,566 | 1,372,566 |
| Other financial assets at fair value | - | - | - | - | - | - | - | - | 6,103 | 6,103 |
| Investments in joint ventures and associates | - | - | - | - | - | - | - | - | 514,522 | 514,522 |
| **Total earning assets** | **4,100,937** | **792,330** | **972,528** | **3,324,401** | **2,990,960** | **2,970,651** | **2,723,717** | **30,023,383** | **4,762,845** | **52,661,752** |
| Central banks | - | - | - | - | - | 2,606,098 | 1,374,057 | - | - | 3,980,155 |
| Credit institutions | 6,880 | 34,819 | 101 | 246,633 | 2,794 | 12,716 | - | 29,910 | 145,404 | 479,257 |
| Customers | 25,792,360 | 2,135,911 | 1,775,033 | 8,268,339 | 850,144 | 575,104 | 325,417 | 1,922,668 | 167,576 | 41,812,552 |
| Marketable debt securities | - | - | 54,158 | 218,320 | 191,030 | 327,480 | 1,146,181 | 1,200,761 | 1,013 | 3,138,943 |
| **Total interest-bearing liabilities** | **25,799,240** | **2,170,730** | **1,829,292** | **8,733,292** | **1,043,968** | **3,521,398** | **2,845,655** | **3,153,339** | **313,993** | **49,410,907** |
| **Net liquidity gap** | **(21,698,303)** | **(1,378,400)** | **(856,764)** | **(5,408,891)** | **1,946,992** | **(550,747)** | **(121,938)** | **26,870,044** | **4,448,852** | **3,250,845** |

| | Thousands of euros | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| 2016 | On demand | Less than 1 month | 1 to 3 months | 3 months to 1 year | 1 to 2 years | 2 to 3 years | 3 to 4 years | More than 4 years | No maturity | Total |
| Cash, cash balances at central banks and other demand deposits | 1,155,599 | - | - | - | - | - | - | - | 325,909 | 1,481,508 |
| Credit institutions | 15,367 | 791,896 | 439,358 | 213,493 | - | - | - | - | 236,488 | 1,696,602 |
| Customers | - | 869,479 | 1,073,006 | 3,277,969 | 2,602,834 | 2,821,985 | 3,116,727 | 27,232,256 | 1,578,877 | 42,573,133 |
| Debt securities: | | | | | | | | | | |
| Available-for-sale financial assets | - | 74,675 | 11,196 | 12,223 | 97,912 | 181,031 | 203,379 | 1,718,056 | 731,360 | 3,029,832 |
| Held-to-maturity investments | - | - | - | - | - | - | - | 44,246 | - | 44,246 |
| Other financial assets at fair value | - | - | - | - | - | - | - | - | 28,745 | 28,745 |
| Equity instruments: | | | | | | | | | | |
| Available-for-sale financial assets | - | - | - | - | - | - | - | - | 2,206,658 | 2,206,658 |
| Other financial assets at fair value | - | - | - | - | - | - | - | - | 6,249 | 6,249 |
| Investments in joint ventures and associates | - | - | - | - | - | - | - | - | 503,118 | 503,118 |
| **Total earning assets** | **1,170,966** | **1,736,050** | **1,523,560** | **3,503,685** | **2,700,746** | **3,003,016** | **3,320,106** | **28,994,558** | **5,617,404** | **51,570,091** |
| Central banks | - | - | - | - | - | - | 2,620,000 | - | - | 2,620,000 |
| Credit institutions | 17,374 | 207,739 | 247 | 235,575 | 8,556 | 21,735 | - | 47,209 | 204,696 | 743,131 |
| Customers | 22,730,011 | 2,037,935 | 2,241,050 | 9,263,350 | 1,796,440 | 836,902 | 536,647 | 1,529,916 | 255,202 | 41,227,453 |
| Marketable debt securities | - | - | 803,969 | 107,196 | 266,964 | 228,649 | 321,588 | 2,304,710 | 2,023 | 4,035,099 |
| **Total interest-bearing liabilities** | **22,747,385** | **2,245,674** | **3,045,266** | **9,606,121** | **2,071,960** | **1,087,286** | **3,478,235** | **3,881,835** | **461,921** | **48,625,683** |
| **Net liquidity gap** | **(21,576,419)** | **(509,624)** | **(1,521,706)** | **(6,102,436)** | **628,786** | **1,915,730** | **(158,129)** | **25,112,723** | **5,155,483** | **2,944,408** |

The terms to maturity of the liabilities shown in the foregoing table include the maturities of the fixed-term deposits disregarding renewal assumptions. Accordingly, the table showing the analysis of the Bank's assets and liabilities should not be interpreted as an exact reflection of the Group’s liquidity position in each of the periods included.

Note 66 contains detailed information on the Group's liquidity sources at 31 December 2017 and 2016.

## 18. Interest rate and foreign currency risks

Structural interest rate risk relates mainly to the exposure where, given a certain financial structure, interest rate fluctuations affect both the Group's net interest income and its economic value as a result of changes in the present value of future flows associated with the various assets and liabilities.

The four main factors identified in structural interest rate risk are: repricing risk, arising from the difference in the maturity and interest rate repricing dates of assets and liabilities; yield curve risk, due to potential changes in the slope and shape of the yield curve; basis risk, resulting from imperfect correlation between fluctuations in interest rates on various instruments with similar maturity and repricing features; and optionality: certain transactions have explicit or implicit options giving the holder the right to buy, sell or in some manner alter their future cash flows.

In accordance with the general risk management policies of the Risk Appetite Framework, management of the Bank's global risk profile should focus on the defence of the Group's value and, therefore, on the sphere of consolidated management. In this regard, Kutxabank performs an efficient, prudent and conservative management of interest rate risk, and conducts a strict monitoring of this risk based on the analysis of different scenarios. To monitor the level of risk, the Bank uses sensitivity indicators of the economic value of the balance sheet and net interest income at one and two years, and establishes limits on its exposure to structural interest rate risk.

The Board of Directors has ultimate responsibility for interest rate risk and delegates to the Asset-Liability Committee (ALCO) as the competent decision-making body in this respect. The Bank's ALCO establishes the future interest rate forecasts and assumptions that make it possible to model customer behaviour and the scenarios against which the possible impact of fluctuations in the forecast rates must be measured.

The ALCO is responsible for assessing exposure to structural interest rate risk and, if appropriate, for taking any corrective measures that might be required as part of its functions to optimise the financial structure of the balance sheet.

With a view to maintaining the desired levels of interest rate risk exposure, in addition to the natural hedges generated by the balance sheet itself, the Group arranges interest rate swaps to hedge against changes in the fair value and the cash flows of certain assets and liabilities.

Another risk factor that might generate losses in relation to the Group's net interest margin and its economic value is foreign currency risk, which is defined as the potential loss arising from adverse fluctuations in the exchange rates of the various currencies in which the Group operates.

The ALCO is similarly responsible for both setting policies and taking decisions on foreign currency risk. The Group systematically hedges its open currency positions relating to customer transactions and, therefore, its exposure to foreign currency risk is scant.

The table below shows the static gap of interest-rate sensitive items, classified by repricing date, which represents an initial approximation of the Group's exposure at 31 December 2017 and 2016 to the risk of changes in interest rates:

| | Millions of euros 2017 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | On-balance-sheet balances | Up to 1 month | 1 to 3 months | 3 months to 1 year | 1 to 2 years | 2 to 3 years | 3 to 4 years | More than 4 years | No maturity |
| Sensitive assets: | | | | | | | | | |
| Cash | 4,960 | 3,838 | - | 201 | - | 663 | - | - | 258 |
| Customers | 42,006 | 5,746 | 11,086 | 20,694 | 879 | 408 | 426 | 2,467 | 300 |
| Investment securities | 3,773 | 680 | 377 | 609 | 48 | 50 | 37 | 1,013 | 959 |
| | **50,739** | **10,264** | **11,463** | **21,504** | **927** | **1,121** | **463** | **3,480** | **1,517** |
| Sensitive liabilities: | | | | | | | | | |
| Bank financing | 4,459 | 29 | - | 208 | 2 | 2,794 | 1,400 | 25 | - |
| Borrowed funds | 44,951 | 5,432 | 6,646 | 9,302 | 165 | 103 | 998 | 22,101 | 205 |
| | **49,410** | **5,461** | **6,646** | **9,510** | **167** | **2,897** | **2,398** | **22,126** | **205** |
| Gap for the period | | 4,803 | 4,817 | 11,994 | 760 | (1,776) | (1,935) | (18,646) | |
| % of total assets | | 8.36% | 8.39% | 20.88% | 1.32% | (3.09%) | (3.37%) | (32.46%) | |
| Cumulative gap | | 4,803 | 9,620 | 21,614 | 22,374 | 20,598 | 18,663 | 17 | |
| % of total assets | | 8.36% | 16.75% | 37.63% | 38.95% | 35.86% | 32.49% | 0.03% | |

| | Millions of euros 2016 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | On-balance-sheet balances | Up to 1 month | 1 to 3 months | 3 months to 1 year | 1 to 2 years | 2 to 3 years | 3 to 4 years | More than 4 years | No maturity |
| Sensitive assets: | | | | | | | | | |
| Cash | 3,178 | 731 | 406 | 197 | - | 1,844 | - | - | - |
| Customers | 42,573 | 6,398 | 11,010 | 20,512 | 1,106 | 408 | 820 | 2,066 | 253 |
| Investment securities | 3,074 | 726 | 387 | 613 | 28 | 31 | 53 | 505 | 731 |
| | **48,825** | **7,855** | **11,803** | **21,322** | **1,134** | **2,283** | **873** | **2,571** | **984** |
| Sensitive liabilities: | | | | | | | | | |
| Bank financing | 3,363 | 186 | - | 211 | 8 | 219 | 2,697 | 42 | - |
| Borrowed funds | 45,263 | 5,024 | 9,551 | 10,284 | 519 | 148 | 264 | 19,142 | 331 |
| | **48,626** | **5,210** | **9,551** | **10,495** | **527** | **367** | **2,961** | **19,184** | **331** |
| Gap for the period | | 2,645 | 2,252 | 10,827 | 607 | 1,916 | (2,088) | (16,613) | |
| % of total assets | | 4.68% | 3.98% | 19.16% | 1.07% | 3.39% | (3.69%) | (29.40%) | |
| Cumulative gap | | 2,645 | 4,896 | 15,723 | 16,330 | 18,246 | 16,159 | (454) | |
| % of total assets | | 4.68% | 8.66% | 27.82% | 28.89% | 32.28% | 28.59% | (0.80%) | |

For the purpose of preparing the foregoing tables, "Cash" was deemed to include "Cash, Cash Balances at Central Banks and Other Demand Deposits" and "Loans and Receivables - Loans and Advances - Credit Institutions"; "Investment Securities" was deemed to include "Financial Assets Designated at Fair Value through Profit or Loss - Debt Securities", "Available-for-Sale Financial Assets - Debt Securities" and "Held-to-Maturity Investments"; "Bank Financing" was deemed to include "Financial Liabilities at Amortised Cost - Deposits - Central Banks" and "Financial Liabilities at Amortised Cost - Deposits - Credit Institutions"; and "Borrowed Funds" was deemed to include "Financial Liabilities at Amortised Cost - Deposits - Customers" and "Financial Liabilities at Amortised Cost - Debt Securities Issued" in the Group's separate balance sheets.

The criteria used to classify transactions with no maturity or with undetermined maturity were as follows:

| | |
|---|---|
| **Assets** | |
| Balances with Bank of Spain | Up to 1 month |
| Balances with other credit institutions | 2 to 3 years |
| Credit cards - Public and private sector | Less than 1 month |
| Matured balances receivable and overdrafts | 1 to 3 months |
| Other loans | 3 to 4 years |
| **Liabilities** | |
| Deposits from credit institutions | 2 to 3 years |
| Ordinary demand savings deposits - Private sector | More than 4 years for the stable portion and less than 1 month for the unstable portion |
| Interest-bearing savings deposits - Private sector | 1 month to 4 years depending on the nature of the product |
| Ordinary demand savings deposits - Public sector | More than 4 years for the stable portion and less than 1 month for the unstable portion |
| Other deposits - Public sector | 2 to 3 years |
| Other liabilities | 2 to 3 years |

At 31 December 2017 and 2016, the sensitivity of the Group's net interest income, accumulated other comprehensive income in equity and economic value to horizontal shifts in the yield curve of 100 bp and 50 bp, based on a time horizon of one year and a scenario of a stable balance sheet, was as follows:

*Sensitivity analysis at 31 December 2017:*

| | Thousands of euros | | |
|---|---|---|---|
| | Net interest income | Impact on accumulated other comprehensive income in equity | Economic value |
| Variations in Euribor: | | | |
| 100-basis-point increase | 81,618 | (78,490) | 462,870 |
| 50-basis-point increase | 42,586 | (40,093) | 259,614 |
| 50-basis-point fall | (4,324) | 37,122 | (291,398) |

*Sensitivity analysis at 31 December 2016:*

| | Thousands of euros | | |
|---|---|---|---|
| | Net interest income | Impact on accumulated other comprehensive income in equity | Economic value |
| Variations in Euribor: | | | |
| 100-basis-point increase | 55,548 | (43,469) | 511,162 |
| 50-basis-point increase | 33,028 | (22,238) | 283,557 |
| 50-basis-point fall | 3,770 | 16,394 | (103,240) |

## 19. Other risks

### *19.1. Market risk*

Market risks relate to the possibility of incurring losses on own portfolios as a result of an adverse trend in money, bond, equity, derivative or other markets.

This risk is present in all the Group's portfolios, although its impact on profit or loss and equity may vary depending on the accounting treatment applicable in each case. Market risk management seeks to limit the Group's exposure to the aforementioned losses and to optimise the ratio between the level of risk assumed and the expected return, in keeping with the guidelines established by the Parent's senior executive bodies.

The Asset-Liability Committee is responsible for managing market risk within the framework of the aforementioned general guidelines.

Close control of market risk requires the implementation of operating procedures in keeping with the regulatory trends arising from the New Capital Accord and with the best practices generally accepted by the market. These procedures include matters such as segregation of functions, information control, definition of objectives, operating limits and other security-related matters.

In addition to procedural matters, market risk control is supported by quantitative tools that provide standardised risk measures. The model used is based on value at risk (VaR), which is calculated using historical simulation and parametric methodologies derived from the variance-covariance matrix. The reference VaR is calculated with a historical simulation model, although VaR is also calculated with a parametric model for comparison purposes. The VaR model used is intended to estimate, with a confidence interval of 99%, the maximum potential loss that might arise from a portfolio or group of portfolios over a given time horizon. The time horizon is one day for trading operations.

The validation, or backtesting, of the VaR model employed consists of comparing the percentage of actual exceptions with the confidence interval used. An exception arises when the actual loss on a portfolio for a given time horizon exceeds the VaR calculated at the beginning of that time horizon. The time horizons used for the validation, or backtesting, are one and ten days.

The methodology described above is supplemented with stress tests which simulate the behaviour of the aforementioned portfolios in extremely adverse scenarios. The systematic stress scenarios used are in line with the recommendations of the Derivatives Policy Group Committee made in 1995 in the "Framework for Voluntary Oversight" working paper. This document introduces a series of recommendations which make it possible to forecast the behaviour of the value of a portfolio in the event of certain extreme behaviours grouped by risk factor. In addition to using these recommended scenarios, stress testing exercises are also performed based on historical scenarios with exceptionally unfavourable trends for the portfolios being analysed.

In order to manage market risk the Group has tools that ensure effective control of market risk at all times, in line with best market practices.

The Group has no net market risk positions of a structural nature in trading derivatives, since it closes out all its positions in derivatives with customers, either through bank counterparties or through opposite-direction derivatives arranged in organised markets. However, under certain circumstances small net market risk positions in trading derivatives are taken for which a special risk analysis is performed.

In 2017 the average daily VaR of the financial assets held for trading, calculated using the parametric model, based on a one-day time horizon and with a confidence level of 99%, amounted to EUR 72 thousand (2016: EUR 145 thousand).

The Group's exposure to structural equity price risk derives mainly from investments in industrial and financial companies with medium- to long-term investment horizons. The exposure to market risk (measured as the fair value of the equity instruments held by the Group) amounted to EUR 1,095,829 thousand at 31 December 2017 (31 December 2016: EUR 1,642,397 thousand). The Group opted to calculate overall VaR by using the historical simulation model, on the basis of which the average ten-day VaR of the investment portfolio, with a 99% confidence level, was EUR 158,082 thousand (2016: EUR 326,652 thousand). The results of the calculation of this variable based on the parametric method used for comparison purposes do not differ significantly from those obtained using the simulation method.

### *19.2. Operational risk*

Operational risk is defined as the risk of loss resulting from failed, erroneous, insufficient or inadequate internal processes, people and systems or from external events. This definition includes legal risk, but excludes reputational and strategic risk.

The Group uses a methodology and IT tools developed specifically for managing operational risk, and has personnel devoted exclusively to this task, the Operational Risk Unit, as well as a broad network of professionals responsible for managing this risk throughout the organisation. This entire system is developed and supervised by the Operational Risk Committee, which is chaired by the General Corporate Resources Manager and comprises representatives from most areas of the Parent.

The operational risk management system consists essentially of the following processes:

1. Qualitative self-assessment process.

2. Loss recognition and risk indicator data collection process.

3. Mitigation action analysis and proposal process.

4. Business continuity planning.

The Kutxabank Group's operational risk regulatory capital calculated at 31 December 2017 amounted to EUR 189,812 thousand (31 December 2016: EUR 185,875 thousand).

## 20. Risk concentration

The Group closely monitors its risk concentration for each possible category: counterparty, sector, product, geographical area, etc.

At 31 December 2017, around 77% of the Group's credit risk arose from the individuals business (31 December 2016: 78%), which guarantees a high degree of capillarity in its portfolio.

The risk exposure to financial institutions is subject to very strict limits established by the Risk Area, compliance with which is checked on an ongoing basis by the Financial Area. Additionally, there are netting and collateral agreements with the most significant counterparties (see Note 16) and, therefore, credit risks arising from the Parent's treasury operations are limited to a minimum.

At 31 December 2017, 75% of the loans granted were secured by collateral, mostly residential properties (31 December 2016: 76%). The mortgages securing these loans and the criteria used to grant them help mitigate credit risk concentration (see Note 25).

In accordance with the requirements of Bank of Spain Circular 5/2011 in relation to information on transparency, Note 66 includes a detail of the information relating to financing granted to the construction and property development industries, financing granted for home purchases, assets acquired to settle debts and financing requirements and strategies.

## 21. Cash, cash balances at central banks and other demand deposits

The detail of "Cash, Cash Balances at Central Banks and Other Demand Deposits" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Cash | 257,891 | 260,969 |
| Balances with the Bank of Spain | 3,893,085 | 873,568 |
| Balances with other central banks | 588 | 590 |
| Reciprocal accounts | 9,892 | - |
| Demand accounts | 246,476 | 346,292 |
| Valuation adjustments | (294) | 89 |
| | **4,407,638** | **1,481,508** |

The balance held in current accounts at the Bank of Spain is earmarked for compliance with the minimum reserve ratio, in accordance with current regulations.

The average annual interest rate on "Balances with the Bank of Spain" ranged from -0.40% to 0% in 2017 (2016: 0.01%).

## 22. Financial assets and liabilities held for trading

The breakdown of the financial assets and liabilities held for trading in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Financial assets held for trading | | Financial liabilities held for trading | |
| | 2017 | 2016 | 2017 | 2016 |
| Derivatives | 83,770 | 142,345 | 83,364 | 140,109 |
| | **83,770** | **142,345** | **83,364** | **140,109** |

The effect of the changes in the fair value of the financial assets and liabilities held for trading on the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows (see Note 50):

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Debt securities | 260 | 276 |
| Equity instruments | 5 | 22 |
| Derivatives | 1,688 | (2,052) |
| **Net gain/(loss)** | **1,953** | **(1,754)** |
| Securities whose fair value is estimated based on their market price | 669 | 298 |
| Securities whose fair value is estimated based on valuation techniques | 1,284 | (2,052) |
| **Net gain/(loss)** | **1,953** | **(1,754)** |

The detail, by currency and maturity, of the financial assets and liabilities held for trading on the asset and liability sides of the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Financial assets held for trading | | Financial liabilities held for trading | |
| | 2017 | 2016 | 2017 | 2016 |
| **By currency:** | | | | |
| Euro | 81,517 | 141,667 | 81,093 | 139,430 |
| US dollar | 2,245 | 678 | 2,263 | 679 |
| US dollar | 8 | - | 8 | - |
| | **83,770** | **142,345** | **83,364** | **140,109** |
| **By maturity:** | | | | |
| Less than 1 month | 5,113 | 9,724 | 3,391 | 8,555 |
| 1 to 3 months | 5,012 | 9,567 | 4,903 | 6,340 |
| 3 months to 1 year | 4,768 | 9,433 | 4,697 | 11,359 |
| 1 to 5 years | 5,161 | 9,326 | 5,167 | 9,161 |
| More than 5 years | 63,716 | 104,295 | 65,206 | 104,694 |
| | **83,770** | **142,345** | **83,364** | **140,109** |

### a) *Credit risk*

The detail of the risk concentration in "Financial Assets Held for Trading", by geographical location, counterparty and type of instrument, showing the corresponding carrying amounts at 31 December 2017 and 2016, is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Thousands of euros | % | Thousands of euros | % |
| **By geographical location:** | | | | |
| Spain | 78,453 | 93.65 | 129,237 | 90.79 |
| Other European Union countries | 5,317 | 6.35 | 12,847 | 9.03 |
| Rest of the world | - | - | 261 | 0.18 |
| | **83,770** | **100.00** | **142,345** | **100.00** |
| **By counterparty:** | | | | |
| Credit institutions | 9,211 | 11.00 | 16,809 | 11.81 |
| Other resident sectors | 74,559 | 89.00 | 125,536 | 88.19 |
| | **83,770** | **100.00** | **142,345** | **100.00** |
| **By type of instrument:** | | | | |
| OTC derivatives | 83,770 | 100.00 | 142,345 | 100.00 |
| | **83,770** | **100.00** | **142,345** | **100.00** |

The detail, by credit ratings assigned by external rating agencies, of "Financial Assets Held for Trading" is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Thousands of euros | % | Thousands of euros | % |
| A+ | - | - | 42 | 0.03 |
| A | 4,370 | 5.22 | 11,495 | 8.08 |
| A- | 201 | 0.24 | 1,210 | 0.85 |
| BBB+ | 4,561 | 5.44 | 4,053 | 2.85 |
| BBB | 69 | 0.08 | - | - |
| BBB- | 10 | 0.01 | 189 | 0.13 |
| Lower than BBB- | - | - | 9 | 0.01 |
| Unrated | 74,559 | 89.00 | 125,347 | 88.06 |
| | **83,770** | **100.00** | **142,345** | **100.00** |

### b) Derivatives

The detail of "Derivatives" on the asset and liability sides of the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | 2017 | | | | 2016 | | | |
|---|---|---|---|---|---|---|---|---|
| | Assets | | Liabilities | | Assets | | Liabilities | |
| | Fair value | Notional amount | Fair value | Notional amount | Fair value | Notional amount | Fair value | Notional amount |
| **Unmatured foreign currency purchases and sales:** | | | | | | | | |
| Purchases of foreign currencies against euros | 163 | 33,127 | 5,450 | 439,900 | 9,469 | 202,340 | 2,558 | 311,427 |
| Sales of foreign currencies against euros | 10,913 | 627,915 | 93 | 16,046 | 10,332 | 321,628 | 6,714 | 260,028 |
| Purchases of foreign currencies against foreign currencies | - | - | 3,291 | 2,223 | 328 | 13,962 | 7,683 | 1,562 |
| **Securities options:** | | | | | | | | |
| Bought | 934 | 38,450 | - | - | 1,362 | 38,450 | - | - |
| Written | - | - | 2,123 | 1,520,154 | - | - | 2,015 | 1,913,645 |
| **Interest rate options:** | | | | | | | | |
| Bought | 473 | 105,491 | - | - | 255 | 171,844 | - | - |
| Written | - | - | 489 | 107,181 | - | - | 245 | 173,735 |
| **Foreign currency options:** | | | | | | | | |
| Bought | 2,253 | 113,898 | - | - | 678 | 71,084 | - | - |
| Written | - | - | 2,271 | 113,898 | - | - | 680 | 160,616 |
| **Other transactions:** | | | | | | | | |
| Securities swaps | 364 | 130,605 | 1 | 909 | 786 | 172,105 | 698 | 1,014 |
| Interest rate swaps (IRSs) | 68,363 | 505,216 | 69,390 | 465,530 | 100,161 | 520,946 | 103,551 | 521,816 |
| **Transactions on other risks** | 307 | 3,427 | 256 | 3,482 | 18,974 | 7,429 | 15,965 | 6,323 |
| | **83,770** | **1,558,129** | **83,364** | **2,669,323** | **142,345** | **1,519,788** | **140,109** | **3,350,166** |

The guarantees granted by the Group to certain investment funds and pension funds are recognised as securities options written. At 31 December 2017, the notional amount and fair value of these transactions were EUR 1,351,887 thousand and EUR 442 thousand, respectively (31 December 2016: EUR 1,704,019 thousand and EUR 470 thousand, respectively).

At 31 December 2017, the effect of considering both counterparty risk and own risk in the measurement of the derivatives was the recognition of a reduction in value of EUR 6,062 thousand and an increase in value of EUR 378 thousand, respectively, in the Group's consolidated balance sheet (31 December 2016: EUR 8,471 thousand and EUR 1,925 thousand, respectively).

Since 2016, the Group has performed certain OTC derivatives transactions through the Eurex clearing house. The net fair value of all the positions held with this clearing house represents a deposit held by the Bank, which is recognised under "Loans and Receivables - Loans and Advances" in the consolidated balance sheet (see Note 25). At 31 December 2017, the amount of this deposit corresponding to the value of the derivatives designated as held for trading totalled EUR 80 thousand, and the notional amount was EUR 30,422 thousand (31 December 2016: EUR 42 thousand and EUR 13,211 thousand, respectively).

The notional and/or contractual amounts of the derivative contracts are not a quantification of the risk assumed by the Group, since its net position is the result of offsetting and/or combining these instruments.

The differences between the value of the derivatives sold to and purchased from customers and the derivatives purchased from and sold to counterparties, in which there is a margin for the Group, are not material.

The market value of the derivatives embedded in structured deposits marketed by the Group at 31 December 2017 amounted to EUR 159 thousand (31 December 2016: EUR 759 thousand), and this amount is recognised under "Financial Liabilities Held for Trading - Derivatives" in the consolidated balance sheet as at that date.

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

The detail, by counterparty, geographical location of risk and type of instrument, of the financial assets included in this category at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Debt securities:** | | |
| **By counterparty:** | | |
| Issued by credit institutions- | | |
| Non-resident | 29,136 | 28,745 |
| | **29,136** | **28,745** |
| **By geographical location:** | | |
| Other European Union countries | 29,136 | 28,745 |
| | **29,136** | **28,745** |
| **By type of instrument:** | | |
| Other financial instruments | 29,136 | 28,745 |
| | **29,136** | **28,745** |
| **Equity instruments:** | | |
| Investment fund units/shares | 6,103 | 6,249 |
| | **6,103** | **6,249** |
| | **35,239** | **34,994** |

At 31 December 2017 and 2016, "Equity Instruments" in the foregoing table included unit-linked investments, i.e. investments linked to life insurance products where the investment risk is borne by the policyholder (see Note 36). These transactions relate to the Group's insurance companies.

The average annual interest rate on debt securities was 6.20% in both 2017 and 2016.

The carrying amount shown in the foregoing table represents the Group's maximum level of credit risk exposure in relation to the financial instruments included therein.

The fair value of all the debt securities included in this category is determined on the basis of internal valuation techniques. Also, the fair value of all the equity instruments included in this category is determined on the basis of their quoted prices.

At 31 December 2017 and 2016, the Group had not pledged any fixed-income securities in this portfolio in order to qualify for European Central Bank financing.

## 24. Available-for-sale financial assets

The detail of "Available-for-Sale Financial Assets" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Debt securities:** | | |
| Government debt securities | 2,902,531 | 2,428,031 |
| Issued by credit institutions | 425,336 | 400,903 |
| Other fixed-income securities | 196,126 | 200,898 |
| | **3,523,993** | **3,029,832** |
| **Equity instruments:** | | |
| Shares of Spanish companies | 1,351,095 | 2,181,259 |
| Shares of foreign companies | 5,546 | 2,403 |
| Investment fund units and shares (*) | 15,925 | 22,996 |
| | 1,372,566 | 2,206,658 |
| | **4,896,559** | **5,236,490** |

(*) At 31 December 2017, EUR 15,925 thousand related to investment funds managed by the Group (31 December 2016: EUR 22,254 thousand).

The detail, by currency, maturity and listing status, of "Available-for-Sale Financial Assets" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **By currency:** | | |
| Euro | 4,896,559 | 5,236,490 |
| | **4,896,559** | **5,236,490** |
| **By maturity:** | | |
| Less than 3 months | 25,779 | 88,876 |
| 3 months to 1 year | 99,980 | 70,353 |
| 1 to 5 years | 824,440 | 732,520 |
| More than 5 years | 2,573,794 | 2,138,120 |
| Undetermined maturity | 1,372,566 | 2,206,621 |
| | **4,896,559** | **5,236,490** |
| **By listing status:** | | |
| Listed- | | |
| Debt securities | 3,475,599 | 2,686,877 |
| Equity instruments | 873,895 | 1,497,247 |
| | 4,349,494 | 4,184,124 |
| Unlisted- | | |
| Debt securities | 48,394 | 342,956 |
| Equity instruments | 498,671 | 709,410 |
| | 547,065 | 1,052,366 |
| | **4,896,559** | **5,236,490** |

"Available-for-Sale Financial Assets - Equity Instruments" at 31 December 2017 includes EUR 36,328 thousand (31 December 2016: EUR 163,419 thousand) relating to equity interests not traded in an active market and measured at acquisition cost adjusted, where appropriate, by any related impairment losses.

Note 38 includes a detail of "Accumulated Other Comprehensive Income" in consolidated equity at 31 December 2017 and 2016 arising from changes in the fair value of the items included in "Available-for-Sale Financial Assets".

EUR 257,726 thousand, before considering the related tax effect, were derecognised from "Accumulated Other Comprehensive Income" in consolidated equity in the year ended 31 December 2017 as a result of sales and impairment losses, and this amount was recognised as a gain in the consolidated statement of profit or loss (2016: a gain of EUR 127,370 thousand) (see Note 38).

In 2017 the Group sold investments in this portfolio giving rise to gains of EUR 260,588 thousand which were recognised in the consolidated statement of profit or loss (2016: EUR 164,140 thousand) (see Note 49).

The average annual interest rate on debt securities was 2.28% in 2017 (2016: 2.72%).

At 31 December 2017 and 2016, the Group had no securities classified in this portfolio pledged to the Bank of Spain under a loan agreement (see Note 42).

The fair value of "Available-for-Sale Financial Assets" is included in Note 41.

### *a) Credit risk*

The detail of the risk concentration, by geographical location, of "Available-for-Sale Financial Assets - Debt Securities" is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Thousands of euros | % | Thousands of euros | % |
| Spain | 3,102,627 | 88.04 | 2,660,833 | 87.82 |
| Other European Union countries | 208,291 | 5.91 | 144,040 | 4.75 |
| Rest of the world | 213,075 | 6.05 | 224,959 | 7.43 |
| | **3,523,993** | **100.00** | **3,029,832** | **100.00** |

The detail, by credit ratings assigned by external rating agencies, at the end of 2017 and 2016 is as follows:

| | 2017 | | 2016 | |
|---|---|---|---|---|
| | Thousands of euros | % | Thousands of euros | % |
| AAA | 31,551 | 0.90 | 33,090 | 1.09 |
| AA+ | - | - | 2,511 | 0.08 |
| AA | 14,745 | 0.42 | 13,105 | 0.43 |
| AA- | 12,786 | 0.36 | 25,874 | 0.85 |
| A+ | 23,227 | 0.66 | 114,539 | 3.78 |
| A | 98,237 | 2.79 | 88,529 | 2.92 |
| A- | 235,807 | 6.69 | 117,435 | 3.88 |
| BBB+ | 2,914,884 | 82.72 | 2,483,635 | 81.97 |
| BBB | 72,213 | 2.05 | 78,263 | 2.58 |
| BBB- | 47,642 | 1.35 | 8,108 | 0.27 |
| Lower than BBB- | 8,019 | 0.23 | 1,737 | 0.07 |
| Unrated | 64,882 | 1.84 | 63,006 | 2.08 |
| | **3,523,993** | **100.00** | **3,029,832** | **100.00** |

***b) Impairment losses***

The detail of "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 statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows (see Note 60):

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Debt securities | (13) | (146) |
| Equity instruments | (57,837) | (39,285) |
| | **(57,850)** | **(39,431)** |
| Impairment losses charged to income | | |
| Individually assessed | (57,850) | (39,431) |
| | **(57,850)** | **(39,431)** |

In 2017 impairment losses arose on available-for-sale financial assets, giving rise to the reclassification of EUR 551 thousand from "Accumulated Other Comprehensive Income" in consolidated equity to "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 statement of profit or loss (2016: EUR 29,916 thousand) (see Note 38).

## 25. Loans and receivables

The detail of “Loans and Receivables” in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Loans and advances: | | |
| Credit institutions | 552,660 | 1,696,602 |
| Customers | 42,006,373 | 42,573,133 |
| | **42,559,033** | **44,269,735** |

At 31 December 2017, the Group had debt instruments loaned or advanced as collateral amounting to EUR 5,028,953 thousand (31 December 2016: EUR 5,407,162 thousand) (see Note 42).

The detail, by currency, of “Loans and Receivables” in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **By currency:** | | |
| Euro | 42,221,827 | 43,962,783 |
| US dollar | 246,203 | 205,498 |
| Pound sterling | 2,957 | 3,292 |
| Japanese yen | 50,867 | 53,827 |
| Swiss franc | 19,201 | 23,037 |
| Mexican peso | 17,569 | 20,815 |
| Other currencies | 408 | 483 |
| | **42,559,033** | **44,269,735** |

***a) Loans and advances - Credit institutions***

The detail, by type of instrument, of “Loans and Advances - Credit Institutions” in the consolidated balance sheet is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Time deposits and other accounts (Note 16) | 351,948 | 327,602 |
| Reverse repurchase agreements | 200,880 | 1,369,368 |
| Valuation adjustments | | |
| Impairment losses | - | - |
| Other | (168) | (368) |
| | (168) | (368) |
| | **552,660** | **1,696,602** |

The annual interest rate on "Loans and Advances - Credit Institutions" was approximately -0.07% in 2017 (2016: approximately 0.00%).

### *b) Loans and advances - Customers*

The detail of "Loans and Receivables - Loans and Advances - Customers" at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **By type:** | | |
| Reverse repurchase agreements | - | 243,752 |
| Commercial credit | 598,351 | 571,974 |
| Mortgage loans | 31,330,598 | 31,877,263 |
| Loans with other collateral | 187,784 | 285,987 |
| Other term loans | 7,521,822 | 6,966,793 |
| Finance leases | 150,661 | 133,945 |
| Receivable on demand and other | 812,094 | 761,168 |
| Non-performing assets | 2,176,518 | 3,000,971 |
| Other financial assets: | | |
| Unsettled financial transactions | 732 | 5,240 |
| Fees and commissions for guarantees given | 3,369 | 4,457 |
| Other items | 128,422 | 143,378 |
| | 42,910,351 | 43,994,928 |
| Valuation adjustments: | | |
| Impairment losses | (904,767) | (1,437,232) |
| Other valuation adjustments | 789 | 15,437 |
| | (903,978) | (1,421,795) |
| | **42,006,373** | **42,573,133** |
| **By geographical area:** | | |
| Spain | 41,669,378 | 42,254,662 |
| Other European Union countries | 178,714 | 159,572 |
| Rest of the world | 158,281 | 158,899 |
| | **42,006,373** | **42,573,133** |
| **By interest rate:** | | |
| Fixed rate | 5,529,659 | 4,507,769 |
| Floating rate tied to Euribor | 33,004,052 | 34,137,883 |
| Floating rate tied to the mortgage benchmark rate (IRPH) | 1,397,890 | 1,593,459 |
| Other currencies | 2,074,772 | 2,334,022 |
| | **42,006,373** | **42,573,133** |

At 31 December 2017, "Loans and Advances - Customers - Valuation Adjustments" in the foregoing table included EUR 3,821 thousand (31 December 2016: EUR 19,477 thousand) relating to changes in the fair value of certain loans to customers attributable to interest rate and foreign currency risk, for which a fair value hedge was arranged as discussed in Note 27.

The average effective interest rate on the debt instruments classified as loans and advances to customers at 31 December 2017 was 1.29% (31 December 2016: 1.42%).

The Group has performed various securitisation transactions and other transfers of assets, the detail at 31 December 2017 and 2016 being as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Assets derecognised in full:** | | |
| Mortgage assets securitised through mortgage participation certificates | 8,079 | 9,581 |
| Other securitised assets | 4,302 | 5,102 |
| | **12,381** | **14,683** |
| *Memorandum item: derecognised before 1 January 2004* | *12,381* | *14,683* |
| **Assets retained in full on the face of the consolidated balance sheet:** | | |
| Mortgage assets securitised through mortgage transfer certificates | 2,996,358 | 3,305,584 |
| Mortgage assets securitised through mortgage participation certificates | 31,135 | 35,847 |
| | **3,027,493** | **3,341,431** |
| | **3,039,874** | **3,356,114** |

In 2002 the Group launched several asset securitisation programmes. The securitised assets were removed from the related balance sheets and this criterion was maintained at 31 December 2017 and 2016 in accordance with IFRS 1, First-time Adoption of International Financial Reporting Standards.

The principal amounts and outstanding balances of the mortgage participation certificates and subordinated loans relating to these asset securitisation programmes at 31 December 2017 and 2016 were as follows:

| | Thousands of euros | | | | | | SPV subscribing to the issue |
|---|---|---|---|---|---|---|---|
| | Principal amount | | Outstanding balance | | Subordinated loans | | |
| | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | |
| 2002 | 61,000 | 61,000 | 8,079 | 9,581 | 284 | 337 | AyT 11, Fondo de Titulización Hipotecaria |
| 2002 | 71,683 | 71,683 | 4,302 | 5,102 | 2,818 | 2,818 | AyT 7, Promociones Inmobiliarias I, Fondo de Titulización de Activos |
| | **132,683** | **132,683** | **12,381** | **14,683** | **3,102** | **3,155** | |

From 2004 to 2009, the Group launched several mortgage loan securitisation programmes through the issuance of mortgage transfer certificates and mortgage participation certificates. These asset transfers do not meet the requirements of Bank of Spain Circular 4/2004 for derecognition of the related assets because the Group retained the risks and rewards associated with ownership of the assets, as it granted to the SPVs subordinated financing which absorbs substantially all the expected losses on the securitised assets.

The principal amounts and outstanding balances of the mortgage transfer certificates, mortgage participation certificates and subordinated loans relating to each of the mortgage loan securitisation programmes are as follows:

| | Thousands of euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Principal amount | | Average term to maturity (in years) | | Outstanding balance | | Subordinated loans/credits | | SPV subscribing to the issue |
| | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | 2017 | 2016 | |
| 2008 | 1,000,000 | 1,000,000 | 16.25 | 17.07 | 446,391 | 497,525 | 39,700 | 39,700 | AyT Colaterales Global Hipotecario BBK II FTA |
| 2007 | 1,500,000 | 1,500,000 | 17.86 | 18.78 | 762,856 | 829,403 | 54,600 | 54,600 | AyT Colaterales Global Hipotecario BBK I FTA |
| 2006 | 1,000,000 | 1,000,000 | 15.24 | 16.16 | 381,409 | 421,778 | 16,496 | 18,173 | AyT Hipotecario BBK II FTA |
| 2005 | 1,000,000 | 1,000,000 | 14.41 | 15.34 | 304,580 | 338,760 | 24,000 | 24,000 | AyT Hipotecario BBK I FTA |
| 2006 | 750,000 | 750,000 | 16.41 | 17.22 | 270,004 | 303,913 | 9,874 | 11,114 | AyT Kutxa Hipotecario I, Fondo de Titulización de Activos |
| 2007 | 1,200,000 | 1,200,000 | 18.67 | 19.55 | 537,735 | 590,083 | 27,600 | 29,114 | AyT Kutxa Hipotecario II, Fondo de Titulización de Activos |
| 2005 | 300,700 | 300,700 | 18.79 | 19.71 | 42,907 | 48,591 | 5,342 | 5,342 | AyT Promociones Inmobiliarias III, Fondo de Titulización de Activos |
| 2004 | 150,000 | 150,000 | 11.44 | 12.21 | 31,135 | 35,847 | 1,125 | 1,125 | AyT Hipotecario Mixto II, Fondo de Titulización de Activos |
| 2004 | - | - | - | - | - | - | 62 | 62 | AyT FTPYME II, Fondo de Titulización de Activos |
| 2006 | 200,000 | 200,000 | 13.86 | 17.65 | 63,228 | 72,373 | 1,346 | 1,605 | TDA 27, Fondo de Titulización de Activos |
| 2007 | 199,900 | 199,900 | 20.37 | 21.33 | 111,729 | 120,572 | 3,138 | 3,138 | AyT Colaterales Global Hipotecario Vital I FTA |
| 2009 | 155,000 | 155,000 | 19.49 | 20.20 | 75,519 | 82,586 | 8,060 | 8,243 | AyT ICO-FTVPO Caja Vital Kutxa, Fondo de Titulización de Activos |
| | **7,455,600** | **7,455,600** | **-** | **-** | **3,027,493** | **3,341,431** | **191,343** | **196,216** | |

The Group has retained a portion of the asset-backed securities relating to the above-mentioned issues and, therefore, the detail of the amount recognised under "Financial Liabilities at Amortised Cost" in the accompanying consolidated balance sheet is as follows (see Note 34-d):

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Funds received under financial asset transfers | 3,007,984 | 3,321,882 |
| Classified as marketable debt securities (Note 34) | (202,823) | (225,930) |
| Retained bonds and subordinated loans | (2,712,240) | (2,990,121) |
| | **92,921** | **105,831** |

Of the EUR 2,707,447 thousand of asset-backed securities retained by the Group, a nominal amount of EUR 2,212,399 thousand was pledged to the Bank of Spain under a loan agreement (2016: of the EUR 2,985,329 thousand of asset-backed securities, a nominal amount of EUR 2,473,152 thousand was pledged to the Bank of Spain under the loan agreement) (see Note 42).
In 2016 the Bank recognised a gain of EUR 5 thousand under "Gains or (-) Losses on Derecognition of Financial Assets and Liabilities not Measured at Fair Value through Profit or Loss, Net" in the consolidated statement of profit or loss (see Notes 34-d and 49) as a result of having repurchased bonds at a cost below the value at which they were issued and were recognised. No amounts were recognised in this connection in 2017.

At 31 December 2017 and 2016, the Group had finance lease contracts with customers for tangible assets including buildings, furniture, vehicles and IT equipment, which are recognised as discussed in Note 14-m. The residual value of these lease contracts, which is the amount of the last lease payment, is secured by the leased asset.

At 31 December 2017 and 2016, the reconciliation of the gross investment in leases classified as standard to the present value of the minimum lease payments receivable, broken down by the terms shown, was as follows:

| | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | | | 2016 | | |
| | Within 1 year | 1 to 5 years | More than 5 years | Within 1 year | 1 to 5 years | More than 5 years |
| Lease payments outstanding | 29,151 | 88,356 | 20,933 | 23,834 | 77,303 | 20,246 |
| Residual value | 871 | 6,316 | 5,034 | 1,044 | 6,177 | 5,341 |
| Unaccrued future interest | 1,969 | 4,228 | 1,032 | 1,964 | 4,526 | 1,193 |
| Unaccrued future VAT | 6,630 | 20,645 | 5,673 | 5,400 | 17,696 | 5,452 |
| **Gross investment** | **38,621** | **119,545** | **32,672** | **32,242** | **105,702** | **32,232** |

At 31 December 2017 and 2016, the accumulated impairment losses covering bad debts relating to the minimum finance lease payments receivable were not material.

The most significant finance lease contracts involving the Group relate to financing transactions granted to customers to acquire assets needed by them to carry on their ordinary business activities.

***c) Impairment losses***

The detail of the impairment losses on "Loans and Receivables", which are recognised mainly under "Impairment (-) or Reversal of Impairment on Financial Assets not Measured at Fair Value through Profit or Loss - Loans and Receivables" in the consolidated statement of profit or loss for the years ended 31 December 2017 and 2016, is as follows (see Note 60):

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Net impairment losses charged to income - Loans and receivables | (173,442) | (186,214) |
| Prior years' impairment losses reversed with a credit to income | 74,084 | 103,315 |
| Recovery of written-off assets | 80,548 | 36,344 |
| Direct write-offs | (9,602) | (3,377) |
| | **(28,412)** | **(49,932)** |

The detail of "Loans and Receivables - Impairment Losses" at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **By geographical area:** | | |
| Spain | (895,938) | (1,425,645) |
| Rest of the world | (8,829) | (11,587) |
| | **(904,767)** | **(1,437,232)** |
| **By counterparty:** | | |
| Credit institutions | - | - |
| Customers: | | |
| Other resident sectors | (895,938) | (1,425,465) |
| Other non-resident sectors | (8,829) | (11,767) |
| | **(904,767)** | **(1,437,232)** |

The changes in 2017 and 2016 in "Loans and Receivables - Impairment Losses - Customers" were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balance at beginning of year | (1,437,232) | (2,158,936) |
| Net impairment losses charged to income | (173,442) | (186,214) |
| Reversal of impairment losses recognised in prior years | 74,084 | 103,315 |
| Assets written off against allowances | 545,168 | 722,432 |
| Transfer to non-current assets held for sale (Note 33) | 77,613 | 50,151 |
| Transfers to tangible assets (Note 29) | - | 4,000 |
| Transfers to/from provisions (Note 35) | 15,442 | - |
| Transfers of provisions for contingent liabilities | (4,314) | - |
| Other | (2,086) | 28,020 |
| **Balance at end of year** | **(904,767)** | **(1,437,232)** |

At 31 December 2017, the Group recognised EUR 9,602 thousand relating to bad debts written off (31 December 2016: EUR 3,377 thousand), and this amount was added to the balance of "Impairment or Reversal of Impairment on Financial Assets not Measured at Fair Value through Profit or Loss - Loans and Receivables" in the consolidated statement of profit or loss (see Note 60).

The cumulative finance income not recognised in the consolidated statement of profit or loss relating to impaired financial assets amounted to EUR 1,026,325 thousand at 31 December 2017 (31 December 2016: EUR 1,028,734 thousand).

The detail of the carrying amount of the non-performing assets, without deducting the impairment losses, is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **By geographical location:** | | |
| Spain | 2,153,216 | 2,970,695 |
| Other | 23,302 | 30,276 |
| | **2,176,518** | **3,000,971** |
| **By counterparty:** | | |
| Public sector | 3,921 | 8,035 |
| Customers: | | |
| Other resident sectors | 2,149,295 | 2,962,660 |
| Other non-resident sectors | 23,302 | 30,276 |
| | **2,176,518** | **3,000,971** |
| **By type:** | | |
| Commercial credit | 15,700 | 30,572 |
| Mortgage loans | 1,912,841 | 2,618,289 |
| Loans with other collateral | 73,788 | 85,289 |
| Other term loans | 150,148 | 211,817 |
| Finance leases | 1,002 | 1,033 |
| Receivable on demand and other | 15,053 | 16,788 |
| Other financial assets | 7,986 | 37,183 |
| | **2,176,518** | **3,000,971** |

The detail of the non-performing assets, by age of the amounts classified as non-performing, without deducting the impairment losses, and of the value of the collateral received is as follows:

| | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | | | | | |
| | ≤90 days | >90 days ≤180 days | >180 days ≤1 year | >1 year | Total | Collateral received |
| **By counterparty:** | | | | | | |
| Central banks | - | - | - | - | - | - |
| Public sector | 28 | - | - | 3,893 | 3,921 | 2,799 |
| Credit institutions | - | - | - | - | - | - |
| Other financial corporations | 1,061 | - | - | 5,487 | 6,548 | 1,080 |
| Non-financial corporations | 262,928 | 18,678 | 28,660 | 626,544 | 936,810 | 542,425 |
| *Of which: secured by commercial real estate* | *138,218* | *6,214* | *10,955* | *358,192* | *513,579* | *353,216* |
| Households | 186,530 | 40,706 | 60,661 | 941,342 | 1,229,239 | 813,004 |
| *Of which: secured by residential real estate* | *153,258* | *36,364* | *52,871* | *837,726* | *1,080,219* | *731,215* |
| | **450,547** | **59,384** | **89,321** | **1,577,266** | **2,176,518** | **1,359,308** |

| | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | 2016 | | | | | |
| | ≤90 days | >90 days ≤180 days | >180 days ≤1 year | >1 year | Total | Collateral received |
| **By counterparty:** | | | | | | |
| Central banks | - | - | - | - | - | - |
| Public sector | 189 | - | 3,417 | 4,414 | 8,020 | 216 |
| Credit institutions | - | - | - | - | - | - |
| Other financial corporations | 1,608 | - | 5,544 | 11,039 | 18,191 | 6,104 |
| Non-financial corporations | 368,275 | 34,596 | 67,450 | 1,122,885 | 1,593,206 | 727,869 |
| *Of which: secured by commercial real estate* | *24,269* | *3,531* | *5,396* | *182,409* | *215,605* | *122,616* |
| Households | 220,996 | 49,405 | 80,134 | 1,031,019 | 1,381,554 | 900,714 |
| *Of which: secured by residential real estate* | *186,346* | *42,997* | *70,220* | *911,323* | *1,210,886* | *809,651* |
| | **591,068** | **84,001** | **156,545** | **2,169,357** | **3,000,971** | **1,634,903** |

The detail of the carrying amount of unimpaired past-due financial assets is as follows:

| | Thousands of euros | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2017 | | | | | | |
| | ≤30 days | >30 days ≤60 days | >60 days ≤90 days | >90 days ≤180 | >180 days ≤1 | >1 year | Total |
| **By counterparty:** | | | | | | | |
| Central banks | - | - | - | - | - | - | - |
| Public sector | 921 | 3,645 | - | - | - | - | 4,566 |
| Credit institutions | - | - | - | - | - | - | - |
| Other financial corporations | 2,022 | 2 | 65 | - | - | 228 | 2,317 |
| Non-financial corporations | 183,620 | 32,048 | 15,283 | 4,240 | 3,230 | 53,280 | 291,701 |
| Households | 509,070 | 137,535 | 104,890 | 13,463 | 16,106 | 145,335 | 926,399 |
| | **695,633** | **173,230** | **120,238** | **17,703** | **19,336** | **198,843** | **1,224,983** |
| **By type of instrument:** | | | | | | | |
| On demand and short notice | 7,187 | 426 | 419 | - | - | 441 | 8,473 |
| Credit card debt | 1,079 | 370 | - | 201 | - | - | 1,650 |
| Trade receivables | 35,915 | 4,174 | 575 | 192 | - | - | 40,856 |
| Finance leases | 3,310 | 496 | 2 | - | - | - | 3,808 |
| Reverse repurchase loans | - | - | - | - | - | - | - |
| Other term loans | 647,820 | 167,760 | 119,233 | 17,310 | 19,336 | 198,402 | 1,169,861 |
| Advances that are not loans | 322 | 4 | 9 | - | - | - | 335 |
| | **695,633** | **173,230** | **120,238** | **17,703** | **19,336** | **198,843** | **1,224,983** |

| | Thousands of euros | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2016 | | | | | | |
| | ≤30 days | >30 days ≤60 days | >60 days ≤90 days | >90 days ≤180 | >180 days ≤1 | >1 year | Total |
| **By counterparty:** | | | | | | | |
| Central banks | - | - | - | - | - | - | - |
| Public sector | 293 | 9,580 | - | - | - | 62 | 9,935 |
| Credit institutions | - | - | - | - | - | - | - |
| Other financial corporations | 682 | 213 | - | - | - | 228 | 1,123 |
| Non-financial corporations | 177,573 | 43,967 | 28,734 | 4,970 | 7,379 | 69,882 | 332,505 |
| Households | 488,515 | 177,153 | 112,843 | 16,183 | 20,248 | 145,313 | 960,255 |
| | **667,063** | **230,913** | **141,577** | **21,153** | **27,627** | **215,485** | **1,303,818** |
| **By type of instrument:** | | | | | | | |
| On demand and short notice | 5,458 | 408 | 248 | - | - | 441 | 6,555 |
| Credit card debt | 1,164 | 341 | - | - | - | - | 1,505 |
| Trade receivables | 24,076 | 2,492 | 1,521 | - | 154 | - | 28,243 |
| Finance leases | 1,705 | 617 | 542 | - | - | - | 2,864 |
| Reverse repurchase loans | - | - | - | - | - | - | - |
| Other term loans | 634,254 | 227,047 | 139,256 | 21,153 | 27,473 | 215,044 | 1,264,227 |
| Advances that are not loans | 406 | 8 | 10 | - | - | - | 424 |
| | **667,063** | **230,913** | **141,577** | **21,153** | **27,627** | **215,485** | **1,303,818** |

The detail of loans and receivables derecognised because their recovery was considered to be remote at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Customers | 4,300,228 | 3,773,326 |

The changes in impaired financial assets derecognised because their recovery was considered to be remote were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balance at beginning of year | 3,773,326 | 2,927,038 |
| Additions: | | |
| Charged to asset impairment losses | 545,168 | 721,023 |
| Direct write-offs | 9,602 | 3,378 |
| Charged to uncollected past-dues | 230,350 | 296,497 |
| | 785,120 | 1,020,898 |
| Recoveries: | | |
| Due to cash collection | (78,104) | (37,279) |
| Due to foreclosure | (50,251) | (32,903) |
| | (128,355) | (70,182) |
| Write-offs: | | |
| Due to forgiveness | (118,843) | (77,331) |
| Due to refinancing or restructuring | - | - |
| Due to other causes | (11,020) | (27,097) |
| | (129,863) | (104,428) |
| **Balance at end of year** | **4,300,228** | **3,773,326** |

## 26. Held-to-maturity investments

At 31 December 2017, "Held-to-Maturity Investments" included debt instruments issued by Spanish government authorities amounting to EUR 248,761 thousand (31 December 2016: EUR 44,246 thousand), of which EUR 44,349 thousand were pledged to the Bank of Spain under a loan agreement at 31 December 2017 and 2016 for an effective amount of EUR 44,246 thousand (see Note 42).

Note 41 provides certain information relating to the fair value of the financial instruments included in this category.

## 27. Derivatives - asset and liability hedge accounting

The breakdown of "Derivatives – Hedge Accounting" on the asset and liability sides of the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Assets | | Liabilities | |
| | 2017 | 2016 | 2017 | 2016 |
| **Micro-hedges** | | | | |
| Fair value hedges | 173,224 | 253,573 | 135,513 | 159,491 |
| Cash flow hedges | 855 | 1,282 | 13,333 | 9,481 |
| | **174,079** | **254,855** | **148,846** | **168,972** |

The detail, by currency and maturity, of "Derivatives – Hedge Accounting" on the asset and liability sides of the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Assets | | Liabilities | |
| | 2017 | 2016 | 2017 | 2016 |
| **By currency:** | | | | |
| Euro | 174,079 | 254,855 | 139,009 | 158,872 |
| Mexican peso | - | - | 9,837 | 10,100 |
| | **174,079** | **254,855** | **148,846** | **168,972** |
| **By maturity:** | | | | |
| Less than 1 year | 23,929 | 23,937 | 10,737 | 2,292 |
| 1 to 5 years | 109,796 | 59,549 | 29,028 | 42,835 |
| More than 5 years | 40,354 | 171,369 | 109,081 | 123,845 |
| | **174,079** | **254,855** | **148,846** | **168,972** |

The detail, by type of transaction, of "Derivatives – Hedge Accounting" on the asset and liability sides of the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | | | 2016 | | | |
| | Notional amount | | Fair value | | Notional amount | | Fair value | |
| | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities | Assets | Liabilities |
| **Fair value hedges** | | | | | | | | |
| **Other exchange rate transactions** | | | | | | | | |
| Swaps | - | 8,571 | - | 9,837 | - | 10,714 | - | 10,100 |
| **Other interest rate transactions** | | | | | | | | |
| Swaps | 2,484,121 | 1,506,619 | 173,224 | 116,919 | 3,147,347 | 1,721,466 | 253,573 | 140,506 |
| **Other risk hedging transactions** | | | | | | | | |
| Swaps | - | 50,000 | - | 8,757 | - | - | - | 8,885 |
| | **2,484,121** | **1,565,190** | **173,224** | **135,513** | **3,147,347** | **1,732,180** | **253,573** | **159,491** |
| **Cash flow hedges** | | | | | | | | |
| **Other interest rate transactions** | | | | | | | | |
| Swaps | 50,000 | 245,291 | 855 | 13,333 | 50,000 | 51,681 | 852 | 9,147 |
| **Other securities transactions** | | | | | | | | |
| **Share options** | | | | | | | | |
| Bought | - | - | - | - | 106,454 | - | 430 | - |
| Sold | - | - | - | - | - | 188,839 | - | 334 |
| | **50,000** | **245,291** | **855** | **13,333** | **156,454** | **240,520** | **1,282** | **9,481** |
| | **2,534,121** | **1,810,481** | **174,079** | **148,846** | **3,303,801** | **1,972,700** | **254,855** | **168,972** |

*Fair value hedges*

The swaps outstanding at 31 December 2017 are intended to hedge the interest rate risk (other interest rate transactions), the interest rate and exchange rate risk (other exchange rate transactions) and the interest rate and other risks (other risk hedging transactions) affecting the changes in the fair value of certain mortgage-backed bond issues recognised under "Financial Liabilities at Amortised Cost" in the consolidated balance sheet with a notional value of EUR 1,567,578 thousand (31 December 2016: EUR 2,267,578 thousand - see Note 34), of customer loans recognised under "Loans and Receivables - Loans and Advances - Customers" amounting to EUR 756,734 thousand (31 December 2016: EUR 816,949 thousand - see Note 25), of a hybrid security recognised under "Financial Liabilities at Amortised Cost - Debt Securities Issued" with a principal amount of EUR 50,000 thousand (31 December 2016: EUR 50,000 thousand - see Note 34) and of certain government bonds recognised under "Available-for-Sale Financial Assets - Debt Securities" amounting to EUR 1,625,000 thousand (31 December 2016: EUR 1,695,000 thousand - see Note 24).

At 31 December 2017, certain embedded derivatives had been designated as hedging a structured bond whose fair value amounted to EUR 8,757 thousand (31 December 2016: EUR 8,885 thousand) and whose principal amount was EUR 50,000 thousand (31 December 2016: EUR 50,000 thousand).

Since 2016, the Group has performed certain OTC derivatives transactions through the Eurex clearing house. The net fair value of all the positions held through Eurex is shown in a deposit in the Group's favour recognised under "Loans and Receivables - Loans and Advances" in the consolidated balance sheet. At 31 December 2017, the balance of this deposit reflects a value of EUR 15,819 thousand (31 December 2016: EUR 11,340 thousand) for the derivatives designated as hedges of the interest rate risk of certain mortgage-backed bond issues recognised under "Financial Liabilities at Amortised Cost" in the consolidated balance sheet for EUR 500,000 thousand (31 December 2016: EUR 250,000 thousand) (see Note 34) and a value of EUR 7,152 thousand (31 December 2016: EUR 3,882 thousand) for the derivatives designated as hedges of loans granted to customers and recognised under "Loans and Receivables - Loans and Advances - Customers" for a notional amount of EUR 337,907 thousand (31 December 2016: EUR 350,000 thousand) (see Note 25).

The notional amount of certain types of financial instruments provides a basis for comparison with instruments recognised on the face of the consolidated balance sheet, but does not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, it does not reflect the Group's exposure to credit risk or price risk. Derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of the fluctuations in market interest rates, exchange rates or quoted share prices.

The amounts recognised on the hedging instruments and the hedged item attributable to the hedged risk under "Gains or (-) Losses from Hedge Accounting, Net" in the accompanying consolidated statement of profit or loss in 2017 were an expense of EUR 24,683 thousand and income of EUR 24,973 thousand, respectively (2016: an expense of EUR 83,092 thousand and income of EUR 83,322 thousand).

*Cash flow hedges*

At 31 December 2017 and 2016, the Group recognised cash flow hedges consisting of interest rate swaps entered into for a notional amount of EUR 50,000 thousand in order to hedge the exposure to fluctuations in the cash flows that periodically fall due on certain Group liabilities or contractual obligations (see Note 34-c). At 31 December 2017, the Group also recognised cash flow hedges consisting of interest rate swaps on certain fixed-income securities recognised under "Available-for-Sale Financial Assets - Debt Securities" for a notional amount of EUR 200,750 thousand (no cash flow hedges had been recognised on these assets at 31 December 2016 - see Note 24). Similarly, the Group recognised hedges on certain loans for a notional amount of EUR 44,541 thousand at 31 December 2017 (31 December 2016: EUR 51,681 thousand).

The cash flow hedges detailed under "Other Securities Transactions" at 31 December 2016 were intended to hedge the changes in quoted prices affecting the expected cash flows of future purchases and sales of financial assets (equity instruments). The hedge was instrumented through options bought and sold, the initial net premium of which was zero. At 31 December 2017, no such hedges were recognised.

A negative amount of EUR 7,001 thousand, net of the related tax effect, was recognised in consolidated equity under "Accumulated Other Comprehensive Income" at 31 December 2017 (31 December 2016: EUR 2,293 thousand) (see Note 38). In 2017 EUR 801 thousand were deducted from the consolidated statement of profit or loss (2016: EUR 822 thousand) (see Notes 45 and 49).

The notional amount of certain types of financial instruments provides a basis for comparison with instruments recognised on the face of the consolidated balance sheet, but does not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, it does not reflect the Group's exposure to credit risk or price risk.

Derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of the fluctuations, with respect to the terms of the derivatives, in market interest rates or exchange rates. The aggregate notional or contractual amount of available derivative financial instruments, the extent to which these instruments are favourable or unfavourable and, therefore, the aggregate fair values of the derivative financial assets and liabilities may fluctuate significantly.

The detail of the estimated terms, from 31 December 2017 and 2016, within which it is expected that the amounts recognised under "Accumulated Other Comprehensive Income - Hedging Derivatives. Cash Flow Hedges" in consolidated equity at that date will be recognised in future consolidated statements of profit or loss is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | | |
| | Less than 1 year | 1 to 3 years | 3 to 5 years | More than 5 years |
| Debit balances (losses) (*) | (493) | (1,955) | (986) | (23,878) |
| Credit balances (gains) (*) | 2,222 | 4,942 | 4,531 | 8,616 |

(*) Considering the related tax effect

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2016 | | | |
| | Less than 1 year | 1 to 3 years | 3 to 5 years | More than 5 years |
| Debit balances (losses) (*) | (610) | (874) | (560) | (558) |
| Credit balances (gains) (*) | 309 | - | - | - |

Also, set forth below is an estimate at 31 December 2017 and 2016 of the amount of the future collections and payments hedged in cash flow hedges, classified by the term, starting from the aforementioned date, within which the collections and payments are expected to be made:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | | |
| | Less than 1 year | 1 to 3 years | 3 to 5 years | More than 5 years |
| Collections | 2,202 | 4,300 | 3,847 | 44,697 |
| Payments | 400 | 455 | - | - |

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2016 | | | |
| | Less than 1 year | 1 to 3 years | 3 to 5 years | More than 5 years |
| Collections | 1,106 | 1,694 | 1,339 | 651 |
| Payments | 469 | 25 | - | - |

The Group periodically measures the effectiveness of its hedges by verifying that the results of the prospective and retrospective tests are within the range established by current regulations (80%-125%). At 31 December 2017 and 2016, on the basis of the tests performed, as indicated in Note 14-e, no ineffectiveness was detected in the hedges. Accordingly, at 31 December 2017 and 2016, the Group did not recognise any amount in this connection in the consolidated statements of profit or loss.

## 28. Investments in joint ventures and associates

The detail of "Investments in Joint Ventures and Associates" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Associates:** | | |
| Listed | 210,403 | 192,381 |
| Unlisted | 304,119 | 310,735 |
| **Jointly controlled entities:** | | |
| Unlisted | - | 2 |
| | **514,522** | **503,118** |

The changes in 2017 and 2016 in "Investments in Joint Ventures and Associates" were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balance at beginning of year | 503,118 | 499,297 |
| Acquisitions | 270 | 4,428 |
| Share of results (Note 37) | 17,555 | 43,838 |
| Share of revaluation gains/losses (Note 38) | 243 | (14) |
| Impairment losses | (4,123) | (687) |
| Sales and other reductions | (4,270) | (21,520) |
| Dividends received | (17,977) | (20,926) |
| Effect of dilution - Euskaltel (Note 1.3) | 20,818 | - |
| Transfers | (1,107) | (891) |
| Other | (5) | (407) |
| **Balance at end of year** | **514,522** | **503,118** |

In compliance with Article 155 of the Spanish Limited Liability Companies Law and Article 125 of Legislative Royal Decree 4/2015, of 23 October, on the Securities Market, following is a detail of the acquisitions and disposals of investments in subsidiaries, jointly controlled entities and associates:

| Investee | Line of business | % of ownership | | Date of notification/ transaction |
|---|---|---|---|---|
| | | Acquired/ sold in the year | Percentage at year-end | |
| **Acquisitions in 2017:** | | | | |
| Fineco Sociedad de Valores, S.A. | Broker-dealer | 18.22% | 98.22% | 26/12/17 |
| **Disposals in 2017** | | | | |
| Ibérico de Bellota, S.A. | Salting and drying of hams and sausages | 25.00% | - | 24/04/17 |
| Viacajas, S.A. | Payment systems | 0.06% | 46.64% | 15/06/17 |
| Aparcamientos de Getxo en Romo y Las Arenas (Las Mercedes) Sociedad Concesionaria, S.L. | Operation of car parks | 33.33% | - | 14/12/17 |

## Other disclosures on associates

The fair value of the investment in Euskaltel, S.A. measured at its quoted market price amounted to EUR 258,922 thousand at 31 December 2017 (31 December 2016: EUR 320,701 thousand).

The financial data on the most significant investments in associates is as follows:

| Condensed financial data (*) | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | Euskaltel, S.A. (**) | Ingeteam, S.A. (**) | Torre Iberdrola, A.I.E. | San Mamés Barria, S.L. | Ekarpen, Private Equity, S.A. | Inversiones Zubiatzu, S.A. (**) |
| Total assets | 2,340,338 | 643,348 | 232,636 | 171,992 | 89,680 | 113,232 |
| Of which: Current assets | 221,118 | 390,510 | 47,058 | 7,452 | 64,190 | 85,097 |
| Total liabilities | 1,598,244 | 317,982 | 33,467 | 1,476 | 74 | 40,145 |
| Of which: Current liabilities | 210,104 | 223,145 | 31,984 | 1,476 | 74 | 28,748 |
| Profit (loss) from ordinary operations | 125,048 | 13,973 | 2,187 | (2,557) | (8,715) | 17,359 |
| Profit (loss) before tax from continuing operations | 77,194 | (3,184) | 2,336 | (2,557) | (8,584) | 18,528 |
| Profit (loss) after tax from continuing operations | 62,145 | (5,711) | 2,316 | (2,557) | (8,584) | 15,997 |

(*) Data taken from the financial statements of the companies, disregarding consolidation adjustments, as at 31 December 2016.

(**) Data from the consolidated financial statements as at 31 December 2016.

As part of the process of accounting for these companies by the equity method, certain adjustments are made to the associates' financial statements. These adjustments do not have a material effect.

The aggregates of the other associates' statements of profit or loss for the years ended 31 December 2017 and 2016 were not material.

Appendix II includes the remaining information on the investments in associates at 31 December 2017 and 2016.

## 29. Tangible assets

The detail of "Tangible Assets" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Property, plant and equipment** | | |
| **For own use:** | | |
| IT equipment and related fixtures | 5,437 | 5,982 |
| Furniture, vehicles and other fixtures | 41,147 | 43,334 |
| Buildings | 685,510 | 694,609 |
| Assets under construction | 562 | 30,702 |
| Other | 887 | 3,860 |
| Impairment losses on property, plant and equipment for own use | (8,857) | (6,956) |
| | 724,686 | 771,531 |
| **Leased out under an operating lease** | 119,333 | 134,081 |
| **Investment property:** | | |
| Buildings | 246,524 | 242,225 |
| Rural land, land lots and buildable land | 32,950 | 9,479 |
| Impairment losses on investment property | (108,207) | (91,853) |
| | 171,267 | 159,851 |
| | **1,015,286** | **1,065,463** |

The changes in 2017 and 2016 in “Tangible Assets” were as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | For own use | Leased out under an operating lease | Investment property | Total |
| **Gross** | | | | |
| Balance at 31 December 2015 | 1,844,653 | 255,883 | 336,813 | 2,437,349 |
| Additions | 30,537 | - | 1,191 | 31,728 |
| Disposals | (17,087) | - | (65,238) | (82,325) |
| Additions to/exclusions from the scope of consolidation (Note 1.3) | (5) | (693) | (10,007) | (10,705) |
| Transfers | (3,695) | - | 3,695 | - |
| Transfers - non-current assets held for sale (Note 33) | - | - | 35,061 | 35,061 |
| Other changes | (261) | - | 112 | (149) |
| Balance at 31 December 2016 | 1,854,142 | 255,190 | 301,627 | 2,410,959 |
| Additions | 15,781 | - | 2,097 | 17,878 |
| Disposals | (21,088) | - | (20,456) | (41,544) |
| Additions to/exclusions from the scope of consolidation (Note 1.3) | (882) | (13,161) | (2,215) | (16,258) |
| Transfers | (22,915) | - | 22,413 | (502) |
| Transfers - non-current assets held for sale (Note 33) | 112 | - | 26,253 | 26,365 |
| Other changes | 1 | - | (76) | (75) |
| **Balance at 31 December 2017** | **1,825,151** | **242,029** | **329,643** | **2,396,823** |
| **Accumulated depreciation** | | | | |
| Balance at 31 December 2015 | (1,053,342) | (111,599) | (58,340) | (1,223,281) |
| Charge for the year (Note 58) | (30,716) | (10,006) | (4,804) | (45,526) |
| Disposals | 8,043 | - | 10,680 | 18,723 |
| Additions to/exclusions from the scope of consolidation (Note 1.3) | 4 | 519 | 2,747 | 3,270 |
| Transfers | 265 | - | (265) | - |
| Transfers - non-current assets held for sale (Note 33) | - | - | - | - |
| Other changes | 91 | (23) | 59 | 127 |
| Balance at 31 December 2016 | (1,075,655) | (121,109) | (49,923) | (1,246,687) |
| Charge for the year (Note 58) | (27,012) | (9,809) | (4,559) | (41,380) |
| Disposals | 13,254 | - | 1,877 | 15,131 |
| Additions to/exclusions from the scope of consolidation (Note 1.3) | 216 | 7,651 | 162 | 8,029 |
| Transfers | (2,580) | - | 2,580 | - |
| Transfers - non-current assets held for sale (Note 33) | - | - | (567) | (567) |
| Other changes | 169 | 571 | 261 | 1,001 |
| **Balance at 31 December 2017** | **(1,091,608)** | **(122,696)** | **(50,169)** | **(1,264,473)** |

| | Thousands of euros | | | |
|---|---|---|---|---|
| | For own use | Leased out under an operating lease | Investment property | Total |
| **Impairment losses** | | | | |
| Balance at 31 December 2015 | (8,289) | - | (97,349) | (105,638) |
| Charge for the year (Note 61) | 1,012 | - | (17,788) | (16,776) |
| Recoveries (Note 61) | 44 | - | 5,758 | 5,802 |
| Additions to/exclusions from the scope of consolidation (Note 1.3) | - | - | 900 | 900 |
| Disposals | 264 | - | 33,251 | 33,515 |
| Transfers - non-current assets held for sale (Note 33) | - | - | (12,627) | (12,627) |
| Transfers - loans and receivables (Note 25) | - | - | (4,000) | (4,000) |
| Other changes | 13 | - | 2 | 15 |
| Balance at 31 December 2016 | (6,956) | - | (91,853) | (98,809) |
| Charge for the year (Note 61) | (386) | - | (20,283) | (20,669) |
| Recoveries (Note 61) | - | - | 1,009 | 1,009 |
| Additions to/exclusions from the scope of consolidation (Note 1.3) | 2 | - | 1,095 | 1,097 |
| Disposals | (976) | - | 8,561 | 7,585 |
| Transfers - non-current assets held for sale (Note 33) | - | - | (7,173) | (7,173) |
| Transfers | (541) | - | 541 | - |
| Other changes | - | - | (104) | (104) |
| **Balance at 31 December 2017** | **(8,857)** | **-** | **(108,207)** | **(117,064)** |
| **Net:** | | | | |
| **Balance at 31 December 2016** | **771,531** | **134,081** | **159,851** | **1,065,463** |
| **Balance at 31 December 2017** | **724,686** | **119,333** | **171,267** | **1,015,286** |

The detail of "Property, Plant and Equipment - For Own Use" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Gross | Accumulated depreciation | Impairment losses | Net |
| **At 31 December 2017** | | | | |
| IT equipment and related fixtures | 346,722 | (341,285) | - | 5,437 |
| Furniture, vehicles and other fixtures | 482,188 | (441,041) | - | 41,147 |
| Buildings | 993,711 | (308,201) | (8,857) | 676,653 |
| Assets under construction | 562 | - | - | 562 |
| Other | 1,968 | (1,081) | - | 887 |
| | **1,825,151** | **(1,091,608)** | **(8,857)** | **724,686** |
| **At 31 December 2016** | | | | |
| IT equipment and related fixtures | 343,435 | (337,453) | - | 5,982 |
| Furniture, vehicles and other fixtures | 485,122 | (441,788) | - | 43,334 |
| Buildings | 989,994 | (295,385) | (6,956) | 687,653 |
| Assets under construction | 30,702 | - | - | 30,702 |
| Other | 4,889 | (1,029) | - | 3,860 |
| | **1,854,142** | **(1,075,655)** | **(6,956)** | **771,531** |

In 1996 BBK, Kutxa and Caja Vital revalued their properties, except for those arising from loan foreclosures, pursuant to the respective Araba, Bizkaia and Gipuzkoa Regulations, and applied the maximum coefficients authorised by the aforementioned Regulations, up to the limit of their market value, which was calculated on the basis of available appraisals. The net surplus arising on the revaluation of the non-current assets amounted to EUR 81,851 thousand.

Bizkaia Regulatory Decree 11/2012, of 18 December, on asset revaluation was published on 28 December 2012. Under this tax legislation, companies may revalue their assets for tax purposes. Pursuant to this legislation, the Parent revalued the tax base of a portion of its assets following the approval of its adoption of this measure, granted by the General Meeting of the Parent on 27 June 2013 (see Note 40).

The fair value of property, plant and equipment for own use is included in Note 41.

The gross amount of fully depreciated property, plant and equipment in use at 31 December 2017 was approximately EUR 789,820 thousand (31 December 2016: EUR 780,301 thousand).

"Tangible Assets - Property, Plant and Equipment - Leased out under an Operating Lease" relates mainly to the leases arranged by the Group companies Alquiler de Trenes, A.I.E. and Alquiler de Metros, A.I.E., the latter's assets having been sold in 2017.

The former leases out 39 completed trains to Autoritat del Transport Metropolitá (ATM) under an operating lease. The lease ends on 15 December 2023. The ATM has a purchase option on the 39 trains, for a total amount of EUR 127,244 thousand plus the related VAT, which is exercisable between 15 June and 15 December 2021 only. The income from the principal lease payment amounted to EUR 19,199 thousand in 2017 (2016: EUR 19,911 thousand) (see Note 53). All subsequent payments are to be made on 10 December of each year until 2023. All the payments are guaranteed by the Catalonia Autonomous Community Government pursuant to an agreement dated 10 June 2003.

The latter company had leased out six completed trains to Serveis Ferroviaris de Mallorca (SFM) under an operating lease that ended on 15 March 2024. SFM had a purchase option on the six trains, for a total amount of EUR 5,544 thousand plus the related VAT, which was exercisable between 15 September 2021 and 15 March 2022 only. On 21 November 2017, the trains were sold giving rise to a gain on disposal of EUR 2,205 thousand which is recognised under "Gains or Losses on Derecognition of Non-Financial Assets and Investments, Net". The income from the lease in 2017, until the date of the sale, totalled EUR 961 thousand (2016: EUR 1,126 thousand) (see Note 53).

The lease agreements in force at 31 December 2017 and 2016 do not include contingent rent and the lessors assume all risks pertaining to possession of the trains.

The minimum non-cancellable future payments (excluding VAT) receivable under the lease agreements in force at 31 December 2017 and 2016 were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Within 1 year | 18,613 | 20,442 |
| 1 to 5 years | 67,324 | 74,158 |
| More than 5 years | 15,048 | 33,288 |
| | **100,985** | **127,888** |

The detail of "Investment Property" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Gross | Accumulated depreciation | Impairment losses | Net |
| **At 31 December 2017** | | | | |
| Buildings | 296,693 | (50,169) | (108,207) | 138,317 |
| Rural land, land lots and buildable land | 32,950 | - | - | 32,950 |
| | **329,643** | **(50,169)** | **(108,207)** | **171,267** |
| **At 31 December 2016** | | | | |
| Buildings | 292,148 | (49,923) | (91,853) | 150,372 |
| Rural land, land lots and buildable land | 9,479 | - | - | 9,479 |
| | **301,627** | **(49,923)** | **(91,853)** | **159,851** |

The rental income earned by the Group from its investment property amounted to EUR 9,062 thousand in 2017 (2016: EUR 9,143 thousand) (see Note 53). The operating expenses of all kinds relating to the Group's investment property amounted to EUR 4,388 thousand in 2017 (2016: EUR 4,402 thousand) (see Note 54).

At 31 December 2017 and 2016, the Group did not have any significant commitments relating to its tangible assets. The Group does not have any tangible assets of a material amount with restrictions on use or title, which are not in service or which have been pledged as security for liabilities.

The fair value of investment property is included in Note 41.

## 30. Intangible assets

The detail of "Intangible Assets" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Goodwill | 301,457 | 301,457 |
| Other intangible assets | 55,701 | 46,302 |
| | **357,158** | **347,759** |

The detail of "Other Intangible Assets" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| With finite useful life | | |
| Computer software in progress | 3,068 | 2,927 |
| Completed computer software | 128,607 | 105,745 |
| Other intangible assets | 56,311 | 56,311 |
| Total gross amount | 187,986 | 164,983 |
| Accumulated amortisation | (126,785) | (113,181) |
| Impairment losses | (5,500) | (5,500) |
| **Total carrying amount** | **55,701** | **46,302** |

The changes in “Other Intangible Assets” in 2017 and 2016 were as follows:

| | Thousands of euros |
|---|---|
| **Gross:** | |
| Balance at 31 December 2015 | 145,598 |
| Additions | 19,629 |
| Disposals | (225) |
| Additions to/exclusions from the scope of consolidation | (19) |
| Balance at 31 December 2016 | 164,983 |
| Additions | 23,016 |
| Disposals | (13) |
| Balance at 31 December 2017 | 187,986 |
| **Accumulated amortisation:** | |
| Balance at 31 December 2015 | (102,870) |
| Charge for the year (Note 58) | (10,560) |
| Disposals | 229 |
| Additions to/exclusions from the scope of consolidation | 20 |
| Balance at 31 December 2016 | (113,181) |
| Charge for the year (Note 58) | (13,617) |
| Disposals | 13 |
| Balance at 31 December 2017 | (126,785) |
| **Impairment losses:** | |
| Balance at 31 December 2015 | (5,500) |
| Balance at 31 December 2016 | (5,500) |
| Charge for the year (Note 61) | - |
| Other changes | - |
| Balance at 31 December 2017 | (5,500) |
| **Net:** | |
| **Balance at 31 December 2016** | **46,302** |
| **Balance at 31 December 2017** | **55,701** |

## 31. Tax assets and liabilities

The detail of "Tax Assets" and "Tax Liabilities" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Assets | | Liabilities | |
| | 2017 | 2016 | 2017 | 2016 |
| **Current taxes** | **34,786** | **36,033** | **20,055** | **23,129** |
| **Deferred taxes** | | | | |
| Tax credit carryforwards | 248,558 | 252,836 | - | - |
| Tax loss carryforwards | 432,461 | 347,164 | - | - |
| DTAs arising from the conversion of tax loss carryforwards | 688,671 | 688,671 | - | - |
| *Deferred taxes arising from:* | | | | |
| Pension obligations | 83,722 | 51,702 | - | - |
| Impairment losses - credit loss allowance | 107,920 | 153,213 | - | - |
| Impairment losses on assets | 214,598 | 239,918 | - | - |
| Other non-tax-deductible provisions/items | 130,231 | 141,003 | 21,613 | 21,576 |
| Financial instrument valuation adjustments | 15,280 | 16,158 | 127,351 | 149,064 |
| Revaluation of property, plant and equipment | 4,666 | 4,735 | 100,091 | 91,371 |
| | **1,926,107** | **1,895,400** | **249,055** | **262,011** |
| | **1,960,893** | **1,931,433** | **269,110** | **285,140** |

Pursuant to Final Provision Two of Royal Decree-Law 14/2013, of 29 November, on urgent measures to adapt Spanish law to European Union legislation in relation to the supervision and capital adequacy of financial institutions, and its transposition to provincial legislation in Bizkaia Regulatory Decree 7/2013, of 23 December, regulating the regime for banking foundations, the Group has certain deferred tax assets convertible into credits receivable from the tax authorities, which amounted to approximately EUR 949 million at 31 December 2017 (31 December 2016: EUR 949 million).

In both 2017 and 2016 certain differences arose as a result of the different recognition criteria for accounting and tax purposes. These differences were recognised as deferred tax assets and liabilities in calculating and recognising the related income tax.

The changes in 2017 and 2016 in the balances of deferred tax assets and liabilities were as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Assets | | Liabilities | |
| | 2017 | 2016 | 2017 | 2016 |
| **Balance at beginning of year** | **1,895,400** | **1,966,266** | **262,011** | **272,573** |
| **Additions** | | | | |
| Tax credit carryforwards | - | - | - | - |
| Tax loss carryforwards | 85,297 | | - | |
| Period provisions for pensions | 32,020 | - | - | - |
| Impairment losses - credit loss allowance | - | - | - | - |
| Impairment losses on assets | - | 34,476 | - | - |
| Other non-tax-deductible items | - | - | - | - |
| Financial instrument valuation adjustments | - | - | - | - |
| Revaluation of property, plant and equipment | - | - | 9,000 | 50,528 |
| DTAs arising from the conversion of tax loss carryforwards | - | 15,732 | - | - |
| **Amounts used** | | | | |
| Tax credit carryforwards | (4,278) | (3,778) | - | - |
| DTAs arising from the conversion of tax loss carryforwards | - | | - | |
| Tax loss carryforwards | - | (49,620) | - | - |
| Impairment losses - credit loss allowance | (45,293) | (10,224) | - | - |
| Impairment losses on assets | (25,320) | - | - | - |
| Pension payments | - | (13,280) | - | - |
| Revaluation of property, plant and equipment | (69) | - | - | - |
| Financial instrument valuation adjustments | (878) | (1,672) | (21,713) | (23,242) |
| Other non-tax-deductible items | (10,772) | (42,500) | (243) | (37,848) |
| **Balance at end of year** | **1,926,107** | **1,895,400** | **249,055** | **262,011** |

As a result of the transfer en bloc of assets and liabilities described in Note 1.2, deferred tax assets and liabilities were recognised for the tax effect of updating the fair values of the assets and liabilities acquired. These and other deferred tax assets arising in subsequent years were recognised in the consolidated balance sheet because the Parent's Board of Directors considered that, based on their best estimate of the Group's future earnings, it is probable that these assets will be recovered.

### Tax credit carryforwards

The Kutxabank tax group (see Note 40), the CajaSur tax group (see Note 40) and the other entities that file tax returns under the general income tax regime had unused tax credits at 31 December 2017, of which those considered to be recoverable within a reasonable time frame were recognised, pursuant to current tax legislation and based on the best estimate of the future results of the Group companies. Specifically, the detail of the amount of the unused tax credits recognised at 31 December 2017 is as follows:

| | 2017 | Year generated |
|---|---|---|
| Domestic and international double taxation | 148,016 | 2008 to 2014 |
| Tax credits with a limit | 82,653 | 2001 to 2015 |
| Tax credits without limit | 17,889 | 2001 to 2015 |
| Other tax credits | - | 2008 to 2010 |
| **Total** | **248,558** | |
| **Of which:** | | |
| Kutxabank tax group | 232,252 | |
| CajaSur tax group | 16,306 | |
| Companies taxed individually | - | |

At 31 December 2017, tax credits amounting to EUR 931 thousand had not been recognised at the Kutxabank tax group (see Note 40). Similarly, at 31 December 2017 tax credits amounting to EUR 2,542 thousand had not been recognised at the CajaSur tax group (see Note 40).

**Tax loss carryforwards**

The Kutxabank tax group, the CajaSur tax group and the other entities that file tax returns under the general income tax regime recognised the following tax loss carryforwards at 31 December 2017, using the tax rate applicable to the taxpayer which generated them:

| | Thousands of euros | |
|---|---|---|
| | Base | Deductible |
| Tax losses arising from 2004 to 2008 | 445 | 125 |
| Tax losses arising in 2009 | 192,149 | 57,639 |
| Tax losses arising in 2010 | 409,119 | 122,590 |
| Tax losses arising in 2011 | 333,375 | 96,299 |
| Tax losses arising in 2012 | 1 | - |
| Tax losses arising in 2013 | 43,874 | 13,162 |
| Tax losses arising in 2014 | 107,935 | 30,222 |
| Tax losses arising in 2015 | - | - |
| Tax losses arising in 2016 | 252,146 | 70,601 |
| Tax losses arising in 2017 (*) | 148,530 | 41,823 |
| **Total** | **1,487,574** | **432,461** |
| **Of which:** | | |
| Kutxabank tax group | 673,394 | 188,551 |
| CajaSur tax group | 814,180 | 243,910 |
| Companies taxed individually | - | - |

(*) The amount of tax losses arising in 2017 is an estimate that under no circumstances should be construed as definitive until the tax group's income tax return for 2017 is filed.

(**) EUR 4,823 thousand (deductible) relate to tax losses incurred by Sekilur, S.A. which formed part of the CajaSur tax group in 2017.

At 31 December 2017, tax loss carryforwards amounting to EUR 253,754 thousand had not been recognised (31 December 2016: EUR 259,774 thousand), most of which related to tax assets generated by property companies prior to their inclusion in the Kutxabank tax group (see Note 40). Similarly, at 31 December 2017 there were tax loss carryforwards amounting to EUR 869,265 thousand which had not been recognised at the CajaSur tax group (31 December 2016: EUR 1,061,005 thousand).

As regards the Kutxabank tax group, it should be noted that for tax periods beginning in or after 2014, the entry into force of Bizkaia Income Tax Regulation 11/2013, of 5 December ("NFIS"), established a 15-year time limit for using any tax loss and tax credit carryforwards that had not been used at the beginning of 2014.

As regards the CajaSur tax group, it should be noted that Royal Decree-Law 3/2016, of 2 December, adopting various tax measures aimed at consolidating public finances and other urgent social measures, introduced Additional Provision Fifteen of Spanish Income Tax Law 27/2014, of 27 November, which establishes that in the tax periods beginning on or after 1 January 2016, the following special features will apply to the offset of prior years' tax losses of taxpayers whose revenue is at least EUR 20 million in the twelve months prior to the date on which the tax period commences:

- The offset of tax losses will be limited to 50% of the taxable profit prior to the capitalisation reserve established in Article 25 of the aforementioned Law 27/2014, of 27 November, and prior to such offset, when in those twelve months revenue is at least EUR 20 million but less than EUR 60 million.

- The offset of tax losses will be limited to 25% of the taxable profit prior to the capitalisation reserve established in Article 25 of the aforementioned Law 27/2014, of 27 November, and prior to such offset, when in those twelve months revenue is at least EUR 60 million.

Also, effective for tax periods beginning on or after 1 January 2016, the aforementioned Additional Provision Fifteen limits the use of tax credits for the avoidance of double taxation for taxpayers whose revenue is at least EUR 20 million within the twelve months prior to the commencement of the tax period to a joint amount of 50% of the taxpayer's gross tax payable.

Note 40 includes details on the tax matters affecting the Group.

## 32. Other assets and liabilities

The detail of "Other Assets" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Inventories:** | | |
| Amortised cost | 715,713 | 747,901 |
| Write-downs | (536,824) | (526,469) |
| | 178,889 | 221,432 |
| **Other:** | | |
| Transactions in transit | 10,830 | 6,064 |
| Other items | 63,041 | 68,454 |
| | 73,871 | 74,518 |
| | **252,760** | **295,950** |

The detail of "Inventories" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Raw materials and other goods held for processing | 667,079 | 690,824 |
| Work in progress | 21,858 | 21,634 |
| Finished goods | 26,640 | 35,443 |
| Other | 136 | - |
| | 715,713 | 747,901 |
| Impairment losses | (536,824) | (526,469) |
| | **178,889** | **221,432** |

In 2017 inventories with a carrying amount of EUR 21,267 thousand were sold (31 December 2016: EUR 12,294 thousand), giving rise to a net gain for the Group of EUR 8,576 thousand (31 December 2016: EUR 1,568 thousand).

At 31 December 2017 and 2016, the inventories in the foregoing table comprised mainly property developments.

The fair value of the inventories was calculated based on updated appraisals conducted pursuant to Ministry of Economy Order ECO/805/2003 by valuers registered in the Special Register of the Bank of Spain.

The changes in 2017 and 2016 in the write-downs on inventories, which include the adjustments required to reduce their cost to net realisable value, were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balance at beginning of year | (526,469) | (623,041) |
| Write-downs (recognised)/reversed with a (charge)/credit to income (Note 61) | (24,905) | (3,972) |
| Disposals | 11,405 | 96,315 |
| Amounts used | 3,145 | 3,513 |
| Other changes | - | 716 |
| **Balance at end of year** | **(536,824)** | **(526,469)** |

The detail of "Other Liabilities" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Accrued expenses and deferred income (Note 11) | 169,743 | 147,262 |
| Other liabilities | 45,240 | 27,367 |
| | **214,983** | **174,629** |

**Disclosures on the periods of payment to suppliers. Additional Provision Three. Disclosure obligation provided for in Law 15/2010, of 5 July**

At 31 December 2017 and 2016, the Group did not have any significant amounts payable to creditors that had not been paid within the statutory payment period stipulated by Law 3/2004, of 29 December:

| | 2017 | 2016 |
|---|---|---|
| | Days | |
| Average period of payment to suppliers | 13.21 | 10.49 |
| Ratio of transactions settled | 12.95 | 10.42 |
| Ratio of transactions not yet settled | 28.52 | 15.46 |
| | Amount (thousands of euros) | |
| Total payments made | 178,620 | 200,352 |
| Total payments outstanding | 3,024 | 2,986 |

The figures shown in the foregoing table in relation to payments to suppliers relate to suppliers that, because of their nature, are trade creditors for the supply of goods and services.

"Average Period of Payment to Suppliers" is taken to be the period that elapses from the delivery of the goods or the provision of the services by the supplier to the effective payment of the transaction. This "Average Period of Payment to Suppliers" is calculated as the quotient whose numerator is the sum of the ratio of transactions settled multiplied by the total amount of payments made and the ratio of transactions not yet settled multiplied by the total amount of payments outstanding and whose denominator is the total amount of payments made and payments outstanding.

The ratio of transactions settled is calculated as the quotient whose numerator is the sum of the products of multiplying the amounts paid by the number of days of payment (calendar days between the date on which calculation of the period begins and effective payment of the transaction) and whose denominator is the total amount of payments made.

Also, the ratio of transactions not yet settled corresponds to the quotient whose numerator is the sum of the products of multiplying the amounts not yet paid by the number of days of outstanding payment (the number of calendar days between the date on which calculation of the period begins and the reporting date) and whose denominator is the total amount of payments outstanding.

To calculate both the number of days of payment and the number of days of outstanding payment, the company begins to calculate the period from the date of receipt of the goods or provision of the services or, in the absence thereof, the date of receipt of the invoice.

The maximum payment period applicable to the Group under Law 11/2013, of 26 July, on measures to support entrepreneurs and to foster business growth and the creation of employment is 30 days, unless the conditions established therein enabling the maximum payment period to be increased to 60 days are met.

## 33. Non-current assets and disposal groups classified as held for sale and Liabilities included in disposal groups classified as held for sale

The breakdown of "Non-Current Assets and Disposal Groups Classified as Held for Sale" and "Liabilities included in Disposal Groups Classified as Held for Sale" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Tangible assets** | | |
| Property, plant and equipment for own use | - | 273 |
| Investment property | - | 1,095 |
| Foreclosed assets | | |
| Residential property | 481,472 | 451,768 |
| Commercial property, rural property and other | 359,848 | 332,283 |
| Buildable urban land and land approved for development | 949,983 | 920,690 |
| | 1,791,303 | 1,706,109 |
| Impairment losses | (903,895) | (847,412) |
| | **887,408** | **858,697** |

At 31 December 2017 and 2016, the Group did not have any liabilities associated with non-current assets and disposal groups classified as held for sale.

At 31 December 2017 and 2016, all non-current assets and disposal groups classified as held for sale were measured at the lower of their carrying amount at the classification date and their fair value less estimated costs to sell.

In the absence of better evidence, the fair value of these items was determined on the basis of appraisals conducted by independent experts pursuant to specific industry regulations issued by the Bank of Spain. All the appraisal companies with which the Bank works are registered in the Bank of Spain's Official Register. The appraisals made by these companies were conducted in accordance with the methodology established in Ministry of Economy Order ECO/805/2003. The main appraisal companies with which the Group worked were: Servatas, S.A., Tinsa, S.A., Eurovaloraciones, S.A., Gesvalt, S.A., Ibertasa, S.A. and Krata, S.A. These companies meet the requirements set forth in Rule 14 of Bank of Spain Circular 4/2004 regarding the neutrality and credibility required to ensure that their appraisals are reliable.

The changes in 2017 and 2016 in "Non-Current Assets and Disposal Groups Classified as Held for Sale", disregarding impairment losses, were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balance at beginning of year | 1,706,109 | 1,696,066 |
| Additions | 338,005 | 243,468 |
| Disposals | (155,391) | (144,235) |
| Transfers from loans and receivables (Note 25) | (67,613) | (46,198) |
| Transfers from/to tangible assets (Note 29) | (25,798) | (35,061) |
| Other | (4,009) | (7,931) |
| **Balance at end of year** | **1,791,303** | **1,706,109** |

The changes in 2017 and 2016 in "Non-Current Assets and Disposal Groups Classified as Held for Sale - Impairment Losses" were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balance at beginning of year | (847,412) | (861,584) |
| Net impairment losses charged to income (Note 63) | (160,897) | (72,155) |
| Disposals | 71,615 | 35,274 |
| Transfers from loans and receivables (Note 25) | (10,000) | (3,953) |
| Transfers from/to tangible assets (Note 29) | 7,173 | 12,627 |
| Amounts used | 36,107 | 40,457 |
| Other changes | (481) | 1,922 |
| **Balance at end of year** | **(903,895)** | **(847,412)** |

Of the total sales of non-current assets and disposal groups classified as held for sale, approximately 27% of the transactions were financed by the Group in 2017 (2016: approximately 15% of the transactions). The average percentage financed in these transactions did not exceed 78% in 2017 (in 2016 it did not exceed 81%).

Any financing provided by the Kutxabank Group to the purchasers of non-current assets and disposal groups classified as held for sale disposed of by the Group is always conducted as a separate transaction from the sale, in market conditions, following a specific analysis of the suitability of the credit risk. In view of the nature of the financing granted, there were no gains or losses yet to be recognised at 31 December 2017 or 2016.

The Group intends to dispose of these assets as soon as possible, at all events within twelve months. However, except as indicated in Note 14-t, market difficulties are causing it to retain them for longer than desired. As a result, at 31 December 2017 and 2016, the average time these non-current assets and disposal groups classified as held for sale actually remain in this category was approximately three years.

## 34. Financial liabilities at amortised cost

The detail of "Financial Liabilities at Amortised Cost" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Deposits - Central banks | 3,980,155 | 2,620,000 |
| Deposits - Credit institutions | 479,257 | 743,131 |
| Deposits - Customers | 41,812,552 | 41,227,453 |
| Debt securities issued | 3,138,943 | 4,035,099 |
| Other financial liabilities | 652,102 | 531,810 |
| | **50,063,009** | **49,157,493** |

The detail, by currency, of "Financial Liabilities at Amortised Cost" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| By currency: | | |
| Euro | 49,922,910 | 48,952,445 |
| US dollar | 119,891 | 192,171 |
| Pound sterling | 4,911 | 5,667 |
| Japanese yen | 12,490 | 4,468 |
| Swiss franc | 1,190 | 1,190 |
| Other | 1,617 | 1,552 |
| | **50,063,009** | **49,157,493** |

The fair value of "Financial Liabilities at Amortised Cost" is included in Note 41.

***a) Deposits - Central banks***

The detail of "Deposits - Central Banks" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Deposits taken (Note 42) | 4,000,570 | 2,620,000 |
| Valuation adjustments | (20,415) | - |
| | **3,980,155** | **2,620,000** |

At 31 December 2017 and 2016, the Group had pledged fixed-income securities, other issued securities and receivables in order to qualify for European Central Bank financing (see Note 42).

The average annual interest rate on "Central Banks" was -0.56% in 2017 (2016: -0.02%).

***b) Deposits - Credit institutions***

The detail of "Deposits - Credit Institutions" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Reciprocal accounts | - | 11,375 |
| Time deposits and other accounts (Note 16) | 249,492 | 348,511 |
| Repurchase agreements (Note 42) | 229,592 | 383,149 |
| Valuation adjustments | 173 | 96 |
| | **479,257** | **743,131** |

The average annual interest rate on "Credit Institutions" was -0.09% in 2017 (2016: -0.12%).

*c) Deposits - Customers*

The detail of “Deposits - Customers” in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Public sector: | | |
| Demand deposits | 1,771,142 | 1,820,365 |
| Time deposits | 93,260 | 96,669 |
| Deposits redeemable at notice | - | - |
| Repurchase agreements (Note 42) | 17,600 | 8,500 |
| Valuation adjustments | 23 | 98 |
| | 1,882,025 | 1,925,632 |
| Other private sectors: | | |
| Demand deposits | 26,449,767 | 23,407,297 |
| Time deposits | 12,184,447 | 14,748,070 |
| Deposits redeemable at notice | - | - |
| Repurchase agreements (Note 42) | 1,123,541 | 889,861 |
| Valuation adjustments | 172,772 | 256,593 |
| | 39,930,527 | 39,301,821 |
| | **41,812,552** | **41,227,453** |

The detail, by product, of the average annual interest rates on “Deposits - Customers” in 2017 and 2016 is as follows:

| | Average interest rate (%) | |
|---|---|---|
| | 2017 | 2016 |
| Ordinary deposits | - | - |
| Interest-bearing demand deposits | 0.02 | 0.02 |
| Short-term deposits | 0.04 | 0.17 |
| Long-term deposits | 0.32 | 0.65 |
| Tax-related and plans | 0.07 | 0.12 |
| Structured term | (0.06) | (0.04) |

The Group has issued several single mortgage-backed bonds, which are governed by Mortgage Market Law 2/1981, of 25 March, and the related implementing provisions. As required by this legislation, the issues are backed by a sufficient amount of mortgage loans or loans to public authorities, as appropriate, meeting the legal requirements for this purpose.

At 31 December 2017, "Deposits - Customers - Other Private Sectors - Time Deposits" included several issues of single mortgage-backed bonds totalling EUR 1,515,769 thousand (31 December 2016: EUR 2,115,287 thousand) issued by the Group and subscribed by securitisation SPVs. The main characteristics of these issues are as follows:

| Subscriber | Final redemption | Interest rate | Thousands of euros | |
|---|---|---|---|---|
| | | | 2017 | 2016 |
| AyT Cédulas Cajas V- Series B | 02/12/18 | 4.76% | 169,355 | 169,355 |
| AyT Cédulas Cajas VIII- Series B | 16/11/19 | 4.26% | 160,976 | 160,976 |
| AyT Cédulas Cajas Global- Series III | 12/12/22 | 3.75% | 174,445 | 174,445 |
| AyT Cédulas Cajas Global- Series XII | 19/03/17 | 4.00% | - | 450,000 |
| AyT Cédulas Cajas Global- Series VII | 24/05/17 | (1) | - | 149,518 |
| AyT Cédulas Cajas Global- Series X | 23/10/23 | 4.25% | 150,000 | 150,000 |
| AyT Cédulas Cajas Global- Series VIII | 12/06/18 | 4.25% | 150,000 | 150,000 |
| AyT Cédulas Cajas IX (Tranche B) | 31/03/20 | 4.00% | 58,333 | 58,333 |
| AyT Cédulas Cajas X (Tranche B) | 28/06/25 | 3.75% | 153,846 | 153,846 |
| AyT Cédulas Cajas Global, F.T.A. Series IV | 20/02/18 | (2) | 200,000 | 200,000 |
| F.T.A. PITCH | 20/07/22 | 5.14% | 298,814 | 298,814 |
| **Total** | | | **1,515,769** | **2,115,287** |

(1) 3-month Euribor plus a 9-basis point spread.
(2) 3-month Euribor plus a 12-basis point spread.

In 2017 issues that matured during the year were redeemed for EUR 600,000 thousand (2016: EUR 1,857,777 thousand).

Although there are no replacement assets or derivatives related to these issues, hedge accounting was applied to certain of them, with a principal amount of EUR 1,067,578 thousand at 31 December 2017 (31 December 2016: EUR 1,517,578 thousand) (see Note 27).

At 31 December 2017, "Deposits - Customers - Other Private Sectors - Valuation Adjustments" included EUR 152,578 thousand (31 December 2016: EUR 206,194 thousand) relating to changes in the fair value of mortgage-backed bonds recognised in profit or loss, attributable to interest rate risk, to which fair value hedge accounting was applied as described in Note 27.

The detail, by currency, of "Deposits - Customers" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **By currency:** | | |
| Euro | 41,706,937 | 41,035,509 |
| US dollar | 97,515 | 183,381 |
| Pound sterling | 4,845 | 5,591 |
| Japanese yen | 477 | 251 |
| Swiss franc | 1,166 | 1,172 |
| Other | 1,612 | 1,549 |
| | **41,812,552** | **41,227,453** |

***d) Debt securities issued***

The detail of "Debt Securities Issued" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Hybrid securities | 50,000 | 50,000 |
| Mortgage-backed securities | 4,514,268 | 6,035,070 |
| Other non-convertible securities | 38,300 | 137,951 |
| Own securities | (1,500,000) | (2,254,000) |
| Subordinated liabilities | - | - |
| Valuation adjustments | 36,375 | 66,078 |
| | **3,138,943** | **4,035,099** |

The changes in 2017 and 2016 in "Debt Securities Issued" were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balance at beginning of year | 4,035,099 | 4,857,387 |
| Issues | - | - |
| Redemptions | (819,826) | (821,721) |
| Other changes | (76,330) | (567) |
| **Balance at end of year** | **3,138,943** | **4,035,099** |

The interest accrued on the Group's debt securities issued amounted to EUR 43,824 thousand in 2017 (31 December 2016: EUR 69,935 thousand) (see Note 45).

I. Debt securities issued - Hybrid securities

With regard to the hybrid securities, on 15 March 2007, the former CajaSur launched an issue of ordinary bonds for a total principal amount of EUR 50,000 thousand maturing on 15 March 2018. The return on the securities is calculated using a fixed annual interest rate of 1.5%. In addition, depending on the date of the last coupon payment, an inflation coupon will be paid which will be calculated according to the cumulative inflation in Spain over the life of the issue. This coupon was separated into an embedded derivative and designated as a hedge (see Note 27).

II. <u>Debt securities issued - Mortgage-backed securities</u>

At 31 December 2017 and 2016, "Mortgage-Backed Securities" included the amount relating to the following issues which were listed on the AIAF market and whose principal characteristics are summarised below:

| Issue | No. of securities | Unit face value | Final redemption (*) | Interest rate | Thousands of euros | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | | Mortgage-backed securities | | Own securities | |
| | | | | | 2017 | 2016 | 2017 | 2016 |
| Bilbao Bizkaia Kutxa mortgage-backed bonds, 27 May 2010 | 1,000 | 100,000 | 30/09/20 | 4.55% | 99,800 | 100,000 | - | - |
| Bilbao Bizkaia Kutxa mortgage-backed bonds, 08 October 2010 | 2,000 | 100,000 | 08/10/18 | (1) | 200,000 | 200,000 | - | - |
| Kutxa mortgage-backed bonds, October 2011 | 2,000 | 50,000 | 14/10/19 | (2) | 100,000 | 100,000 | - | - |
| Caja Vital Kutxa mortgage-backed bonds, October 2011 | 1,500 | 50,000 | 17/10/19 | (3) | 75,000 | 75,000 | - | - |
| Kutxabank, S.A. mortgage-backed bonds, December 2012 | 7,500 | 100,000 | 03/12/17 | (4) | - | 750,000 | - | 750,000 |
| Kutxabank, S.A. mortgage-backed bonds, February 2013 | 7,500 | 100,000 | 01/02/17 | 3.00% | - | 747,495 | - | 4,000 |
| Kutxabank, S.A. mortgage-backed bonds, May 2013 | 1,000 | 100,000 | 21/12/26 | 3.68% | 99,595 | 99,595 | - | - |
| Kutxabank, S.A. mortgage-backed bonds, June 2013 | 500 | 100,000 | 08/06/2021 | (5) | 50,000 | 50,000 | - | - |
| Kutxabank, S.A. mortgage-backed bonds, 27 May 2014 | 10,000 | 100,000 | 27/05/21 | 1.75% | 993,750 | 993,750 | - | - |
| Kutxabank, S.A. mortgage-backed bonds, 30 March 2015 | 2,000 | 100,000 | 30/03/20 | (6) | 200,000 | 200,000 | - | - |
| Kutxabank, S.A. mortgage-backed bonds, 22 September 2015 (7) | 10,000 | 100,000 | 22/09/25 | 1.25% | 993,300 | 993,300 | - | - |
| CajaSur mortgage-backed bonds, 17 March | 15,000 | 100,000 | 16/03/20 | (8) | 1,500,000 | 1,500,000 | 1,500,000 | 1,500,000 |
| **Total** | **60,000** | | | | **4,311,445** | **5,809,140** | **1,500,000** | **2,254,000** |

(*) The Group may redeem early, at par, through a reduction in the face value, the amount, if any, by which the issue exceeds the mortgage-backed bond issue limits established at any time by the applicable legislation.

(1) 3-month Euribor plus a 200-basis point spread.
(2) 3-month Euribor plus a 275-basis point spread.
(3) 3-month Euribor plus a 300-basis point spread.
(4) 12-month Euribor plus a 300-basis point spread.
(5) 3-month Euribor plus a 175-basis point spread.
(6) 3-month Euribor plus a 20-basis point spread.
(7) Social housing bond for the acquisition and construction of state-sponsored housing units.
(8) 12-month Euribor plus a 75-basis point spread.

The columns relating to own securities include the amounts of the issues acquired by the Group, which are recognised under "Own Securities" with a debit balance, as a reduction of the amount of the bonds issued. At 31 December 2017, a portion of these securities amounting to EUR 1,303,900 thousand (31 December 2016: EUR 2,250,000 thousand) was pledged to the Bank of Spain under a loan agreement.

On 22 September 2015, the Group issued its first social housing bond through the launch of a mortgage-backed bond for a principal amount of EUR 1,000 thousand, the purpose of which was to finance lending to low-income individuals and families and facilitate their access to adequate housing. In this regard, the funds obtained from the transaction were used to finance the existing portfolio of loans for the acquisition of state-sponsored housing units (VPOs) in the Basque Country and, additionally, to grant new loans for VPO construction projects in the same geographical region over the life of the bond.

The Group hired an independent expert adviser to establish the conceptual framework of the social housing bond, the eligible projects and the selection of the social criteria to be met. This evaluation agency, in its role as an independent third party, provided its opinion on the social housing bond and on the Group in respect of its social responsibility in the performance of its activity.

The detail of the use of the funds obtained on the issue of the social mortgage-backed bond at 31 December 2017 and 2016, including the granting of new loans for the acquisition and construction of VPOs, is as follows:

| | 31/12/17 | | | |
|---|---|---|---|---|
| Type of transaction | Total no. of transactions | No. of end beneficiaries | Total granted (thousands of euros) | Average balance (thousands of euros) |
| Acquisition of VPOs | 1,217 | 1,635 | 127,573 | 105 |
| Construction of VPOs | 7 | 7 | 43,133 | 6,162 |
| **Total financing** | **1,224** | **1,642** | **170,706** | **6,267** |

| | 31/12/16 | | | |
|---|---|---|---|---|
| Type of transaction | Total no. of transactions | No. of end beneficiaries | Total granted (thousands of euros) | Average balance (thousands of euros) |
| Acquisition of VPOs | 785 | 1,056 | 81,401 | 104 |
| Construction of VPOs | 1 | 1 | 9,945 | 9,945 |
| **Total financing** | **786** | **1,057** | **91,346** | **10,049** |

In 2017 issues totalling EUR 746,000 thousand were redeemed (2016: no issues were redeemed).

There are no replacement assets or derivatives related to these issues. At 31 December 2017, hedge accounting was applied to certain issues with a principal amount of EUR 500,000 thousand (31 December 2016: EUR 750,000 thousand) (see Note 27).

In addition, as described in Note 25, "Debt Securities Issued - Mortgage-Backed Securities" includes the Group's net position in asset-backed bonds subscribed by third parties, amounting to EUR 202,823 thousand at 31 December 2017 (31 December 2016: EUR 225,930 thousand).

III. Debt securities issued - Other non-convertible securities

"Other Non-Convertible Securities" includes the following bond issues launched by the Parent and by the Group company Caja Vital Finance, B.V. (this issue has been hedged (see Note 27)). The main features of these issues are as follows:

| Issue | No. of securities | Unit face value | Final redemption | Interest rate | Thousands of euros | |
|---|---|---|---|---|---|---|
| | | | | | 2017 | 2016 |
| Caja Vital Finance - Euro Medium Term Notes Programme (*) | - | 50,000 | July 2019 | (*) | 38,300 | 38,300 |
| Non-convertible Kutxabank bonds of 24 April 2014 | 1,000 | 100,000 | April 2017 | 3-month Euribor + 0.95% | - | 99,651 |
| **Total** | | | | | **38,300** | **137,951** |

(*) This issue bears annual interest of 6.05% in the first year and 90% of the 10-year IRS rate from the second year until maturity. This issue has been admitted to listing on the Luxembourg Stock Exchange.

In 2017 issues recognised under "Other Non-Convertible Securities" totalling EUR 100,000 thousand were redeemed (2016: no issues were redeemed).

IV. Debt securities issued - Valuation adjustments

At 31 December 2017, "Debt Securities Issued - Valuation Adjustments" included EUR 16,617 thousand (31 December 2016: EUR 24,510 thousand) relating to changes in the fair value of mortgage-backed bonds, and EUR 161 thousand (31 December 2016: EUR 329 thousand) relating to changes in the fair value of hybrid bonds, attributable to interest rate risk, for which fair value hedges had been arranged as described in Note 27.

***e) Other financial liabilities***

The detail, by type of financial instrument, of “Other Financial Liabilities” is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Trade payables | 3,682 | 6,371 |
| Factoring accounts payable | 70 | 48 |
| Guarantees received | 1,413 | 1,873 |
| Tax collection accounts | 111,152 | 84,588 |
| Payment orders and travellers’ cheques | 311,718 | 260,193 |
| Unsettled stock exchange or organised market transactions | 9,894 | 49 |
| Liabilities due to financial guarantees given | 3,129 | 3,531 |
| Deposit Guarantee Fund (Note 11) | 43,129 | 51,005 |
| Other | 167,915 | 124,152 |
| | **652,102** | **531,810** |

***f) Mortgage-market securities***

As an issuer of mortgage-backed bonds, the Group presents below certain relevant information on all the mortgage-backed bond issues mentioned earlier in this Note, the disclosure of which in the consolidated financial statements is obligatory under current mortgage-market legislation:

1. Information on the coverage and privileges for the holders of the mortgage-backed securities issued by the Group.

   The Parent and the wholly-owned subsidiary CajaSur Banco are the only Group companies that issue mortgage-backed bonds.

   These mortgage-backed bonds are securities, the principal and interest of which are specially secured (there being no need for registration in the Property Register) by mortgage in respect of all the mortgages registered in the above companies' name, without prejudice to their unlimited liability.

   The mortgage-backed bonds include the holder’s financial claim on these companies, secured as indicated in the preceding paragraphs, and may be enforced to claim payment from the issuer after maturity. The holders of these securities have the status of special preferential creditors vis-à-vis all other creditors (established in Article 1923.3 of the Spanish Civil Code) in relation to all the mortgage loans and credits registered in the issuer’s favour. All holders of these bonds, irrespective of their date of issue, have equal priority of claim with regard to the loans and credits securing them.

   In the event of insolvency, the holders of mortgage-backed bonds will enjoy the special privilege established in Article 90.1.1 of Insolvency Law 22/2003, of 9 July.

   Without prejudice to the foregoing, in accordance with Article 84.2.7 of Insolvency Law 22/2003, of 9 July, during the insolvency proceedings the payments relating to the repayment of the principal and interest of the mortgage-backed bonds issued and outstanding at the date of the insolvency filing will be settled, as preferred claims, up to the amount of the income received by the insolvent party from the mortgage loans and credits.

If, due to a timing mismatch, the income received by the insolvent party is insufficient to meet the payments described in the preceding paragraph, the insolvency managers must obtain financing to meet the mandated payments to the holders of the mortgage-backed bonds, and the finance provider must be subrogated to the position of the bond-holders.

In the event that the measure indicated in Article 155.3 of Insolvency Law 22/2003, of 9 July, were to be adopted, the payments to all holders of the mortgage-backed bonds issued would be made on a pro-rata basis, irrespective of the issue dates of the bonds.

2. Information on issues of mortgage-market securities

The value of the mortgage-market securities issued by the Group and outstanding at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Mortgage-backed bonds not issued in a public offering** | | |
| Term to maturity of less than 3 years | 2,238,664 | 1,279,849 |
| Term to maturity of between 3 and 5 years | 473,258 | 1,558,332 |
| Term to maturity of between 5 and 10 years | 303,846 | 778,292 |
| Term to maturity of more than 10 years | - | - |
| | **3,015,768** | **3,616,473** |
| **Mortgage-backed bonds issued in a public offering** | | |
| Term to maturity of less than 3 years | 675,000 | 1,872,495 |
| Term to maturity of between 3 and 5 years | 1,043,750 | 1,343,750 |
| Term to maturity of between 5 and 10 years | 1,092,895 | 1,092,895 |
| Term to maturity of more than 10 years | - | - |
| | **2,811,645** | **4,309,140** |
| | **5,827,413** | **7,925,613** |

As detailed in Note 17, the Group has policies and procedures in place for the management of its liquidity, and specifically in relation to its mortgage-market activities.

3. Information relating to the issue of mortgage-backed bonds

The face value of all the Group's mortgage loans and credits, as well as that of those eligible in accordance with applicable legislation for the purpose of calculating the mortgage-backed bond issue limit, are as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Face value of the outstanding mortgage loans and credits | 30,412,529 | 31,236,972 |
| Face value of the outstanding mortgage loans and credits that would be eligible disregarding the limits for their calculation established in Article 12 of Royal Decree 716/2009, of 24 April | 25,037,756 | 25,081,258 |
| Value of the total amount of the outstanding mortgage loans and credits that are eligible, based on the criteria stipulated in Article 12 of Royal Decree 716/2009, of 24 April | 24,910,304 | 24,918,856 |

In addition, set forth below is certain information on all the outstanding mortgage loans and credits and on those that are eligible considering the limits for their calculation established by Article 12 of Royal Decree 716/2009, of 24 April:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Total loan and credit portfolio | Total eligible loan and credit portfolio | Total loan and credit portfolio | Total eligible loan and credit portfolio |
| **By currency:** | | | | |
| Euro | 30,352,171 | 24,981,050 | 31,161,729 | 25,012,921 |
| Other | 60,358 | 56,706 | 75,243 | 68,337 |
| | **30,412,529** | **25,037,756** | **31,236,972** | **25,081,258** |
| **By payment status:** | | | | |
| Performing | 27,770,434 | 23,896,851 | 27,865,142 | 23,704,682 |
| Non-performing | 2,642,095 | 1,140,905 | 3,371,830 | 1,376,576 |
| | **30,412,529** | **25,037,756** | **31,236,972** | **25,081,258** |
| **By average term to maturity:** | | | | |
| Up to 10 years | 4,047,153 | 2,753,595 | 4,476,968 | 3,011,435 |
| 10 to 20 years | 9,972,499 | 8,344,528 | 9,443,393 | 7,856,542 |
| 20 to 30 years | 13,806,508 | 12,053,718 | 13,897,652 | 11,739,570 |
| More than 30 years | 2,586,369 | 1,885,915 | 3,418,959 | 2,473,711 |
| | **30,412,529** | **25,037,756** | **31,236,972** | **25,081,258** |
| **By interest rate formula:** | | | | |
| Fixed | 1,742,601 | 1,485,702 | 1,140,733 | 929,312 |
| Floating | 27,857,996 | 23,020,586 | 29,506,122 | 23,846,916 |
| Hybrid | 811,932 | 531,468 | 590,117 | 305,030 |
| | **30,412,529** | **25,037,756** | **31,236,972** | **25,081,258** |
| **By purpose of transactions:** | | | | |
| Business activity - Property development | 965,775 | 312,087 | 1,406,428 | 544,635 |
| Business activity - Other | 3,185,827 | 1,814,528 | 3,503,288 | 2,090,519 |
| Household financing | 26,260,927 | 22,911,141 | 26,327,256 | 22,446,104 |
| | **30,412,529** | **25,037,756** | **31,236,972** | **25,081,258** |
| **By guarantee of transactions:** | | | | |
| Completed buildings-residential (*) | 26,984,452 | 23,203,892 | 27,259,299 | 22,837,328 |
| Completed buildings-commercial | 594,380 | 360,823 | 667,967 | 421,095 |
| Completed buildings-other | 1,652,679 | 961,113 | 1,749,041 | 1,085,428 |
| Buildings under construction-housing units (*) | 319,809 | 185,578 | 228,662 | 125,833 |
| Buildings under construction-commercial | 779 | 569 | 22,694 | 22,214 |
| Buildings under construction-other | 74,911 | 24,740 | 102,781 | 47,638 |
| Land-developed land | 510,525 | 224,632 | 839,382 | 416,429 |
| Land-other | 274,994 | 76,409 | 367,146 | 125,293 |
| | **30,412,529** | **25,037,756** | **31,236,972** | **25,081,258** |

(*) Of which EUR 2,331,945 thousand and EUR 2,013,810 thousand of the total mortgage loans and credits and loans and credits that are eligible for the purposes of Royal Decree 716/2009, respectively, are collateralised by state-sponsored housing units at 31 December 2017 (31 December 2016: EUR 2,427,168 thousand and EUR 2,052,567 thousand, respectively).

The face value of all the outstanding mortgage loans and credits that are ineligible because they do not comply with the LTV limits established in Article 5.1 of Royal Decree 716/2009, but which meet the other requirements for eligible loans set forth in Article 4 of the aforementioned Royal Decree, was EUR 3,494,234 thousand at 31 December 2017 (31 December 2016: EUR 4,448,187 thousand).

The detail of the eligible mortgage loans and credits securing the Group's mortgage-backed bond issues at 31 December 2017 and 2016, based on the LTV ratio (outstanding principal of the loans and credits divided by the latest fair value of the guarantees securing them), is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Home mortgages:** | | |
| Transactions with LTV of less than 40% | 4,301,462 | 4,137,203 |
| Transactions with LTV of between 40% and 60% | 5,890,688 | 5,587,071 |
| Transactions with LTV of between 60% and 80% | 9,238,838 | 8,382,545 |
| Transactions with LTV of more than 80% | 3,931,949 | 4,856,343 |
| | **23,362,937** | **22,963,162** |
| **Other assets received as collateral:** | | |
| Transactions with LTV of less than 40% | 860,631 | 1,126,434 |
| Transactions with LTV of between 40% and 60% | 521,552 | 657,542 |
| Transactions with LTV of more than 60% | 292,636 | 334,120 |
| | **1,674,819** | **2,118,096** |
| | **25,037,756** | **25,081,258** |

The detail of the eligible and non-eligible mortgage loans and credits eliminated from the portfolio in 2017 and 2016, with an indication of the percentages relating to the eliminations due to termination at maturity, early termination, creditor subrogation or other circumstances, is as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Non-eligible portfolio | | Eligible portfolio | |
| 2017 | Amount | % | Amount | % |
| Termination at maturity | 992 | 0.05% | 11,250 | 0.40% |
| Early termination | 110,158 | 5.78% | 508,330 | 18.01% |
| Other circumstances | 1,794,289 | 94.17% | 2,302,129 | 81.59% |
| | **1,905,439** | **100.00%** | **2,821,709** | **100.00%** |

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Non-eligible portfolio | | Eligible portfolio | |
| 2016 | Amount | % | Amount | % |
| Termination at maturity | 39,502 | 1.58% | 19,962 | 0.69% |
| Early termination | 184,847 | 7.40% | 639,096 | 22.39% |
| Other circumstances | 2,274,896 | 91.02% | 2,196,011 | 76.92% |
| | **2,499,245** | **100.00%** | **2,854,769** | **100.00%** |

The detail of the eligible and non-eligible mortgage loans and credits added to the portfolio in 2017 and 2016, with an indication of the percentages relating to the additions due to originated transactions, creditor subrogation or other circumstances, is as follows:

| 2017 | Thousands of euros | | | |
|---|---|---|---|---|
| | Non-eligible portfolio | | Eligible portfolio | |
| | Amount | Percentage | Amount | Percentage |
| Originated transactions | 946,260 | 84.15% | 2,603,479 | 93.71% |
| Subrogations from other entities | 6,933 | 0.62% | 12,465 | 0.45% |
| Other circumstances | 171,305 | 15.23% | 162,264 | 5.84% |
| | **1,124,498** | **100.00%** | **2,778,208** | **100.00%** |

| 2016 | Thousands of euros | | | |
|---|---|---|---|---|
| | Non-eligible portfolio | | Eligible portfolio | |
| | Amount | Percentage | Amount | Percentage |
| Originated transactions | 839,424 | 90.80% | 2,673,094 | 93.89% |
| Subrogations from other entities | 1,891 | 0.20% | 22,946 | 0.81% |
| Other circumstances | 83,192 | 9.00% | 151,095 | 5.30% |
| | **924,507** | **100.00%** | **2,847,135** | **100.00%** |

4. Information relating to mortgage participation certificates and mortgage transfer certificates

At 31 December 2017 and 2016, the only mortgage participation certificates (participaciones hipotecarias) or mortgage transfer certificates (certificados de transmisión hipotecaria) held by the Group were those issued by Kutxabank and CajaSur relating to the securitisation programmes described in Note 25 to these consolidated financial statements.

Further information relating to the mortgage participation certificates and mortgage transfer certificates is presented below:

| | Principal amount (Thousands of euros) | |
|---|---|---|
| | 2017 | 2016 |
| **Mortgage participation certificates issued** | **39,214** | **45,428** |
| Of which: retained on the balance sheet | *31,135* | *35,847* |
| Of which: not issued in a public offering | *31,135* | *35,847* |
| **Mortgage transfer certificates issued** | **3,000,660** | **3,315,788** |
| Of which: retained on the balance sheet | *2,996,358* | *3,305,584* |
| Of which: not issued in a public offering | *3,000,660* | *3,310,686* |

| | Average term to maturity (years) | |
|---|---|---|
| | 2017 | 2016 |
| Mortgage participation certificates issued, retained on the balance sheet | 11.60 | 12.21 |
| Mortgage transfer certificates issued | 17.24 | 17.94 |

## 35. Provisions

The detail of "Provisions" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Pensions and other post-employment defined benefit obligations:** | | |
| Provisions for pensions under Royal Decree 1588/1999 | 70,439 | 75,894 |
| Other provisions for pensions | 257,875 | 177,256 |
| | 328,314 | 253,150 |
| **Other long-term employee benefits (Note 14-o)** | 52,595 | 57,381 |
| **Pending legal issues and tax litigation** | 679 | 690 |
| **Commitments and guarantees given:** | | |
| Provisions for guarantees given | 31,044 | 36,166 |
| Provisions for contingent commitments given | 3,772 | 3,674 |
| | 34,816 | 39,840 |
| **Other provisions** | 149,836 | 207,359 |
| | **566,240** | **558,420** |

The changes in "Provisions" in 2017 and 2016 were as follows:

| | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | Pensions and other remuneration | Provisions for taxes and other legal contingencies | Commitments and guarantees given | Other provisions | Total |
| | | | | | |
| **Balance at 31 December 2015** | **320,608** | **690** | **36,262** | **176,000** | **533,560** |
| Additions charged to income- | | | | | |
| Staff costs | 3,621 | - | - | - | 3,621 |
| Interest expenses (Note 45) | 2,493 | - | - | - | 2,493 |
| Net period provisions (Note 59) | 37,278 | 306 | 8,677 | 71,324 | 117,585 |
| Amounts used- | | | | | |
| Pension payments | (3,174) | - | - | - | (3,174) |
| Payments for pre-retirements | (48,880) | - | - | - | (48,880) |
| Other payments | (13,937) | (306) | - | (50,874) | (65,117) |
| Internal transfers | 1,481 | - | - | (1,481) | - |
| Other changes | 11,041 | - | (5,099) | 12,390 | 18,332 |
| **Balance at 31 December 2016** | **310,531** | **690** | **39,840** | **207,359** | **558,420** |
| Additions charged to income- | | | | | |
| Staff costs | 4,012 | - | - | - | 4,012 |
| Interest expenses (Note 45) | 2,576 | - | - | - | 2,576 |
| Net period provisions (Note 59) | 135,614 | (1) | 794 | 1,841 | 138,248 |
| Amounts used- | | | | | |
| Pension payments | - | - | - | - | - |
| Payments for pre-retirements | (58,588) | - | - | - | (58,588) |
| Other payments | (12,418) | - | (418) | (82,392) | (95,228) |
| Transfers to/from loans and receivables (Note 25) | - | - | (4,314) | 15,442 | 11,128 |
| Internal transfers | - | - | - | - | - |
| Other changes | (818) | (10) | (1,086) | 7,586 | 5,672 |
| **Balance at 31 December 2017** | **380,909** | **679** | **34,816** | **149,836** | **566,240** |

The balance of "Provisions - Pensions and Other Post-Employment Defined Benefit Obligations" includes the present value of the obligations to employees.

"Pensions and Other Remuneration - Other Changes" in 2016 included mainly the impact of the actuarial gains and losses recognised, which represented a net negative impact of EUR 10,726 thousand on the Group's equity, before considering the related tax effect. The actuarial gains and losses recognised in 2016 arose mainly as a result of the Group having changed the discount rate from 1.5% to 1.0%.

This impact, net of the related tax effect, was recognised in equity under "Accumulated Other Comprehensive Income" (see Note 38) and may not be reclassified to the consolidated statement of profit or loss in subsequent years (see Note 14-o).

### a) *Provisions - Pensions and other post-employment defined benefit obligations*

The detail of "Provisions - Pensions and Other Post-Employment Defined Benefit Obligations" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Post-employment benefit obligations: | | |
| Vested | 139,642 | 138,241 |
| Current and pre-retired employees | 25,923 | 32,870 |
| | 165,565 | 171,111 |
| Early retirement benefit obligations | 162,749 | 82,039 |
| | **328,314** | **253,150** |

**Post-employment benefit obligations**

*Defined benefit plans*

Following is a detail, at 31 December 2017 and 2016, of the present value of the Group's post-employment benefit obligations for each of the plans, showing the funding status of these obligations, the fair value of the plan and non-plan assets funding them and the present value of the obligations not recognised in the consolidated balance sheet as at those dates pursuant to IAS 19, based on the balance sheet headings under which they are recognised, where appropriate, at those dates:

| | Thousands of euros | | |
|---|---|---|---|
| 2017 | Kutxabank | CajaSur Banco | Total Group |
| **Obligations:** | | | |
| To current employees and early retirees | 37,509 | - | 37,509 |
| To retired employees | 438,333 | 102,650 | 540,983 |
| | **475,842** | **102,650** | **578,492** |
| **Funding:** | | | |
| Internal provisions (Note 14-o) | 70,742 | 94,822 | 165,564 |
| Assets assigned to the funding of obligations | 464,187 | 8,293 | 472,480 |
| | **534,929** | **103,115** | **638,044** |

| 2016 | Thousands of euros Kutxabank | CajaSur Banco | Total Group |
|---|---|---|---|
| **Obligations:** | | | |
| To current employees and early retirees | 46,174 | - | 46,174 |
| To retired employees | 448,928 | 108,756 | 557,684 |
| | **495,102** | **108,756** | **603,858** |
| **Funding:** | | | |
| Internal provisions (Note 14-o) | 70,662 | 100,450 | 171,112 |
| Assets assigned to the funding of obligations | 485,411 | 8,744 | 494,155 |
| | **556,073** | **109,194** | **665,267** |

In order to determine the pension obligations for each of the defined benefit plans described in this Note, the Group used a discount rate based on the yields of high quality European corporate bond curves (Iboxx Corporates AA), adapting the maturities on these curves to those of the obligations.

At 31 December 2017 and 2016, actuarial studies on the funding of post-employment benefit obligations were performed using the projected unit credit method and considering that the estimated retirement age of each employee is the earliest at which the employee is entitled to retire. The main actuarial assumptions used in the calculations were as follows:

| | 2017 | 2016 |
|---|---|---|
| Discount rate | 1% and 1.25% | 1% |
| Mortality tables | PERM/F 2000P | PERM/F 2000P |
| Disability tables | EVKM/F 90 | EVKM/F 90 |
| Annual pension increase rate | 2% | 2% |
| Annual salary increase rate | 2% | 2% |
| Cumulative annual CPI growth | 2% | 2% |

The detail of the fair value of the assets assigned to the funding of post-employment benefits at 31 December 2017 and 2016 is as follows:

| 2017 | Thousands of euros Kutxabank | CajaSur Banco | Total Group |
|---|---|---|---|
| Assets of EPSVs | 464,187 | - | 464,187 |
| Assets assigned to the funding of obligations | - | 8,293 | 8,293 |
| **Total** | **464,187** | **8,293** | **472,480** |

| 2016 | Thousands of euros | | |
|---|---|---|---|
| | Kutxabank | CajaSur Banco | Total Group |
| Assets of EPSVs | 485,411 | - | 485,411 |
| Assets assigned to the funding of obligations | - | 8,744 | 8,744 |
| **Total** | **485,411** | **8,744** | **494,155** |

Following is a detail of the fair value of the main types of assets composing the plan assets included in the foregoing table at 31 December 2017 and 2016:

| 2017 | Thousands of euros | | |
|---|---|---|---|
| | Kutxabank | CajaSur Banco | Total Group |
| Shares | 239 | - | 239 |
| Debt instruments | 454,715 | - | 454,715 |
| Other assets | 9,233 | 8,293 | 17,526 |
| **Total** | **464,187** | **8,293** | **472,480** |

| 2016 | Thousands of euros | | |
|---|---|---|---|
| | Kutxabank | CajaSur Banco | Total Group |
| Debt instruments | 478,151 | - | 478,151 |
| Other assets | 7,260 | 8,744 | 16,004 |
| | **485,411** | **8,744** | **494,155** |

The annual return on the assets assigned to the funding of post-employment benefits in 2017 ranged from -0.43% to 6.86% (2016: 0.10% to 6.86%).

The expected annual return on these assets for 2018 ranges from -0.60% to 4.60%.

The value of certain aggregates related to defined benefit post-employment obligations at 31 December 2017, together with the same aggregates for the last four years, for comparison purposes, is as follows:

| | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | 2017 | 2016 | 2015 | 2014 | 2013 |
| Present value of the defined benefit obligations | 578,492 | 603,858 | 608,343 | 648,974 | 574,217 |
| Funding | 638,044 | 665,267 | 672,470 | 695,532 | 626,612 |
| Surplus/(Deficit) | 59,552 | 61,409 | 64,127 | 46,558 | 52,395 |

The surplus or deficit shown in the foregoing table includes mainly the excess of the fair value of the assets forming part of the EPSVs over the present value of the obligations externalised to these EPSVs, and the solvency margin which the regulations require EPSVs to hold, which amounted to EUR 11,693 thousand at 31 December 2017 (31 December 2016: EUR 11,907 thousand). The aforementioned solvency margin was not recognised as an asset since the Group considers that it is unlikely to obtain refunds from the EPSV or reductions of future cash outflows.

Changes in the main assumptions can affect the calculation of the obligations. Had the discount rate risen or fallen by 50 basis points, the present value of the Group's obligations would have decreased or increased by approximately EUR 21 million or EUR 22 million, respectively.

Following is a reconciliation of the present value of the defined benefit obligations at the beginning and end of 2017 and 2016:

| | Thousands of euros | | |
|---|---|---|---|
| | Kutxabank | CajaSur Banco | Total Group |
| **Balance at 31 December 2015** | **499,953** | **108,390** | **608,343** |
| Interest cost | 7,133 | 1,632 | 8,765 |
| Current service cost | 1,621 | - | 1,621 |
| Actuarial (gains) and losses | 17,203 | 5,121 | 22,324 |
| Benefits paid | (30,808) | (6,387) | (37,195) |
| **Balance at 31 December 2016** | **495,102** | **108,756** | **603,858** |
| Interest cost | 4,945 | 1,085 | 6,030 |
| Current service cost | 1,331 | - | 1,331 |
| Actuarial (gains) and losses | 2,429 | (950) | 1,479 |
| Benefits paid | (27,965) | (6,241) | (34,206) |
| **Balance at 31 December 2017** | **475,842** | **102,650** | **578,492** |

As indicated above, these obligations are covered by both internal funds and plan assets. Following is a reconciliation of the fair value of the plan assets of each plan at the beginning and end of 2017 and 2016:

| | Thousands of euros | | |
|---|---|---|---|
| | Kutxabank | CajaSur Banco | Total Group |
| **Fair value at 31 December 2015** | **492,481** | **9,412** | **501,893** |
| Expected return on plan assets | 19,585 | 148 | 19,733 |
| Actuarial gains and (losses) | 2,471 | (552) | 1,919 |
| Contributions made by plan participants | - | - | - |
| Benefits paid | (29,126) | (264) | (29,390) |
| **Fair value at 31 December 2016** | **485,411** | **8,744** | **494,155** |
| Expected return on plan assets | 18,910 | 85 | 18,995 |
| Actuarial gains and (losses) | (12,427) | (336) | (12,763) |
| Contributions made by plan participants | 69 | - | 69 |
| Benefits paid | (27,776) | (200) | (27,976) |
| **Fair value at 31 December 2017** | **464,187** | **8,293** | **472,480** |

***b) Commitments and guarantees given***

“Commitments and Guarantees Given” includes the amount of the provisions made to cover guarantees given -defined as those transactions in which the Group guarantees the obligations of a third party, arising as a result of guarantees given or contracts of another kind- and contingent commitments -defined as irrevocable commitments that may give rise to the recognition of financial assets.

### c) *Other provisions*

The purpose of the balance of "Other Provisions" is to cover possible contingencies, liabilities and other specific circumstances to which the Group is exposed in its ordinary business activity. These provisions are based on the best estimate of future obligations arising from past events whose nature at the reporting date is clearly specified but whose amount or timing is uncertain and that the Group expects to settle on maturity through an outflow of resources embodying economic benefits. Provisions are quantified on the basis of the best information available on the consequences of the event giving rise to them and are reviewed and adjusted at the end of each year. Provisions are used to cater for the specific obligations for which they were recognised and they are fully or partially reversed when such obligations cease to exist or are reduced.

The detail, by nature, of the main items recognised under "Other Provisions" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Contingencies due to assets sold | 65,202 | 126,589 |
| Coverage of legal contingencies and litigation and other liabilities | 9,693 | 5,551 |
| Contingencies incurred by subsidiaries in the ordinary course of their business | 40,769 | 47,878 |
| Other items | 34,172 | 27,341 |
| | **149,836** | **207,359** |

In addition, following is the estimated timetable of outflows of funds or any future reimbursements of the items included in the foregoing table:

| | Thousands of euros | |
|---|---|---|
| | 2017 timetable | 2016 timetable |
| Contingencies due to assets sold | 2018 | 2017 |
| Coverage of legal contingencies and litigation and other liability | 2018 and 2019 | 2017 and 2018 |
| Contingencies incurred by subsidiaries in the ordinary course of their business | 2018 and 2019 | 2017 to 2019 |
| Other items | - | - |

#### *Court proceedings and/or claims in process*

Following the various judgments handed down in relation to the floor clauses included in consumer mortgage loans and, particularly, following the judgment by the Court of Justice of the European Union of 21 December 2016, the Group recognised a provision of EUR 113 million in 2016, after conducting an analysis of the portfolio of consumer mortgage loans containing a floor clause, of which EUR 85 million were recognised with a charge to profit or loss for 2016, before considering the related tax effect, in order to cover any claims that might be made in the future.

Also, on 20 January 2017, Royal Decree-Law 1/2017 on urgent consumer-protection measures relating to floor clauses was approved, which establishes the out-of-court procedures to be implemented by financial institutions in order to facilitate the reimbursement of the amounts unduly paid by the consumer to such entities due to the application of certain floor clauses contained in loan or mortgage loan agreements. The Group implemented the legally-required procedure within the time period established in the aforementioned Royal Decree-Law.

In addition, at the end of 2017 and 2016 certain court proceedings and claims were in process against the Group arising from the ordinary course of its operations.

The Group's legal advisers and the Parent's directors consider that the outcome of these court proceedings and claims will not have a material effect for which provisions have not already been recognised in the consolidated financial statements for the years in which they are settled.

## 36. Assets and liabilities under insurance and reinsurance contracts

The detail of "Assets under Reinsurance and Insurance Contracts" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Reinsurer's share of technical provisions for: | | |
| Unearned premiums | 3,557 | 3,645 |
| Life insurance | 21,523 | 24,056 |
| Claims outstanding | 23,555 | 21,622 |
| | **48,635** | **49,323** |

The foregoing table includes the amounts that the Group is entitled to receive for reinsurance contracts with third parties and, specifically, the reinsurer's share of the technical provisions recognised by the insurance entities.

The detail of "Liabilities under Insurance and Reinsurance Contracts" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Technical provisions for: | | |
| Unearned premiums and unexpired risks | 89,633 | 80,868 |
| Mathematical provisions | 425,633 | 454,208 |
| Claims outstanding | 62,785 | 58,258 |
| Bonuses and rebates | 485 | 534 |
| Other technical provisions | 2,837 | - |
| | 581,373 | 593,868 |
| Accounting mismatches | 45,481 | 41,482 |
| | **626,854** | **635,350** |

The Group markets insurance products of its subsidiaries Kutxabank Aseguradora Compañía de Seguros y Reaseguros, S.A.U. and Kutxabank Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.U.

The main insurance products offered by the Group include individual and group life insurance, and various types of savings insurance.

The modelling methods and techniques that are used for calculating the mathematical provisions of insurance products comprise actuarial and financial methods and modelling techniques approved by the Directorate-General of Insurance and Pension Funds. The modelling methods and techniques used for calculating the mathematical provisions of insurance products are set forth in IFRSs and consist mainly of the calculation of estimated future cash flows discounted at each policy's technical interest rate. The measures taken in order to hedge this technical interest rate involve the acquisition of a portfolio of securities which generate the flows required to cover the payment commitments to the insureds.

The mortality tables used in the calculation of the mathematical provisions in the case of life insurance policies are GKF80, GKF95 and PASEMF2010. For savings products, PERNP, PER CARTERA, GRF80 and GRF95 survival tables are used, depending on the type of product, in addition to the mortality tables mentioned above.

The discount rates used at 31 December 2017 and 2016 in the calculation of the mathematical provisions for the main types of insurance were as follows:

| Type of insurance | 2017 discount rate | 2016 discount rate |
|---|---|---|
| Individual life | 0.00% - 3.50% | 0.00% - 3.50% |
| Group life | 0.00% - 1.09% | 0.00% - 1.91% |
| Savings | 1.25% - 6.00% | 1.25% - 6.00% |
| Individual annuity | 0.56% - 5.53% | 0.56% - 5.53% |
| Group annuity | 0.05% - 5.92% | 0.00% - 5.88% |
| Combined | 1.12% - 1.45% | 1.02% - 1.35% |

In 2017 and 2016 no significant changes occurred in the assumptions used in the foregoing tables.

## 37. Shareholders' equity

The detail of "Shareholders' Equity" in the accompanying consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Share capital | 2,060,000 | 2,060,000 |
| Retained earnings | 420,891 | 296,780 |
| Other reserves | 2,364,185 | 2,369,642 |
| Profit attributable to owners of the Parent | 301,954 | 244,248 |
| Interim dividends | (115,422) | (95,154) |
| | **5,031,608** | **4,875,516** |

### Share capital

At 14 June 2011, the share capital of the Parent consisted of 18,050 registered shares of EUR 1,000 par value each, all with identical voting and dividend rights and fully subscribed and paid by BBK.

As a result of the spin-off of the Savings Banks' financial business described in Note 1.2, the Parent increased share capital by EUR 1,981,950 thousand through the issuance of 1,981,950 registered shares of EUR 1,000 par value, with a share premium of EUR 3,432,939 thousand. These shares were fully subscribed and paid by BBK, Kutxa and Caja Vital.

On 27 March 2014, at the Annual General Meeting of the Parent, the shareholders unanimously resolved, pursuant to Article 296 of the Spanish Limited Liability Companies Law, to increase the share capital of Kutxabank, S.A. by EUR 60,000 thousand, with a charge to reserves, through an increase of EUR 30 in the par value of each of the existing 2,000,000 shares. Following this capital increase, at 31 December 2017 and 2016, the Parent's share capital amounted to EUR 2,060,000 thousand, represented by 2,000,000 fully subscribed and paid registered shares of EUR 1,030 par value each, numbered from 1 to 2,000,000, both inclusive, all with identical voting and dividend rights. The distribution of the share capital, by shareholder, is as follows:

| | % of ownership |
|---|---|
| Bilbao Bizkaia Kutxa Fundación Bancaria - Bilbao Bizkaia Kutxa Banku Fundazioa | 57% |
| Fundación Bancaria Kutxa - Kutxa Banku Fundazioa | 32% |
| Caja de Ahorros de Vitoria y Álava - Araba eta Gasteizko Aurrezki Kutxa, Fundación Bancaria | 11% |

At 31 December 2017 and 2016, the Group did not hold any treasury shares.

At 31 December 2017 and 2016, the ownership interests of 10% or more in the capital of Group subsidiaries held by non-Group entities, either directly or through their subsidiaries, were as follows:

| | % of ownership | |
|---|---|---|
| | 2017 | 2016 |
| Norbolsa, Sociedad de Valores y Bolsa, S.A.: | | |
| Caja de Crédito de los Ingenieros, S. Coop. de Crédito | 10.00 | 10.00 |
| Parking Zoco Córdoba, S.L.: | | |
| Deza Alimentación, S.A. | 21.08 | 21.08 |
| Compañía Meridional de Inversiones y Patrimonio, S.L.U. | 13.08 | 13.08 |

In addition, at 31 December 2016, 12 individuals held ownership interests in the Fineco Group, representing a total of 20% of its capital (31 December 2017: one individual held an ownership interest of 1.78%).

**Retained earnings**

"Retained Earnings" includes the net amount of the accumulated profits or losses recognised in prior years in the consolidated statement of profit or loss and appropriated to equity. Accordingly, it includes the legal, bylaw and voluntary reserves resulting from the appropriation of profits.

**Other reserves**

"Other Reserves" includes the net amount of the profits or losses accumulated in prior years that were generated by companies accounted for using the equity method and which were recognised in the consolidated statement of profit or loss, together with the amount of the reserves not included under other items, such as, as the case may be, amounts resulting from permanent adjustments made directly in equity in connection with expenses arising from the issuance, redemption or retirement of own equity instruments, and the retrospective adjustment of the consolidated financial statements due to errors or changes in accounting policies.

*Legal reserve*

Under the Consolidated Spanish Limited Liability Companies Law, 10% of net profit for each year must be transferred to the legal reserve until the balance of this reserve reaches 20% of the share capital. The legal reserve can be used to increase capital provided that the remaining reserve balance does not fall below 10% of the increased share capital amount. Otherwise, until the legal reserve exceeds 20% of share capital, it can only be used to offset losses, provided that sufficient other reserves are not available for this purpose.

On 27 March 2014, at the Annual General Meeting of the Parent, the shareholders unanimously resolved to transfer EUR 400,529 thousand from "General Reserves" to "Legal Reserve". Following this transfer, at 31 December 2017 and 2016, the balance recognised under "Legal Reserve" amounted to EUR 412,000 thousand, which represents 20% of the share capital.

Bizkaia Regulatory Decree 11/2012, of 18 December, on asset revaluation was published on 28 December 2012. Under this tax legislation, companies may revalue their assets for tax purposes. Pursuant to this legislation, the Parent revalued the tax base of a portion of its assets following the approval of its adoption of this measure, granted by the General Meeting of the Bank on 27 June 2013.

Accordingly, in conformity with the aforementioned regulatory decree, the Parent created the "Revaluation Reserve Bizkaia Regulatory Decree 11/2012", effective from 1 January 2013, amounting to EUR 51,685 thousand (see Note 14-q), which did not give rise to any change in the value at which the assets were recognised in the Group's consolidated balance sheet.

This reserve includes the amount of the revaluation net of the single 5% levy established by the aforementioned regulatory decree. The balance of the Revaluation Reserve Bizkaia Regulatory Decree 11/2012, of 18 December, will be restricted until it has been verified and approved by the tax authorities, or until three years have elapsed following settlement of the single levy. Once it has been verified by the tax authorities or the verification period has elapsed, the balance of this account may be used to offset accounting losses or increase capital. After ten years have elapsed, the balance may only be allocated to unrestricted reserves. However, this balance may only be distributed, directly or indirectly, when the revalued assets have been fully depreciated, transferred or derecognised. On 19 December 2013, the revaluation reserve was verified and approved by the tax authorities (see Note 40).

The breakdown, by company, of "Retained Earnings" and "Other Reserves" at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Parent** | **2,981,573** | **2,765,333** |
| **Subsidiaries:** | | |
| Kutxabank Gestión, S.G.I.I.C., S.A.U. | 89 | 186 |
| Kartera 1, S.L. | 92,756 | 87,461 |
| Kartera 2, S.L. (*) | - | 13,724 |
| Kutxabank Aseguradora Compañía de Seguros y Reaseguros, S.A.U. | 2,026 | (859) |
| Kutxabank Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.U. | 31,308 | 20,225 |
| Property companies | (264,381) | (250,365) |
| CajaSur Banco subgroup | (102,448) | (11,756) |
| Other entities | 18,301 | 14,631 |
| | **(222,349)** | **(126,753)** |
| **Reserves (losses) of entities accounted for using the equity method** | | |
| Jointly controlled entities: | - | 1 |
| Associates: | | |
| Euskaltel, S.A. | 34,550 | 32,460 |
| Property companies | (6,236) | (9,064) |
| CajaSur Banco subgroup | 25 | 415 |
| Other entities | (2,487) | 4,030 |
| | 25,852 | 27,841 |
| | **25,852** | **27,842** |
| | **2,785,076** | **2,666,422** |

(*) Company absorbed in 2017 (see Note 1.3).

**Profit attributable to owners of the Parent**

The detail, by entity, of the contribution to the profit attributable to owners of the Parent at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Parent** | **102,151** | **208,857** |
| **Subsidiaries:** | | |
| Kutxabank Gestión, S.G.I.I.C., S.A.U. | 12,758 | 11,584 |
| Kartera 1, S.L. | 279,356 | 103,468 |
| Kartera 2, S.L. (*) | - | 20,097 |
| Kutxabank Aseguradora Compañía de Seguros y Reaseguros, S.A.U. | 14,452 | 10,130 |
| Kutxabank Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.U. | 15,614 | 16,110 |
| Property companies | (165,647) | (84,192) |
| CajaSur Banco subgroup | 15,922 | (91,155) |
| Other entities | 9,793 | 5,511 |
| | **182,248** | **(8,447)** |
| **Share of results of entities accounted for using the equity method** | | |
| Associates: | | |
| Euskaltel, S.A. | 10,913 | 15,801 |
| Property companies | 591 | 1,043 |
| CajaSur Banco subgroup | (7) | 74 |
| Other entities | 6,058 | 26,920 |
| | **17,555** | **43,838** |
| | **301,954** | **244,248** |

(*) Company absorbed in 2017 (see Note 1.3).

## 38. Accumulated other comprehensive income

The detail of "Accumulated Other Comprehensive Income" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Items that will not be reclassified to profit or loss:** | | |
| Actuarial gains or (-) losses on defined benefit pension plans (Note 35) | (48,491) | (49,153) |
| **Items that may be reclassified to profit or loss:** | | |
| Hedging derivatives: cash flow hedges (Note 27) | (7,001) | (2,293) |
| Available-for-sale financial assets (Note 24): | | |
| *Debt instruments* | *138,110* | *92,667* |
| *Equity instruments* | *345,912* | *465,891* |
| | 484,022 | 558,558 |
| Share of other recognised income and expense of investments in joint ventures and associates (Note 28) | 591 | 348 |
| | **429,121** | **507,460** |

The balance of "Items that May Be Reclassified to Profit or Loss - Available-for-Sale Financial Assets" relates to the net amount of the changes in fair value of these financial instruments which must be classified in consolidated equity. When the financial assets are sold or become impaired, these changes are recognised in the consolidated statement of profit or loss.

The amounts transferred from "Accumulated Other Comprehensive Income" to profit or loss at 31 December 2017 in this connection, disregarding the related tax effect, were EUR 551 thousand of impairment losses (31 December 2016: EUR 29,916 thousand) (see Note 24) and EUR 258,277 thousand of gains on disposals (31 December 2016: EUR 157,286 thousand).

The detail, by entity, of the amount included in "Accumulated Other Comprehensive Income" in consolidated equity at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Parent** | **128,723** | **312,591** |
| **Subsidiaries:** | | |
| Kartera 1, S.L. | 279,214 | 175,435 |
| Grupo de Empresa CajaSur, S.A.U. | - | (10) |
| Fineco Sociedad de Valores, S.A. | (10) | 2 |
| GIIC Fineco S.G.I.I.C., S.A.U. | (15) | 48 |
| Fineco Previsión E.G.F.P., S.A.U. | 4 | 16 |
| Fineco Patrimonios, S.G.I.I.C., S.A.U. | (1) | 6 |
| CajaSur Banco, S.A.U. | 10,708 | 7,255 |
| Norbolsa Sociedad de Valores y Bolsa, S.A. | 5,323 | 5,909 |
| Kutxabank Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.U. | 3,920 | 3,116 |
| Kutxabank Aseguradora Compañía de Seguros y Reaseguros, S.A.U. | 3,947 | 4,720 |
| Kutxabank Pensiones, S.A. | 11 | (18) |
| Alquiler de Trenes, A.I.E. | (3,294) | (1,958) |
| | **299,807** | **194,521** |
| **Associates:** | | |
| Talde Promoción y Desarrollo, S.C.R. | (31) | (29) |
| Ingeteam Corporación, S.A. | 29 | 297 |
| Inversiones Zubiatzu, S.A. | 209 | 128 |
| Aguas y Gestión de Servicios Ambientales, S.A. | (32) | (32) |
| Euskaltel, S.A. | (14) | (16) |
| Viacajas, S.A. | 430 | - |
| | **591** | **348** |
| | **429,121** | **507,460** |

## 39. Minority interests (non-controlling interests)

The detail of "Minority Interests (Non-Controlling Interests)" in the consolidated balance sheets as at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Alquiler de Metros, A.I.E. | 111 | 30 |
| Alquiler de Trenes, A.I.E. | 859 | 866 |
| Fineco Group | 498 | 4,795 |
| Norbolsa Sociedad de Valores y Bolsa, S.A. | 6,350 | 6,366 |
| Parking Zoco Córdoba, S.L. | 788 | 770 |
| | **8,606** | **12,827** |

The changes in 2017 and 2016 in "Minority Interests (Non-Controlling Interests)" in the consolidated balance sheet were as follows:

| | Fineco Group | Norbolsa, S.A. | Other | Total |
|---|---|---|---|---|
| **Balance at 31 December 2015** | **4,491** | **5,054** | **1,717** | **11,262** |
| Profit for the year | 346 | 140 | 192 | 678 |
| Changes in the scope of consolidation (Note 1.3) | - | 1,222 | (342) | 880 |
| Other changes | (42) | (50) | 99 | 7 |
| **Balance at 31 December 2016** | **4,795** | **6,366** | **1,666** | **12,827** |
| Profit for the year | 794 | 322 | 161 | 1,277 |
| Changes in the scope of consolidation (Note 1.3) | (5,074) | - | - | (5,074) |
| Other changes | (17) | (338) | (69) | (424) |
| **Balance at 31 December 2017** | **498** | **6,350** | **1,758** | **8,606** |

## 40. Tax matters

**Kutxabank Tax Group**

In 2017 the Parent and the subsidiaries that met the requirements provided for in this respect applied the special tax consolidation regime under Bizkaia Income Tax Regulation 11/2013, of 5 December ("NFIS"), as part of the Kutxabank Tax Group.

The legislation applicable in the province of Bizkaia for the settlement of 2017 income tax is the NFIS, as it came into force with effect from 1 January 2014; prior to that date, i.e. until 2013, the aforementioned Tax Group had been taxed under the special tax consolidation regime provided for in Bizkaia Income Tax Regulation 3/1996, of 26 June.

Pursuant to Articles 14 et seq of Law 12/2002, of 23 May, approving the Economic Accord with the Autonomous Community of the Basque Country (the "Economic Accord"), the Kutxabank Tax Group pays income tax to the various competent tax authorities in proportion to the volume of transactions performed in each territory. These transactions are located mainly in the three provinces making up the Autonomous Community of the Basque Country, as determined by the Economic Accord.

In 2017 this tax group comprised the Bank as Parent and the entities which, in accordance with the applicable legislation, met the requirements to be considered subsidiaries. The other subsidiaries file individual income tax returns pursuant to the tax legislation applicable to them.

The tax group comprises the following entities:

| | |
|---|---|
| **Parent:**<br>Kutxabank, S.A. | |
| **Subsidiaries:**<br>Kartera 1, S.L.<br>Kartera 2, S.L. (*)<br>Kartera 4, S.A. (*)<br>Gesfinor Administración, S.A.<br>Kutxabank Empréstitos, S.A.U.<br>Kutxabank Gestión, S.G.I.I.C., S.A.U.<br>Harri Iparra, S.A.<br>Harri Inmuebles, S.A.<br>Logística Binaria, S.A. | Inverlur Gestión Inmobiliaria 1, S.L.<br>Yerecial, S.L.<br>Kutxabank Aseguradora, Cía de Seguros y Reaseguros, S.A.U.<br>Kutxabank Vida y Pensiones, Cía de Seguros y Reaseguros, S.A.U.<br>Binaria 21, S.A.<br>GIIC FINECO, S.A.<br>Kutxabank Pensiones, S.A.<br>Fineco Previsión Entidad Gestora de Fondos de Pensiones |
| **Other tax group entities:**<br>Bilbao Bizkaia Kutxa Fundación Bancaria<br>Fundación Bancaria Kutxa | |

(*) Companies absorbed in 2017 by Kutxabank, S.A.

At the date of approval of these consolidated financial statements, and in application of the rules of universal succession as a result of the integration transaction described in Note 1.2, pursuant to current legislation, the Kutxabank Tax Group had 2013 and subsequent years open for review by the tax authorities for income tax and the last four years for the other main taxes and tax obligations applicable to it, since the related statute-of-limitations periods had not elapsed. However, with respect to the returns filed from 21 March 2013 by the entities subject to legislation of the province of Álava, the last five years are open for review since they have not yet become statute-barred.

The companies which form part of a consolidated tax group are jointly and severally liable to pay the tax debts.

There were no tax audits in progress at 2017 year-end.

Furthermore, the Bank fulfilled the entire investment commitment acquired in previous years as a result of the investment that had qualified for the tax incentive provided for, under the name of "Reserve for productive investments and/or for environmental conservation and enhancement or energy saving activities", in the applicable provincial income tax regulations. At 31 December 2017, the amount of the reserve for which the five-year investment maintenance period had not yet elapsed was EUR 5,033 thousand (31 December 2016: EUR 5,033 thousand). The detail is as follows:

- Between 2006 and 2011, Kutxa allocated EUR 72,033 thousand to the reserve for productive investments. Of this amount, a total of EUR 65,033 thousand were invested, and in 2013 the deduction relating to the EUR 7,000 thousand allocated that had not been invested by the required deadline was regularised. The investments were made from 2007 and 2008 onwards, and the amount for which the five-year investment maintenance period has yet to be complied with is EUR 5,033 thousand (2016: EUR 5,033 thousand).

**CajaSur Tax Group**

On 1 January 2011, the transfer en bloc of the assets and liabilities of CajaSur to BBK Bank CajaSur, S.A.U. led to the dissolution of consolidated tax group 193/05 headed by the former CajaSur. Pursuant to Article 81 of the Consolidated Spanish Income Tax Law, the tax losses generated by the tax group which were available for offset were taken over by the companies included in the tax group in proportion to their contribution to the generation thereof. Similarly, the tax group's unused tax credits were taken over by the companies in the tax group in proportion to their contribution to the generation thereof.

Also, as provided for in Chapter VII of Title VII of the Consolidated Spanish Income Tax Law, a new consolidated tax group was formed in 2011, headed by CajaSur Banco as the parent until 2014. However, since 2015, due to the modification of the composition of the tax group as a result of the entry into force of Spanish Income Tax Law 27/2014, of 27 November, the Cajasur tax group has comprised, on the one hand, Kutxabank, S.A. as the Parent, with Cajasur Banco representing the group vis-à-vis the general Spanish tax authorities, and, on the other hand, the entities which, in accordance with the applicable legislation, met the requirements to be considered subsidiaries under the new rules on the configuration of the group.

In this respect, in 2017 Sekilur, S.A. was included in the tax group, after the required resolutions had been adopted and the appropriate notification served to the tax authorities. Also, 2017 will be the last tax period in which Columba 2010, S.L. and Grupo de Empresas CajaSur, S.A.U. will be included in the CajaSur tax group, due to the dissolution and liquidation thereof, executed in public deeds before the notary Jose Maria Montero Pérez-Barquero under numbers 1,983/2017 and 2,155/2017, respectively, of his protocol.

Thus, in 2017 tax group 0513/11 comprised the following entities:

| |
|---|
| **Parent:** |
| Kutxabank, S.A. |
| **Representative entity:** |
| CajaSur Banco, S.A.U. |
| **Subsidiaries:** |
| GPS Mairena El Soto, S.L.U. |
| Norapex, S.A. |
| Viana Activos Agrarios, S.L. |
| Sekilur, S.A. (*) |
| Fineco Patrimonios S.G.I.I.C., S.A.U. (**) |
| Compañía Promotora y de Comercio del Estrecho, S.L. (**) |
| Golf Valle Romano Golf & Resort, S.L. (**) |
| Harri Hegoalde 2, S.A. (formerly Neinor Ibérica Inversiones) (**) |
| Harri Sur Activos Inmobiliarios, S.L. (formerly Neinor Activos Inmobiliarios) (**) |
| Grupo de Empresas CajaSur, S.A.U. (***) |
| Columba 2010, S.L. (***) |

(*) Company included in the CajaSur tax group, due to volume of transactions, as a result of the change in the applicable legislation.

(**) Companies forming part of the Kutxabank Group which, in accordance with the Spanish Income Tax Law, meet the requirements to be considered subsidiaries of the CajaSur tax group.

(***) Companies dissolved and liquidated in 2017.

In 2017 the CajaSur tax group was subject to general Spanish tax legislation and, in particular, the Spanish Income Tax Law. Therefore, a tax rate of 30% is applicable to it since its representative company is a credit institution, as a result of which it does not qualify for the standard tax rate established in the aforementioned legislation, which was 25% for 2017.

In addition, in accordance with the Spanish Income Tax Law, the Cajasur tax group files tax returns solely with the Spanish State Tax Agency.

The companies which form part of a consolidated tax group are jointly and severally liable to pay the tax debts.

At the date of approval of these consolidated financial statements, and in application of the rules of universal succession as a result of the transfer en bloc of the assets and liabilities of the former CajaSur, CajaSur Banco had 2013 and subsequent years open for review by the tax authorities for income tax. It had 2014 and subsequent years open for review by the tax authorities for VAT, withholdings from salary income and withholdings from income from movable capital. In general, all other tax obligations for the last four years are subject to review by the tax authorities.

At 31 December 2017, a tax audit was in progress at Harri Hegoalde 2, S.A. in relation to the tax on economic activities, as well as an audit relating to transfer tax.

In view of the varying interpretations that can be made of the tax legislation applicable to the operations carried out by financial institutions, the tax audits of the open years might give rise to contingent tax liabilities. However, the Parent's Board of Directors considers that the tax liability which might result from such contingent liabilities would not materially affect these consolidated financial statements.

**Income tax**

The detail of “Income Tax” in the accompanying consolidated statements of profit or loss for 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Current income tax (expense)/benefit | - | - |
| Deferred income tax (expense)/benefit | 21,362 | (68,803) |
| **Total income tax (expense)/benefit recognised in the consolidated statement of profit or loss** | **21,362** | **(68,803)** |

The detail of the income tax expense or benefit recognised directly in equity at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Tax effect of valuation adjustments | 21,215 | 21,570 |
| **Total income tax (expense)/benefit** | **21,215** | **21,570** |

The reconciliation of the accounting profit for 2017 and 2016 to the income tax expense is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Accounting profit | 281,869 | 313,729 |
| Permanent differences | (555,027) | (250,759) |
| Share of results of entities accounted for using the equity method | 17,555 | (43,838) |
| Effects of consolidation and other | 180,589 | 231,608 |
| **Adjusted accounting profit (loss)** | **(75,014)** | **250,740** |
| Tax at the Group's average tax rate | (21,379) | 71,461 |
| Tax credits capitalised | 209 | (625) |
| Adjustment to prior year's income tax | (192) | (2,033) |
| **Total income tax expense/(benefit)** | **(21,362)** | **68,803** |

The permanent differences in 2017 and 2016 arose, among other reasons, from the exemption for dividends and domestic capital gains, and from the amounts that the banking foundations allocate to the funding of social welfare projects which, pursuant to the applicable legislation, may be deducted from the banking foundation's own tax base or, alternatively, may be deducted, from the tax base of the credit institutions in which the banking foundations hold ownership interests, in the proportion that the dividends received from these credit institutions represent of the banking foundations' total income, up to the limit of these dividends. Similarly, these permanent differences arose partly as a result of the consideration of the donations contributed to foundations as non-tax-deductible expenses at entities subject to general Spanish tax legislation.

The Kutxabank tax group bore withholdings amounting to EUR 4,677 thousand in 2017 (2016: EUR 13,093 thousand) and the withholdings borne by the CajaSur tax group totalled EUR 124 thousand (2016: EUR 665 thousand).

**Revaluation of assets at the Kutxabank Tax Group**

In 2012 the Parent availed itself of the revaluation of assets regulated in Bizkaia Regulatory Decree 11/2012, of 18 December. Pursuant to Article 12 of this Decree, availing itself of this option obliged the Parent to include certain disclosures in these consolidated financial statements:

a) Criteria used in the revaluation, indicating the assets affected in the relevant financial statements.

   The Parent calculated the amount of the revaluation in the terms expressly stated in Bizkaia Regulatory Decree 11/2012.

   In order to determine the amount by which to revalue each property, the Parent applied the coefficients set forth in Article 7 of Bizkaia Regulatory Decree 11/2012. The coefficients were applied as follows:

   - On the acquisition price or production cost, taking into account the year of acquisition or production of the asset. The coefficient applicable to improvements is that relating to the year in which they were carried out.

   - On the depreciation for accounting purposes of the acquisition price or production cost that was tax deductible, taking into account the year in which it was recognised.

Pursuant to Article 3 of Bizkaia Regulatory Decree 11/2012, the Parent, for the purpose of applying the revaluation coefficients, did not take into account the property revaluations that were carried out previously, as a result of the first-time application of Bank of Spain Circular 4/2004, of 22 December, to credit institutions, on public and confidential financial reporting rules and formats, which did not have an effect on tax.

The amount resulting from the revaluation described above was reduced by the net increase in value resulting from the revaluations provided for in Bizkaia Regulation 6/1996, of 21 November, on the revaluation of assets. The positive difference that was calculated using this method represented the net increase in value of the revalued asset.

The revalued amount did not in any case exceed the market value of the revalued asset, taking into consideration its condition in terms of technical and financial deterioration, and wear and tear as a result of the taxpayer's use of it.

b) Amount of the revaluation of the various on-balance-sheet assets and the related effect on depreciation and amortisation.

The Parent's representation bodies approved the revaluation of the following properties for a total revaluation surplus of EUR 54,405 thousand:

| Property | Thousands of euros |
|---|---|
| | Revaluation surplus |
| Gran Vía 30-32, Bilbao | 31,379 |
| Marqués del Puerto 3, Bilbao | 1,026 |
| Garibai 15, San Sebastián | 4,137 |
| Getaria 9, San Sebastián | 6,848 |
| San Marcial, San Sebastián | 565 |
| Ibaeta, San Sebastián | 6,828 |
| Boulevard, San Sebastián | 463 |
| Benta Berri, San Sebastián | 292 |
| Isabel II, San Sebastián | 448 |
| Paseo Colon, Irún | 601 |
| Rentería Viteri | 542 |
| Gran Vía Gros, San Sebastián | 526 |
| Las Ramblas, Barcelona | 750 |
| **Total** | **54,405** |

The properties detailed above were previously revalued in accordance with Bank of Spain Circular 4/2004 which, as stated in Transitional Provision One, permitted entities to measure their tangible assets at fair value on a once-only basis. This revaluation for accounting purposes did not have a tax effect. The impact of the new revaluation, taking into account the revaluation provided for in the Bank of Spain Circular, entailed the reclassification of the reserve recognised in 2004 to a new Revaluation Reserve Bizkaia Regulatory Decree 11/2012. By applying this measure, the Parent conferred a tax effect on the revaluation already recognised for accounting purposes.

c) Changes in the year in the balance of "Revaluation Reserve Bizkaia Regulatory Decree 11/2012, of 18 December", and explanation of the reason for these changes.

Pursuant to Article 8 of Bizkaia Regulatory Decree 11/2012, in 2013 the Parent credited the amount resulting from the revaluation, i.e. EUR 54,405 thousand, to the account "Revaluation Reserve Bizkaia Regulatory Decree 11/2012, of 18 December".

The Parent settled the single 5% levy by charging EUR 2,720 thousand against the credit balance of "Revaluation Reserve Bizkaia Regulatory Decree 11/2012, of 18 December".

At 31 December 2015, the balance of "Revaluation Reserve Bizkaia Regulatory Decree 11/2012, of 18 December" was zero, as at 2014 year-end. In this regard, in accordance with Bizkaia Regulatory Decree 11/2012, of 18 December, this reserve will be restricted until it has been verified and approved by the tax authorities, or until three years have elapsed following settlement of the single levy. Once it has been verified by the tax authorities or the verification period has elapsed, the balance of this account may be used to offset accounting losses or increase capital.

After ten years have elapsed, the balance may only be allocated to unrestricted reserves. On 19 December 2013, the revaluation reserve was verified and approved by the tax authorities and, accordingly, the Bank used the aforementioned amount to carry out the capital increase approved by the Annual General Meeting on 27 March 2014 (see Note 37).

**Group restructuring transactions**

In 2017 Kartera 2, S.L. and Kartera 4, S.A. were merged by absorption into the Parent. These mergers by absorption were carried out under the special regime provided for in Title VI, Chapter VII of the Bizkaia Income Tax Regulation. Under this regime, the financial statements of the absorbing entity must include the disclosures established in Article 110 of the Bizkaia Income Tax Regulation. These required disclosures were included in the separate financial statements of Kutxabank, S.A. for 2017.

In 2016 Lasgarre, S.A.U., Harri Bat, S.A., Harri Kartera, S.A., Inverlur 6006, S.A., Inverlur Can Balasch, S.L.U., Inverlur del Tebre, S.L.U., Inverlur Cantamilanos, S.L.U. and Inverlur 2002, S.A. were merged by absorption into Harri Iparra, S.A. Also, Kartera 2, S.L. acquired Mail Investment, S.A. by means of merger by absorption. Both transactions were carried out under the special regime provided for in Title VI, Chapter VII of the Bizkaia Income Tax Regulation. Under this regime, the financial statements of the absorbing entity must include the disclosures established in Article 110 of the Bizkaia Income Tax Regulation. These required disclosures were included in the separate financial statements of Kartera 2, S.L. and Harri Iparra, S.A. for 2016.

In addition, in 2016 Tirsur, S.A., Rofisu 2003, S.L., Grupo Inmobiliario Cañada XXI, S.L. and Ñ XXI Perchel Málaga, S.L. were merged by absorption into GPS Mairena del Soto, S.A. Furthermore, Harri Hegoalde 1, S.A. and AEDIS Promociones Urbanísticas, S.L. were merged by absorption into Harri Hegoalde 2, S.A. These transactions were carried out under the special regime provided for in Title VI, Chapter VII of the Bizkaia Income Tax Regulation. Under this regime, the financial statements of the absorbing entity must include the disclosures established in Article 86 of the Consolidated Spanish Income Tax Law. These required disclosures were included in the separate financial statements of GPS Mairena del Soto, S.A. and Harri Hegoalde 2, S.A. for 2016.

Also, in 2015 Kartera 2, S.L. acquired the companies Araba Gertu, S.A. and SPE Kutxa, S.A. by means of merger by absorption. This transaction is described in Note 1.3 and was carried out under the special regime provided for in Title VI, Chapter VII of the Bizkaia Income Tax Regulation. Under this regime, the financial statements of the absorbing entity must include the disclosures established in Article 110 of the Bizkaia Income Tax Regulation. These required disclosures were included in the separate financial statements of Kartera 2, S.L. for 2015.

In addition, Harri Hegoalde 1, S.A.U. acquired the following companies through merger by absorption in 2014: Promotora Inmobiliaria Prienesur, S.A.U., Inverlur 3003, S.L.U., Inverlur Gestión Inmobiliaria II, S.L.U., Inverlur Encomienda I, S.L.U., Inverlur Encomienda II, S.L.U., Lurralia I, S.L.U., Goilur Servicios Inmobiliarios I, S.L.U., Inverlur Estemar, S.L.U., Inverlur Gestión Inmobiliaria IV, S.L.U., Goilur Guadaira I, S.L.U. and Inverlur Guadaira I, S.L.U. For its part, Harri Hegoalde 2, S.A. acquired the following companies through merger by absorption in 2014: SGA CajaSur, S.A.U., Silene Activos Inmobiliarios, S.A.U., Mijasmar I Servicios Inmobiliarios, S.L. and Mijasmar II Servicios Inmobiliarios, S.L.

Both merger by absorption transactions qualified for taxation under the special regime provided for in Title VII, Chapter VIII of the Consolidated Spanish Income Tax Law, approved by Legislative Royal Decree 4/2004, of 5 March. Under this regime, the financial statements of the absorbing entity must include the disclosures established in Article 93 of the Consolidated Spanish Income Tax Law. These required disclosures were included in the separate financial statements of Harri Hegoalde 2, S.A.U. and Harri Hegoalde 1, S.A. for 2014, respectively.

Also, in 2014 Harri Iparra, S.A. acquired Nyesa Inversiones, S.L.U. through merger by absorption. This transaction was carried out under the special regime provided for in Title VI, Chapter VII of the Bizkaia Income Tax Regulation, which requires the absorbing entity to include the disclosures established in Article 110 of the Bizkaia Income Tax Regulation in its financial statements. These disclosures were included in the separate financial statements of Harri Iparra, S.A.

Previously, the transfer en bloc of assets and liabilities described in Note 1.2 qualified for taxation under the special regime provided for in Title VI, Chapter VII of the Bizkaia Income Tax Regulation. Under this regime, the acquirer's financial statements had to include the disclosures established in Article 100 of the aforementioned regulation.

These disclosures were included in the notes to the 2012 separate financial statements of Kutxabank, S.A.

Also, the merger by absorption transactions performed in 2013 (merger by absorption of CK Corporación Kutxa - Kutxa Korporazioa, S.A. and merger by absorption of Kutxabank Kredit EFC S.A.) qualified for taxation under the special regime provided for in Title VI, Chapter VII of the Bizkaia Income Tax Regulation. Under this regime, the financial statements of the absorbing entity also had to include the disclosures established in Article 100 of the aforementioned regulation. These disclosures were included in the notes to the 2013 separate financial statements of Kutxabank, S.A.

## 41. Fair value of on-balance-sheet assets and liabilities

As indicated in Notes 14-e and 14-f, the Group's financial assets are carried at fair value in the consolidated balance sheet, except for loans and receivables, held-to-maturity investments, investments in associates and equity instruments whose market values cannot be measured reliably. Also, the Group's financial liabilities are carried at fair value in the consolidated balance sheet, except for financial liabilities at amortised cost.

The method for determining the fair value of financial assets and liabilities carried at fair value and all other relevant information in this respect are disclosed in Note 14.

The tables below present the fair value of the Group's financial instruments at 31 December 2017 and 2016, broken down, by class of financial asset and liability, into the following levels:

- **LEVEL 1:** financial instruments whose fair value was determined by reference to their quoted prices (unadjusted) in active markets.

- **LEVEL 2:** financial instruments whose fair value was estimated by reference to quoted prices on organised markets for similar instruments or using other valuation techniques in which all the significant inputs are based on directly or indirectly observable market data.

- **LEVEL 3:** instruments whose fair value was estimated by using valuation techniques in which one or another significant input is not based on observable market data.

For scantly material investments on which there is no new relevant information available, cost is used as an approximation to fair value, provided that there are no other external indications of impairment or significant revaluation of the investments concerned.

The data used in fair value calculations were obtained by the Group's external market data service, which offers, for each type of risk, the most liquid data obtained from official agencies, organised markets, brokers, market contributors or independent information providers such as Bloomberg or Reuters. In very specific cases data provided by counterparties or private entities are used, although the amount of the assets valued using these data was scantly material at 31 December 2017 and 2016.

| | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | 2017 | | | | |
| | Carrying amount | Fair value | | | |
| | | Level 1 | Level 2 | Level 3 | Total |
| **Assets-** | | | | | |
| Cash, cash balances at central banks and other demand deposits | 4,407,638 | 4,407,638 | - | - | 4,407,638 |
| Financial assets held for trading | 83,770 | 11,142 | 72,628 | - | 83,770 |
| Other financial assets at fair value through profit or loss | 35,239 | 6,103 | 29,136 | - | 35,239 |
| Available-for-sale financial assets | 4,860,231 | 4,064,954 | 334,307 | 460,970 | 4,860,231 |
| Loans and receivables | 42,559,033 | - | 46,420,362 | - | 46,420,362 |
| Held-to-maturity investments | 248,761 | - | 258,749 | - | 258,749 |
| Derivatives – hedge accounting | 174,079 | - | 174,079 | - | 174,079 |
| **Total** | **52,368,751** | **8,489,837** | **47,289,261** | **460,970** | **56,240,068** |
| | | | | | - |
| **Liabilities-** | | | | | - |
| Financial liabilities held for trading | 83,364 | 8,902 | 74,462 | - | 83,364 |
| Financial liabilities at amortised cost | 50,063,009 | - | 49,732,511 | - | 49,732,511 |
| Derivatives – hedge accounting | 148,846 | - | 148,846 | - | 148,846 |
| **Total** | **50,295,219** | **8,902** | **49,955,819** | - | **49,964,721** |

| | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | 2016 | | | | |
| | Carrying amount | Fair value | | | |
| | | Level 1 | Level 2 | Level 3 | Total |
| **Assets-** | | | | | |
| Cash, cash balances at central banks and other demand deposits | 1,481,508 | 1,481,508 | - | - | 1,481,508 |
| Financial assets held for trading | 142,345 | 20,201 | 122,144 | - | 142,345 |
| Other financial assets at fair value through profit or loss | 34,994 | 6,249 | 28,745 | - | 34,994 |
| Available-for-sale financial assets | 5,073,071 | 4,184,124 | 351,656 | 537,291 | 5,073,071 |
| Loans and receivables | 44,269,735 | - | 48,289,924 | - | 48,289,924 |
| Held-to-maturity investments | 44,246 | - | 54,202 | - | 54,202 |
| Derivatives – hedge accounting | 254,855 | - | 254,855 | - | 254,855 |
| **Total** | **51,300,754** | **5,692,082** | **49,101,526** | **537,291** | **55,330,899** |
| **Liabilities-** | | | | | |
| Financial liabilities held for trading | 140,109 | 16,973 | 123,136 | - | 140,109 |
| Financial liabilities at amortised cost | 49,157,493 | - | 49,482,120 | - | 49,482,120 |
| Derivatives – hedge accounting | 168,972 | - | 168,972 | - | 168,972 |
| **Total** | **49,466,574** | **16,973** | **49,774,228** | - | **49,791,201** |

The Group recognised certain equity instruments at cost in the consolidated balance sheet as at 31 December 2017 and 2016. The balance of these equity instruments amounted to EUR 36,328 thousand at 31 December 2017 (31 December 2016: EUR 163,419 thousand) (see Note 24).

Also, the Group does not have any non-financial assets whose use, as assigned to them in the estimation of their fair value, differs from their current use.

The table below shows the amounts recognised under "Gains or (-) Losses on Derecognition of Financial Assets and Liabilities Not Measured at Fair Value Through Profit or Loss, Net", "Gains or (-) Losses on Financial Assets and Liabilities Held for Trading, Net", "Gains or (-) Losses on Financial Assets and Liabilities Designated at Fair Value through Profit or Loss, Net" and "Gains or (-) Losses from Hedge Accounting, Net" in the 2017 and 2016 consolidated statements of profit or loss in respect of changes in the fair value (relating to unrealised gains and losses) of the Group's financial instruments carried at fair value through profit or loss in the consolidated balance sheet as at the reporting date:

| | Thousands of euros | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2017 | | | | 2016 | | | |
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| **Assets-** | | | | | | | | |
| Cash, cash balances at central banks and other demand deposits | - | - | - | - | - | - | - | - |
| Financial assets held for trading | - | (11,103) | - | (11,103) | - | 1,900 | - | 1,900 |
| Other financial assets at fair value through profit or loss | - | - | - | - | - | (9) | - | (9) |
| Available-for-sale financial assets | - | - | - | - | - | - | - | - |
| Loans and receivables | - | - | - | - | - | - | - | - |
| Held-to-maturity investments | - | - | - | - | - | - | - | - |
| Derivatives – hedge accounting | - | (44,979) | - | (44,979) | - | (43,412) | - | (43,412) |
| | - | **(56,082)** | - | **(56,082)** | - | **(41,521)** | - | **(41,521)** |
| **Liabilities-** | | | | | | | | |
| Financial liabilities held for trading | - | 12,852 | - | 12,852 | - | (2,024) | - | (2,024) |
| Financial liabilities at amortised cost | - | - | - | - | - | - | - | - |
| Derivatives – hedge accounting | - | 17,611 | - | 17,611 | - | (35,613) | - | (35,613) |
| | - | **30,463** | - | **30,463** | - | **(37,637)** | - | **(37,637)** |

Following is a detail of the primary valuation methods, assumptions and inputs used in estimating the fair value of the financial instruments classified at Level 2, by type of financial instrument, and the corresponding balances at 31 December 2017 and 2016:

| | Level 2 | | | |
|---|---|---|---|---|
| | Fair value | | Valuation techniques and assumptions | Inputs |
| | 2017 | 2016 | | |
| **Assets-** | | | | |
| Financial assets held for trading | 72,628 | 122,144 | (1) | (2) |
| Other financial assets designated at fair value through profit or loss | 29,136 | 28,745 | (1) | (2) |
| Available-for-sale financial assets | 334,307 | 351,656 | (3) | (2) |
| Loans and receivables | 46,420,362 | 48,289,924 | (3) | Observable market interest rates |
| Held-to-maturity investments | 258,749 | 54,202 | (1) | (2) |
| Derivatives – hedge accounting | 174,079 | 254,855 | (1) | (2) |
| | **47,289,261** | **49,101,526** | | |
| **Liabilities-** | | | | |
| Financial liabilities held for trading | 74,462 | 123,136 | (1) | (2) |
| Financial liabilities at amortised cost | 49,732,511 | 49,482,120 | (3) | Observable market interest rates |
| Derivatives – hedge accounting | 148,846 | 168,972 | (1) | (2) |
| | **49,955,819** | **49,774,228** | | |

(1) Instruments supported by future cash flows: cash flows discounted using a yield curve corrected for the counterparty risk associated with the transaction.

Instruments with simple options and volatilities: formulas resulting from non-linear mathematical models based on methodologies considered standard for each product type.
Instruments with exotic options: valued using Monte Carlo simulations, which replicate the random behaviour of these instruments.

(2) External market data service, which offers, for each type of risk, the most liquid data obtained from official agencies, organised markets, brokers, market contributors and independent information providers.

(3) Discounting the estimated or estimable future cash flows, taking into account the contractual maturity dates, interest repricing dates and assumptions of early total payment, calculated using the Euribor and IRS curves for the various terms, corrected for the counterparty risk associated with the transaction.

At 31 December 2017, the Group included in Level 3 certain available-for-sale financial assets with a fair value of EUR 460,970 thousand (31 December 2016: EUR 537,291 thousand).

Financial instruments classified at Level 3 are equity instruments measured using valuation techniques in which one or another significant input is not based on observable market data. The unobservable inputs used in estimating the fair value of these instruments include internal financial information, projections or reports, combined with other assumptions or available market data, which, in general, for each type of risk, are obtained from organised markets, industry reports, market contributors or data providers, amongst others.

The changes in the balances of "Available-for-Sale Financial Assets" classified at Level 3 included in the accompanying consolidated balance sheets were as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Balance at beginning of year** | 537,291 | 339,791 |
| Disposals | (172,500) | - |
| Changes in fair value recognised in equity | 9,958 | 197,500 |
| Reclassifications to Level 3 | 86,221 | - |
| **Balance at end of year** | **460,970** | **537,291** |

Equity instruments amounting to EUR 77,283 thousand, the best estimate of the fair value of which was considered to be the cost thereof, were included in Level 3 in 2017. In addition, an investee was reclassified from Level 2 to Level 3 for the amount of EUR 8,938 thousand.

*Sensitivity analysis*

The sensitivity analysis is carried out on assets included in Level 3, that is, those with significant inputs that are not based on observable market variables, in order to be able to obtain a reasonable range of possible alternative valuations. Every six months the Group reviews, based on asset type, methodology and availability of inputs, the changes in the principal assumptions and their possible impact on the assets' valuation. A full update of these valuations is conducted on an annual basis.

At 31 December 2017, the effect on consolidated profit and consolidated equity that would result from changing the principal assumptions used in the valuation of Level 3 financial instruments to other reasonably possible assumptions was as follows:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | Potential impact on the statement of profit or loss | | Potential impact on accumulated other comprehensive income | |
| | Most favourable scenario | Least favourable scenario | Most favourable scenario | Least favourable scenario |
| **Assets-** | | | | |
| Available-for-sale financial assets | - | - | 10,000 | (34,974) |
| | **-** | **-** | **10,000** | **(34,974)** |

Following is a detail, by category, of the fair value of certain of the Group's tangible assets at 31 December 2017 and 2016, together with their corresponding carrying amounts at those dates:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Carrying amount | Fair value | Carrying amount | Fair value |
| **Tangible assets (Note 29)** | | | | |
| Property, plant and equipment for own use - buildings | 676,653 | 864,330 | 687,653 | 860,638 |
| Investment property | 171,267 | 259,004 | 159,851 | 239,308 |
| | **847,920** | **1,123,334** | **847,504** | **1,099,946** |

The fair value of tangible assets was calculated using both appraisals performed by independent valuers (the most important of which were Servicios Vascos de Tasaciones, S.A., Tasaciones Inmobiliarias, S.A., Krata Sociedad de Tasación, S.A., Tecnitasa, S.A., Gesvalt, S.A. and Ibertasa, S.A.) and internal valuations. The valuations made by these appraisal companies were conducted in accordance with the methodology established in Ministry of Economy Order ECO/805/2003. These companies comply with Rule 14 of Bank of Spain Circular 4/2004 in relation to the neutrality and credibility required for their valuations to be considered reliable.

Thus, using these valuations, the Group assesses at each reporting date whether there is any indication that the carrying amount of these assets exceeds their recoverable amount. If this is the case, the Group reduces the carrying amount of the corresponding asset to its recoverable amount.

The fair value of the other financial assets and liabilities is similar to the amounts at which they are recognised in the consolidated balance sheets as at 31 December 2017 and 2016, except for equity instruments whose fair value could not be estimated reliably.

## 42. Guarantees given

"Guarantees Given" relates to the amounts that would be payable by the Group on behalf of third parties as a result of the commitments assumed by it in the course of its ordinary business, if the parties who are originally liable to pay failed to do so. The detail of this item at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Financial guarantees: | | |
| Financial guarantees classified as standard | 384,930 | 426,938 |
| Financial guarantees classified as doubtful | 23,517 | 31,858 |
| | 408,447 | 458,796 |
| Irrevocable documentary credits: | | |
| Irrevocable documentary credits issued | 25,210 | 22,691 |
| Of which: Doubtful | - | - |
| | 25,210 | 22,691 |
| Other bank guarantees and indemnities provided classified as standard | 1,482,405 | 1,321,431 |
| Other bank guarantees and indemnities provided classified as doubtful | 85 | 92 |
| | 1,482,490 | 1,321,523 |
| | **1,916,147** | **1,803,010** |

A significant portion of the financial guarantees given will expire without any payment obligation materialising for the Group and, therefore, the aggregate balance of these commitments cannot be considered to be an actual future need for financing or liquidity to be provided by the Group to third parties.

Income from guarantee instruments is recognised under "Fee and Commission Income" and "Interest Income" (for the amount relating to the discounted value of the fees and commissions) in the consolidated statements of profit or loss for 2017 and 2016 and is calculated by applying the rate established in the related contract to the nominal amount of the guarantee.

The provisions made to cater for the guarantees provided, which were calculated using criteria similar to those applied in the calculation of the impairment of financial assets measured at amortised cost, were recognised under "Provisions - Commitments and Guarantees Given" in the consolidated balance sheet (see Note 35).

The detail of the Group's assets loaned or advanced as collateral at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Available-for-sale financial assets:** | | |
| Assets pledged as guarantees to Bank of Spain (Note 24) | - | - |
| Other assets loaned or advanced as collateral | 1,180,526 | 333,058 |
| | **1,180,526** | **333,058** |
| **Held-to-maturity investments (Note 26):** | | |
| Assets pledged as guarantees to Bank of Spain | 44,349 | 44,246 |
| | **44,349** | **44,246** |
| **Loans and receivables (Note 25):** | | |
| Assets pledged as guarantees to Bank of Spain | 2,000,787 | 1,276,563 |
| Securitised assets | 2,973,837 | 3,282,283 |
| Other assets loaned or advanced as collateral | 54,329 | 848,316 |
| | **5,028,953** | **5,407,162** |

The detail of repurchase agreements and assets earmarked for own obligations is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Repurchase agreements (Note 34) | 1,370,733 | 1,281,510 |
| Assets earmarked for own obligations | 5,651,476 | 5,844,985 |
| | **7,022,209** | **7,126,495** |

"Assets Earmarked for Own Obligations" includes repurchased asset-backed bonds with a principal amount of EUR 2,212,399 thousand at 31 December 2017 (31 December 2016: EUR 2,473,152 thousand) (see Note 25), and repurchased mortgage-backed bonds amounting to EUR 1,303,900 thousand at 31 December 2017 (31 December 2016: EUR 2,250,000 thousand) (see Note 34).

At 31 December 2017, the Group had pledged or advanced as collateral financial instruments with a total principal amount of EUR 5,651,476 thousand (31 December 2016: EUR 5,844,985 thousand) in order to obtain financing from the European Central Bank. At 31 December 2017, the deposit from the Bank of Spain amounted to EUR 4,000,570 thousand (31 December 2016: EUR 2,620,000 thousand) (see Note 34). The Bank of Spain deposit will mature in 2018.

## 43. Contingent commitments given

The detail of "Contingent Commitments Given" at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Loan commitments given | | |
| Central banks | | |
| Public sector | 1,084,683 | 858,412 |
| Credit institutions | - | - |
| Other financial corporations | 123,042 | 165,555 |
| Non-financial corporations | 2,530,916 | 1,993,293 |
| Households | 1,269,387 | 1,241,775 |
| | 5,008,028 | 4,259,035 |
| Financial asset forward purchase commitments | | |
| Securities subscribed but not paid | 638 | 1,858 |
| Other contingent commitments | 1,263,510 | 1,191,356 |
| | 1,264,148 | 1,193,214 |
| | **6,272,176** | **5,452,249** |

## 44. Interest income

The detail of "Interest Income" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Balances with central banks | - | 39 |
| Credit institutions | 491 | 604 |
| Customers | 515,519 | 581,587 |
| Debt securities | 85,319 | 114,124 |
| Doubtful assets | 39,030 | 42,591 |
| Rectification of income as a result of hedging transactions | (21,244) | (20,158) |
| Finance income from liabilities | 24,551 | 3,409 |
| Other | 7,316 | 6,460 |
| | **650,982** | **728,656** |

Of the total interest income in the foregoing table at 31 December 2017, approximately 90.2% was calculated using the effective interest method (31 December 2016: approximately 91%) and the remainder was not calculated at fair value through profit or loss.

## 45. Interest expenses

The detail of "Interest Expenses" in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Central banks | - | (1,220) |
| Credit institutions | (3,853) | (4,467) |
| Customers | (73,812) | (174,080) |
| Customers - Subordinated deposits (Note 34) | - | (236) |
| Marketable debt securities (Note 34) | (43,824) | (69,935) |
| Rectification of costs as a result of hedging transactions | 61,453 | 107,420 |
| Interest cost of pension provisions (Note 35) | (2,576) | (2,493) |
| Finance costs from assets | (10,192) | (4,637) |
| Other | (19,446) | (21,010) |
| | **(92,250)** | **(170,658)** |

Of the total interest expense and charges in the foregoing table at 31 December 2017, approximately 83.4% were calculated using the effective interest method (31 December 2016: approximately 92%) and the remainder was not calculated at fair value through profit or loss.

## 46. Dividend income

The detail of "Dividend Income" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Shares | 49,681 | 94,779 |
| | **49,681** | **94,779** |

## 47. Fee and commission income

The detail of "Fee and Commission Income" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Guarantees given | 10,931 | 10,597 |
| Contingent commitments given | 4,219 | 4,085 |
| Foreign currency and banknote exchange | 350 | 386 |
| Collection and payment services | 100,119 | 90,309 |
| Securities services: | | |
| Securities underwriting and placement | 864 | 814 |
| Purchase and sale of securities | 6,030 | 5,625 |
| Administration and custody | 23,697 | 25,967 |
| Asset management | 156,147 | 137,249 |
| | 186,738 | 169,655 |
| Marketing of non-banking financial products | 81,863 | 76,335 |
| Other fees and commissions | 38,664 | 31,250 |
| | **422,884** | **382,617** |

## 48. Fee and commission expenses

The detail of "Fee and Commission Expenses" in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Fees and commissions assigned to other correspondents: | | |
| Collection and return of bills and notes | (24) | (27) |
| Off-balance-sheet items | (27) | (27) |
| Other items | (7,107) | (6,702) |
| | (7,158) | (6,756) |
| Fee and commission expenses on securities transactions | (1,680) | (2,288) |
| Other fees and commissions | (34,484) | (29,748) |
| | **(43,322)** | **(38,792)** |

## 49. Gains or (-) losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net

The detail of "Gains or (-) Losses on Derecognition of Financial Assets and Liabilities Not Measured at Fair Value through Profit or Loss, Net" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Available-for-sale financial assets (Note 24) | 260,588 | 164,140 |
| Loans and receivables | 10,425 | 4,457 |
| Financial liabilities at amortised cost (Notes 25 and 34-d) | - | 5 |
| | **271,013** | **168,602** |
| Net gains on disposals | 260,588 | 164,140 |
| Net gains (losses) from other items | 10,425 | 4,462 |
| | **271,013** | **168,602** |
| Net gains from debt instruments | 10,892 | 80,528 |
| Net gains from equity instruments | 260,121 | 88,074 |
| Net gains (losses) from derivative instruments (Note 27) | - | - |
| | **271,013** | **168,602** |

## 50. Gains or (-) losses on financial assets and liabilities held for trading, net

The detail of "Gains or (-) Losses on Financial Assets and Liabilities Held for Trading, Net" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Financial assets held for trading (Note 22) | 1,953 | (1,754) |
| | **1,953** | **(1,754)** |
| Net gains (losses) arising from valuation adjustments | 1,845 | (2,027) |
| Net gains on disposals | 108 | 273 |
| | **1,953** | **(1,754)** |
| Net gains from debt instruments | 260 | 276 |
| Net gains from equity instruments | 5 | 22 |
| Net gains (losses) from derivative instruments | 1,688 | (2,052) |
| | **1,953** | **(1,754)** |

## 51. Gains or (-) losses on financial assets and liabilities designated at fair value through profit or loss, net

The detail of "Gains or (-) Losses on Financial Assets and Liabilities Designated at Fair Value through Profit or Loss, Net" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Financial assets and liabilities designated at fair value through profit or loss (Note 23) | 397 | (9) |
| Net gains arising from disposals | 84 | 56 |
| Net gains (losses) arising from valuation adjustments | 313 | (65) |
| | 397 | (9) |
| Net gains from equity instruments | 397 | (9) |

## 52. Exchange differences (gain or (-) loss), net

The detail of "Exchange Differences (Gain or Loss), Net" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Gains | 351,524 | 389,739 |
| Losses | (348,986) | (386,034) |
| | **2,538** | **3,705** |

## 53. Other operating income

The detail of "Other Operating Income" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Property development | 31,670 | 15,316 |
| Lessor companies (Note 29) | 20,160 | 21,037 |
| Income from operation of investment property (Note 29) | 9,062 | 9,143 |
| Financial fees and commissions offsetting direct costs | 4,028 | 3,676 |
| Other income | 8,690 | 15,698 |
| | **73,610** | **64,870** |

## 54. Other operating expenses

The detail of "Other Operating Expenses" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Property development | (25,536) | (16,566) |
| Expenses of operation of investment property (Note 29) | (4,388) | (4,402) |
| Contribution to Deposit Guarantee Fund (Note 11) | (46,681) | (39,192) |
| Contribution to National Resolution Fund (Note 11) | (11,776) | (12,671) |
| Other items | (33,791) | (34,387) |
| | **(122,172)** | **(107,218)** |

## 55. Income from assets under insurance and reinsurance contracts and Expenses of liabilities under insurance and reinsurance contracts

These income and expense items include the contribution from the Group's consolidated insurance and reinsurance companies to the Group's gross income. The detail of "Income from Assets under Insurance and Reinsurance Contracts" and "Expenses of Liabilities under Insurance and Reinsurance Contracts" in the accompanying consolidated statements of profit or loss for 2017 and 2016 is as follows:

| | Thousands of euros | | |
|---|---|---|---|
| 2017 | Life | Non-Life | Total |
| **Income** | | | |
| Premiums: | | | |
| Direct insurance | 98,860 | 89,993 | 188,853 |
| Reinsurance assumed | 1,705 | - | 1,705 |
| | **100,565** | **89,993** | **190,558** |
| **Expenses** | | | |
| Premiums paid for reinsurance ceded | (22,471) | (2,904) | (25,375) |
| Benefits paid and other Insurance-related expenses: | | | |
| *Direct insurance* | *(67,446)* | *(25,254)* | *(92,700)* |
| *Reinsurance assumed* | *(22,745)* | - | *(22,745)* |
| *Reinsurance ceded* | *14,387* | *1,047* | *15,434* |
| Life insurance policies in which the investment risk is borne by the policyholders | 62 | - | 62 |
| Net provisions for insurance contract liabilities: | | | |
| *Unearned premiums and unexpired risks* | *(964)* | *(7,888)* | *(8,852)* |
| *Provision for claims outstanding* | *(2,097)* | *(492)* | *(2,589)* |
| *Life insurance* | *47,535* | *(2,838)* | *44,697* |
| *Bonuses and rebates* | *45* | *4* | *49* |
| | **(53,694)** | **(38,325)** | **(92,019)** |
| | **46,871** | **51,668** | **98,539** |

| 2016 | Thousands of euros Life | Non-Life | Total |
|---|---|---|---|
| **Income** | | | |
| Premiums: | | | |
| Direct insurance | 88,408 | 81,589 | 169,997 |
| Reinsurance assumed | 1,320 | 1,241 | 2,561 |
| | **89,728** | **82,830** | **172,558** |
| **Expenses** | | | |
| Premiums paid for reinsurance ceded | (20,706) | (7,753) | (28,459) |
| Benefits paid and other Insurance-related expenses: | | | |
| *Direct insurance* | *(68,900)* | *(24,367)* | *(93,267)* |
| *Reinsurance assumed* | *(23,762)* | - | *(23,762)* |
| *Reinsurance ceded* | *13,913* | *13,502* | *27,415* |
| Life insurance policies in which the investment risk is borne by the policyholders | 404 | - | 404 |
| Net provisions for insurance contract liabilities: | | | |
| *Unearned premiums and unexpired risks* | *(985)* | *(16,768)* | *(17,753)* |
| *Provision for claims outstanding* | *(2,753)* | *(4,982)* | *(7,735)* |
| *Life insurance* | *57,924* | - | *57,924* |
| *Bonuses and rebates* | *229* | *4* | *233* |
| | **(44,636)** | **(40,364)** | **(85,000)** |
| | **45,092** | **42,466** | **87,558** |

## 56. Staff costs

The detail of “Staff Costs” in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Salaries and bonuses of current personnel | (325,954) | (340,747) |
| Social security costs | (77,520) | (79,467) |
| Additions to provisions for internal defined benefit plans | (4,320) | (4,153) |
| Contributions to external defined contribution plans | (9,891) | (9,707) |
| Termination benefits | (238) | (222) |
| Training expenses | (2,207) | (2,682) |
| Other staff costs | (14,263) | (15,888) |
| | **(434,393)** | **(452,866)** |

Following is a detail of other remuneration consisting of the delivery of fully or partially subsidised goods or services depending on the conditions agreed upon between the Group and its employees:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Medical and life insurance | (3,314) | (3,314) |
| Study grants and other items | (5,459) | (5,429) |
| Other | (1,117) | (1,198) |
| | **(9,890)** | **(9,941)** |

Additionally, remuneration is provided to employees in the form of the provision of services inherent to the business activity of credit institutions, the detail being as follows:

| | Thousands of euros | | | | | |
|---|---|---|---|---|---|---|
| | 2017 | | | 2016 | | |
| | Interest received | Market interest | Difference | Interest received | Market interest | Difference |
| Low-interest loans and credit facilities | 1,403 | 3,669 | 2,266 | 1,913 | 4,440 | 2,527 |

The number of employees at the Group in 2017 and 2016, by professional category, gender and location, was as follows:

| | 2017 | | | 2016 | | |
|---|---|---|---|---|---|---|
| | Men | Women | Total | Men | Women | Total |
| Executives | 53 | 13 | 66 | 55 | 13 | 68 |
| Supervisors and other line personnel | 875 | 967 | 1,842 | 943 | 957 | 1,900 |
| Clerical/commercial staff | 1,637 | 2,410 | 4,047 | 1,789 | 2,454 | 4,243 |
| Other personnel | 8 | - | 8 | 19 | 8 | 27 |
| | **2,573** | **3,390** | **5,963** | **2,806** | **3,432** | **6,238** |
| Parent | 1,588 | 2,270 | 3,858 | 1,786 | 2,306 | 4,092 |
| Spanish credit institutions | 860 | 935 | 1,795 | 890 | 952 | 1,842 |
| Shareholders (Note 1.3) | - | - | - | - | - | - |
| Other Spanish subsidiaries | 125 | 185 | 310 | 130 | 174 | 304 |
| | **2,573** | **3,390** | **5,963** | **2,806** | **3,432** | **6,238** |

At 31 December 2017 and 2016, the average number of employees by professional category and gender did not differ significantly from the number of employees presented in the table above.

At 31 December 2017, the Board of Directors of the Parent was composed of 13 men and 3 women (31 December 2016: 13 men and 3 women).

## 57. Other administrative expenses

The detail of “Other Administrative Expenses” in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Property, fixtures and supplies: | | |
| Rent | (8,784) | (8,926) |
| Maintenance of fixed assets | (12,445) | (13,698) |
| Lighting, water and heating | (8,241) | (8,511) |
| Printed forms and office supplies | (2,139) | (2,171) |
| | (31,609) | (33,306) |
| Information technology | (47,577) | (49,597) |
| Levies and taxes other than income tax | (22,275) | (22,490) |
| Communications | (16,274) | (16,537) |
| Advertising and publicity | (15,055) | (16,655) |
| Legal expenses | (5,229) | (2,684) |
| Technical reports | (9,517) | (11,899) |
| Surveillance and cash courier services | (5,242) | (5,799) |
| Insurance premiums | (1,473) | (1,288) |
| Governing and supervisory bodies | (2,891) | (2,804) |
| Entertainment and staff travel expenses | (2,893) | (2,850) |
| Association membership fees | (1,036) | (1,129) |
| Outsourced administrative services | (9,022) | (7,651) |
| Other | (22,110) | (20,950) |
| | (160,594) | (162,333) |
| | **(192,203)** | **(195,639)** |

In relation to the rent expense included in the foregoing table, the table below presents the total future minimum payments to be made in the following periods:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Within 1 year | 7,478 | 8,192 |
| 1 to 5 years | 1,357 | 1,413 |
| More than 5 years | 1,845 | 1,173 |
| | **10,680** | **10,778** |

Also, the total amount of future minimum sublease payments expected to be received was zero, both at 31 December 2017 and 31 December 2016. All of the rent expense for 2017 and 2016 related to lease payments, with no amounts relating to contingent rents or sublease payments.

The leased properties are intended to be used as offices and bank ATMs. At 31 December 2017, of a total of 331 lease contracts, 6 had been in force for more than the two-year mandatory period, and 7 had been in force for five years or more (31 December 2016: of a total of 334 lease contracts, 4 had been in force for more than the two-year mandatory period, and 6 had been in force for five years or more). In this connection, no early-termination penalties of a material nature that might give rise to an outflow of resources for the Group are envisaged.

## 58. Depreciation and amortisation charge

The detail of "Depreciation and Amortisation Charge" in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Tangible assets (Note 29): | | |
| For own use | (27,012) | (30,716) |
| Investment property | (4,559) | (4,804) |
| Other assets leased out under an operating lease | (9,809) | (10,006) |
| | (41,380) | (45,526) |
| Intangible assets (Note 30) | (13,617) | (10,560) |
| | **(54,997)** | **(56,086)** |

## 59. Provisions or (-) reversal of provisions

The detail of "Provisions or Reversal of Provisions" in the consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows (see Note 35):

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Pensions and Other remuneration:** | | |
| Internal pension provisions | (135,614) | (37,278) |
| External pension funds | - | - |
| | (135,614) | (37,278) |
| **Pending legal issues and tax litigation** | 1 | (306) |
| **Commitments and guarantees given** | | |
| For contingent liabilities | (667) | (13,019) |
| For contingent commitments | (127) | 4,342 |
| | (794) | (8,677) |
| **Other provisions** | (1,841) | (71,324) |
| | **(138,248)** | **(117,585)** |

## 60. Impairment or (-) reversal of impairment on financial assets not measured at fair value through profit or loss

The detail of "Impairment or Reversal of Impairment on Financial Assets Not Measured at Fair Value through Profit or Loss" in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Available-for-sale financial assets (Note 24) | (57,850) | (39,431) |
| Loans and receivables (Note 25) | (28,412) | (49,932) |
| | **(86,262)** | **(89,363)** |

## 61. Impairment or (-) reversal of impairment on non-financial assets

The detail of "Impairment or Reversal of Impairment on Non-Financial Assets" in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Tangible assets (Note 29) | | |
| For own use | (386) | 1,056 |
| Investment property | (19,274) | (12,030) |
| | (19,660) | (10,974) |
| Other | | |
| Inventories (Note 32) | (24,905) | (3,972) |
| Other assets | - | - |
| | (24,905) | (3,972) |
| | **(44,565)** | **(14,946)** |

## 62. Gains or (-) losses on derecognition of non-financial assets and investments, net

The detail of "Gains or Losses on Derecognition of Non-Financial Assets and Investments, Net" in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Gains** | | |
| Gains on disposal of tangible assets | 16,716 | 5,656 |
| Gains on disposal of investments (Note 1.3) | 20,894 | 17,419 |
| Gains on disposal of branches (Note 1.1) | - | 3,916 |
| | **37,610** | **26,991** |
| **Losses** | | |
| Losses on disposal of tangible assets | (198) | (1,432) |
| Losses on disposal of investments (Note 1.3) | (708) | (82) |
| Other losses | - | (1) |
| | **(906)** | **(1,515)** |
| | **36,704** | **25,476** |

## 63. Profit or (-) loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations

The detail of "Profit or Loss from Non-Current Assets and Disposal Groups Classified as Held for Sale Not Qualifying as Discontinued Operations" in the accompanying consolidated statements of profit or loss for 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Gains (losses) on non-current assets held for sale: | | |
| On disposal of assets | 29,155 | 31,156 |
| Due to impairment (Note 33) | (160,897) | (72,155) |
| | **(131,742)** | **(40,999)** |

## 64. Profit attributable to minority interests (non-controlling interests)

The detail of "Profit for the Year - Attributable to Minority Interests (Non-Controlling Interests)" in the accompanying consolidated statements of profit or loss for the years ended 31 December 2017 and 2016, which corresponds to the share of non-controlling interests in the profit of the subsidiaries, is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Alquiler de Metros, A.I.E. | 80 | 3 |
| Alquiler de Trenes, A.I.E. | 63 | 73 |
| Estacionamientos Urbanos del Norte, S.A. (*) | - | 15 |
| Fineco Patrimonios, S.G.I.I.C., S.A.U. | 78 | 13 |
| Fineco Previsión E.G.F.P., S.A.U. | 6 | 2 |
| Fineco Sociedad de Valores, S.A. | 248 | (23) |
| Gesfir Servicios de Back Office, S.L. (*) | - | (5) |
| GIIC Fineco, S.G.I.I.C., S.A.U. | 462 | 354 |
| Kufinex, S.L. (*) | - | 4 |
| Norbolsa Sociedad de Valores y Bolsa, S.A. | 322 | 140 |
| Parking Zoco Córdoba, S.L. | 18 | 102 |
| | **1,277** | **678** |

(*) Companies liquidated or sold at 2016 year-end.

## 65. Related party transactions

For the purposes of the preparation of these consolidated financial statements, the Group's "related parties", in accordance with Ministry of Economy and Finance Order EHA/3050/2004, of 15 September, were considered to be those parties over which, either individually or as part of a group acting together, the Group exercises or has the possibility of exercising, directly or indirectly, or by means of covenants or agreements between shareholders, control or significant influence in relation to their financial and operational decision-making, as well as those entities or parties who exercise, or have the possibility of exercising, such control or influence over the Group.

The transactions performed by the Group with its related parties are part of the ordinary business of the Group. The loans and receivables granted to Group entities and associates are approved by the Parent's Board of Directors. The other transactions with related entities or persons are approved in conformity with the general procedures in force at any time. The terms and conditions of these transactions do not differ from those applicable to customers, based on the nature of the transaction, or from those applicable to employees of the Parent and of CajaSur Banco under the collective agreement.

The detail of the Group's most significant balances with associates, jointly controlled entities and other related parties at 31 December 2017 and 2016, of the effect of the transactions performed with them, and of the significant balances and transactions with individuals related to the Group because they were members of the Parent's governing bodies or senior executives in the years then ended, is as follows:

| 2017 | Thousands of euros | | |
|---|---|---|---|
| | Shareholders | Other related entities | Related individuals |
| **Asset positions:** | | | |
| Loans and receivables | 12 | 279,465 | 356 |
| Derivatives | - | 67 | - |
| Other assets - Other | 1,194 | 3 | - |
| Impairment losses on doubtful loans and receivables | - | (12,184) | - |
| | **1,206** | **267,351** | **356** |
| **Liability positions:** | | | |
| Deposits | 174,027 | 214,195 | 2,551 |
| Other financial liabilities | 28,990 | 2,012 | - |
| Derivatives | - | 400 | - |
| Other liabilities - Other | - | 1,623 | - |
| Provisions for financial guarantees | - | 2,754 | - |
| | **203,017** | **220,984** | **2,551** |
| **Statement of profit or loss:** | | | |
| Debit- | | | |
| Interest expenses | - | (125) | (1) |
| Fee and commission expenses | - | (48) | - |
| Administrative expenses | - | (17,435) | - |
| Net additions/reversals of impairment losses on doubtful assets | - | 132 | - |
| | **-** | **(17,476)** | **(1)** |
| Credit- | | | |
| Interest income | 264 | 6,019 | 2 |
| Fee and commission income | 46 | 2,088 | 6 |
| Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, Gains or losses on financial assets and liabilities held for trading, net and Exchange differences, net | - | 22 | - |
| Other operating income | 1,181 | 1,206 | - |
| | **1,491** | **9,335** | **8** |
| **Off-balance-sheet exposures:** | | | |
| Guarantees given | - | 51,897 | - |
| Contingent commitments given | 25,001 | 22,894 | 251 |
| | **25,001** | **74,791** | **251** |

| 2016 | Thousands of euros | | |
|---|---|---|---|
| | Shareholders | Other related entities | Related individuals |
| **Asset positions:** | | | |
| Loans and receivables | 10,154 | 348,599 | 547 |
| Derivatives | - | 12 | - |
| Other assets - Other | 714 | 3 | - |
| Impairment losses on doubtful loans and receivables | - | (29,603) | - |
| | **10,868** | **319,011** | **547** |
| **Liability positions:** | | | |
| Deposits | 129,020 | 219,198 | 2,644 |
| Other financial liabilities | 9,735 | 1,145 | - |
| Derivatives | - | 100 | - |
| Provisions for financial guarantees | - | 2,754 | - |
| | **138,755** | **223,197** | **2,644** |
| **Statement of profit or loss:** | | | |
| Debit- | | | |
| Interest expenses | (8) | (1,330) | (1) |
| Fee and commission expenses | - | (50) | - |
| Administrative expenses | - | (19,341) | - |
| Net additions/reversals of impairment losses on doubtful assets | - | 15,969 | - |
| | **(8)** | **(4,752)** | **(1)** |
| Credit- | | | |
| Interest income | 4 | 6,967 | 4 |
| Fee and commission income | 13 | 742 | 4 |
| Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, Gains or losses on financial assets and liabilities held for trading, net and Exchange differences, net | 6,106 | 26 | - |
| Other operating income | 1,703 | 1,229 | - |
| Gains or (-) losses on disposal of non-financial assets and investments | 12,794 | - | - |
| | **20,620** | **8,964** | **8** |
| **Off-balance-sheet exposures:** | | | |
| Guarantees given | - | 51,032 | - |
| Contingent commitments given | 14,904 | 33,500 | 285 |
| | **14,904** | **84,532** | **285** |

## 66. Other disclosures

The detail of the Group's off-balance-sheet customer funds at 31 December 2017 and 2016 is as follows:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| **Managed by the Group:** | | |
| Investment companies and funds | 9,811,809 | 9,591,635 |
| Pension funds | 6,896,757 | 6,640,300 |
| Client portfolios managed discretionally | 6,228,624 | 4,998,279 |
| | 22,937,190 | 21,230,214 |
| **Marketed but not managed by the Group** | 223,353 | 77,975 |
| | **23,160,543** | **21,308,189** |

In 2017 and 2016 the Group provided the following investment services for the account of third parties:

| | Thousands of euros | |
|---|---|---|
| | 2017 | 2016 |
| Securities market brokerage | | |
| Purchases | 54,835,084 | 30,392,930 |
| Sales | 48,160,760 | 25,482,053 |
| | 102,995,843 | 55,874,983 |
| Custody of financial instruments owned by third parties | 29,107,088 | 26,359,154 |

**Management of exposure to the property development sector**

The most noteworthy measures contained in the policies and strategies established by the Group in order to manage its exposure to the construction and property development sector and to cater for the problematic assets of this sector are as follows:

- To maintain and, if possible, heighten the traditionally stringent control of the drawdowns against credit facilities provided for property development, as well as the monitoring of the marketing and sale of these facilities.

- To form and continually train a team specialising in the management of customers with exposure of this kind, with a view to obtaining effective results in the recovery of credit transactions and/or in the enhancement of the collateral securing them.

- Also, in view of the property crisis, an area was created that focuses specifically on the refinancing and restructuring of credit risk transactions and on the management of foreclosed property assets. To this end it has a specialised team of non-performing loan managers.

a) Financing for construction, property development and home purchase (Businesses in Spain)

Following is certain information relating to the Kutxabank Group's exposure to the construction and property development sector:

| | Thousands of euros | | |
|---|---|---|---|
| | Gross carrying amount | Excess over collateral value | Cumulative impairment losses |
| **31 December 2017** | | | |
| Financing for construction and property development (including land) | 1,250,023 | 236,014 | (208,678) |
| *Of which: Doubtful* | *453,653* | *118,835* | *(151,601)* |
| **31 December 2016** | | | |
| Financing for construction and property development (including land) | 1,722,491 | 625,484 | (531,409) |
| *Of which: Doubtful* | *901,646* | *504,353* | *(467,363)* |

The detail, by type of guarantee, of the information included in the foregoing table is as follows:

| | Thousands of euros | |
|---|---|---|
| | Gross carrying amount | |
| | 2017 | 2016 |
| **Not collateralised by immovable property** | **21,107** | **31,802** |
| **Collateralised by immovable property** | | |
| Completed buildings and other structures | | |
| Residential | 479,788 | 716,601 |
| Other | 88,156 | 124,359 |
| | 567,944 | 840,960 |
| Buildings and other structures under construction | | |
| Residential | 255,171 | 247,075 |
| Other | 18,688 | 20,105 |
| | 273,859 | 267,180 |
| Land | | |
| Buildable urban land | 310,654 | 523,677 |
| Other land | 76,459 | 58,872 |
| | 387,113 | 582,549 |
| | **1,228,916** | **1,690,689** |
| **Total** | **1,250,023** | **1,722,491** |

Also, following is certain information on the gross carrying amount of the loans granted for construction and property development derecognised due to having been classified as written-off at 31 December 2017 and 2016:

| | Thousands of euros | |
|---|---|---|
| | Gross carrying amount | |
| | 2017 | 2016 |
| Written-off assets | 1,900,359 | 1,636,929 |

The maximum credit risk exposure relating to "Loans and Receivables - Loans and Advances - Customers" is as follows:

| | Thousands of euros | |
|---|---|---|
| | Carrying amount | |
| | 2017 | 2016 |
| Loans to customers, excluding public sector | 39,275,568 | 39,912,407 |
| **Total assets** | **57,441,741** | **56,515,916** |
| Impairment and provisions for exposures classified as standard | 186,355 | 191,561 |

Also, following is certain information on the Kutxabank Group's home purchase loans:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Gross carrying amount | Of which: Doubtful | Gross carrying amount | Of which: Doubtful |
| Home purchase loans | | | | |
| Without property mortgage | 218,307 | 1,621 | 222,071 | 1,546 |
| With property mortgage | 27,617,096 | 892,408 | 27,922,193 | 997,794 |
| | **27,835,403** | **894,029** | **28,144,264** | **999,340** |

The following table shows the LTVs taking into account the latest appraisals, pursuant to current legislation:

| | Thousands of euros | | | | |
|---|---|---|---|---|---|
| | LTV ranges | | | | |
| | Less than or equal to 40% | More than 40% and less than or equal to 60% | More than 60% and less than or equal to 80% | More than 80% and less than or equal to 100% | More than 100% |
| **31 December 2017** | | | | | |
| Gross carrying amount | 4,362,976 | 6,598,518 | 10,111,714 | 4,109,252 | 2,434,636 |
| *Of which: Doubtful* | *22,018* | *37,140* | *89,431* | *97,319* | *646,500* |
| **31 December 2016** | | | | | |
| Gross carrying amount | 4,088,240 | 6,173,363 | 9,455,005 | 5,046,697 | 3,158,888 |
| *Of which: Doubtful* | *27,708* | *55,756* | *124,147* | *142,215* | *647,968* |

b) Assets foreclosed or received in payment of debts and other non-current assets classified as held for sale

Following is certain information on Kutxabank Group's foreclosures portfolio and the Group's other non-current assets and disposal groups classified as held for sale:

| | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | | 2016 | |
| | Gross carrying amount | Cumulative impairment losses | Gross carrying amount | Cumulative impairment losses |
| Property assets arising from financing granted for construction and property development | 1,469,813 | (818,178) | 1,379,795 | (768,744) |
| Completed buildings and other structures | | | | |
| Residential | 139,819 | (75,446) | 125,336 | (54,180) |
| Other | 118,382 | (30,672) | 80,423 | (24,329) |
| | 258,201 | (106,118) | 205,759 | (78,509) |
| Buildings and other structures under construction | | | | |
| Residential | 137,958 | (89,587) | 131,086 | (75,552) |
| Other | 29,522 | (20,694) | 28,292 | (18,807) |
| | 167,480 | (110,281) | 159,378 | (94,359) |
| Land | | | | |
| Buildable urban land | 258,353 | (122,341) | 249,524 | (121,971) |
| Other land | 785,779 | (479,438) | 765,134 | (473,905) |
| | 1,044,132 | (601,779) | 1,014,658 | (595,876) |
| Property assets from home purchase mortgage loans to households | 211,499 | (57,409) | 195,329 | (51,401) |
| Other property assets foreclosed or received in payment of debts | 152,170 | (42,264) | 136,287 | (28,936) |
| Total foreclosed assets - Businesses in Spain (*) | 1,833,482 | (917,851) | 1,711,411 | (849,081) |
| Total foreclosed assets - Businesses abroad and other | 1,161 | (549) | 1,348 | (365) |
| Other non-current assets held for sale | 294 | (294) | 1,368 | (39) |
| **Total** | **1,834,937** | **(918,694)** | **1,714,127** | **(849,485)** |

(*) Includes foreclosed assets classified as "Tangible Assets - Investment Property" for a carrying amount of EUR 28,835 thousand at 31 December 2017 (31 December 2016: EUR 5,945 thousand).

*Funding structure*

The nominal amounts of the maturities of wholesale issues placed with third parties to be met by the Group at 31 December 2017 and 2016 are as follows:

| 2017 | Thousands of euros | | | |
|---|---|---|---|---|
| | 2018 | 2019 | 2020 | > 2020 |
| Mortgage bonds ("bonos hipotecarios") and mortgage-backed bonds ("cédulas hipotecarias") | 719,355 | 335,976 | 358,333 | 2,928,291 |
| Senior debt | 50,000 | 38,300 | - | - |
| Subordinated debt, preference shares and convertible debt | - | - | - | - |
| Other medium- and long-term financial instruments | - | - | - | - |
| Securitisation issues sold to third parties | - | - | - | 295,745 |
| Commercial paper | 19,899 | - | - | - |
| **Total maturities – wholesale issues** | **789,254** | **374,276** | **358,333** | **3,224,036** |

| 2016 | Thousands of euros | | | |
|---|---|---|---|---|
| | 2017 | 2018 | 2019 | > 2019 |
| Mortgage bonds ("bonos hipotecarios") and mortgage-backed bonds ("cédulas hipotecarias") | 1,346,000 | 719,355 | 335,976 | 3,286,624 |
| Senior debt | 100,000 | 50,000 | 38,300 | - |
| Subordinated debt, preference shares and convertible debt | - | - | - | - |
| Other medium- and long-term financial instruments | - | - | - | - |
| Securitisation issues sold to third parties | - | - | - | 331,761 |
| Commercial paper | 399,221 | - | - | - |
| **Total maturities – wholesale issues** | **1,046,779** | **769,355** | **374,276** | **3,618,385** |

The detail of the available liquid assets and the issue capacity of the Kutxabank Group at 31 December 2017 and 2016 is as follows:

| | Millions of euros | |
|---|---|---|
| | 2017 | 2016 |
| Cash and balances with central banks | 3,758 | 811 |
| Liquid assets (nominal value) | 2,535 | 5,515 |
| Liquid assets (market value and ECB "haircut") | 2,459 | 5,196 |
| *Of which: Central government debt securities* | *1,525* | *2,578* |
| Liquid assets used (including ECB "haircut") | - | 2,620 |
| Quoted equity securities (including ECB "haircut") | 667 | 1,167 |
| State-guaranteed issues - available capacity | - | - |
| Issue capacity for mortgage-backed bonds ("cédulas hipotecarias") | 14,086 | 11,097 |
| Issue capacity for territorial bonds | 889 | 1,191 |
| **Total issue capacity** | **14,975** | **12,288** |

## 67. Explanation added for translation to English

These consolidated financial statements are presented on the basis of the regulatory financial reporting framework applicable to the Group in Spain (see Note 2-a). Certain accounting practices applied by the Group that conform with that regulatory framework may not conform with other generally accepted accounting principles and rules.

# APPENDIX I

## Consolidated subsidiaries composing the Kutxabank Group at 31 December 2017:

| | | Percentage of ownership at 31/12/17 | | | Shares held by the Group at 31/12/17 | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Equity at 31/12/17 (**) | | | Carrying amount at 31/12/17 (Direct and indirect) | |
| Name | Line of business | Direct | Indirect | Total | Number of shares | Par value (Euros) | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Alquiler de Metros, A.I.E. | Railway material lease. | 75.00 | 20.00 | 95.00 | 50,027 | 25.00 | 8,856 | 1,131 | 1,516 | 362 | 138 |
| Alquiler de Trenes, A.I.E. | Railway material acquisition and lease. | 95.00 | - | 95.00 | 913,539 | 25.00 | 130,417 | 27,260 | 4,400 | 7,402 | 7,402 |
| Binaria 21, S.A. | Industrial property projects. | - | 100.00 | 100.00 | 321,334 | 60.00 | 24,347 | 28,094 | (4,347) | 27,917 | 23,748 |
| Caja Vital Finance, B.V | Issuance of financial instruments. | 100.00 | - | 100.00 | 1,500 | 334.00 | 50,604 | 485 | (27) | 600 | 457 |
| CajaSur Banco, S.A. | Banking. | 100.00 | - | 100.00 | 1,318,050 | 1,000.00 | 11,204,746 | 930,057 | 15,725 | 1,317,027 | 1,237,322 |
| Compañía Promotora del Estrecho, S.L. | Property development. | - | 100.00 | 100.00 | 5,301,000 | 33.50 | 126,504 | 122,931 | (4,977) | 484,271 | 117,954 |
| Fineco Patrimonios, S.G.I.I.C., S.A.U. | Management of collective investment undertakings. | - | 98.22 | 98.22 | 124,300 | 10.00 | 2,688 | 1,785 | 390 | 1,523 | 1,523 |
| Fineco Previsión E.G.F.P., S.A.U. | Pension fund management. | - | 98.22 | 98.22 | 93,700 | 10.00 | 1,091 | 1,011 | 30 | 937 | 937 |
| Fineco Sociedad de Valores, S.A. | Broker-dealer. | 98.22 | - | 98.22 | 280,841 | 9.12 | 53,073 | 48,568 | 1,238 | 31,221 | 31,221 |
| Gesfinor Administración, S.A. | Administrative services. | 99.99 | 0.01 | 100.00 | 10,000 | 60.10 | 1,950 | 1,077 | 402 | 665 | 665 |
| GIIC Fineco, S.G.I.I.C., S.A.U. | Management of collective investment undertakings. | - | 98.22 | 98.22 | 68,183 | 6.01 | 17,307 | 10,415 | 2,313 | 35,455 | 35,455 |
| Golf Valle Romano Golf & Resort, S.L. | Golf course management. | - | 100.00 | 100.00 | 1,103,010 | 1.45 | 1,933 | 1,483 | 198 | 4,743 | 1,681 |
| G.P.S. Mairena el Soto, S.L.U. | Property development. | - | 100.00 | 100.00 | 3,000 | 1.00 | 18,577 | 2,474 | (2,875) | 2,282 | - |
| Harri Hegoalde 2, S.A.U. | Holding of property assets. | - | 100.00 | 100.00 | 48,500,000 | 10.00 | 634,332 | 475,512 | (101,776) | 1,246,325 | 451,785 |
| Harri Inmuebles, S.A.U. | Holding of property assets. | - | 100.00 | 100.00 | 6,289,300 | 10.00 | 58,854 | 42,041 | (4,834) | 63,328 | 41,829 |

## APPENDIX I

## Consolidated subsidiaries composing the Kutxabank Group at 31 December 2017 (cont.):

| | | Percentage of ownership at 31/12/17 | | | Shares held by the Group at 31/12/17 | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Equity at 31/12/17 (**) | | | Carrying amount at 31/12/17 (Direct and indirect) | |
| Name | Line of business | Direct | Indirect | Total | Number of shares | Par value | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Harri Iparra, S.A.U. | Other activities auxiliary to financial services. | 100.00 | - | 100.00 | 941,000,000 | 1.00 | 962,158 | 594,016 | (126,421) | 2,242,826 | 389,235 |
| Harrisur, Activos Inmobiliarios, S.L. | Holding of property assets. | - | 100.00 | 100.00 | 148,003,000 | 1.00 | 185,949 | 89,408 | (43,448) | 148,003 | 67,837 |
| Inverlur Gestión Inmobiliaria I, S.L. | Property development. | - | 100.00 | 100.00 | 9,910,000 | 2.10 | 13,573 | 14,845 | (1,433) | 107,878 | 14,609 |
| Kartera 1, S.L. | Holding of shares. | 100.00 | - | 100.00 | 13,089,161 | 60.10 | 1,356,853 | 1. 100,667 | 194,116 | 891,927 | 823,779 |
| Kutxabank Aseguradora Compañía de Seguros y Reaseguros, S.A.U. | General insurance. | 100.00 | - | 100.00 | 3,496,773 | 6.01 | 153,131 | 32,903 | 4,114 | 26,166 | 26,166 |
| Kutxabank Empréstitos, S.A.U. | Financial services. | 100.00 | - | 100.00 | 61 | 1,000.00 | 176,259 | 1,282 | 35 | 655 | 655 |
| Kutxabank Gestión, S.G.I.I.C., S.A.U. | Management of collective investment undertakings. | 100.00 | - | 100.00 | 95,000 | 60.10 | 54,346 | 6,852 | 1,255 | 6,802 | 6,802 |
| Kutxabank, Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.U. | Insurance. | 100.00 | - | 100.00 | 7,000,000 | 6.01 | 837,301 | 121,786 | 9,924 | 76,599 | 76,599 |
| Kutxabank Pensiones, S.A. E.G.F.P | Pension fund management. | - | 100.00 | 100.00 | 2,000,000 | 1.00 | 6,278 | 3,882 | 451 | 3,600 | 3,600 |
| Logística Binaria, S.L. | Lease of logistics buildings. | - | 100.00 | 100.00 | 1,223,000 | 1.00 | 17,360 | 6,060 | (638) | 6,339 | 5,552 |
| Norapex, S.A. | Property development. | - | 100.00 | 100.00 | 4,000 | 15.00 | 19,752 | 11 | (519) | 700 | 700 |
| Norbolsa Sociedad De Valores, S.A. | Broker-dealer. | 80.00 | - | 80.00 | 1,860,611 | 6.10 | 88,779 | 30,173 | 1,607 | 22,068 | 22,068 |
| Parking Zoco Córdoba, S.L. | Car park management. | - | 56.72 | 56.72 | 10,232 | 164.00 | 1,841 | 1,779 | 41 | 700 | 700 |
| Sekilur, S.A. | Holding of property assets. | - | 100.00 | 100.00 | 31,035 | 228.20 | 6,474 | 7,144 | (680) | 34,075 | 7,099 |
| Sendogi Capital, F.C.R. | Venture capital. | 100.00 | - | 100.00 | 13 | 500,000.00 | 818 | 841 | (23) | 1,606 | 404 |
| Viana Activos Agrarios, S.L. | Operation of rural land. | - | 100.00 | 100.00 | 5,059,093 | 1.00 | 33,241 | 6,638 | (7,099) | 10,059 | - |
| Yerecial, S.L. | Property development. | - | 100.00 | 100.00 | 20,532,900 | 10.00 | 135,954 | 137,259 | (8,388) | 766,768 | 136,045 |

(*) Net profit or loss for the year less interim dividend.
(**) Disregarding uniformity adjustments.

## APPENDIX I

## Consolidated subsidiaries composing the Kutxabank Group at 31 December 2016:

| Name | Line of business | Percentage of ownership at 31/12/16 | | | Shares held by the Group at 31/12/16 | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Equity at 31/12/16 (**) | | | Carrying amount at 31/12/16 (Direct and indirect) | |
| | | Direct | Indirect | Total | Number of shares | Par value (Euros) | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Alquiler de Metros, A.I.E. | Railway material lease. | 75.00 | 20.00 | 95.00 | 50,027 | 25.00 | 6,591 | 162 | (40) | 362 | 138 |
| Alquiler de Trenes, A.I.E. | Railway material acquisition and lease. | 95.00 | - | 95.00 | 913,539 | 25.00 | 140,190 | 20,514 | 4,313 | 7,402 | 7,402 |
| Binaria 21, S.A. | Industrial property projects. | - | 100.00 | 100.00 | 321,334 | 60.00 | 29,381 | 31,290 | (2,545) | 27,917 | 24,250 |
| Caja Vital Finance, B.V | Issuance of financial instruments. | 100.00 | - | 100.00 | 1,500 | 334.00 | 50,567 | 509 | (25) | 600 | 524 |
| CajaSur Banco, S.A. | Banking. | 100.00 | - | 100.00 | 1,318,050 | 1,000.00 | 11,485,952 | 1,029,148 | (92,395) | 1,317,027 | 1,221,549 |
| Cascada Beach, S.L. (***) | Property development. | - | 100.00 | 100.00 | 3,006 | 1.00 | 2 | (685) | (11,752) | 1,800 | - |
| Columba 2010, S.L.U. | Business advisory services. | - | 100.00 | 100.00 | 60,102 | 1.00 | 44 | 46 | (2) | 56 | 48 |
| Compañía Promotora y de Comercio Estrecho, S.L. | Property development. | - | 100.00 | 100.00 | 5,301,000 | 33.50 | 132,353 | 124,352 | (638) | 484,271 | 123,714 |
| Fineco Patrimonios, S.G.I.I.C., S.A.U. | Management of collective investment undertakings. | - | 80.00 | 80.00 | 99,440 | 10.00 | 2,251 | 1,576 | 216 | 1,523 | 1,523 |
| Fineco Previsión E.G.F.P., S.A.U. | Pension fund management. | - | 80.00 | 80.00 | 74,960 | 10.00 | 1,080 | 1,015 | 12 | 937 | 937 |
| Fineco Sociedad de Valores, S.A. | Broker-dealer. | 80.00 | - | 80.00 | 228,753 | 9.12 | 51,323 | 47,887 | 694 | 21,327 | 21,327 |
| Gesfinor Administración, S.A. | Administrative services. | 99.99 | 0.01 | 100.00 | 10,000 | 60.10 | 1,424 | 820 | 259 | 665 | 665 |
| GIIC Fineco, S.G.I.I.C., S.A.U. | Management of collective investment undertakings. | - | 80.00 | 80.00 | 54,546 | 6.01 | 13,996 | 8,723 | 1,768 | 35,455 | 35,455 |
| Golf Valle Romano Golf & Resort, S.L. | Golf course management. | - | 100.00 | 100.00 | 1,103,010 | 1.45 | 1,784 | 1,434 | 108 | 4,743 | 1,541 |
| G.P.S. Mairena el Soto, S.L.U. | Property development. | - | 100.00 | 100.00 | 3,000 | 1.00 | 28,228 | 94 | 3,350 | 91,363 | 3,444 |
| Grupo de Empresas CajaSur, S.A.U. | Holding company. | - | 100.00 | 100.00 | 130,815,133 | 1.00 | 268,423 | 251,640 | 12,386 | 310,271 | 78,244 |
| Harri Iparra, S.A.U. | Holding of property assets. | 100.00 | - | 100.00 | 941,000,000 | 1.00 | 1,146,171 | 836,460 | (130,559) | 2,242,826 | 597,592 |
| Harri Hegoalde 2, S.A.U. | Holding of property assets. | - | 100.00 | 100.00 | 48,500,000 | 10.00 | 816,222 | 702,604 | (102,554) | 1,246,325 | 600,300 |

## APPENDIX I

## Consolidated subsidiaries composing the Kutxabank Group at 31 December 2016 (cont.):

| | | Percentage of ownership at 31/12/16 | | | Shares held by the Group at 31/12/16 | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | Equity at 31/12/16 (**) | | | Carrying amount at 31/12/16 (Direct and indirect) | |
| Name | Line of business | Direct | Indirect | Total | Number of shares | Par value (Euros) | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Harri Inmuebles, S.A.U. | Holding of property assets. | - | 100.00 | 100.00 | 6,289,300 | 10.00 | 50,033 | 50,406 | (4,591) | 63,328 | 45,766 |
| Harrisur, Activos Inmobiliarios, S.L. | Holding of property assets. | - | 100.00 | 100.00 | 148,003,000 | 1.00 | 156,641 | 134,373 | (20,403) | 148,003 | 114,033 |
| Inverlur Gestión Inmobiliaria I, S.L. | Property development. | - | 100.00 | 100.00 | 9,910,000 | 2.10 | 16,021 | 18,616 | (2,639) | 107,878 | 15,976 |
| Kartera 1, S.L. | Holding of shares. | 100.00 | - | 100.00 | 13,089,161 | 60.10 | 1,942,847 | 1,625,303 | 124,490 | 1,296,663 | 1,228,516 |
| Kartera 2, S.L. | Holding of shares. | 100.00 | - | 100.00 | 1,288,615 | 10.00 | 226,078 | 215,231 | 6,921 | 262,691 | 261,564 |
| Kartera 4, S.A. | Asset holding company. | 100.00 | - | 100.00 | 1,515,558 | 6.01 | 10,365 | 10,128 | 224 | 11,447 | 10,423 |
| Kutxabank Aseguradora Compañía de Seguros y Reaseguros, S.A.U. | General insurance. | 100.00 | - | 100.00 | 3,496,773 | 6.01 | 136,321 | 31,865 | 2,548 | 26,166 | 26,166 |
| Kutxabank Empréstitos, S.A.U. | Financial services. | 100.00 | - | 100.00 | 61 | 1,000.00 | 425,398 | 1,156 | 125 | 655 | 655 |
| Kutxabank Gestión, S.G.I.I.C., S.A.U. | Management of collective investment undertakings. | 100.00 | - | 100.00 | 95,000 | 60.10 | 21,300 | 6,852 | 1,079 | 6,802 | 6,802 |
| Kutxabank, Vida y Pensiones Compañía de Seguros y Reaseguros, S.A.U. | Insurance. | 100.00 | - | 100.00 | 7,000,000 | 6.01 | 834,868 | 114,890 | 8,851 | 76,599 | 76,599 |
| Kutxabank Pensiones, S.A. E.G.F.P | Pension fund management. | - | 100.00 | 100.00 | 2,000,000 | 1.00 | 5,695 | 3,628 | 385 | 3,600 | 3,600 |
| Logística Binaria, S.L. | Lease of logistics buildings. | - | 100.00 | 100.00 | 1,223,000 | 1.00 | 18,866 | 6,648 | (530) | 6,648 | 6,648 |
| Norapex, S.A. | Property development. | - | 100.00 | 100.00 | 34,958 | 15.00 | 20,195 | 524 | (557) | 9,450 | - |
| Norbolsa Sociedad De Valores, S.A. | Broker-dealer. | 80.00 | - | 80.00 | 1,860,611 | 6.10 | 66,310 | 30,910 | 945 | 22,068 | 22,068 |
| Parking Zoco Córdoba, S.L. | Car park management. | - | 56.72 | 56.72 | 10,232 | 230.60 | 1,802 | 1,608 | 171 | 2,340 | 872 |
| Promociones Ames Bertan, S.L. | Property development. | - | 100.00 | 100.00 | 1,113,302 | 1.00 | 3 | (5,859) | 5,735 | 1,113 | 656 |
| Sekilur, S.A. | Leasing activities. | - | 100.00 | 100.00 | 31,035 | 1,000.00 | 8,216 | 10,973 | (2,766) | 34,075 | 8,207 |
| Sendogi Capital, F.C.R. | Venture capital. | 100.00 | - | 100.00 | 50 | 143,520.00 | 817 | 845 | (28) | 1,573 | 371 |
| Viana Activos Agrarios, S.L. | Operation of rural land. | - | 100.00 | 100.00 | 5,059,093 | 1.00 | 25,128 | 7,931 | (357) | 10,059 | 7,899 |
| Yerecial, S.L. | Property development. | - | 100.00 | 100.00 | 20,532,900 | 10.00 | 151,488 | 135,922 | 2,601 | 766,768 | 138,523 |

(*) Net profit or loss for the year less interim dividend.
(**) Disregarding uniformity adjustments.
(***) In liquidation.

## APPENDIX II

## Investments in jointly controlled entities and associates
## Jointly controlled entities accounted for using the equity method at 31 December 2017:

There are no jointly controlled entities forming part of the Kutxabank Group at 31 December 2017.

## APPENDIX II

## Investments in jointly controlled entities and associates
## Associates accounted for using the equity method at 31 December 2017

| Name | Line of business | Percentage of ownership at 31/12/17 | | | Thousands of euros: Equity at 31/12/16 (**) | | | Thousands of euros: Carrying amount at 31/12/17 (Direct and indirect) | |
|---|---|---|---|---|---|---|---|---|---|
| | | Direct | Indirect | Total | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Agua y Gestión Servicios Ambientales, S.A. | Water collection, treatment and distribution. | - | 23.20 | 23.20 | 65,224 | 10,840 | 162 | - | - |
| Aguas de Bilbao, S.A. (***) | Water service. | 24.50 | - | 24.50 | 2,036 | 1,737 | (42) | - | - |
| Altun Berri, S.L. | Management and operation of hotel establishments. | 50.00 | - | 50.00 | 19,579 | 7,386 | (11,156) | - | - |
| Araba Logística, S.A. | Construction and operation of buildings for logistics activities. | 36.71 | - | 36.71 | 53,883 | 1,964 | (1,545) | 270 | 270 |
| Aurea Sur Fotovoltaica, S.L. | Development, management, installation and operation of solar PV plants. | - | 40.00 | 40.00 | 7,344 | 3,735 | 257 | 1,336 | 1,336 |
| Baserri, S.A. | Dormant. | 33.38 | - | 33.38 | 1 | 165 | - | 55 | 30 |
| Centro de Transportes de Vitoria, S.A. | Development and operation of the Vitoria transport interchange and customs centre. | 27.67 | - | 27.67 | 23,692 | 16,323 | (1,722) | 2,124 | - |
| Cienpozuelos Servicios Inmobiliarios I, S.L. | Property development. | - | 42.50 | 42.50 | 1,600 | (4,633) | (5) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios II, S.L. | Property development. | - | 42.50 | 42.50 | 1,602 | (4,632) | (4) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios III, S.L. | Property development. | - | 42.50 | 42.50 | 1,596 | (4,633) | (3) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios IV, S.L. | Property development. | - | 42.50 | 42.50 | 1,596 | (4,632) | (3) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios V, S.L. | Property development. | - | 42.50 | 42.50 | 1,596 | (4,633) | (3) | 4 | - |
| Corporación Industrial Córdoba Este, S.A. | Development of industrial parks. | - | 46.46 | 46.46 | 5,276 | 5,127 | (119) | 1,235 | 1,235 |
| Corporación Industrial Córdoba Norte, S.A. | Development of industrial parks. | - | 32.63 | 32.63 | 1,933 | 1,916 | 1 | 496 | 496 |

## APPENDIX II

## Investments in jointly controlled entities and associates
## Associates accounted for using the equity method at 31 December 2017 (cont.):

| Name | Line of business | Percentage of ownership at 31/12/17 | | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Equity at 31/12/16 (**) | | | Carrying amount at 31/12/17 (Direct and indirect) | |
| | | Direct | Indirect | Total | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Corporación Industrial Córdoba Occidental, S.A. | Development of industrial parks. | - | 48.90 | 48.90 | 2,025 | 1,485 | 6 | 459 | 459 |
| Corporación Industrial Córdoba Sur, S.A. | Development of industrial parks. | - | 48.20 | 48.20 | 2,492 | 1,302 | 5 | 111 | 111 |
| Corporación Industrial Córdoba Sureste, S.A. | Development of industrial parks. | - | 48.50 | 48.50 | 2,546 | 1,275 | 8 | 200 | 200 |
| Ekarpen Private Equity, S.A. | Business development. | 22.22 | 22.22 | 44.44 | 89,680 | 98,191 | (8,584) | 53,016 | 38,609 |
| Euskaltel, S.A. | Telecommunications. | 21.35 | - | 21.35 | 2,340,338 | 712,303 | 29,368 | 121,407 | 121,407 |
| Gabialsur 2006, S.L. (***) | Property development. | - | 50.00 | 50.00 | 851 | 923 | (134) | - | - |
| Gestión Capital Riesgo País Vasco S.G.E.C.R., S.A. | Administration and capital management. | 10.00 | 10.00 | 20.00 | 4,072 | 2,619 | 953 | 327 | 327 |
| Gestora del Nuevo Polígono Industrial, S.A. (***) | Development of industrial parks. | - | 30.00 | 30.00 | 16,390 | 10,780 | (103) | 2,849 | 2,849 |
| Hazibide, S.A. | Business development. | 34.88 | - | 34.88 | 868 | 950 | (85) | 289 | 269 |
| Informática De Euskadi, S.L. | IT services. | 50.00 | - | 50.00 | 17,292 | 2,679 | 3,272 | 293 | 293 |
| Ingeteam, S.A. | Installation engineering and development. | 29.18 | - | 29.18 | 643,348 | 331,389 | (5,711) | 94,604 | 94,315 |
| Inverlur Aguilas I, S.L. | Property development. | - | 50.00 | 50.00 | 476 | 412 | (5) | 9,767 | 204 |
| Inverlur Aguilas II, S.L. | Property development. | - | 50.00 | 50.00 | 1,448 | 1,328 | (8) | 27,413 | 661 |
| Inversiones Zubiatzu, S.A. | Holding company. | 20.27 | - | 20.27 | 113,232 | 57,090 | 15,996 | 12,988 | 12,988 |

## APPENDIX II

## Investments in jointly controlled entities and associates
## Associates accounted for using the equity method at 31 December 2017 (cont.):

| Name | Line of business | Percentage of ownership at 31/12/17 | | | Thousands of euros: Equity at 31/12/16 (**) | | | Carrying amount at 31/12/17 (Direct and indirect) | |
|---|---|---|---|---|---|---|---|---|---|
| | | Direct | Indirect | Total | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Los Jardines De Guadaira I, S.L. | Property development. | - | 50.00 | 50.00 | 1,854 | 13 | (6) | 20 | - |
| Los Jardines De Guadaira II, S.L. | Property development. | - | 50.00 | 50.00 | 1,854 | 15 | (3) | 5 | - |
| Luzaro Establecimiento Financiero de Crédito, S.A. | Participating loans. | 47.06 | - | 47.06 | 190,919 | 18,967 | 615 | 4,564 | 4,564 |
| Mecano Del Mediterráneo, S.L. (***) | Real estate. | - | 50.00 | 50.00 | 22,360 | 2,297 | 527 | 2,657 | - |
| Neos Surgery, S.L. | Manufacturing of surgical and medical material. | - | 35.49 | 35.49 | 6,158 | 3,838 | 95 | 1,000 | 814 |
| Paisajes del Vino, S.L. (***) | Property development. | 23.86 | - | 23.86 | 12,462 | 7,986 | (15,994) | 1,885 | - |
| Promoción Los Melancólicos, S.L. | Property development. | - | 42.50 | 42.50 | 985 | (493) | - | 1,148 | - |
| Promotora Inmobiliaria Sarasur, S.A. (***) | Residential development. | - | 50.00 | 50.00 | 1,176 | (25,284) | (420) | - | - |
| San Mames Barria, S.L. | Real estate. | 24.99 | - | 24.99 | 171,992 | 173,073 | (2,557) | 42,616 | 41,960 |
| Talde Gestión S.G.E.C.R., S.A. | Venture capital. | 37.23 | - | 37.23 | 6,282 | 5,638 | (216) | 2,232 | 1,045 |
| Talde Promoción y Desarrollo, S.C.R. de Régimen Común, S.A. | Venture capital. | 43.12 | - | 43.12 | 22,615 | 22,158 | 98 | 4,712 | 4,712 |
| Torre Iberdrola, A.I.E. | Real estate construction and development. | - | 31.90 | 31.90 | 232,636 | 196,853 | 2,316 | 66,911 | 58,949 |
| Viacajas, S.A. | Means of payment. | 46.64 | - | 46.64 | 38,936 | (26,829) | 57,185 | 876 | 876 |
| Vitalquiler, S.L. | Housing leases. | 20.00 | - | 20.00 | 72,968 | 10,123 | 2,104 | 10,564 | 7,081 |
| Zierbena Bizkaia 2002, A.I.E. | Logistics activities and operations. | - | 36.84 | 36.84 | 2,695 | 2,958 | (315) | 2,016 | 841 |

(*) Net profit or loss for the year less interim dividend.
(**) Disregarding uniformity adjustments.
(***) In liquidation.

## APPENDIX II

## Investments in jointly controlled entities and associates
## Jointly controlled entities accounted for using the equity method at 31 December 2016:

| | | | | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Percentage of ownership at 31/12/16 | | | Equity at 31/12/15 (**) | | | Carrying amount at 31/12/16 (Direct and indirect) | |
| Name | Line of business | Direct | Indirect | Total | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Araba Logística, S.A. | Construction and operation of buildings for logistics activities. | - | 43.99 | 43.99 | 57,613 | 2,650 | (1,661) | 2,110 | - |
| Peri 3 Gestión, S.L (***). | Management and administration of services company. | - | 50.00 | 50.00 | 9 | 3 | - | 2 | 2 |

(*) Net profit or loss for the year less interim dividend.
(**) Disregarding uniformity adjustments.
(***) In liquidation.

# APPENDIX II

## Investments in jointly controlled entities and associates
## Associates accounted for using the equity method at 31 December 2016

| Name | Line of business | Percentage of ownership at 31/12/16 | | | Thousands of euros: Equity at 31/12/15 (**) | | | Carrying amount at 31/12/16 (Direct and indirect) | |
|---|---|---|---|---|---|---|---|---|---|
| | | Direct | Indirect | Total | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Agua y Gestión Servicios Ambientales, S.A. | Water collection, treatment and distribution. | - | 23.20 | 23.20 | 72,732 | 11,121 | (647) | 6,071 | 400 |
| Aguas de Bilbao, S.A. | Water service. | 24.50 | - | 24.50 | 2,042 | 1,967 | (229) | - | - |
| Altun Berri, S.L. | Management and operation of hotel establishments. | 50.00 | - | 50.00 | 36,550 | 7,290 | 95 | - | - |
| Aparcamiento de Getxo en Romo y Las Arenas (Las Mercedes), S.L. | Operation of car parks. | - | 33.33 | 33.33 | 5,289 | 274 | (111) | 98 | - |
| Aurea Sur Fotovoltaica, S.L. | Development, management, installation and operation of solar PV plants. | - | 40.00 | 40.00 | 7,723 | 3,729 | 60 | 1,447 | 1,447 |
| Baserri, S.A. | Dormant. | 33.38 | - | 33.38 | 1 | 165 | - | 55 | 30 |
| Centro de Transportes de Vitoria, S.A. | Development and operation of the Vitoria transport interchange and customs centre. | 13.21 | 14.46 | 27.67 | 31,572 | 15,683 | (1,971) | 8,423 | - |
| Cienpozuelos Servicios Inmobiliarios I, S.L. | Property development. | - | 42.50 | 42.50 | 545 | (5,638) | (18) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios II, S.L. | Property development. | - | 42.50 | 42.50 | 546 | (5,637) | (18) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios III, S.L. | Property development. | - | 42.50 | 42.50 | 546 | (5,637) | (18) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios IV, S.L. | Property development. | - | 42.50 | 42.50 | 546 | (5,637) | (18) | 4 | - |
| Cienpozuelos Servicios Inmobiliarios V, S.L. | Property development. | - | 42.50 | 42.50 | 545 | (5,638) | (18) | 4 | - |
| Corporación Industrial Córdoba Sur, S.A. | Development of industrial parks. | - | 48.20 | 48.20 | 2,961 | 1,289 | 13 | 634 | 619 |
| Corporación Industrial Córdoba Este, S.A. | Development of industrial parks. | - | 46.46 | 46.46 | 5,441 | 5,119 | 8 | 1,411 | 1,411 |

## APPENDIX II

## Investments in jointly controlled entities and associates
## Associates accounted for using the equity method at 31 December 2016 (cont.):

| | | Percentage of ownership at 31/12/16 | | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Equity at 31/12/15 (**) | | | Carrying amount at 31/12/16 (Direct and indirect) | |
| Name | Line of business | Direct | Indirect | Total | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Corporación Industrial Córdoba Norte, S.A. | Development of industrial parks. | - | 32.63 | 32.63 | 1,944 | 2,077 | (161) | 512 | 512 |
| Corporación Industrial Córdoba Sureste, S.A. | Development of industrial parks. | - | 48.50 | 48.50 | 1,673 | 1,272 | 3 | 555 | 555 |
| Corporación Industrial Córdoba Occidental, S.A. | Development of industrial parks. | - | 48.90 | 48.90 | 2,105 | 1,503 | 1 | 601 | 601 |
| Ekarpen Private Equity, S.A. | Business development. | 22.22 | 22.22 | 44.44 | 102,265 | 91,710 | 6,480 | 53,016 | 38,101 |
| Euskaltel, S.A. | Telecommunications. | 25.11 | - | 25.11 | 2,126,303 | 695,264 | 6,781 | 122,283 | 122,283 |
| Gabialsur 2006, S.L. (***) | Property development. | - | 50.00 | 50.00 | 851 | 923 | (134) | 313 | - |
| Gestión Capital Riesgo País Vasco S.G.E.C.R., S.A. | Administration and capital management. | 10.00 | 10.00 | 20.00 | 4,091 | 2,619 | 993 | 327 | 327 |
| Gestora del Nuevo Polígono Industrial, S.A. | Development of industrial parks. | - | 30.00 | 30.00 | 16,634 | 10,872 | (79) | 2,490 | 2,490 |
| Informática De Euskadi, S.L. | IT services. | - | 50.00 | 50.00 | 7,627 | 2,679 | 2,394 | 113 | 113 |
| Hazibide, S.A. | Business development. | 34.88 | - | 34.88 | 868 | 950 | (85) | 375 | 344 |
| Inverlur Aguilas I, S.L. | Property development. | - | 50.00 | 50.00 | 513 | 467 | (8) | 9,767 | 218 |
| Inverlur Aguilas II, S.L. | Property development. | - | 50.00 | 50.00 | 1,560 | 1,478 | (18) | 27,413 | 701 |
| Ibérico de Bellota, S.A. | Salting and drying of hams and sausages. | - | 25.00 | 25.00 | 4,699 | 2,521 | 158 | 545 | 260 |
| Ingeteam, S.A. | Installation engineering and development. | - | 29.30 | 29.30 | 613,145 | 339,904 | (6,988) | 27,375 | 27,375 |
| Inversiones Zubiatzu, S.A. | Holding company. | - | 20.49 | 20.49 | 106,054 | 49,724 | 14,634 | 10,200 | 10,200 |
| Los Jardines De Guadaira I, S.L. | Property development. | - | 50.00 | 50.00 | 4,363 | (56) | 47 | 20 | - |
| Los Jardines De Guadaira II, S.L. | Property development. | - | 50.00 | 50.00 | 4,352 | (28) | 46 | 5 | - |
| Luzaro Establecimiento Financiero de Crédito, S.A. | Participating loans. | 47.06 | - | 47.06 | 250,063 | 18,313 | 654 | 4,564 | 4,564 |

## APPENDIX II

## Investments in jointly controlled entities and associates
## Associates accounted for using the equity method at 31 December 2016 (cont.):

| | | Percentage of ownership at 31/12/16 | | | Thousands of euros | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | Equity at 31/12/15 (**) | | | Carrying amount at 31/12/16 (Direct and indirect) | |
| Name | Line of business | Direct | Indirect | Total | Assets | Equity (excluding profit or loss) | Net profit (loss) (*) | Gross | Net |
| Mecano Del Mediterráneo, S.L. (***) | Real estate. | - | 50.00 | 50.00 | 22,360 | 2,297 | (527) | 2,657 | - |
| Neos Surgery, S.L. | Manufacturing of surgical and medical material. | - | 35.49 | 35.49 | 6,300 | 3,620 | 98 | 1,000 | 814 |
| Paisajes del Vino, S.L. | Property development. | 23.86 | - | 23.86 | 23,458 | 3,128 | (34) | 1,885 | - |
| Promega Residencial, S.L (***). | Real estate. | - | 35.00 | 35.00 | 7,510 | (5,967) | (1,084) | 2,920 | - |
| Promoción Los Melancólicos, S.L. | Property development. | - | 42.50 | 42.50 | 1,226 | (238) | (14) | 1,148 | - |
| Promotora Inmobiliaria Sarasur, S.A. (***) | Residential development. | - | 50.00 | 50.00 | 2,167 | (22,738) | (2,546) | 5,783 | - |
| San Mames Barria, S.L. | Real estate. | - | 24.99 | 24.99 | 172,714 | 170,967 | (2,488) | 44,500 | 43,351 |
| Talde Gestión S.G.E.C.R., S.A. | Venture capital. | 37.23 | - | 37.23 | 6,293 | 6,065 | (428) | 2,232 | 2,096 |
| Talde Promoción y Desarrollo, S.C.R. de Régimen Común, S.A. | Venture capital. | 49.21 | - | 49.22 | 30,313 | 26,928 | 3,139 | 4,712 | 4,712 |
| Torre Iberdrola, A.I.E. | Real estate construction and development. | - | 31.90 | 31.90 | 230,128 | 225,868 | 1,454 | 70,151 | 62,189 |
| Viacajas, S.A. | Means of payment. | 46.70 | - | 46.70 | 74,804 | 55,575 | 30 | 877 | 877 |
| Vitalquiler, S.L. | Housing leases. | 20.00 | - | 20.00 | 78,042 | 12,931 | 1,387 | 10,564 | 7,081 |
| Zierbena Bizkaia 2002, A.I.E. | Logistics activities and operations. | - | 31.82 | 31.82 | 3,010 | 3,255 | (297) | 2,016 | 892 |

(*) Net profit or loss for the year less interim dividend.
(**) Disregarding uniformity adjustments.
(***) In liquidation.

## APPENDIX III

## Detail of remuneration of governing bodies (Board of Directors) in 2017

The overall remuneration earned in 2017 and 2016, including the remuneration of members with executive duties, was as follows:

2017

| Position | Name and surnames | Thousands of euros | | | |
|---|---|---|---|---|---|
| | | Fixed remuneration | Variable remuneration | Attendance fees | Total remuneration |
| Executive Chairman | Gregorio Villalabeitia Galarraga (*) | 623.8 | 225.3 | - | 849.1 |
| First Deputy Chairman | Xabier Gotzon Iturbe Otaegi | 316.8 | - | - | 316.8 |
| Second Deputy Chairman and Director (until 28 March 2017) | Luis Viana Apraiz | - | - | - | - |
| Second Deputy Chairman (from 3 May 2017) and Director | Juan María Ollora Ochoa de Aspuru | | | 69.0 | 69.0 |
| CEO | Javier García Lurueña (**) | 395.6 | 131.4 | - | 527.0 |
| Director | Joseba Mikel Arieta-Araunabeña Bustinza | - | - | 64.9 | 64.9 |
| Director | José Antonio Ruíz-Garma Martínez | - | - | 59.0 | 59.0 |
| Director | José Miguel Martín Herrera | - | - | 62.9 | 62.9 |
| Director | María Victoria Mendia Lasa | - | - | 48.3 | 48.3 |
| Director | Carlos Aguirre Arana | - | - | 43.3 | 43.3 |
| Director | Jesús Mª Herrasti Erlogorri | - | - | 31.6 | 31.6 |
| Director | Roxana Meda Inoriza | - | - | 31.6 | 31.6 |
| Director | Manuela Escribano Riego | - | - | 31.6 | 31.6 |
| Director | Alexander Bidetxea Lartategi | - | - | 28.6 | 28.6 |
| Director | Josu de Ortuondo Larrea | - | - | 28.6 | 28.6 |
| Director | Antonio Villar Vitores | - | - | 37.4 | 37.4 |
| Director (from 28 July 2017) | Jorge Hugo Sánchez | - | - | 23.8 | 23.8 |
| | | **1,336.2** | **356.7** | **560.6** | **2,253.5** |

(*) In addition, certain members of the Board of Directors have pension rights which were earned in years in which they held positions at the Bank. These rights were externalised through insurance policies with non-Group companies. In 2017 no amount accrued in this connection.

(**) Certain members of the Board of Directors are entitled to post-employment benefits due to their status as directors. These benefits were externalised through insurance policies with non-Group companies. In 2017 EUR 24 thousand accrued in this connection.

2016

| Position | Name and surnames | Thousands of euros | | | |
|---|---|---|---|---|---|
| | | Fixed remuneration | Variable remuneration | Attendance fees | Total remuneration |
| Executive Chairman | Gregorio Villalabeitia Galarraga (*) | 601.1 | 219.6 | - | 820.7 |
| First Deputy Chairman | Xabier Gotzon Iturbe Otaegi | 316.8 | - | - | 316.8 |
| Second Deputy Chairman and Director | Luis Viana Apraiz | - | - | 69.1 | 69.1 |
| CEO | Javier García Lurueña (**) | 381.3 | 125.1 | - | 506.4 |
| Director | Joseba Mikel Arieta-Araunabeña Bustinza | - | - | 65.9 | 65.9 |
| Director (until 30 June 2016) | Ainara Arsuaga Uriarte | - | - | 17.7 | 17.7 |
| Director (until 30 June 2016) | Iosu Arteaga Álvarez | - | - | 15.8 | 15.8 |
| Director (until 30 June 2016) | Maria Begoña Achalandabaso Manero | - | - | 15.8 | 15.8 |
| Director | Alexander Bidetxea Lartategi | - | - | 28.6 | 28.6 |
| Director | Jesús Mª Herrasti Erlogorri | - | - | 32.5 | 32.5 |
| Director | María Victoria Mendia Lasa | - | - | 48.3 | 48.3 |
| Director | Josu de Ortuondo Larrea | - | - | 29.6 | 29.6 |
| Director | Juan María Ollora Ochoa de Aspuru | - | - | 61.9 | 61.9 |
| Director | José Antonio Ruíz-Garma Martínez | - | - | 59.0 | 59.0 |
| Director | José Miguel Martín Herrera | - | - | 64.9 | 64.9 |
| Director | Carlos Aguirre Arana | - | - | 43.3 | 43.3 |
| Director (from 30 June 2016) | Manuela Escribano Riego | - | - | 16.8 | 16.8 |
| Director (from 30 June 2016) | Roxana Meda Inoriza | - | - | 16.8 | 16.8 |
| Director (from 30 June 2016) | Antonio Villar Vitores | - | - | 16.8 | 16.8 |
| | | **1,299.2** | **344.7** | **602.8** | **2,246.7** |

(*) In addition, certain members of the Board of Directors have pension rights which were earned in years in which they held positions at the Bank. These rights were externalised through insurance policies with non-Group companies. In 2016 no amount accrued in this connection.

(**) Certain members of the Board of Directors are entitled to post-employment benefits due to their status as directors. These benefits were externalised through insurance policies with non-Group companies. In 2016 EUR 19 thousand accrued in this connection.

## Appendix IV

**Annual Banking Report - Information of the Kutxabank Group for compliance with Article 89 of Directive 2013/36/EU of the European Parliament and its transposition into Spanish law by means of Law 10/2014**

The information set forth below was prepared pursuant to Article 89 of Directive 2013/36/EU of the European Parliament and of the Council, of 26 June 2013, on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, and its transposition into Spanish law pursuant to Law 10/2014, of 26 June, on the regulation, supervision and capital adequacy of credit institutions, specifically in accordance with Article 87.1 and Transitional Provision Twelve thereof.

Accordingly, following is a detail of the information for 31 December 2017 (in thousands of euros):

| Name of the main entity | Nature of activities | Geographical location | Turnover (1) | Number of employees on a full time basis | Profit or loss before tax | Tax on profit or loss |
|---|---|---|---|---|---|---|
| Kutxabank, S.A. | Banking, finance, asset management, insurance and property business | Spain | 1,329,757 | 5,921 | 282,518 | 21,362 |
| Kutxabank France - Branches in France | Finance | France | 1,941 | 22 | (649) | - |
| Total | | | | | | |

(1) Turnover was considered to be gross income in the consolidated statement of profit or loss for the year ended 31 December 2017.

In 2017 the return on the assets of the Kutxabank Group, calculated by dividing net profit by total assets, was 0.53%.

In 2017 the Kutxabank Group did not receive any significant public subsidies or government assistance of any kind.

*Translation of a report originally issued in Spanish. In the event of a discrepancy, the Spanish-language version prevails.*

# Kutxabank, S.A. and Subsidiaries (Consolidated Group)

## Consolidated Directors' Report for the year ended 31 December 2017

### 1. ANALYSIS OF THE ECONOMIC BACKGROUND

The second half of 2017 witnessed a progressive bolstering of the improvement of the global economy, and opinion indicators point to the continuation of sustained worldwide growth in the short term. Indeed, towards the end of the year there was a sharp upturn in global economic activity, heralding growth of close to 3.6%, above the figure for 2016. Particularly noteworthy was the more uniform behaviour across the various groups of countries. Thus, while the developed countries advanced by around 2.2%, the emerging economies reported growth of nearly 4.6%, and the outlook is that this trend will continue in 2018. The performance of the developed economies was influenced by Donald Trump's presidency in the US, the elections in Germany and France, the effect of Brexit in the European sphere, as well as the so-called "Catalonian crisis" in the case of Spain. In other words, the world of politics brought its influence to bear on the economic plane.

Economic activity in the **United States** surpassed even the most optimistic forecasts (up 2.3% in the third quarter of 2017), and advanced robustly in the last quarter, underpinned by both domestic demand and the recovery of external demand, shielded by the depreciation of the US dollar, all in combination with moderate inflation prospects. Medium-term forecasts, however, signal a gradual slowdown in this growth.

The accentuated dynamism of **the eurozone** continues to pivot on the favourable interest rate scenario introduced by the European Central Bank, which, however, has begun to phase out its asset purchase policy, prompting a sequence of expansion in terms of eurozone GDP (around 2.3%). In addition to this, oil prices remained at reasonably low levels. The sound performance is evidenced by the improved economic outlook, bolstered confidence and the growth in employment. The **United Kingdom**, on the other hand, is showing signs of a weakened economy, due to the fall of the pound sterling and increased uncertainty surrounding Brexit, together with the resulting collateral effects.

Against this backdrop, the **Spanish economy** posted growth of 3.1% in the third quarter of 2017, maintaining the momentum of the previous quarter, based, mainly, on burgeoning domestic demand, which contributed 2.7 pps to GDP growth.

The labour market is evolving positively since, according to Spanish National Accounts data for the third quarter, employment continued to improve at a rate of 2.9%, although the Bank of Spain has already detected certain effects of the Catalonian situation. This favourable trend is mirrored by the creation of around 500,000 jobs over the last twelve months, which makes a total of 1.5 million jobs created in the last three years. This is reflected in the increased number of Social Security contributors (up 3.4% in December) and in the reduction of the unemployment rate (16.5% in the fourth quarter).

Prices grew by 1.1% in 2017, with an underlying inflation of 0.8% in the same period, in aggregate representing a stable behaviour in which the various components display a certain uniformity and food prices and energy-related components show the steepest rises.

With regard to Spain's achievement of its deficit target for 2017, it should be pointed out that the deficit will stand at around 3%, its lowest level in ten years. In 2017 there were no upward revisions of the deficit target, which remained at 3.1%. Furthermore, progress was made in reducing public debt, which fell to 98.7% of GDP at the end of the third quarter (same period in 2016: 99.9% of GDP).

The volume of new bank lending transactions grew in year-on-year terms, in a context in which average costs remained at very meagre levels, hitting all-time lows. This gave rise to a certain decline in the rate of contraction of the stock of bank loans, while the deleveraging of businesses and households continued following the increase in their income and the reduction of their debts. This is reflected in the fall in the ratio of debt to gross disposable income (GDI) which, combined with the maintenance of the average cost of debt, resulted in a lower financial burden. The sound performance of the property market, which grew by more than 9.2% (December), although the pace of growth slowed towards the end of the year, suggests a very intense demand for housing, which is an indication that, as expected, house prices will continue to rise.

Private sector deposits increased by 2.28%, continuing an upward trend that had already begun in the last few quarters, and confirmed the gradual restoration of the income of private individuals and non-financial companies.

The **Basque economy** itself also enjoyed the favourable scenario experienced by its closest neighbouring regions, and in the fourth quarter of 2017 reported year-on-year GDP growth of 3.0%, surpassing the rates achieved in previous quarters. This increase was driven mainly by powerful domestic demand, whose growth advanced to reach 3.1%.

Behind this expansive development lies the good performance of the Basque labour market, featuring growth in job creation (2%), an increase in salaries and social security registrations (2.1%) and a fall in the registered unemployment rate to 11.1%. This rate compares favourably with the 16.7% for Spain as a whole, although not so well with the 7.3% for the EU-28 nations. All in all, these factors have had a positive influence on the recovery of consumer and business expectations, triggering a self-feeding upward cycle, even though the growth rates are expected to gradually recede in the course of 2018.

Average price growth rates displayed a downward trend, falling from 2.9% at the beginning of the year to hit an annual average of 1.1%. The areas which reported the largest increases were transport, leisure, education and the restaurant/catering industry.

According to the Bank of Spain, private sector lending in the Basque Country at the end of the third quarter of 2017 had fallen by 3.1%, while private sector deposits had risen by 1%. The two changes are to be interpreted in the context of a reduction in the level of indebtedness of private individuals.

Official GDP growth forecasts for the Basque economy in 2018 are within a range consistent with the across-the-board moderation to be observed in its reference surrounding regions. In its latest official forecast, the Basque Autonomous Community Government placed GDP growth at 2.5%. Similar considerations regarding moderation are also applicable to the labour market, with employment expected to grow by 2% in 2017 and 1.7% in 2018.

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According to the data held by the **Andalusian** Institute of Statistics and Cartography, the Andalusian economy reported significant growth in 2017 in both its GDP (up 3% at the end of the third quarter of 2017) and employment, and has strung together twelve successive quarters of increases, outperforming its neighbours in Europe and matching the performance of Spain. As a result, Andalusia has edged even closer to both of these areas, reducing the gap with respect to the EU.

The labour market activity rate stood at around 57%, down slightly on the same period in 2016, with 825,364 people unemployed (2016: 1,133,800 unemployed) and an unemployment rate of 25.4%, following an improvement of more than 3 pps with respect to the figure for 2016. The number of persons registered with the social security system rose to 3,011,953, and Andalusia ranks as the autonomous community that created the highest number of jobs in the last year, accounting for more than one-fifth (21.3%) of all jobs created in Spain as a whole.

At year-end the consumer price index stood at 1.7%, displaying moderate growth and matching the figure for the Spanish economy; however, the regional fluctuations in components such as transport (3.6%), housing (3%) and food and non-alcoholic beverages (2.4%) outstripped those at state level. Analysing the CPI by sector, the highest growth in prices is observed in the primary and industrial sectors.

Based on the data published by the Bank of Spain, at the end of the third quarter of 2017 Andalusia's public sector debt was 21.9% of its GDP, the same level as that recorded for the year-ago period, which compares favourably with the average for the autonomous communities (24.7% of their GDP). Furthermore, Andalusia reported a slight GDP surplus.

According to the data published by the Autonomous Community Government of Andalusia, lending fell by 4.4% in year-on-year terms (third quarter of 2017) as the reduction of debt continued. This contraction is due largely to the reduction in loans granted to the public sector, which were down by around 23%, while private sector lending retreated by 3.4%.

The expansionary trend is expected to continue throughout 2018, with the Autonomous Community Government of Andalusia estimating growth of close to 2.6%, in line with the performance of the rest of the Spanish market.

## 2. BUSINESS PERFORMANCE

Since the integration of the Basque savings banks in 2012, the Kutxabank Group has consolidated its position among the leading medium-sized banks in the Spanish financial industry and, without neglecting its need for high levels of write-downs, it has managed to achieve profits in each year since its formation. These profits have enabled it to improve its capital adequacy and to fund the welfare projects of its shareholders, whose full ownership was maintained, without resorting to state aid, capital increases or the issue of hybrid instruments.

This positive outcome is the result of its successful local banking model based on the retail sector, its particular roots in, and commitment to, its home territories, and the strong social content of its activity. This model is underpinned by a low risk profile and a strong capital adequacy and liquidity position that was recognised in the European Banking Authority transparency exercise in 2017. For the third consecutive year, the results of the exercise placed the Kutxabank Group at the forefront of the Spanish financial industry in capital adequacy terms.

It should not be forgotten that the Group's results for 2016 were adversely impacted by two extraordinary events. On the one hand, the judgment handed down by the Court of Justice of the European Union on 21 December 2016 relating to the so-called floor clauses, and the entry into force of Royal Decree-Law 1/2017, of 20 January, on urgent consumer-protection measures relating to floor clauses, led Kutxabank to recognise a one-off provision to cover potential claims from its customers. On the other hand, the publication of Royal Decree-Law 3/2016, of 2 December, adopting tax measures aimed at consolidating public finances and other urgent social measures, introduced significant changes to income tax, including the elimination of certain tax credits previously allowed by the regulations.

The Kutxabank Group was able to successfully mitigate the adverse effect of these profit-damaging factors and now, once again in 2017, in keeping with the upturn observed since 2015, it has reported rising profits consistent with its forecasts, thanks basically to the improvement in all the variables associated with the banking business, favoured by a high volume of new contracts for financial products and the growth in loyal and digital customers. Adding to the effect of these profit levers were the positive contribution of the investee portfolio, the traditional policy of prudence regarding costs, which continued to focus on efficiency, and the reduction in the need for ordinary provisions due to the improved quality of risk exposure, albeit offset by higher non-recurring provisions recognised to enhance the long-term sustainability of the financial business.

This improvement in profits was achieved in a complex social and economic environment, characterised by the continued upward trend of the macroeconomic indicators and the financial and capital markets, but also amidst highly demanding financial and regulatory conditions for the obtainment of returns, which remained under strong pressure from negative interest rates, which once again hit all-time lows in 2017. Despite these ongoing unfavourable conditions facing the banking business, the increasingly intense commercial activity, the reactivation of solvent demand for credit, the reduction in non-performing loan ratios and the firm commitment to digital transformation enabled Kutxabank to achieve the targets set for this year.

**Kutxabank Group financial highlights**

**FINANCIAL DATA**

| STATEMENT OF PROFIT OF LOSS (thousands of euros) | 2017 | 2016 | ∆% Year-on-year |
|---|---|---|---|
| Net interest income | 558,732 | 557,998 | 0.1 |
| Net income from transactions with customers | 938,294 | 902 | 4.0 |
| Gross income | 1,331,698 | 1,256,424 | 6.0 |
| Profit from operations | 650,105 | 551,833 | 17.8 |
| Profit for the year | 301,954 | 244,248 | 23.6 |

| BALANCE SHEET (thousands of euros) | 2017 | 2016 | ∆% Year-on-year |
|---|---|---|---|
| Total assets | 57,441,741 | 56,515,916 | 1.6 |
| Loans and advances to customers - net | 41,874,689 | 42,176,178 | -0.7 |
| Loans and advances to customers - gross | 42,771,033 | 43,561,012 | -1.8 |
| Customer funds under management | 59,394,034 | 56,760,223 | 4.6 |
| Business volume | 102,165,067 | 100,321,235 | 1.8 |

| FINANCIAL RATIOS | 2017 |
|---|---|

| NON-PERFORMING LOANS | % |
|---|---|
| Non-performing loans ratio including off-balance sheet items (*) | 4.89 |
| Coverage ratio | 41.76 |
| Non-performing loans ratio | 5.05 |

| EFFICIENCY | % |
|---|---|
| Operating expenses/ATAs | 1.21 |
| Efficiency ratio | 51.18 |

| CAPITAL ADEQUACY RATIO | 15.7% |
|---|---|
| Core Tier 1 | 15.7% |

| OTHER DATA | 2017 | Kutxabank | CajaSur |
|---|---|---|---|
| No. of employees | 5,653 | 3,858 | 1,795 |
| No. of branches | 931 | 600 | 331 |
| No. of ATMs | 1,969 | 1,572 | 397 |

| RATINGS | Long-term | Short-term |
|---|---|---|
| Fitch | BBB+ | F3 |
| Moody's | Baa3 | NP |
| Standard & Poor's | BBB | A2 |

(*) Contingent credit and risks included.

* The data given for the workforce relate to the employees engaged in the financial activity carried on by Kutxabank S.A. and Caja Sur Banco S.A.U.

## Statement of profit or loss

The Kutxabank Group ended 2017 with consolidated profit of EUR 302.0 million, up 23.6% on that obtained in the previous year. The CajaSur Group contributed EUR 15.9 million to this profit. This positive performance was achieved in a context that continued to be marked by the confirmation of improved macroeconomic indicators, but also by the persistence of damaging factors for the banking business, in particular the slide of market interest rates into negative territory.

Nevertheless, the Kutxabank Group managed to counterbalance the inevitable pressure placed on returns by this negative interest rate scenario, thanks mainly to the support of the key levers already used in previous years: margin management helped by liability costs, greater returns due to increased product marketing, the cost containment policy and the improvement of the risk-related variables. These levers were supplemented by a slowing of the decline in lending volumes, which have already reached a turning point, the customary positive contribution of the investee portfolio, the increased activity and loyalty of our customers and the new digital functionalities resulting from the Bank’s firm strategic commitment in this connection. In addition to all this, Kutxabank maintained, and even intensified, a significant level of write-downs in line with its traditional policy of prudence.

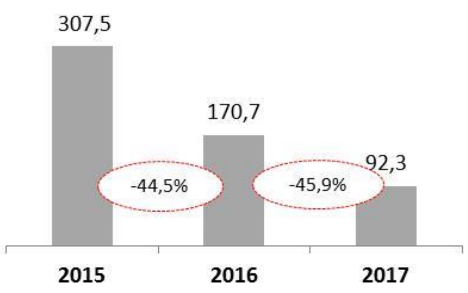
| Thousands of euros | 2017 | 2016 | ∆% | %/ATAs |
|---|---|---|---|---|
| **Net interest income** | **558,732** | **557,998** | **0.1** | **0.99** |
| Net fee and commission income | 379,562 | 343,825 | 10.4 | 0.67 |
| **Net income from transactions with customers** | **938,294** | **901,823** | **4.0** | **1.67** |
| Dividend income | 49,681 | 94,779 | (47.6) | 0.09 |
| Share of results of entities accounted for using the equity method | 17,555 | 43,838 | (60.0) | 0.03 |
| Net gains on financial assets and liabilities and exchange differences | 276,191 | 170,774 | 61.7 | 0.49 |
| Other operating income and expenses | 49,977 | 45,210 | 10.5 | 0.09 |
| **Gross income** | **1,331,698** | **1,256,424** | **6.0** | **2.37** |
| Administrative expenses | (626,596) | (648,505) | (3.4) | (1.11) |
| Depreciation and amortisation charge | (54,997) | (56,086) | (1.9) | (0.10) |
| **Profit from operations** | **650,105** | **551,833** | **17.8** | **1.16** |
| Provisions (net) | (138,248) | (117,585) | 17.6 | (0.25) |
| Impairment losses on financial assets | (86,262) | (89,363) | (3.5) | (0.15) |
| Impairment losses on other assets | (48,688) | (15,633) | n.s. | (0.09) |
| Other gains and losses | (95,038) | (15,523) | n.s. | (0.17) |
| *. Impairment of non-current assets held for sale (tangible assets)* | *(160,895)* | *(72,155)* | 123.0 | (0.29) |
| *. Other gains and losses* | *65,857* | *56,632* | 16.3 | 0.12 |
| **Profit before tax** | **281,869** | **313,729** | **(10.2)** | **0.50** |
| Income tax | 21,362 | (68,803) | n.s. | 0.04 |
| **Net profit for the year** | **303,231** | **244,926** | **23.8** | **0.54** |
| Profit attributable to non-controlling interests | (1,277) | (678) | 88.3 | (0.00) |
| **Profit attributable to the Group** | **301,954** | **244,248** | **23.6** | **0.54** |

One of the key elements that continued to mark the financial background in 2017 was the ongoing situation of negative interest rates, which in the course of the year hit new all-time lows. 1-year Euribor closed at -0.19% in December 2017, with an annual average of -0.15%, 11 basis points below the average for 2016.

In spite of this, the Kutxabank Group managed to increase its **net interest income** to EUR 558.7 million, 0.1% higher than the figure for 2016, thus breaking the downward trend of recent years. The main driver of this growth continued to be the decrease in interest expenses, which displayed the same high rate of contraction as in 2016, falling by 45.9% with respect to December 2016. Although the margin for improvement is increasingly small, the Group continued to actively manage liability prices, as a result of which the cost of new production of deposits in the business areas closed the year with an average cost for the arrangement of new deposits of 0.03%, 2 basis points lower than in December 2016.

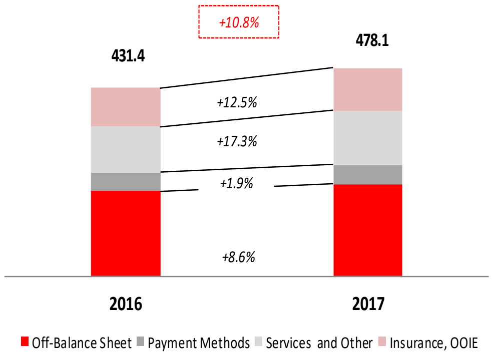
*Net interest income (millions of euros)*


*Interest expenses (millions of euros)*




This decline in interest expenses offset the drop in interest income, which fell by 10.7%, far below the 21.3% recorded in 2016. Although interest income continues to be severely affected by the returns on the loan portfolio -in particular on floating-rate mortgage loans- as a result of the negative market interest rates, an upswing in loan volumes is already being observed, which minimises the impact of the Euribor curve and of the lower returns on the fixed-income portfolio, which were down with respect to the amount obtained in 2016. In this context it is important to remember that, for reasons of management orthodoxy, in relation to the on-balance-sheet government debt instruments, carry trades, i.e. arbitrage of interest rates between the ECB's key rate and the yield on government debt, were not significant at Kutxabank, since they only accounted for 8.7% of net interest income.

**Service income** (recognised as net fee and commission income) amounted to EUR 379.6 million, up 10.4% on the figure for 2016. The good performance of the financial markets in the year had a positive effect on the assets of our customers managed by the Group, and on the fees and commissions received for such services. Similarly, there was an upward trend in other fees and commissions, associated with the improvement in consumer spending and the new services offered by the Kutxabank Group. Including the results relating to the insurance business (which are recognised under "Other Operating Income and Expenses"), service income plus insurance would total EUR 478.1 million, 10.8% more than in 2016.



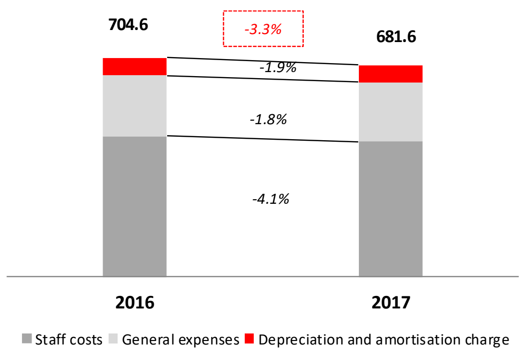

As a result of the simultaneous improvement in the typical banking business variables, i.e. net interest income and service income, **net income from transactions with customers,** the sum of the two aggregates, rose to EUR 938.3 million, up 4.0% on 2016, confirming the positive trend observed in recent quarters.

The positive contribution of results from the **investee portfolio** continued to be as strong as in the past. However, the recurring results contributed in the form of dividends received and the amount contributed by associates were not as high in 2017 (EUR 67.2 million, down from EUR 138.6 million at 2016 year-end), as a result of the reduction of the portfolio and certain non-recurring extraordinary impacts recognised in 2016, in particular the sale of the investment held by the subsidiary Viacajas in Visa Europa. By contrast, the income arising from net gains on financial assets and liabilities and exchange differences, due mainly to the habitual rotation of investments, stood at EUR 276.2 million.

Particularly noteworthy with respect to **"Other Operating Income and Expenses"** is the positive, increasing contribution made by the **insurance business**, amounting to close to EUR 100 million, 12.5% more than in the same period in 2016. This positive performance is the result of the intense, successful commercial activity generated in this business line, in keeping with one of the targets set in the Group's Business Development Plan, namely to assist customers in meeting all their insurance needs. This line item also includes the Group's contributions to the Deposit Guarantee Fund and to the Resolution Fund. In view of all the foregoing, its net balance amounts to EUR 50.0 million, 10.5% higher than that reported in 2016.

Thus, **gross income** amounted to EUR 1,331.7 million, up 6.0% on 2016, confirming the improvement in commercial activity and in the investee portfolio.

The containment of **operating expenses** continued with a reduction of 3.3%, demonstrating the effectiveness of the cost moderation and resource optimisation policy, and emphasising the role of efficiency management as one of Kutxabank's fundamental strategic objectives. Staff costs fell by a significant 4.1% on 2016 as a result of the workforce streamlining measures undertaken in the last two years, coupled with a 1.8% decrease in general expenses and a



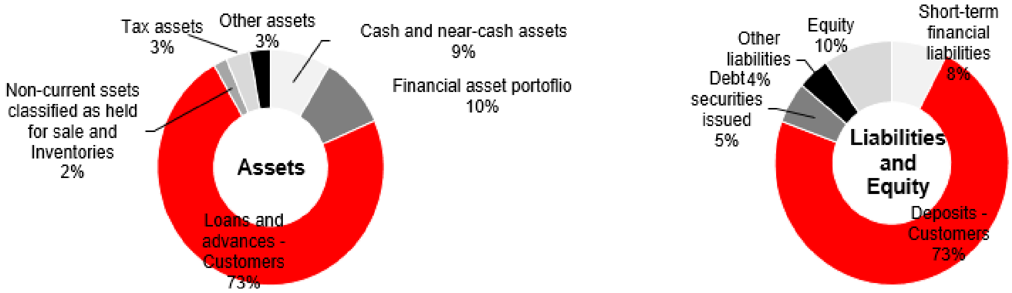
1.9% reduction in the depreciation and amortisation charge. All in all, the efficiency ratio stood at 51.18%, nearly five points lower than the rate at 2016 year-end.

The **write-downs** on the loan portfolio and other assets remained at the maximum prudent levels in relation to the coverage of credit and property risk, despite the improvement in the quality of these risks and the efforts made in previous years. In addition, provisions in excess of EUR 135 million were recognised in 2017 in relation to the pre-retirement plans agreed upon for the purpose of enhancing the long-term sustainability of the business. Thus, the increase in the results of the banking business, backed by other income from the investee portfolio, made it possible to continue to recognise significant provisions in 2017, amounting to EUR 434.1 million, in order to ensure that Kutxabank is ready to face the demanding legislative and regulatory environment.

As a result of all the foregoing, after considering the related income tax, the Group's **consolidated profit** amounted to EUR 302.0 million, up 23.6% on 2016.

**Balance sheet**

At 31 December 2017, the total size of the Kutxabank Group's balance sheet was EUR 57,442 million, up 1.6% on the figure for 2016, thus curbing the deleveraging process that had characterised the last few years.




On the **asset side,** almost 75% of the consolidated balance sheet relates to "Loans and Advances - Customers", and this line item was down slightly in year-on-year terms (-1.3%). Also, the total balance of "Loans and Receivables" fell by 3.9% due to the significant decrease in positions held at other financial institutions. Nevertheless, there was a circumstantial increase in the Group's total cash and near-cash assets as a percentage of the balance sheet, due to the sharp increase in "Cash, Cash Balances at Central Banks and Other Demand Deposits". On the other hand, "Available-for-Sale Financial Assets" decreased by 6.5% as a result of the reduced positions in equities, which offset the increases in fixed-income securities that were due to the partial replacement of the portfolio following the sales made in December 2016.

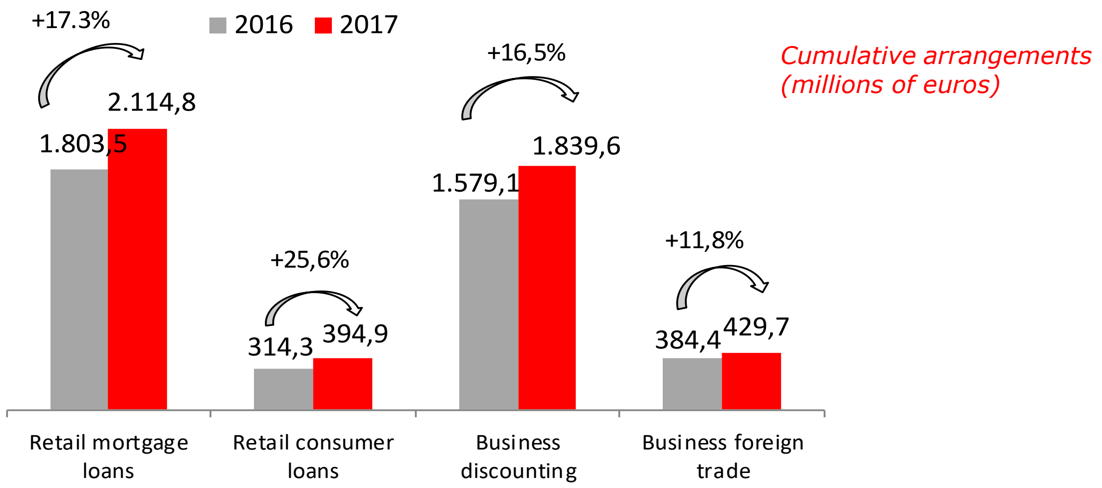
On the **liability side**, customer deposits, which account for nearly three-quarters of the balance sheet, rose by 1.4% with respect to 2016 (3.2% excluding the mortgage-backed bonds included in this category). Also noteworthy is the increase in the Group's short-term financial liabilities relating to the positions held at central banks. These rises counterbalance other significant falls, such as those observed in the financial liabilities associated with wholesale financing, which are included under "Debt Securities Issued" and "Deposits from Credit Institutions". Indeed, there was a substantial reduction in wholesale financing as a result of the arrangements that matured in 2017 and which it was not necessary to renew. Lastly, including off-balance-sheet customer funds, total customer funds under management amounted to EUR 59,394 million, up 4.6% on the December 2016 figure.

| Thousands of euros | 2017 | 2016 | ∆% |
|---|---|---|---|
| Cash, cash balances at central banks and other demand deposits | 4,407,638 | 1,481,508 | n.s. |
| Financial assets held for trading | 83,770 | 142,345 | (41.2) |
| Financial assets designated at fair value through profit or loss | 35,239 | 34,994 | 0.7 |
| Available-for-sale financial assets | 4,896,559 | 5,236,490 | (6.5) |
| Loans and receivables | 42,559,033 | 44,269,735 | (3.9) |
| . Loans and advances- Credit institutions | 552,660 | 1,696,602 | (67.4) |
| . Loans and advances- Customers | 42,006,373 | 42,573,133 | (1.3) |
| Held-to-maturity investments | 248,761 | 44,246 | n.s. |
| Derivatives – hedge accounting | 174,079 | 254,855 | (31.7) |
| Non-current assets and disposal groups classified as held for sale | 887,408 | 858,697 | 3.3 |
| Investments in joint ventures and associates | 514,522 | 503,118 | 2.3 |
| Assets under reinsurance and insurance contracts | 48,635 | 49,323 | (1.4) |
| Tangible assets | 1,015,286 | 1,065,463 | (4.7) |
| Intangible assets | 357,158 | 347,759 | 2.7 |
| Tax assets | 1,960,893 | 1,931,433 | 1.5 |
| Other assets | 252,760 | 295,950 | (14.6) |
| *Of which: inventories* | *221,432* | *230,868* | *(4.1)* |
| **TOTAL ASSETS** | **57,441,741** | **56,515,916** | **1.6** |
| Financial liabilities held for trading | 83,364 | 140,109 | (40.5) |
| Financial liabilities at amortised cost | 50,063,009 | 49,157,493 | 1.8 |
| . Deposits from central banks | 3,980,155 | 2,620,000 | 51.9 |
| . Deposits from credit institutions | 479,257 | 743,131 | (35.5) |
| . Customer deposits | 41,812,552 | 41,227,453 | 1.4 |
| . Debt securities issued | 3,138,943 | 4,035,099 | (22.2) |
| . Other financial liabilities | 652,102 | 531,810 | 22.6 |
| Derivatives – hedge accounting | 148,846 | 168,972 | (11.9) |
| Liabilities under insurance contracts | 626,854 | 635,350 | (1.3) |
| Provisions | 566,240 | 558,420 | 1.4 |
| Tax liabilities | 269,110 | 285,140 | (5.6) |
| Other liabilities | 214,983 | 174,629 | 23.1 |
| **TOTAL LIABILITIES** | **51,972,406** | **51,120,113** | **1.7** |
| Shareholders' equity | 5,031,608 | 4,875,516 | 3.2 |
| Accumulated other comprehensive income | 429,121 | 507,460 | (15.4) |
| Non-controlling interests | 8,606 | 12,827 | (32.9) |
| **TOTAL EQUITY** | **5,469,335** | **5,395,803** | **1.4** |
| **TOTAL LIABILITIES AND EQUITY** | **57,441,741** | **56,515,916** | **1.6** |

The Kutxabank Group's **net loans and advances to customers** ended 2017 at EUR 42,006 million, falling back slightly (-1.3%) from the figure for December 2016. Disregarding the changes in other financial assets, the net lending portfolio stood at EUR 41,875 million, down 0.7% on the balance at 2016 year-end (a 1.8% decrease in gross terms). However, the significant reduction in the "Non-Performing Assets" line item (-26.8%) must be taken into consideration, without which the Group's gross lending would have matched the figure for 2016, already evidencing as it does the upturn in lending volumes. The balance of "Secured Loans", which accounts for 75% of the Group's loans and advances to customers, fell by only 1.9% (compared with 3.7% in 2016), a decrease which in any case was offset by the very positive performance of the other line items, which also counterbalanced the fall in lending to the public sector.

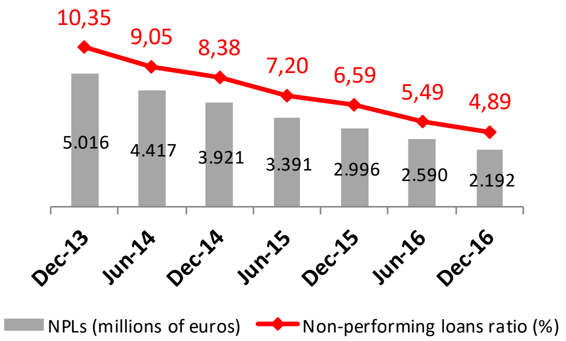
| Thousands of euros | 2017 | 2016 | ∆% |
|---|---|---|---|
| PRIVATE SECTOR | 40,261,383 | 40,902,770 | (1.6) |
| Secured loans | 31,309,094 | 31,913,490 | (1.9) |
| Other term loans | 5,267,302 | 4,597,899 | 14.6 |
| Receivable on demand | 807,548 | 759,033 | 6.4 |
| Commercial credit | 565,878 | 546,567 | 3.5 |
| Finance leases | 146,950 | 130,028 | 13.0 |
| Non-performing loans | 2,164,611 | 2,955,753 | (26.8) |
| PUBLIC SECTOR | 2,509,650 | 2,658,242 | (5.6) |
| **LOANS AND RECEIVABLES - GROSS** | **42,771,033** | **43,561,012** | **(1.8)** |
| Valuation adjustments | (896,344) | (1,384,834) | (35.3) |
| **LOANS AND RECEIVABLES - NET** | **41,874,689** | **42,176,178** | **(0.7)** |
| Other financial assets | 131,684 | 396,955 | n.s. |
| **LOANS AND ADVANCES TO CUSTOMERS** | **42,006,373** | **42,573,133** | **(1.3)** |
| *Memorandum item: Loans and receivables - gross excl. NPLs* | *40,606,422* | *40,605,259* | *0.0* |

In fact, 2017 witnessed the continuation of a very significant increase in new lending, in both the retail and corporate networks. Thus, in the retail customer-related business networks, supported by the high share of the mortgage market in the home territories, and a rigorous control of the risks approved, the volume of mortgage loans arranged grew by 17% with respect to the same period in 2016. Also worthy of note was the increase in personal consumer lending (up 25%). This also demonstrates Kutxabank's commitment to the revival of consumer spending and trade, for which purpose it applies its traditional model based on knowledge of the customer, analysis, control and responsible extension of credit.




In line with this commitment to the economic and social development of the community, and assisted by an extensive network of specialised managers, Kutxabank also contributed to boosting the commercial activity of the SME segment, in which the improved figures in terms of new lending and the trend in loan volumes were also observed. Thus, 2017 saw increases, with respect to the previous year, of 16.5% in the amount of discounting facilities and of 11.8% in the financing provided for foreign trade. This upswing in new lending also underpinned a year-on-year increase in the balances of loans to companies, which grew by 2.8% (or 5.1%, if non-performing assets are excluded).

Furthermore, the figures for 2017 once again confirm the downward trend observed in **non-performing loans** in the last few quarters. New NPLs fell by 31% compared with the same period in 2016, while the balance of non-performing loans decreased by almost EUR 800 million in the year. This resulted in a further improvement in the Kutxabank Group's NPL ratio, which, including contingent exposures, now stands at 4.89%, 170 basis points lower than the ratio at the end of 2016. Excluding the non-performing loans relating to the real estate business, the ratio falls to 3.88%. All of the foregoing confirms the maintenance of high credit quality levels, far above the average for the financial industry, which closed November 2017, the latest available figure, with a non-performing loans ratio of 8.08% for "Loans to Other Resident Sectors", 303 basis points above Kutxabank's NPL ratio, which stood at 5.05%.




**Customer funds under management**, excluding wholesale issues, totalled EUR 59,394 million, significantly higher (4.6%) than the December 2016 figure. Customer deposits (excluding mortgage-backed bonds) grew by 3.2%, bolstered by the excellent performance of demand deposits (+13.0%). In addition, in a context in which interest rates remained at an all-time low, customers continued to favour off-balance-sheet products in the search for more attractive returns. Accordingly, contributions to investment funds and to pension plans/employee benefit entities (EPSVs) continued to rise at a steady pace, with increases of 9.9% and 3.9%, respectively, in the year. Thus, total off-balance-sheet funds displayed substantial growth (7.9%). Once again in 2017 an outstanding role was played by one of the Bank's essential tools, the delegated portfolio management system, which has been in operation for the last ten years. As a result of its firm commitment to investment and employee benefit funds, coupled with its excellence in managing them, the Kutxabank Group ranks as the fourth largest fund manager in Spain.

Consequently, the sizeable transfer of balances to off-balance-sheet products continued, prompting a 15.5% fall in time deposits. The lack of liquidity pressure enabled the Bank to maintain a balanced funding structure, despite the decline in time deposits and the significant maturities in wholesale financing that took place in the year.

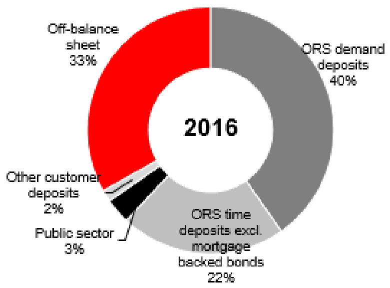
| Thousands of euros | 2017 | 2016 | ∆% |
|---|---|---|---|
| PRIVATE SECTOR | 38,244,547 | 36,845,219 | 3.8 |
| Demand deposits | 26,449,767 | 23,407,297 | 13.0 |
| Time deposits (excl. mortgage-backed bonds) | 10,668,679 | 12,632,784 | (15.5) |
| Repos | 1,123,541 | 786,601 | 42.8 |
| Valuation adjustments | 2,560 | 18,537 | (86.2) |
| PUBLIC SECTOR | 1,882,025 | 1,925,632 | (2.3) |
| MONEY MARKET TRANSACTIONS - COUNTERPARTY ENTITIES | 0 | 103 | n.s |
| **CUSTOMER DEPOSITS EXCLUDING WHOLESALE FINANCING** | **40,126,572** | **38,874,108** | **3.2** |
| Mortgage-backed bonds | 1,685,980 | 2,353,345 | (28.4) |
| Subordinated liabilities | 0 | 0 | - |
| **CUSTOMER DEPOSITS** | **41,812,552** | **41,227,453** | **1.4** |

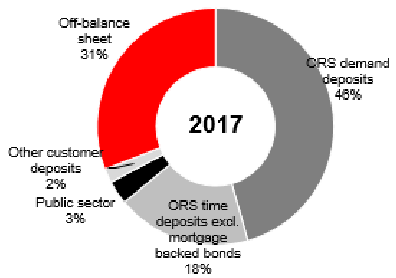
| Thousands of euros | 2017 | 2016 | ∆% |
|---|---|---|---|
| Investment funds | 16,117,761 | 14,664,006 | 9.9 |
| EPSVs and pension funds | 6,896,757 | 6,640,300 | 3.9 |
| Combined insurance and other | 150,341 | 165,452 | (9.1) |
| **OFF-BALANCE-SHEET FUNDS MANAGED** | **23,164,859** | **21,469,758** | **7.9** |

(*) This table includes off-balance sheet funds gross of duplicated investments, whereas in the table below they are presented net

| Thousands of euros | 2017 | 2016 | ∆% |
|---|---|---|---|
| Customer deposits excluding wholesale financing | 40,126,572 | 38,874,108 | 3.2 |
| Off-balance sheet funds managed | 19,267,462 | 17,886,115 | 7.7 |
| **CUSTOMER FUNDS UNDER MANAGEMENT** | **59,394,034** | **56,760,223** | **4.6** |

*Breakdowns of customer funds under management and off-balance-sheet funds*




In addition, Kutxabank has a **financial asset portfolio** amounting to almost EUR 5,700 million, of which slightly more than EUR 3,800 million relate to fixed-income securities. 2017 saw 22.5% growth in fixed-income securities due to the partial replacement of positions adjusted following the sale of a significant portion of the portfolio in December 2016. Equity instruments, both those classified as available for sale and those under “Investments in Joint Ventures and Associates”, total EUR 1,893 million. This equity portfolio is the result of Kutxabank's commitment to the industrial and social fabric of the area in which it operates. Although in general these are strategic investments which the Group clearly intends to hold in the long term, the portfolio is reviewed on an ongoing basis. This review, at all times in step with the cycles of the projects in which Kutxabank takes part, is adapted in line with existing capital levels and also involves managing the related concentration risk. The sales in 2017 in this connection gave rise to a 2.1% reduction in the total financial asset portfolio, in spite of the aforementioned increase in fixed-income positions. At 2017 year-end, the gross gains on the equity portfolio amounted to EUR 480 million.

| Thousands of euros | 2017 | 2016 | ∆% |
|---|---|---|---|
| Financial assets designated at fair value through profit or loss | 35,239 | 34,994 | 0.7 |
| Available-for-sale financial assets | 4,896,559 | 5,236,490 | (6.5) |
| *Debt securities* | *3,523,993* | *3,029,832* | *16.3* |
| *Other equity instruments* | *1,372,566* | *2,206,658* | *(37.8)* |
| Held-to-maturity investments | 248,761 | 44,246 | n.s. |
| Investments in joint ventures and associates | 514,522 | 503,118 | 2.3 |
| **FINANCIAL ASSET PORTFOLIO** | **5,695,081** | **5,818,848** | **(2.1)** |

The Kutxabank Group's **equity** at the end of 2017 totalled EUR 5,469 million, up 1.4% on the figure at the 2016 close, including a 3.2% rise in shareholders' equity.

Kutxabank remains at the forefront of the Spanish financial industry in capital adequacy terms, with regard to both its phased-in and fully loaded CET1 capital ratios, and is the bank with the largest buffer between CET1 capital and the SREP capital requirement in the entire Spanish financial system.

| Thousands of euros | 2017 | 2016 | Δ% |
|---|---|---|---|
| Shareholders' equity | 5,031,608 | 4,875,516 | 3.2 |
| Share capital | 2,060,000 | 2,060,000 | 0.0 |
| Reserves | 2,785,076 | 2,666,422 | 4.4 |
| Profit attributable to the Group | 301,954 | 244,248 | 23.6 |
| Interim dividend | (115,422) | (95,154) | 21.3 |
| Accumulated other comprehensive income | 429,121 | 507,460 | (15.4) |
| Non-controlling interests | 8,606 | 12,827 | (32.9) |
| **EQUITY** | **5,469,335** | **5,395,803** | **1.4** |

## 3. COMMERCIAL ACTIVITY

In a challenging economic environment, especially at an extremely complex time with regard to interest rates, as discussed in the preceding section, the achievement of the Kutxabank Group's objectives was founded on the strong performance of its commercial activity, with a significant increase in the arrangement of new financial products, mainly funding for companies, mortgage loans and personal loans, and the increasing contribution of the insurance business.

With demand recovering more as time goes by, and a rising **mortgage market**, loans earmarked for the purchase of housing units continued their upward trend. Following the launch of the fixed-rate mortgage in 2015 and of the mixed-rate mortgage in 2016, Kutxabank's offering is one of the most complete in the entire market, with ample flexibility with respect to terms and interest rates. Consequently, lending rose by more than 17%, which is above the market average in all the areas where the Bank has a presence. With a product offering in which fixed-rate and mixed-rate mortgages carry increasing weight, the Kutxabank Group has consolidated its leading share of new mortgages arranged, which exceeds 35% in its home territories.

In this context the contribution made by digital marketing in obtaining trade and business volume is particularly noteworthy. The mortgages arranged using digital resources grew by 50% in 2017 to represent 6% of the total figure for Kutxabank. Kutxabank's Housing Guide, which had more than 80,000 visits in 2017, played a particularly important role in this respect.

Also noteworthy was the burgeoning business in the area of **consumer loans**, where arrangements increased by more than 25%. The ongoing incorporation of technological channels into consumer lending led to an increase in the number of people arranging financing transactions via on-line banking and mobile banking. The number of people who can take advantage of the loans known as 'pre-approved' loans also continued to rise. This portfolio, which comprises 1.6 million customers, totals EUR 32,534 million.

The increasing activity of **SMEs** brought their financing needs back close to pre-crisis levels, and considerable growth of 16% in working capital funding for these businesses was confirmed. Over 1,200 new SMEs entrusted their business to Kutxabank in 2017.

For the fifth consecutive year, Kutxabank and the three Basque employers' associations put their names to the **'Makina Berria' plan**, a cooperation facility playing a key role in boosting investment funding which, this time, will once again allocate an additional EUR 2,000 million to the renewal of production machinery.

The **Kutxabank Business Plan** has also continued, with intense commercial activity in terms of teams and branches, achieving growth of nearly 50% in billings relating to commercial credit and business financing, and of 8% in billings of Kutxabank's POS terminals in 2017. Also of note was Kutxabank's leadership, in Andalusia, in the **provision of services to the agricultural sector,** where it strengthened its ongoing support through tailored products in both agricultural financing, achieving growth of 21% in 2017, and in agricultural insurance brokerage.

The Group is making a firm commitment to **integrated insurance services for customers**, which continue to make an increasing contribution to earnings, due mainly to an active commercial strategy and good management of the portfolio. For that purpose, various commercial initiatives have been undertaken which place emphasis on customer relationships and loyalty-building, and enable customers to benefit from special discounts for taking out new home, life and car insurance policies. In this respect, the Group now has more than 370,000 customers who have purchased insurance.

The Group has also improved and completed its range of insurance products with the launch of a new funeral insurance policy from Kutxabank Aseguradora, S.A.U. This insurance helps customers manage all the needs that arise following a death, and provides families with a personal assistant whose role is to assist and support them and facilitate all the formalities relating to the management of burials, while ensuring the quality of the services provided.

Also as part of the extended insurance range, a health insurance policy specifically for the self-employed was launched in 2017. This insurance from IMQ, S.A., which is sold exclusively by the branches in the Autonomous Community of the Basque Country, aims to respond to the healthcare requirements of the self-employed, which focus mainly on the need for a high-quality, rapid service, with a wide range of medical and healthcare practitioners, such as those offered by IMQ, at a special price in comparison with policies for individuals.

In an environment of interest rates at all-time lows and continuing to fall, the best performing **savings and investment products** were investment funds and pension and employee benefit plans. Contributing higher value added alternatives has been key, with portfolios as the fundamental tool and the tailoring of products to each customer's investor profile as the action strategy. The offering has been completed with issues of guaranteed "Horizon Funds" which enable the most conservative customers to access markets and yield expectations that would otherwise be unattainable. The Kutxabank Group, with total managed assets of over EUR 23,000 million, remains the sector's fourth largest manager in investment funds, pension plans and employee benefit entities.

In addition, 2017 was also a particularly active year for the Kutxabank Group in the area of new technologies. The consolidation of the **new KutxabankPay app**, which already has 90,000 users, has, to a large extent, shaped the efforts made by Kutxabank to provide customers with the latest in payment services.

KutxabankPay enables payment between individuals using the Bizum payment system - in which Kutxabank has played a very active role since its beginnings at the end of 2016, forming part of its Board of Directors and recording transactions totalling EUR 30 million in 2017- as well as mobile phone-based payment using HCE technology (virtual cards) for Android terminals, a service to which already more than 22,000 cards have access. It also provides access to various card control and management functionalities included in our Mobile Banking offering.

Through this application, as well as the OnLine Banking facility, users can directly manage their cards' credit limits and the daily security limits in the various areas (ATMs, purchases, online purchases, etc.) or choose to "switch on" and "switch off" their cards at will and with total freedom.

Customers may also defer their card payments on their mobiles using **Flexibuy**. Through push notifications they receive on their phones, customers can decide whether to finance their debit and credit card purchases; this system experienced a 225% rise in the number of transactions and a 10% increase in amounts compared with 2016.

With a view to maintaining communication channels with current and potential customers, Kutxabank has created an interactive website that provides detailed didactic explanations of all the steps involved in purchasing a home. **'Kutxabank Hipotecas'** structures the process into four simple sections, starting with the search for a home, continuing with the sale and purchase agreement and an analysis of the details of mortgage loans, and ending with deeds.

2017 also saw the launch of **"Cuentas OK"** accounts, which are available to all customer segments if they meet certain minimum loyalty requirements, and provide access to a package of basic services for customers to manage their finances at no cost. 30% of Kutxabank's customers have already opened one of these accounts.

Kutxabank has also continued with its commitment to bringing value to the various customer segments; with a complete offering for senior citizens: a welcome gift on banking their pension and ongoing prize draws and offers, as well as a wide range of travel offers with special conditions for customers.

We have also continued to provide advantages for all the holders of Kutxabank children's saving plans: Gaztedi and Plan A, with programmes of activities, holiday camps, language courses, promotions, prize draws and competitions, all especially prepared for them.

Young people have once again been the focus of attention at Kutxabank: with commission-free products and preferential terms and conditions, such as the young person's salary account, mortgage and personal loan; with a programme of discounts and advantages associated with the K26 card called kutxabankplus for which almost 15,000 people have signed up; and with loyalty-building actions such as direct gifts to all customers on their birthdays and welcome gifts for this particular customer segment, among others, all under the umbrella of Kutxabank's youth brand**: kutxabankorner.eus**

As for **social networks**, the Kutxabank Group had obtained 170,871 followers by the end of 2017, representing growth of 23,107 followers, 23% more than in 2016. In 2017, 8,212 news stories were posted, more than 170 infographics were designed and over 400,000 interactions with followers were recorded. We have publicised our campaigns and activities on social networks and also use them to obtain opportunities for contacts and business. Of particular note in this respect is the strategy to capture leads or contacts for the mortgage offering.

The **@KBfinanzas Twitter** profile publishes financial news generated by Kutxabank's own activities, as well as news stories from the media, and also responds to any queries or concerns that the followers may have regarding this information. In addition, the **Kutxabankmedia.es blog** contains the most important news stories resulting from Kutxabank's activities, featuring highly elaborate infographics and an attractive design.

A blog aimed at companies called **"Magazine Kutxabank Empresas"** has also been launched, which aims to provide companies with useful information on the business world: current economic and financial affairs, access to our social media profiles, information on grants, economic and cash-related reports, infographics or financial bits, as well as current campaigns with easy-access forms for existing or potential customers, all the with aim of increasing the importance of results-oriented digital marketing. We send our business customers a newsletter each quarter that summarises news of interest and contains links to our blog.

In line with its strategic commitment to new technologies, the Kutxabank Group is taking up the **challenge of digitalisation,** conscious of the need to respond to changing and increasingly digital-minded customers. By the end of 2017, 34.3% of the Bank's customers were digital users, namely customers that operate mainly using the internet. The percentage increased by more than five points compared with 2016.

These developments are not just due to changes in customers' financial habits. It should also be noted that the Kutxabank Group has made a concerted effort to incorporate new technological solutions on an ongoing basis, while maintaining the priority of offering a higher value added service and the best experience for users. The adoption of the **"Agile" methodology,** combined with ongoing customer feedback, has enabled us to speed up the implementation processes for these new digital services.

Some of the **improvements and new features launched in 2017,** such as fingerprint or facial recognition access, checking correspondence using mobile banking (almost 22% of correspondence is now checked using mobiles), improvements in the management of bills, including payment using a mobile phone camera, or improvements in card functionalities, enabling them to be switched on and off and their limits managed, have been endorsed by positive reviews from our customers, who gave them a score of 4.18 out of 5.

In addition, the new remote management system serves as a technological support for specific customers of the Kutxabank Group, enabling us to attend to their needs in a closer and more personalised, convenient and accessible fashion. In parallel to this new interactive communication space, also worthy of note is the gradual incorporation of new remote electronic signature transactions into online banking and the implementation of this service in mobile and online business banking.

Analysing the behaviour of our digital customers in greater depth, the percentage of transactions and total accesses registered in the Kutxabank Group's online banking system shows that mobiles are the favourite device used by customers to access the digital banking channels, to the detriment of PCs. Of the 115.7 million accesses in 2017 (up 33%) through the Group's various portals and apps, 58% were on mobiles, a growing proportion that already exceeded 64% in December.

Also worthy of note in relation to online and mobile banking is their consolidation as strategic channels for arranging loans and financing. In this respect, 19% of all personal loans at the Bank were arranged online, bolstered since June when the types of transactions that could be financed using mobile banking and the related maximum amounts were extended, while, as indicated, mortgage loans originating from the internet are becoming increasingly significant. As regards the card purchases financed using Flexibuy, 72% were also made using these channels.

In business online banking, the acceptance and management of bills between companies (B2B debits) has become significantly easier, with the inclusion of SMS alerts which are sent when a new bill needs to be accepted or rejected, and there is notably also the possibility of financing international transfers, even partially. Also, the process to finance reverse factoring for non-customer suppliers has been improved and can now be performed automatically over the internet.

**Branch network**

At 31 December 2017, the Kutxabank Group had a network of 931 branches, of which 600 belonged to Kutxabank and 331 to CajaSur. The geographical distribution is as follows:

| BRANCH NETWORK | |
|---|---|
| **Autonomous community** | **KB GROUP** |
| **Basque Country** | **368** |
| *Bizkaia* | *184* |
| *Gipuzkoa* | *117* |
| *Araba* | *67* |
| **Andalusia** | **331** |
| *Córdoba* | *141* |
| *Jaén* | *56* |
| *Rest of Andalusia* | *134* |
| Madrid | 84 |
| Valencia Autonomous Community | 37 |
| Catalonia | 34 |
| Castilla-León | 14 |
| Cantabria | 13 |
| Aragon | 7 |
| Navarre | 10 |
| Galicia | 9 |
| La Rioja | 7 |
| Castilla-La Mancha | 6 |
| Murcia | 4 |
| Asturias | 3 |
| France | 4 |
| **Total** | **931** |

## 4. RISK MANAGEMENT

Maintaining an appropriate global risk profile is a key feature in managing the Kutxabank Group, since it ultimately provides the greatest guarantee for the continuity of its business activities over time and, therefore, of its contribution to society, especially through the dividends paid to its owners, the banking foundations.

In this regard, the strategic guidelines established by the Bank's governance bodies in relation to risk, which were included in the *Kutxabank Group Risk Appetite Framework,* set as a corporate objective the presentation of a medium-low risk profile, based on an appropriate risk management infrastructure (in terms of internal governance and the availability of material and human resources), a capital and liquidity base in line with its business model, and a prudent risk approval policy.

The aforementioned document complements the generic definition of the Bank's risk appetite level with the establishment of more specific qualitative and quantitative targets. On the qualitative side, the following basic features that should characterise the Group's risk profile are identified:

- The Group should base its business model on business lines that are viable at long term, supported by its structural strengths and managed with controlled risk levels
- The Group's governance structure should be closely aligned with prevailing international corporate governance standards, and should ensure that its governance bodies can discharge their risk management functions with the required standards of competence and independence
- The Group's risk management infrastructure should encompass all the types of risk to which it is exposed and include control frameworks proportional to their levels of complexity and significance
- The Group should hold a sufficient capital base to comply with the capital requirements associated with its risk portfolio from a three-fold perspective -regulatory, supervisory and internal-, in addition to having a capital buffer that is sufficient to ensure compliance in especially unfavourable scenarios
- The Group should maintain a financial structure that involves a moderate level of dependence on the wholesale financing markets and features sufficient available liquid assets and alternative sources of financing to guarantee compliance with its payment obligations over a prolonged period of time, even in particularly adverse liquidity scenarios

Also, the *Kutxabank Group Risk Appetite Framework* identifies various risk indicators that mirror, in a summarised fashion, changes in the Group's global risk profile, and for which corporate objectives and observation and warning thresholds are established which, if exceeded, would automatically trigger the related management protocols. By regularly monitoring changes in the risk indicators included in this *Central Set of Indicators*, the Bank's governance bodies secure access to a summarised, up-to-date view of changes in the Group's global risk profile.

The content of the guidelines for the internal governance of risk management at the Group is completed with the formalisation of various additional items:

- Establishment of General Risk Management Policies that include the Group's lines of action relating to the management of its global risk profile
- Definition of corporate risk categories
- Establishment of the main levels of responsibility to consider for each risk type
- Specific assignment of responsibilities within the Organisation, for each area of responsibility, resulting from the combination of the risk types defined and the levels of responsibility established
- Formulation of a policy for reporting risk-related matters to the market
- Approval of specific policy manuals for the most significant types of risk
- Design of a system to monitor changes in the various risk types

The internal governance of risk management under ordinary conditions, the basic guidelines of which are established in the Group's *Risk Appetite Framework*, is complemented with a governance model designed to address exceptional situations, which is contained in the

Group's Recovery Plan. This recovery plan addresses risk management under various hypothetical scenarios in which, following a sharp deterioration of its "vital signs", although they remain at levels compliant with the regulatory and supervisory capital adequacy and liquidity requirements, the Group would attempt to redress the situation using its own means, under an exceptional, autonomous management approach.

As regards the capital base with which the Group supports the risks to which it is exposed, it must be stated that, at 31 December 2017, the Kutxabank Group's total capital ratio, calculated in accordance with the specifications included in the transitional (phase-in) arrangements envisaged in current legislation, stood at 15.71%, higher than the 15.20% recorded at 2016 year-end and comfortably above the regulatory and supervisory requirement established by the ECB for the Kutxabank Group for 2018, which was set at 11.075% (including a Pillar 2 supervisory requirement of 1.20% and a capital conservation buffer of 1.875%).

As is already known, the new features of the calculation of the capital adequacy of financial institutions pursuant to the Capital Accord of December 2010 (known as Basel III), which were contained in Directive 2013/36/EU of the European Parliament and of the Council (known as CRD IV) and, most importantly, Regulation (EU) No 575/2013 of the European Parliament and of the Council (known as CRR), are subject to various phase-in periods. If the definitive regulatory specifications were applied as if the aforementioned phase-in periods had already elapsed (fully loaded version), the Kutxabank Group's total capital ratio would be 15.32%.

It is important to point out that the Group's total eligible capital consists of top quality capital (core tier one), and the regulatory and supervisory requirements established by the ECB for 2018 are for this ratio to be 7.575%.

When it comes to assessing the Kutxabank Group's capital adequacy position with respect to other financial institutions, it is essential to bear in mind that in order to calculate its risk-weighted assets the Group uses the standardised approaches envisaged in the legislation which, when compared with institutions that use internal models to perform this calculation, generally leads to higher levels of capital consumption for identical risk exposures. This methodological distortion does not affect the leverage ratio, which stood at 8.07% at 2017 year-end (compared with 8.09% in December 2016), comfortably above the average for the Spanish and European financial industries.

Mention must be made of the following in relation to the Group's main risk exposures in 2017:

<u>Credit risks (credit, counterparty, country and sovereign risk)</u>

As described in a preceding section of this report, the continuation in 2017 of the economic recovery initiated in previous years has translated into a notable fall in unemployment figures and has had a positive effect on the average level of quality of financial institutions' credit risk exposures.

In line with the economic and financial context, in 2017 the non-performing loans ratio of the Kutxabank Group's loans and receivables continued the fall initiated in 2016, and ended the year at 5.05%, well below the figure of 6.78% at 2016 year-end.

This non-performing loans ratio is comfortably below the average for the Spanish financial industry (8.08% for loans to other resident sectors in November, according to the latest available information), although the latter figure includes various significant impacts of exogenous origin, such as transfers of problem assets to the SAREB (2012 and 2013) or sales of non-performing assets to third parties.

In the case of the Kutxabank Group, a highly significant portion of its non-performing assets still relates to transactions with the property development sector that have not yet been settled, and to the residential mortgage portfolio, the default rate on which (3.22%) is also below the average for the Spanish financial industry.

Financial risks (liquidity, market, interest rate and foreign currency risk)

With regard to liquidity risk, the Kutxabank Group has a financing structure that is founded largely on its working capital and stable customer deposits. As a result, its use of wholesale financing is kept at manageable levels and is highly diversified in terms of finance providers and maturities.

In 2017 the Group continued to reduce its use of wholesale financing sources in line with the positive trend in its customer funding gap, reflecting the increase in customer deposits, as well as the net divestments in securities markets.

In addition, general conditions in the wholesale financing markets have continued to be extraordinarily favourable for entities seeking liquidity, which has made it possible to keep the finance costs associated with the financing provided to the Group at very low levels.

With respect to the market risk inherent to the Group's portfolios of listed equities, it should be noted that the divestments made by the Group throughout 2017 in relation to its portfolio of ownership interests significantly reduced its exposure to that risk, while also generating significant contributions to its statement of profit or loss.

In relation to interest rate risk, the Group continued to manage the maturity and repricing structure of its assets and liabilities in order to minimise the impact on its net interest income of the monetary policy implemented by the European Central Bank, which is based on low, or even negative, interest rates. These rates, which were at levels that had never been seen before, are designed to boost the financial viability of indebted economic agents and, in turn, the level of economic activity. However, at the same time, they make it considerably more difficult for financial institutions to obtain financial margins.

Other risks (operational, reputational, technological, strategic, pension-related and other risks)

Throughout 2017 the Kutxabank Group continued to work on the design and implementation of specific control frameworks for other categories of risk to which it is exposed owing to its corporate personality, albeit within certain proportionality parameters with respect to the complexity and importance of those risks.

## 5. CORPORATE SOCIAL RESPONSIBILITY

The Kutxabank Group is highly committed to corporate social responsibility matters, in keeping with its origin as a result of the integration of the Basque Country savings banks which, now transformed into banking foundations, are the Bank's shareholders (the owners of all of its share capital). Thanks mainly to the dividends received from the Group's financial activity, these foundations carry out their social, cultural, healthcare-related and educational activities.

This commitment is also displayed by Kutxabank in the annual publication of its sustainability report, which, available for consultation on its website, is in line with the international quality standards of the Global Reporting Initiative G4 Guidelines and is subject to audit by AENOR. The Group and the savings banks from which it originated were pioneers in the publication of corporate social responsibility reports more than ten years ago.

November 2017 saw the publication of Royal Decree-Law 18/2017 which, inter alia, amended the Spanish Commercial Code and the Limited Liability Companies Law, establishing the duty to present information on environmental and social issues, as well as on aspects concerning employees, respect for human rights and measures to combat corruption and bribery, with the ultimate aim of emphasising the importance of corporate social responsibility values as part of the public information made available by companies. The Kutxabank Group has developed these values since its very beginnings.

Strategically, the Kutxabank Group focuses on putting into practice a local banking model, centred on the retail segment, which enables it to have a positive influence on the environment in which it carries on its activity and generate profits that help maintain its shareholders' welfare projects, applying risk criteria that ensure its continuity over time. The following should be highlighted in relation to the various aspects identified in Royal Decree-Law 18/2017:

- Combined with its participation in activities to preserve the natural, historical and cultural environment, the Kutxabank Group's commitment to environmental sustainability has been reflected in the improvements made to energy efficiency in its day-to-day activities, through its ongoing review of its energy consumption and the continuous process of reducing the use of paper.
- In relation to social welfare matters, the dividend that will be distributed to the Bank's banking foundation shareholders out of 2017 profit will be EUR 151 million, and around EUR 500 million have been distributed since it was incorporated in 2012, representing the largest contribution to welfare projects -according to the Bank's size- in the whole of Spain.
  The study of the Group's economic impact was prepared for the first time in 2017. It reflects its significant impact on wealth creation in terms of employment, maintenance of suppliers, contribution to public finances and, in short, the part it plays in bringing wealth to the territories where it has a presence.
- With regard to employment-related issues, in 2016 Kutxabank's new Equal Opportunities Plan was approved with a majority trade union vote in favour. The plan is underpinned by the large strides already made by the Basque Country savings banks in this area and its guiding principle consists of continuing to ensure equal opportunities in the workplace. This commitment means applying a series of measures to make progress in terms of respect for people, their dignity, integrity and achieving a good work-life balance.
- In the area of corruption and bribery the Group has processes and procedures in place, in compliance with current legislation, the preparation, monitoring and control of which are the responsibility of the Regulatory Compliance area, reporting directly to the office of the Group's Executive Chairman which, in turn, reports directly to Kutxabank's Board of Directors and Audit and Compliance Committee.

Each year the Group's sustainability report explains the results of these policies, which are audited by an independent expert.

The Annual Corporate Governance Report included in the last point of this consolidated directors' report contains information on the Board of Directors diversity policy. On this issue, it should be noted that the Kutxabank Group complies with the recommendations in the Spanish Unified Code of Good Governance since it has the following:

- a policy to assess the suitability of the members of the Board of Directors, general managers or similar-level personnel, managers in charge of internal control functions and other key positions at the Group, in accordance with the applicable legislation (Law 10/2014, of 26 June, on the regulation, supervision and capital adequacy of credit institutions, and the related implementing regulations) and
- a policy for the selection of candidates for appointment as members of the Board of Directors. These policies ensure that the appointment and re-election proposals are based on a prior analysis of the needs of the Board of Directors and favour diversity with respect to knowledge, experience and gender.

KUTXABANK, S.A. also has a policy on the representation target for the least represented gender on the Board of Directors of KUTXABANK, S.A., which includes the need to increase the percentage of women on the Board, currently at 18.75%, subject to the evolution of the Bank and the existence of vacancies.

## 6. RESEARCH AND DEVELOPMENT

The Kutxabank Group continued to implement a policy of capitalising on technological resources, which has led to improved efficiency and enhanced process rationalisation. Software was developed to provide cost savings, improve the quality of the service provided to customers and meet new technological and functional renewal needs. The Group continued to train its workforce and to adapt it to the new business requirements, thus ensuring the ongoing development of its professionals.

To facilitate this process, a training development strategy focusing on continuous learning, professional development and harnessing the latest technologies was implemented.

## 7. OUTLOOK FOR 2018

The Kutxabank Group's equity and capital adequacy position, its tried and tested low-risk local banking business model focused on individual customers and SMEs and its proven capacity to generate recurring income place it in an excellent position to face up to and overcome the challenges and difficulties in store in 2018. The organisation's efforts will centre on complying with the commercial and business objectives set in the Group's Business Development Plan for 2015-2019.

## 8. EVENTS AFTER THE REPORTING PERIOD

IFRS 9, Financial Instruments came into effect on 1 January 2018. This is a new standard which has an impact on the classification and measurement of financial instruments. Explanatory Note XX to the consolidated financial statements provides information on the main impacts of first-time application.

The other events that took place from 2017 year-end to the date on which these consolidated financial statements were authorised for issue are explained in explanatory Note 13 to the consolidated financial statements.

## GLOSSARY ATTACHED TO THE DIRECTORS' REPORT

In addition to the financial information contained in this document, prepared in accordance with International Financial Reporting Standards (IFRSs), certain Alternative Performance Measures (APMs) are included, as defined in the Guidelines on Alternative Performance Measures published by the European Securities and Markets Authority on 30 June 2015 (ESMA/2015/1057 ESMA Guidelines on Alternative Performance Measures).

The ESMA guidelines define an APM as a financial measure of historical or future financial performance, financial position, or cash flows, other than a financial measure defined or specified in the applicable financial reporting framework.

The additional disclosures provided by these APMs used by the Kutxabank Group give the reader additional information but they do not substitute the information prepared in accordance with IFRSs. The way in which the Kutxabank Group defines and calculates its APMs may differ from the definitions and calculations of other comparable companies.

Set forth below is the detail of the APMs used and how they are calculated:

*ALTERNATIVE PERFORMANCE MEASURES*

| ALTERNATIVE PERFORMANCE MEASURES | |
|---|---|
| **Non-Performing Loans Ratio** | Quotient resulting from: (Numerator) Total gross non-performing assets relating to "Loans and Receivables - Gross"; (Denominator) Total "Loans and Receivables - Gross". Confidential consolidated sources. |
| **Non-Performing Loans Coverage Ratio** | Quotient resulting from: (Numerator) Total Impairment Losses on "Loans and Receivables - Gross" ; (Denominator) Total gross non-performing assets relating to "Loans and Receivables - Gross". Confidential consolidated sources. |
| **Non-Performing Loans Ratio including Off-Balance Sheet Items** | Quotient resulting from: (Numerator) Total gross non-performing assets relating to "Loans and Receivables - Gross" + Total gross non-performing assets relating to Contingent Liabilities - included in memorandum items- ; (Denominator) Total "Loans and Receivables - Gross" + Total Contingent Liabilities. Confidential consolidated sources. |
| **Non-Performing Loans Ratio excluding NPLs relating to the Real Estate Business** | Quotient resulting from: (Numerator) Total gross non-performing assets relating to "Loans and Receivables - Gross" excluding those relating to the construction and property development segment (); (Denominator) Total "Loans and Receivables - Gross" excluding lending to that same segment. Confidential consolidated sources and own management data. |
| **Efficiency Ratio** | Quotient resulting from: (Numerator) Administrative Expenses and Amortisation and Depreciation Charge; (Denominator) Gross Income. Public consolidated sources. Moving average for last four quarters. |
| **Operating Expenses/Average Total Assets** | Quotient resulting from: (Numerator) Administrative Expenses and Annualised Amortisation and Depreciation Charge - public consolidated sources-; (Denominator) Average Total Assets - moving average for the last four quarters per confidential consolidated sources- |
| **Average Total Assets** | Moving average of the quarterly observations of "Total Assets" between the last quarter of the preceding year and the reference quarter (the values of the beginning and ending observations are weighted by 50%)- Confidential consolidated sources- |

## *RECONCILIATION OF MANAGEMENT INDICATORS TO THE CONSOLIDATED FINANCIAL STATEMENTS*

| RECONCILIATION OF MANAGEMENT INDICATORS TO CONSOLIDATED FINANCIAL STATEMENTS | |
|---|---|
| **Net Fee and Commission Income / Service Income** | Includes "Fee and Commission Income" and "Fee and Commission Expenses" in the public consolidated statement of profit or loss |
| **Net Income from Transactions with Customers** | Includes "Net Interest Income", "Fee and Commission Income" and "Fee and Commission Expenses" in the public consolidated statement of profit or loss |
| **Net Gains/Losses on Financial Assets and Liabilities and Exchange Differences** | *Includes the following public consolidated statement of profit or loss headings:* |
| | Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net |
| | Gains or losses on financial assets and liabilities held for trading, net |
| | Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net |
| | Gains or losses from hedge accounting, net |
| | Exchange differences, net |
| **Other Operating Income and Expenses** | *Includes the following public consolidated statement of profit or loss headings:* |
| | Other operating income |
| | Other operating expenses |
| | Income from assets under insurance and reinsurance contracts |
| | Expenses of liabilities under insurance and reinsurance contracts |
| **Operating Expenses** | Includes the administrative expenses and depreciation and amortisation charge headings of the public consolidated statement of profit or loss |
| **Profit from Operations** | Includes the gross income, administrative expenses and depreciation and amortisation charge headings of the public consolidated statement of profit or loss |
| **Provisions (net)** | Equivalent to "Provisions or reversal of provisions" in the public consolidated statement of profit or loss |
| **Impairment Losses on Financial Assets** | Equivalent to "Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss" in the public consolidated statement of profit or loss |
| **Impairment Losses on Other Assets** | Includes "Impairment or reversal of impairment of investments in joint ventures and associates" and "Impairment or reversal of impairment on non-financial assets" in the public consolidated statement of profit or loss |
| **Other Gains and Losses** | *Includes the following public consolidated statement of profit or loss headings:* |
| | Gains or losses on derecognition of non-financial assets and investments, net |
| | Profit or loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations |
| **Other Gains and Losses - Other** | *Includes the following public consolidated statement of profit or loss headings:* |
| | Gains or losses on derecognition of non-financial assets and investments, net |
| | "Profit or loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations" excluding "Impairment losses on non-current assets held for sale (tangible assets)" included in this heading per confidential consolidated sources- |
| **Insurance Business** | *Includes the following public consolidated statement of profit or loss headings:* |
| | Income from assets under insurance and reinsurance contracts |
| | Expenses of liabilities under insurance and reinsurance contracts |
| **Write-downs** | *Includes the following public consolidated statement of profit or loss headings:* |
| | Provisions or reversal of provisions |
| | Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss |
| | Impairment or reversal of impairment of investments in joint ventures and associates |
| | Impairment or reversal of impairment on non-financial assets |
| | Impairment losses on non-current assets held for sale (tangible assets) included under "Profit or loss from non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations" - Calculated on the basis of confidential consolidated sources- |
| **Cash or Near-Cash Assets** | *Includes the following public consolidated balance sheet headings:* |
| | Cash, cash balances at central banks and other demand deposits |
| | Loans and advances- Central banks |
| | Loans and advances- Credit institutions |
| **Loans and Advances to Customers** | Loans and advances- Customers in the public consolidated balance sheet |
| **Loans and Receivables - Net** | Loans and advances- Customers excluding Other financial assets in the public consolidated balance sheet |
| **Loans and Receivables - Gross** | Loans and advances- Customers excluding Other financial assets and the Valuation adjustments to the heading -public consolidated balance sheet- |
| **Financial Asset Portfolio** | *Includes the following public consolidated balance sheet headings:* |
| | Financial assets designated at fair value through profit or loss |
| | Available-for-sale financial assets |
| | Held-to-maturity investments |
| | Investments in joint ventures and associates |
| **Fixed-Income Portfolio** | *Includes the following public consolidated balance sheet headings:* |
| | Financial assets designated at fair value through profit or loss - Debt securities |
| | Available-for-sale financial assets - Debt securities |
| | Held-to-maturity investments |
| **Equity Securities Portfolio** | *Includes the following public consolidated balance sheet headings:* |
| | Other equity instruments (equivalent to "Equity instruments" in the balance sheet) under Financial assets designated at fair value through profit or loss |
| | Other equity instruments (equivalent to "Equity instruments" in the balance sheet) under Available-for-sale financial assets |
| | Investments in joint ventures and associates |
| **Short-Term Financial Liabilities** | *Includes the following public consolidated balance sheet headings:* |
| | Financial liabilities at amortised cost - Deposits - Central banks |
| | Financial liabilities at amortised cost - Deposits - Credit institutions |
| **Customer Funds under Management** | Financial liabilities at amortised cost - Deposits - Customers in the public consolidated balance sheet |
| | Less mortgage-backed bonds recognised under Deposits - Customers (due to their wholesale nature) |
| | Plus off-balance-sheet funds (investment funds, EPSVs and pension funds, combined insurance and other) |

# ANNUAL CORPORATE GOVERNANCE REPORT OF OTHER ENTITIES, APART FROM SAVINGS BANKS, WHICH ISSUE SECURITIES TRADED ON OFFICIAL MARKETS

IDENTIFICATION DETAILS OF THE ISSUER

| | |
|---|---|
| **END DATE OF THE REFERRED FINANCIAL YEAR** | 2017/12/31 |

| | |
|---|---|
| **Corporate Tax Code** | A95653077 |

| **BUSINESS NAME** |
|---|
| KUTXABANK, S.A. |

| **REGISTERED OFFICE** |
|---|
| CALLE GRAN VÍA 30-32 (BILBAO) BIZKAIA |

**ANNUAL CORPORATE GOVERNANCE REPORT OF OTHER ENTITIES, APART FROM SAVINGS BANKS, WHICH ISSUE SECURITIES TRADED ON OFFICIAL MARKETS**

## A PROPERTY STRUCTURED

A.1 List the entity's main shareholders or interest holders at year end:

| Name or business name of the shareholder or interest holder | % of share capital |
|---|---|
| CAJA DE AHORROS DE VITORIA Y ÁLAVA -ARABA ETA GASTEIZKO AURREZKI KUTXA, FUNDACIÓN BANCARIA | 11% |
| FUNDACIÓN BANCARIA KUTXA – KUTXA BANKU FUNDAZIOA | 32% |
| BILBAO BIZKAIA KUTXA FUNDACIÓN BANCARIA - BILBAO BIZKAIA KUTXA BANKU FUNDAZIOA | 57% |

A.2 Indicate, where relevant, any relationships of a family, commercial, contractual or business nature between any main shareholders or interest holders, where known by the entity, except for those that are of little significance or which derive from the normal course of business:

A.3 Indicate, where relevant, any relationships of a family, commercial contractual or business nature between main shareholders or interest holders, and the entity, unless they are of little significance or are derived from the ordinary course of business.

| Names or corresponding business names |
|---|
| BILBAO BIZKAIA KUTXA FUNDACIÓN BANCARIA - BILBAO BIZKAIA KUTXA BANKU FUNDAZIOA |

**Type of relationship:** Contractual
**Brief description:**
Service provision contract

| Names or corresponding business names |
|---|
| FUNDACIÓN BANCARIA KUTXA-KUTXA BANKU FUNDAZIOA |

**Type of relationship:** Contractual
**Brief description:**
Service provision contract

| Names or corresponding business names |
|---|
| CAJA DE AHORROS DE VITORIA Y ÁLAVA -ARABA ETA GASTEIZKO AURREZKI KUTXA, FUNDACIÓN BANCARIA |

**Type of relationship:** Contractual
**Brief description:**
Service provision contract

## A.4 Indicate whether there are any restrictions on exercising voting rites, as well as restrictions on acquiring or transferring ownership interests in the share capital:

YES ☐ No ☒

# B GENERAL MEETING OR EQUIVALENT BODY

## B.1 State the quorum required to constitute the general meeting or equivalent body, as established in the articles of association. Describe in which is differentiated of the regime of minimum considered in the Act of Corporations or the regulations that him out of application. Describe any differences with respect to the minimums laid down in the Spanish Companies Law or applicable regulations.

As established in article 18 of the articles of association, the ordinary or extraordinary meeting of shareholders will be deemed properly constituted in the first sitting when the shareholders present, or represented, hold at least twenty-five percent (25%) of the subscribed share capital with voting rights. The meeting shall be deemed constituted in the second sitting, regardless of the amount of share capital present. This is without prejudice to the special quorum requirements that may established at any given moment by applicable legislation or the articles of association, according to whichever is more demanding.

## B.2 Explain the regime for adopting corporate resolutions. Describe any differences with respect to the Companies Act or any other regulations that may be applicable.

In accordance with article 20.2 of the articles of association, agreements will generally be adopted by an ordinary majority of shareholders present or represented at the meeting. Nevertheless, the following resolutions can only be adopted at the general meeting if voted for by at least fifty-nine percent (59%) of holders of subscribed share capital with voting rights that are present or represented.

(i) The increase of the share capital with full or partial suppression of the right of preference and the reduction of the share capital. An exception is made if capital increases are made to comply with applicable regulations, or if required by supervisory authorities. In any case, pre-emptive rights are recognised under the terms laid out by applicable law.
(ii) The issuance of convertible bonds, options, warrants or any other securities that entitle the holder to acquire or subscribe to shares.
(iii) Transformation, merger, demerger, dissolution or global transfer of assets and liabilities.
(iv) The determination of a number of directors, within the minimum and maximum parameters established in article 25 of the articles of association.
(v) Any modifications to the articles of association.

The foregoing is without prejudice to special majority requirements that may be established at any given time by applicable legislation where these prove more demanding.

The above-mentioned majorities differ, as they are more demanding, from those indicated in article 201 of the Companies Law, in accordance with which the resolutions outlined in the previous points (except for point IV, which, by regulations, is subject to a lower majority) will be adopted by absolute majority in the event that the present or represented share capital exceeds 50%, and by a favourable vote of at least 2/3 of present or represented share capital in the event that, at the second sitting, the meeting is attended by shareholders that represent 25% or more of subscribed share capital with voting rights, without reaching 50%.

## B.3. Summarise the resolutions adopted by the general meetings or equivalent bodies that were held during the financial year referred to in the present report, and the percentage of votes with which such resolutions were adopted (maximum 4000 characters).

* On 3 May 2017 the Annual General Meeting of shareholders was held as a universal meeting, which unanimously adopted the following resolutions, among others:

- To approve the individual and consolidated annual accounts of the company, the appropriation of earnings and the approval of the corporate management for the financial year ended 31 December 2016.

-To reappoint Deloitte, S.L. as the KUTXABANK, S.A.'s auditor for the individual and consolidated accounts corresponding to financial year 2017.

- Acknowledge KUTXABANK, S.A.'s Board of Directors proposal of (i) renewing Juan María Ollora Ochoa de Aspuru, for the term set forth in the articles of association, and (ii) name Jorge Hugo Sánchez Moreno, for the term set forth in the bylaws, as members of the Board of Directors of KUTXABANK, S.A.
- Acknowledge the appointments as member of certain delegate committees held by the Board of Directors of KUTXABANK, S.A., conditioned to the effective renewal/appointment of the directors referred to in the previous paragraph by the General Shareholders' Meeting.
- KUTXABANK, S.A. (and, therefore, as Second Vice-President and member of the Executive Committee of Risk Control).
- Renew Juan María Ollora de Aspuru, for the term set forth in the articles of association, as member of the Board of Directors.
- Confirm the allowance regime for attendance, for financial year 2017, corresponding to the performance of duties of the directors, in the terms approved by the General Shareholders' Meeting held on 28 November 2014, and partially amended, by means of the agreement adopted by the General Meeting on 28 May 2015 and 30 June 2016.

* An extraordinary universal general shareholders meeting was held on **28 June 2017** that adopted, among others, the following agreements:

- Renew, prior proposal by the Board of Directors of KUTXABANK, S.A., José Miguel Martín Herrera as member of Kutxabank's Board of Directors, for the term set forth in the articles of association.
- Name, for the term foreseen in the articles of association, Jorge Hugo Sánchez Moreno as member of the Board of Directors of KUTXABANK, S.A.
- Approve as Merger Balance regarding the operation subsequently referred to, the balance sheet closed on 31 December 2016 of the companies participating in the merger: KUTXABANK, S.A., as the absorbing company and Kartera 2, S.L.U. and Kartera 4, S.A.U., as absorbed companies, and approve the Common Merger Project.
- Approve the merger through absorption of Kartera 2, S.L.U. and Kartera 4, S.A.U. (absorbed companies by KUTXABANK, S.A. (absorbing company) in strict accordance with the Common Merger Project, and receive the operation referred to in the special tax regime foreseen for this type of operations.

* An extraordinary universal general shareholders meeting was held on **28 December 2017** that unanimously adopted, among others, the following agreements:

- Distribute an interim dividend for financial year 2017, for a total amount of ONE HUNDRED AND FIFTEEN MILLION FOUR HUNDRED AND TWENTY TWO THOUSAND EUROS (115,422,000.00 €).

### B.4 State the address and the means of access to corporate governance content on the entity's website.

www.kutxabank.com

### B.5 Indicate whether meetings have been held between any trade unions and holders of securities issued by the company, the purpose of such meetings held in the financial year and the primary resolutions adopted.

No syndicate of bondholders meetings were held during 2017, nor any similar meetings.

# C ORGANISATIONAL STRUCTURE OF THE ENTITY

## C.1 BOARD OR GOVERNING BODY

### C.1.1 State the maximum and minimum numbers of board members, as indicated in the articles of association:

| | |
|---|---|
| MAXIMUM NUMBER OF DIRECTORS | 20 |
| MINIMUM NUMBER OF DIRECTORS | 10 |

### C.1.2 Complete the following table of board members, indicating their positions:

## DIRECTORS/MEMBERS OF THE BOARD OF DIRECTORS

| NAME OR BUSINESS NAME OF THE DIRECTOR/MEMBER OF THE BOARD OF DIRECTORS | WHERE APPLICABLE, THE NAME OF THE REPRESENTATIVE | DATE OF MOST RECENT APPOINTMENT |
|---|---|---|
| MR JOSÉ ANTONIO RUIZ-GARMA MARTÍNEZ | | 2016/06/30 |
| MR FRANCISCO JAVIER GARCÍA LURUEÑA | | 2015/05/28 |
| MR JOSEBA MIKEL ARIETA-ARAUNABEÑA BUSTINZA | | 2016/06/30 |
| MR GREGORIO VILLALABEITIA GALARRAGA | | 2014/11/28 |
| MR JOSU DE ORTUONDO LARREA | | 2016/06/30 |
| MR CARLOS AGUIRRE ARANA | | 2014/03/26 |
| MS MARÍA VICTORIA MENDIA LASA | | 2016/06/30 |
| MS ROXANA MEDA INORIZA | | 2016/06/30 |
| MR JOSÉ MIGUEL MARTÍN HERRERA | | 2017/07/28 |
| MR XABIER GOTZON ITURBE OTAEGI | | 2016/06/30 |
| MR JUAN MARÍA OLLORA OCHOA DE ASPURU | | 2017/05/03 |
| MR ANTONIO VILLAR VITORES | | 2016/06/30 |
| MS MANUELA ESCRIBANO RIEGO | | 2016/06/30 |
| MR ALEXANDER BIDETXEA LARTATEGI | | 2016/06/30 |
| MR JESÚS Mª HERRASTI ERLOGORRI | | 2016/06/30 |
| MR JORGE HUGO SÁNCHEZ MORENO | | 2017/07/28 |

C.1.3 Name any members of the board of directors or governing body that hold office as directors or officers of any other entities that form part of the entity's group:

| NAME OR BUSINESS NAME OF THE MEMBER OF THE BOARD OF DIRECTORS | BUSINESS NAME OF THE ENTITY WITHIN THE SAME GROUP | POSITION |
|---|---|---|
| MR JOSÉ ANTONIO RUIZ-GARMA MARTÍNEZ | KUTXABANK EMPRÉSTITOS, S.A.U. | DIRECTOR |
| MR JOSÉ ANTONIO RUIZ-GARMA MARTÍNEZ | KARTERA 1, S.L. | DIRECTOR |
| MR FRANCISCO JAVIER GARCÍA LURUEÑA | FINECO SOCIEDAD DE VALORES, SA | DIRECTOR |
| MR FRANCISCO JAVIER GARCÍA LURUEÑA | KUTXABANK EMPRÉSTITOS, S.A.U. | DIRECTOR |
| MR FRANCISCO JAVIER GARCÍA LURUEÑA | CAJASUR BANK, S.A.U. | DIRECTOR |
| MR FRANCISCO JAVIER GARCÍA LURUEÑA | KARTERA 1, S.L. | DIRECTOR |
| MR JOSEBA MIKEL ARIETA-ARAUNABEÑA BUSTINZA | KUTXABANK EMPRÉSTITOS, S.A.U. | DIRECTOR |
| MR JOSEBA MIKEL ARIETA-ARAUNABEÑA BUSTINZA | KARTERA 1, S.L. | DIRECTOR |
| MR GREGORIO VILLALABEITIA GALARRAGA | KUTXABANK EMPRÉSTITOS, S.A.U. | CHAIRMAN OF THE BOARD |
| MR GREGORIO VILLALABEITIA GALARRAGA | KARTERA 1, S.L. | CHAIRMAN OF THE BOARD |
| MR JOSÉ MIGUEL MARTÍN HERRERA | KUTXABANK EMPRÉSTITOS, S.A.U. | DIRECTOR |
| MR JOSÉ MIGUEL MARTÍN HERRERA | KARTERA 1, S.L. | DIRECTOR |
| MR XABIER GOTZON ITURBE OTAEGI | KUTXABANK EMPRÉSTITOS, S.A.U. | DIRECTOR |
| MR XABIER GOTZON ITURBE OTAEGI | KARTERA 1, S.L. | DIRECTOR |
| MR JUAN MARÍA OLLORA OCHOA DE ASPURU | KUTXABANK EMPRÉSTITOS, S.A.U. | DIRECTOR |
| MR JUAN MARÍA OLLORA OCHOA DE ASPURU | KARTERA 1, S.L. | DIRECTOR |
| MR JORGE HUGO SÁNCHEZ MORENO | KUTXABANK EMPRÉSTITOS, S.A.U. | DIRECTOR |
| MR JORGE HUGO SÁNCHEZ MORENO | KARTERA 1, S.L. | DIRECTOR |

C.1.4 Complete the following table with information about the number of directors that comprise the Board of Directors and its Committees, as well as their evolution of the last four financial years.

| | Number of directors | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | YEAR 2017 | | YEAR 2016 | | YEAR 2015 | | YEAR 2014 | |
| | Nunber | % | Nunber | % | Nunber | % | Nunber | % |
| Board of Directors | 3 | 18.75% | 3 | 18.75% | 3 | 18.75% | 3 | 20.00% |
| Audit and Compliance Commission | 3 | 60.00% | 3 | 60.00% | 1 | 33.30% | 1 | 33.30% |
| Risk Control Committee | 1 | 14.28% | 1 | 14.28% | 1 | 16.66% | 1 | 16.66% |
| Appointments Committee | 1 | 25.00% | 1 | 25.00% | 1 | 25.00% | 1 | 25.00% |
| Remuneration Committee | 1 | 25.00% | 1 | 25.00% | 2 | 50.00% | 2 | 50.00% |
| Executive Committee | 0 | 0.00% | 0 | 0.00% | 0 | 0.00% | 0 | 0.00% |

C.1.5 Complete the following table regarding the aggregate remuneration of directors or members of the board of directors throughout the year:

| REMUNERATION ITEM | INDIVIDUAL (THOUSANDS OF EUROS) | GROUP (THOUSANDS OF EUROS) |
|---|---|---|
| FIXED REMUNERATION | 1,336 | 0 |
| VARIABLE REMUNERATION | 357 | 0 |
| ALLOWANCES | 561 | 0 |
| OTHER REMUNERATION | 0 | 0 |
| TOTAL | 2,254 | 0 |

C.1.6 Name any members of senior management who are not directors or executive members of the board of directors, and indicate their total remuneration throughout the year:

| Name or business name | Charge |
|---|---|
| MR FERNANDO MARIA IRIGOYEN ZUAZOLA | General Manager of Wholesale Business |
| MR JOSÉ ALBERTO BARRENA LLORENTE | Deputy Corporate General Manager Financial and group |
| MS MARÍA ALICIA VIVANCO GONZÁLEZ | General Manager of Subsidiaries |
| MR EDUARDO RUÍZ DE GORDEJUELA PALACIO | General Manager of Retail Business |
| MR FERNANDO MARTÍNEZ JORCANO EGUILUZ | Deputy Corporate General Manager media |

| | |
|---|---|
| Total remuneration for senior management (thousands of euros) | 1,560 |

C.1.7 State whether the articles of association or the regulations of the board establish a limited term for directors or members of the board:

YES [X] NO

| | |
|---|---|
| **Maximum number of years in office** | **4** |

C.1.8 State whether the individual or consolidated annual accounts submitted to the board or governing body for approval are previously certified:

YES NO [X]

If so, name which person(s) certified the entity's individual or consolidated accounts for their preparation by the board of governing body.

C.1.9 Explain any mechanisms established by the board or governing body to prevent individual and consolidated accounts being presented to the general meeting or equivalent body, with qualifying statements in the auditor's report.

Continuous contact between the Departments of Finance and Internal Auditing with auditors, so as to strictly enforce accounting standards, and prior review by the Audit and Compliance Committee which, inter alia, is responsible for monitoring the process for the elaboration and presentation of regulated financial information.

C.1.10 Is the secretary to the Board of Directors or governing body also a director?

YES NO [X]

C.1.11 Indicate any mechanisms in place to preserve the independent nature of the auditor, of financial analysts, of investment banks and of rating agencies.

The Audit and Compliance Committee is responsible for, among other things, liaising with external auditors to obtain information on any issues that may jeopardise their independence, at the time of the Committee's inspection, as well as any other issues related to the process of developing and auditing accounts.

In any case, the aforementioned Committee_must receive from the Accounts Auditors the written confirmation of their independence from the Company or entities to which they are directly or indirectly linked on an annual basis, as well as information pertaining to additional services of any kind provided by these entities by the aforementioned auditors, or by the persons or entities to which they are linked, in accordance with the indications of audit legislation and technical auditing standards.

The Audit and Compliance Committee issues annual reports, prior to issuance of the auditor's report on the accounts, expressing an opinion on the independent nature of the auditors. In any event, this report should describe the rendering of any additional services other than the account audits.

## C.2 COMMITTEES OF THE BOARD OF DIRECTORS OR GOVERNING BODY

C.2.1 List all committees of the board of directors or governing body

| Name of the body | No. of members |
|---|---|
| **AUDIT AND COMPLIANCE COMMISSION** | **5** |
| **RISK CONTROL COMMITTEE** | **7** |

| | |
|---|---|
| APPOINTMENTS COMMITTEE | 4 |
| REMUNERATION COMMITTEE | 4 |
| EXECUTIVE COMMITTEE | 8 |
| Board of Directors | 16 |

C.2.2 Provide details regarding all committees of the Board of Directors or governing body and their members, as well as the number of executive, proprietary, independent and other external directors integrated therein (entities that do not have the legal form of a capital company will not fall under the category of director in the corresponding table, and in the accompanying text, the category of each director will be explained in accordance with their legal statuses and the manner in which such directors comply with the composition conditions of the audit committee as well as the committees for appointments and remunerations):

## EXECUTIVE OR DELEGATE COMMITTEE

| Name | charge | Category |
|---|---|---|
| MR JOSÉ ANTONIO RUIZ-GARMA MARTÍNEZ | MEMBER | INDEPENDENT DIRECTOR |
| MR FRANCISCO JAVIER GARCÍA LURUEÑA | MEMBER | EXECUTIVE DIRECTOR |
| MR JOSEBA MIKEL ARIETA-ARAUNABEÑA BUSTINZA | MEMBER | PROPRIETARY DIRECTOR |
| MR GREGORIO VILLALABEITIA GALARRAGA | CHAIRMAN | EXECUTIVE DIRECTOR |
| MR JOSÉ MIGUEL MARTÍN HERRERA | MEMBER | PROPRIETARY DIRECTOR |
| MR XABIER GOTZON ITURBE OTAEGI | MEMBER | EXECUTIVE DIRECTOR |
| MR JUAN MARÍA OLLORA OCHOA DE ASPURU | MEMBER | PROPRIETARY DIRECTOR |
| MR JORGE HUGO SÁNCHEZ MORENO | MEMBER | PROPRIETARY DIRECTOR |

| | |
|---|---|
| % of executive directors | 37.5% |
| % of proprietary directors | 50% |
| % of independent directors | 12.5% |
| % of other external directors | 0% |
| Number of meetings | 44 |

Explain the functions attributed to this committee, and describe the procedures and rules for the organisation and performance thereof, followed by a summary of its most important activities during the financial year.

In accordance with the Articles of Association and Regulations of the Board of Directors, the Executive Committee is responsible for carrying out all activities allocated by the Board of Directors.
On a recurring basis, (i) all financial operations that go beyond the framework of facilities delegated to the Company's management will be subject to approval by the Executive Committee, (ii) said committee will be informed of the evolution of markets and the cash situation of KUTXABANK, S.A.,, adopting any agreements that, if applicable, come from managing liquidity, (iii) the Committee will be informed of any operations regarding approved property, and its approval will be requested for any property sales or leasing operations that go beyond the framework of facilities delegated to the KUTXABANK, S.A., management, and (iv) the Committee will acknowledge and, if relevant, carry out any appropriate clarifications, with respect to regulation updates that may have taken place, and which may be of particular interest to the KUTXABANK, S.A.,'s business activity. The above takes place regardless of additional issues that may be put forward to the Committee while exercising its delegated activities.

## AUDIT COMMITTEE AND COMPLIANCE COMMISSION

| Name | charge | Category |
|---|---|---|
| MR CARLOS AGUIRRE ARANA | CHAIRMAN | INDEPENDENT DIRECTOR |
| MS MARÍA VICTORIA MENDIA LASA | SECRETARY | INDEPENDENT DIRECTOR |
| MS ROXANA MEDA INORIZA | MEMBER | INDEPENDENT DIRECTOR |

| | | |
|---|---|---|
| **MS MANUELA ESCRIBANO RIEGO** | **MEMBER** | **INDEPENDENT DIRECTOR** |
| **MR JESÚS Mª HERRASTI ERLOGORRI** | **MEMBER** | **PROPRIETARY DIRECTOR** |

| | |
|---|---|
| **% of proprietary directors** | **20.00%** |
| **% of independent directors** | **80.00%** |
| **% of other external directors** | **0%** |
| **Number of meetings** | **12** |

Explain the functions attributed to this committee, and describe the procedures and rules for the organisation and performance thereof, followed by a summary of its most important activities during the financial year.

In accordance with the Articles of Association and the Regulations of the Board of Directors, the Board of Directors will delegate an Audit and Compliance Committee, consisting in a minimum of three members and a maximum of five members. In accordance with the Audit and Compliance Committee Regulations, the Committee will have, inter alia, the following functions, as well as any others foreseen in the internal regulations of KUTXABANK, S.A. and applicable legislation: (i) informing the General Meeting and the Board of Directors about matters arising therein with regard to matters concerning their respective roles; (ii) monitoring the effectiveness of the KUTXABANK, S.A.'s internal control, internal auditing and risk management systems, as well as discussing any significant weaknesses in the internal control system detected during the audit process with the auditors; (iii) monitoring the process of preparing and presenting regulated financial reports; (iv) proposing the appointment of auditors to the Board of Directors, so that the latter can present this to the General Shareholders' Meeting, in accordance with applicable regulations. (v) establishing the appropriate relationships with Account Auditors' (vi) issuing a report on the independence of Account Auditors on an annual basis; and vii) informing the Board of Directors about any issues prescribed by Law, the articles of associations and the regulations of the Board.
In particular, regarding the issues dealt with by the Audit and Compliance Committee during financial year 2017, the following should be noted, inter alia: (i) financial and non-financial information and mechanisms associated to internal control (Annual Corporate Governance Report, SCIIF supervision Reports, Reports in the field of prevention of money laundering and terrorist financing (“PBCFT”), control Report on the Internal Regulations of Conduct and Communication of Suspicious Operations, periodic reports on the controls carried out by Regulatory Compliance, Mifid, LOPD, Bank Transparency Control Report, Customer Assets Protection Reports “IPAC’s” of the Group, Management and Annual Accounts Report, individual and consolidated, etc.); (ii) analysis of related party transactions; (iii) risk management and control (even though this function lies essentially in the hands of the Risk Control Committee, the Audit and Compliance Committee acknowledged of certain issues related with said subject area, such as the information document of Prudential Relevance, (iv) follow up of the IFRS9 implementation Project; (v) internal audit (quarterly reports on audit and consultancy work, capital and liquidity assessment process reports, Recovery Plan, etc.); (vi) external auditor (favourable opinion regarding accounts auditor independence, follow up of the external auditors’ fees, proposed appointing of auditors by KUTXABANK, S.A. and certain investee companies, follow up of the authorised and contracted services with the external auditor, (vii) approval and follow up of the Internal Auditing Plan and the Regulatory and Control Compliance Plan of the Group; (viii) follow up of the requirements carried out by the supervisors. All of the above is without prejudice to any other activities carried out, including those arising from relationships with auditors, to (i) discuss potential weaknesses in the internal control system and, on the other hand, (ii) receive information regarding any issues that may put the independence of said account auditors at risk.

Name the designated director member of the audit committee, indicating his or her knowledge and experience regarding accounting, auditing or both, and state how many years the Chairman of this committee has held the position.

| | |
|---|---|
| **Name of the director and corresponding experience** | MS MARÍA VICTORIA MENDIA LASA |
| **No. of years the chairman has held the position** | **2** |

## APPOINTMENTS COMMITTEE

| Name or business name | charge | Category |
|---|---|---|
| **MR JOSÉ ANTONIO RUIZ-GARMA MARTÍNEZ** | **MEMBER** | **INDEPENDENTDIRECTOR** |
| **MR JOSU DE ORTUONDO LARREA** | **MEMBER** | **PROPRIETARY DIRECTOR** |
| **MS MANUELA ESCRIBANO RIEGO** | **CHAIRMAN** | **INDEPENDENT DIRECTOR** |
| **MR ALEXANDER BIDETXEA LARTATEGI** | **SECRETARY** | **PROPRIETARY DIRECTOR** |

| | |
|---|---|
| **% of proprietary directors** | **50%** |
| **% of independent directors** | **50%** |
| **% of other external directors** | **0%** |
| **Number of meetings** | **7** |

Explain the functions attributed to this committee, and describe the procedures and rules for the organisation and performance thereof, followed by a summary of its most important activities during the financial year.

In accordance with the Articles of Association and the Regulations of the Board of Directors, the Appointments Committee will have, intra alia, general powers of proposal and reporting with respect to the appointment and removal of directors and senior managers.
In accordance with the regulations of the Appointments Committee, the Committee will have, inter alia, the following functions (in addition to those already foreseen in the internal regulations of KUTXABANK, S.A. and applicable legislation: (i) formulate and review the criteria that must be followed for the composition of the Board; (ii) formulate proposals for appointing and re-electing new directors; (iii) notify the appointments and dismissals of the top management; (iv) submit the Suitability Assessment Policy to the Board; (v) submit the assessment systems linked to the aforementioned policy to the Board; (vi) supervise the proper implementation of the aforementioned policy; (vii) assess the suitability of the candidates or members of the Board and other collectives subject to the referred policy; (viii) submit the training plans of the collectives subject to the aforementioned policy to the Board; (ix) set a representation target for the less represented gender in the Board; (x) assess the balance of knowledge, capacity, diversity and experience of the Board, and draft a description of the functions and skills required for specific appointments and (xi) regularly assess the structure, size, composition and performance of the Board of Directors. Furthermore, in the succession Plan of the Chairman, CEO and the other members of KUTXABANK, S.A.'s board of directors it is established that the Appointments Committee is responsible for (xii) revising the contents of the succession Plan annually, notify the aforementioned revision to the Board of Directors and, when applicable, propose the pertinent amendments. Specifically, regarding issues dealt with by the Appointments Committee during financial year 2017, it is worth noting, inter alia, the following: (i) formulate the proposed appointments and re-election of directors, as well as the new members of each one of the delegated committees; (ii) assess the suitability of directors, with regards to ratifying the suitability of pre-existing directors, as well as a new director (and member of one of the delegated committees) appointed during financial year 2017; (iii) annual assessment (and when changes occur in the composition of the Board) of the balance of knowledge, capacity, diversity and experience of the Board of Directors, (iv) submit a training plan and a reception plan for the new director; (v) suitability assessment of the person responsible for the Customer Care Service.; (vi) submit a succession plan for the Chairman, CEO and the rest of the members of KUTXABANK, S.A.'s Board of Directors and another plan for key staff; (vii) submit and amendment of the Suitability Assessment Policy; and (ix) submit a reception and training Programme for the members of KUTXABANK, S.A.'s Board of Directors.

## REMUNERATIONS COMMITTEE

| Name or business name | charge | Category |
|---|---|---|
| **MR JOSU DE ORTUONDO LARREA** | **SECRETARY** | **PROPRIETARY DIRECTOR** |
| **MS ROXANA MEDA INORIZA** | **MEMBER** | **INDEPENDENT DIRECTOR** |
| **MR ANTONIO VILLAR VITORES** | **CHAIRMAN** | **INDEPENDENT DIRECTOR** |
| **MR ALEXANDER BIDETXEA LARTATEGI** | **MEMBER** | **PROPRIETARY DIRECTOR** |

| | |
|---|---|
| **% of proprietary directors** | **50%** |
| **% of independent directors** | **50%** |
| **% of other external directors** | **0%** |
| **Number of meetings** | **5** |

Explain the functions attributed to this committee, and describe the procedures and rules for the organisation and performance thereof, followed by a summary of its most important activities during the financial year.

According to the articles of association and regulations of the Board of Directors the Remunerations Committee will have, inter alia, power to make proposals and reports in terms of remunerations. In accordance with the provisions of the Remunerations Committee's regulations, the Committee will have, inter alia, the following functions (in addition to any others foreseen in KUTXABANK, S.A.'s internal regulations and in applicable law): (i) submit the retribution system for the Board of Directors; (ii) submit the extent and amount of the remunerations, rights and compensations of the executive directors; (iii) submit to the Board of Directors the remuneration policy of the senior management; (iv) ensure the compliance of the remuneration policy of KUTXABANK, S.A.; and (v) ensure the transparency of remunerations. In particular, regarding issues dealt with by the Remunerations Committee in financial year 2017, it is worth noting, inter alia, the following: (i) the results of the variable remuneration of 2016 and the remuneration proposed for the management team in 2017; (ii) an independent expert assessment of the degree of suitability of KUTXABANK Group's remuneration policy regarding the regulatory framework; (iii) revision of the identified collective, in accordance with the prudential regulatory framework; (iv) analysis of the new regulatory framework and its impact on KUTXABANK Group's Remuneration Policy, and (v) adapting senior management contracts to the new regulatory framework.

## RISK CONTROL COMMITTEE

| Name or business name | charge | Category |
|---|---|---|
| MR JOSEBA MIKEL ARIETA-ARAUNABEÑA BUSTINZA | MEMBER | PROPRIETARY DIRECTOR |
| MR CARLOS AGUIRRE ARANA | MEMBER | INDEPENDENT DIRECTOR |
| MS MARÍA VICTORIA MENDIA LASA | CHAIRMAN | PROPRIETARY DIRECTOR |
| MR JOSÉ MIGUEL MARTÍN HERRERA | MEMBER | PROPRIETARY DIRECTOR |
| MR JUAN MARÍA OLLORA OCHOA DE ASPURU | SECRETARY | PROPRIETARY DIRECTOR |
| MR ANTONIO VILLAR VITORES | MEMBER | INDEPENDENT DIRECTOR |
| MR JORGE HUGO SÁNCHEZ MORENO | SECRETARY | PROPRIETARY DIRECTOR |

| | |
|---|---|
| % of proprietary directors | 57.14% |
| % of independent directors | 42.86% |
| % of other external directors | 0% |
| Number of meetings | 12 |

Explain the functions attributed to this committee, and describe the procedures and rules for the organisation and performance thereof, followed by a summary of its most important activities during the financial year.

According to the articles of association and the regulations of the Board of Directors the Risk Control Committee is tasked to carry out, inter alia, the following functions (in addition to those foreseen in KUTXABANK, S.A.'s internal regulations and the applicable legislation): (i) systematically revise exposures to the main types of risk; (ii) analyse and assess proposals regarding strategy and policies of risk control management; (iii) advise the Board of Directors on the propensity of global risk, current and future, and its strategy in this field; (iv) advise the Board about how nature, quantity, format and strategy of risks is determined; (v) advise the Board about how the nature, format and frequency of information on risks should be received by the Committee and the Board; (vi) revise and analyse KUTXABANK, S.A.'s risk map; (vii) check to see whether the prices of assets and liabilities offered to customers have fully taken into consideration KUTXABANK, S.A.'s business model and risk strategy; and (viii) check, without prejudice to the functions of the Remunerations Committee, whether the incentives foreseen in the remuneration system, take risk, capital, liquidity, and probability and opportunity of profits into consideration. In particular, regarding the issues dealt with by the Risk Control Committee during the financial year 2017, it's worth noting, enter alia, the following: (i) participation in the update and follow up of the risk appetite framework; (ii) participation in the drafting and formalization process of the capital self-assessment report and the liquidity self-assessment report; (iii) quarterly revision of the corporate risk scorecard; (iv) follow up of the evolution of solvency; (v) follow up of the recovery activity; (vi) analysis of the transparency exercise results; (vii) drawing up the Corporate Risk Map; (viii) follow up of the monographic information on the evolution of KUTXABANK Group's level of exposure of the main types of risk; (ix) participation in the drafting and formalization of the Recovery Plan and Resolution Pack; and (x) participation in the drafting and formalization of information of prudential relevance.

# D RELATED PARTY TRANSACTIONS AND INTRA-GROUP TRANSACTIONS

## D.1 List any relevant operations that implicate transactions between the entity or entities in its group, its shareholders, stakeholders, cooperative interest holders, holders of nominee rights or any other equivalent of the entity:

As relevant operations in this sense we note the distribution of dividends, service provision contract and financial costs and income with shareholders.

### D.2 List any transactions between the entity or entities in its group and the directors or members of the entity's governing body or senior managers.

It is not deemed necessary to report on this, given that operations are part of the ordinary business of the company, are carried out under normal market conditions and are of very little importance in giving a faithful picture of the company's assets and financial position.

### D.3 State any intra-group transactions

No transactions need to be reported, given that this refers to transactions between companies or entities in the same consolidated group, which have been eliminated in the preparation of consolidated financial statements and which form part of the ordinary business of the companies or entities with respect to their subject and conditions.

### D.4 Specify the mechanisms that have been established to detect, identify and resolve possible conflicts of interest arising between the entity and/or its group and directors or members of the governing body or senior managers

The mechanisms set forth in prevailing legislation and, in particular, articles 229 and 230 of the Spanish Companies Law.

In this regard, the KUTXABANK, S.A. has Regulations on conflicts of interest and related party transactions with directors, significant shareholders and senior executives and intra-group relations, which have been approved by the Board of Directors and determine the procedure to be followed in the following cases, in the framework of applicable legislation and KUTXABANK, S.A.'s Articles of Association:

(i) in situations whereby a conflict of interest arises between the KUTXABANK, S.A. or any Kutxabank Group company, "Group" being understood by the definition given in article 42 of the Commercial Code, and the direct or indirect personal interest of directors and/or persons related to them, or persons subject to conflict of interest regulations;

(ii) in situations in which a conflict of interest arises, directly or indirectly, between different companies of the KUTXABANK Group;

(iii) in the case of transactions which KUTXABANK Group carries out with the Directors of KUTXABANK, S.A. –and/or persons linked to them-, with persons subject to conflict of interest rules or with significant shareholders; and

(iv) in relation to the transactions that take place, or to agreements entered into, between companies of the KUTXABANK Group.

The above-mentioned Regulations also implement the provisions of the Regulations of the Board of Directors (articles 29 to 34) and are complementary to the provisions of the Internal Code of Conduct for the Securities Market (article 30), which provides detailed regulations on the rules of conduct for the securities market, to be observed by the members of the Board of Directors, the Management Committee and other managers and employees of the KUTXABANK, S.A..

## E RISK CONTROL AND MANAGEMENT SYSTEMS

### E.1 Explain the scope of the Entity's Risk Management System.

KUTXABANK, S.A. sets out the broad lines of the risk management system applicable to its consolidated group of credit institutions in its Risk Appetite Policy Manual, the latest edition of which was formally approved by its Board of Directors at a meeting on 30 March 2017 (on 30 November 2017 the Board of Directors approved a partial revision of the document).

In this document the governing bodies set out the strategic guidelines of the KUTXABANK Group on matters of risk management and the main elements applicable to risk management and control, including the following:

- General risk management policies
- Types of corporate risk
- Levels of responsibility applicable to each type of risk
- Specific allocation of responsibilities for each type of risk
- Market information policy as regards risks

- The specific policy manuals for the most relevant types of risk

The risk management system therefore seeks to cover all the risks to which the KUTXABANK consolidated group of credit institutions is exposed, and applies to the whole group.

The level of implementation of the various control frameworks that make up the system varies according to the importance of each type of risk at each KUTXABANK Group, in line with the principle of proportionality

## E.2 Identify the bodies of the entity responsible for developing and implementing the Risk Management System.

The Risk Appetite Policy Manual of KUTXABANK Group establishes different responsibilities in the field of risk management and control, on three main levels:

- The decision-making level, where the main lines of action to be followed for each type of risk are determined and the most important decisions are made.
- The management level, where the functions related to the specific management of each type of risk are implemented.
- The supervision level, through which KUTXABANK Group ensures that its control frameworks are compliant with current regulations, with the main industry standards and with the strategic guidelines in force.

At the decision-making level general responsibility for each type of risk is held by the Board of Directors of KUTXABANK, S.A., which exercises that responsibility through the functions assigned to it in such matters under its regulations. To that end, it is assessed on strategic and policy matters by the Risk Control Committee, while the approval of specific operations is delegated to the Executive Committee.
Responsibility for managing the overall risk profile of the KUTXABANK Group therefore lies ultimately with the Board of Directors of KUTXABANK, S.A.

At this decision level and with regard to the executive function area, main decisions concerned with the management and control of the different types of risk are assigned to a number of specialist committees (the Risk Committee, the Assets & Liabilities Committee, the Operational Risk Committee, etc.) or to the Management Committee itself when there is no specialist body in place for the type of risk in question

At the management level, responsibilities for implementing the various functions are assigned differently within each control framework, and are not specified in the Risk Appetite Policy Manual, which is more general in nature. Specific responsibility for the coordination of each control framework is, however, assigned to a single area per risk type.

Finally, at the supervision level responsibilities for validating the various frameworks of control and assessment of the overall risk profile of Grupo KUTXABANK are assigned to the Overall Risk Control area, while the Internal Audit Department takes responsibility for checking that the functions envisaged in each control framework are implemented as per the internal guidelines of Grupo KUTXABANK, and that they are implemented with rigour and loyalty.

General supervision of the risk management infrastructure of Grupo KUTXABANK lies with the Audit and Compliance Committee, in the framework of the functions assigned to it under the regulations governing the Board of Directors of KUTXABANK, S.A.

A more detailed description of the functions of the aforesaid governing bodies can be found in section C of this document.

## E.3 Describe the key risks that may affect the achievement of business objectives.

The KUTXABANK Group has established a corporate typology of risks that includes twenty categories, the most important of which are defined below.

Credit risk: the possibility of impairment losses as a result of its customers (essentially individuals, corporations, governments and non-profit institutions) defaulting on their payment obligations arising from any of the banking products that they may use with the entity, including derivative transactions. Credit risks contracted with financial institutions, as well as credit risks included in debt instruments, are expressly excluded from this category.

Counterparty risk: the possibility of impairment losses resulting from a breach of payment obligations by financial institutions incorporated in bank instruments, including derivative transactions. In addition, this management area expressly includes liquidity risk (linked to transactions in which the flows exchanged are not entirely simultaneous) and expressly excludes issuer risk (the private issuer of a security does not fulfil the rights that it includes).

Sovereign risk: the possibility of incurring value losses as a result of defaults, deferments or debt renegotiations incorporated in debt securities issued by supranational entities or states classified for country risk purposes in Group 1 as foreseen in CBE 4/2016.

Structural interest rate risk: the possibility of impairment losses due to the effect of adverse movements in interest rates on all its sensitive balance sheet positions.

Liquidity risk: the possibility of incurring impairment losses due to the time lag between the maturities of its assets and liabilities and the impact of this financial structure on its strategic position, on the cost of financing it and on its ability to meet its payment obligations.

Market risk: the possibility of incurring impairment losses due to the effect of adverse movements in the main financial risk factors (interest rates, exchange rates, stock exchange listings, volatility and price of goods) on its portfolios of securities and derivatives (investment and/or negotiation).

Operational risk: the possibility of incurring impairment losses due to failings, errors, shortcomings or inadequacies in its processes, systems or personnel or as a result of external events. In addition, this management area expressly includes legal risk and technology risk but does not include strategic risk or reputational risk.

Technological risk: the possibility of incurring value losses as a result of failure, errors, insufficiencies and inadequacies in processes, systems, networks, etc. or personnel, or external events related to information and communications technologies.

Reputational risk: the possibility of incurring impairment losses due to a drop in the level of corporate reputation perceived by the main stakeholders of the Group.

- The list and description of main risks continues in subsection G of this report-

## E.4 Indicate whether the entity has a risk tolerance level.

The Board of Directors of KUTXABANK, S.A. draws up strategic guidelines on matters of risk management via its Risk Appetite Policy Manual. This document is drawn up in a process coordinated by Overall Risk Control Department, a formula which involves both the executive function, via the Management Committee, and the governing bodies, with the Risk Control Committee playing a particularly prominent role.

Through KUTXABANK Group's Risk Appetite Framework, notes that KUTXABANK Group wishes to present a medium-low risk, in which the objective of guaranteeing its activity over time, and therefore, its contribution to society.

In order to achieve said medium-low risk profile, the KUTXABANK Group will operate with a prudent policy on exposure to different types of risk, an adequate risk-management infrastructure in terms of internal governance and the availability of material and human resources, and a capital and liquidity basis that is adapted to its business model of being a local retail bank.

The KUTXABANK Group compliments this general statement by assuming various, specific core objectives, both qualitative and quantitative in nature. The quantitative objectives are linked to a core set of risk indicators. These are strategic objectives, which the KUTXABANK Group deems to be coherent with its business model and with the risk profile that it wishes to present, and which serve as a reference point towards which to aim in the medium/long term, in normal economic cycle conditions and which are not attached to a specific time frame.

The core set of risk indicators established in the Risk Appetite Policy Manual comprises 23 indicators. Each of them has a range of follow-up areas (objective, thresholds for observation and alert, recovery thresholds), in such a way that the development of the level of compliance can be easily identified for each of them, as well as the applicable management style for each.

## E.5 Indicate the risks that have occurred during the year

The materialization of most relevant risks registered by Kutxabank Group during 2017 originate from impairments registered in its real estate activity, from its shareholder perspective (impairment of its participation in SAREB) as well as regards to its real estate assets portfolio (mainly, foreclosed assets). In the financial risk field, no significant risk materializations have occurred, further than delving into unusually low and/or negative interest rate scenarios, which has added even more pressure on the commercial margins of the banking business. As regards credit, the continued economic recovery process initiated in previous years, along with the operations carried out by the Group, have enabled its doubtful assets portfolio to continue to decrease significantly, placing it default level at 5.05% (compared to 6.78% at the close of 2016). This positive development has translated into the lowest impact in results of recent years for this type of risk. The annual accounts published by the Group contain detailed information regarding the materialization of risks that have had an explicit impact in results and/or equity. In general terms, it's worth noting, that the aforementioned materializations have not prevented the Group from improving its main profitability and solvency indicators during 2017.

## E.6 Explain the response and monitoring plans for the Entity's primary risks

The governing bodies of KUTXABANK Group have a system for monitoring primary risks which comprises the following tools:

- A corporate risk map, which is drawn up annually and identifies the main types of risk to which the Group is exposed, assesses their level of importance and provides detailed information on main exposures at sub-risk level.

- A corporate balanced scorecard for risks, which provides quarterly updated information on a broad set of risk indicators, including back-up reports on the calculation of the said indicators, historical series showing their trends and a categorisation by risk levels.

- Monographic reports on the most important types of risk, submitted to and set out before the Risk Control Committee at intervals proportional to the importance of each risk type.

The monitoring system thus set up enables the governing bodies to have a permanently updated idea of the evolution of the global risk profile of KUTXABANK Group, as well as the deviations that have occurred regarding the strategic guidelines formulated for each case.

As regards response mechanisms for dealing with cases where the materialisation of risks exceeds the levels desirable, Grupo KUTXABANK has a number of specific tools in place depending on the different control frameworks. They include the Liquidity Contingency Plan and the Business Continuity Plan.

In overall terms, as far as ordinary, autonomous management is concerned Grupo KUTXABANK has set up a governance system that ensures that certain protocols for action will be activated should certain risk indicators cross the threshold established in the Risk Appetite Policy Manual. Those protocols are intended to alert the governing bodies of drops in one or more indicators, carry out a causal analysis to explain what has happened and establish a remediation plan to bring the situation back on track.

If the worsening in risk indicators reaches a more serious level (still within the framework of exceptional autonomous management) financial organisations included in the field of application of Directive 2017/59/EU must have a Recovery Plan that envisages activating a system of governance that reflects the relevant level of exceptional circumstances, based on the implementation of a set of pre-identified recovery measures that can enable Grupo KUTXABANK to bring the situation back on track by its own means.

# F INTERNAL CONTROL AND RISK MANAGEMENT SYSTEMS IN RELATION TO THE FINANCIAL REPORTING PROCESS (ICFR)

Describe the mechanisms in the control and risk management systems in relation to the entity's internal controls over financial reporting (ICFR).

## F.1 Control environment of the Entity.

State and describe the main features of, at least:

### F.1.1. Which bodies and/or functions are responsible for: (i) the existence and maintenance of a appropriate and effective ICFR; (ii) its implementation; and (iii) its supervision

The Board of Directors of Kutxabank, S.A. as the highest decision-making body of the Company (except for matters reserved for the General Meeting), is entrusted legally, and through the Articles of Association, with the administration and representation of the KUTXABANK, S.A. Furthermore, it has overall responsibility for the Bank, including the approval and supervision of implementing strategic objectives, risk strategy, corporate governance and corporate values.

Article 5 of the Regulations of the Board of Directors states that, among the functions of the Board of Directors, it is responsible for ensuring the integrity of the accounting and financial systems, including financial and operational control and compliance with applicable legislation; monitoring the dissemination process of information and communications pertaining to the Bank; as well as issues regarding risk control and management, setting the principles and policies that mark the general action lines of the KUTXABANK, S.A. and the KUTXABANK Group in the field of risk management, which will be reviewed and updated periodically.

The Board of Directors has delegated the function of monitoring the internal control systems to the Audit and Compliance Committee. Article 16 of the Regulations of the Board of Directors regulates the Audit and Compliance Committee, and Article 1 of the Regulations of said Committee states that it is constituted as a "permanent internal organ of an informative and advisory nature, without executive powers, with powers to inform, advise and make proposals within its scope, governed by the rules contained in the Articles of Association, the Regulations of the Board of Directors, in these Regulations and in applicable legislation".

In accordance with the provisions of article 16 of the Regulations of the Board of Directors, the functions of the Audit and Compliance Committee include:

-Reporting to the General Meeting and to the Board of Directors on matters arising within their respective jurisdictions.
-Monitoring the effectiveness of the Company's internal control, the internal audit and, where appropriate, risk management, including the tax systems, and discussing any significant internal control weaknesses detected in the audit with the auditors.
-Monitoring the process of preparing and presenting of regulated financial information.

In turn, the Head of the Control and Internal Auditing Department of KUTXABANK Group assists the Audit and Compliance Committee, reporting on the supervision of the correct design and implementation of risk management and control systems, including the financial information (ICFR) preparation process, ensuring that they run correctly and efficiently.

Lastly, the Finance Department collaborates in the design and implementation of risk management and control systems, particularly with respect to the preparation, presentation and completeness of the financial information disclosed to the markets.

This allocation of responsibilities has been disseminated to the organisation through an Internal standard approved by the Board of Directors, which determines responsibilities regarding the monitoring procedures and criteria to be followed to ensure the correct, appropriate monitoring mechanism for Internal Control over Financial Reporting (ICFR).

### F.1.2. If the following elements exist, particular with respect to the process of drawing up financial reports:

- Departments and/or mechanisms responsible for: (i) designing and reviewing the organisational structure; (ii) defining clear lines of responsibility and authority, with an appropriate distribution of tasks and functions; and (iii) ensuring that sufficient procedures are in place for their correct dissemination within the entity.

The design and review of the Entity's organisational structure and the definition of lines of responsibility and authority are outlined in the Board of Directors' guidelines.

In accordance with articles 17 and 18 of the regulations of the Board of Directors, the Appointments Committee and the Remunerations Committee are responsible for, inter alia, (i) reporting to the Committee on nominations and resignations of senior officers (Appointments Committee) and (ii) proposing their remuneration policy and ensuring it is adhered to (Remunerations Committee).

The Human Resources Department is responsible for allocating the necessary resources with the appropriate profile for the functions and workloads in conjunction with the corresponding area department, while the Board of Directors is responsible for approving the organisational structure of the Entity.

Lines of authority and responsibility are clearly defined with respect to the elaboration of financial information. Specifically, the Finance Department is in charge of preparing the financial reports presented to the markets and it has its own functional organisation chart that defines the lines of responsibility, tasks and functions.
In the elaboration of financial information the lines of authority and responsibility are clearly defined. Specifically, the Financial Management Department is in charge of preparing the financial information presented (after the pertinent approvals or validations) to the markets and it has its own functional organisation chart that defines its lines of responsibility, tasks and functions.

- Code of conduct, approving body, degree of dissemination and instruction, principles and values covered (stating whether it makes specific reference to record keeping and financial reporting), body in charge of investigating breaches and proposing corrective or disciplinary action.

KUTXABANK, S.A. has a code of ethics approved by the Board of Directors on 30 June 2016, which is disseminated throughout the organisation via the KUTXABANK, S.A. intranet.

It is understood that all those persons subject to the code of ethics on the date of its approval have expressly agreed to its contents and to the rules derived from it as from its publication on the intranet. Furthermore, as of the date of its approval the full text of the code of ethics is made available to all new hires at the time of the signing of their respective employment contracts, which contain a specific acceptance clause.

The code of ethics applies to the members of the Board of Directors and to all employees of KUTXABANK, S.A. without prejudice to whether certain of them are also subject to the Internal Code of Conduct of the Stock Market or other regulations and codes of conduct specific to the activities or areas in which they carry out their functions.

The Code of Ethics applies to members of the Board of Directors and all Kutxabank employees, without prejudice to whether some of these individuals are also subject to the Stock Market Code of Conduct or other Codes of Conduct specific to the activity in which they perform their functions.

The Code of Ethics sets forth the basic principles of conduct, both in internal and third-party relations, applicable to persons subject to this code, as well as rules of conduct on specific matters (privileged information, data protection, etc.), including specific references to internal procedures relating to the process of preparing financial information to be disclosed to the markets, and ensuring its integrity.

The Department of Regulatory Compliance and Internal Control is responsible for promoting the dissemination, awareness and compliance of this Code of Ethics, while the Human Resources Department is responsible for the application of disciplinary measures in the event of non-compliance.

In addition, there are other specific codes that regulate the conduct of employees on specific matters:

1. The Internal Code of Conduct (ICC) for the sector accepted by the CNMV, which is the top-level standard and includes the general principles derived from the rules of conduct laid down in the Securities Market Law, and has a scope of generality and permanence. The ICC and its accompanying Annexes, published on KUTXABANK, S.A.'s website and intranet, are applicable to KUTXABANK, S.A. and to the following individuals:

a) Members of the KUTXABANK, S.A. Board of Directors;
b) Members of the KUTXABANK, S.A. Management Committee;
c) Other directors, employees, representatives and agents of KUTXABANK, S.A., whose work is directly related to operations and activities in securities markets;
d) Other people that belong to or provide services at Kutxabank, S.A., and who, without having a function directly related to the securities markets, as determined by the compliance function, should be temporarily subject to the regulations due to their participation in or knowledge of a transaction in such markets.

2. Policy in terms of Criminal Risk and Code of Ethics, that provide a control framework to prevent irregular actions by KUTXABANK, S.A.'s group of employees.

- A whistle-blower channel for reporting financial and accounting irregularities to the Audit Committee, as well as breaches of the code of conduct and improper activities in the organisation, stating whether reports made through this channel are confidential.

KUTXABANK, S.A. has an "Ethical Channel" for filing Internal reports of breaches of the Code of Ethics as well as financial and accounting irregularities or, in general, the performance of irregular or fraudulent activities in the organisation.

Reports received through this channel are treated and analysed confidentially by the Department of Regulatory Compliance and Internal Control and, once accepted for processing, are notified to the Human Resources Department.

If the conduct reported is proved and confirmed, the Human Resources Department resolves the matter by applying disciplinary measures in accordance with the offences and penalties system in the applicable collective workers' agreement or employment legislation, sending a report to General Management and the Department of Regulatory Compliance and Internal Control of KUTXABANK Group.

In order for this channel to function properly, it can be accessed directly on the intranet, where there is a form for reporting breaches of the Code of Ethics.

The Regulatory Compliance Department, in collaboration with the Human Resources Department, evaluates and elaborates an annual report on the level of compliance with the Code of Ethics, which is reported to the KUTXABANK, S.A. 's Governing Bodies.

- Regular training programmes and refresher courses for personnel involved in preparing and reviewing financial reports or evaluating ICFR, covering, at a minimum, accounting standards, auditing, internal control and risk management.

All KUTXABANK, S.A. staff involved in the various processes relating to financial reporting and evaluating ICFR receives training and knowledge updates, designed specifically to facilitate the proper performance of their functions.

In order to meet its objective of having a Training Plan in place for accounting, financial and internal control issues, tailored to each of the roles and responsibilities of staff involved in preparing and reviewing financial reports or evaluating ICFR, the Kutxabank, S.A. has provided a total of 7,594 hours of training to 201 employees in these sectors.
The training provided was primarily focused on the following areas:

-Accounting / Consolidation
-Fiscal matters
-Audits

-Regulatory Compliance
-Solvency
-Risk analysis and management
- MiFID II

The training sessions that take place in the Kutxabank, S.A. are both face-to-face and online, and are taught by both internal and external trainers.
Regarding the training given to the members of the Board of Directors, throughout 2017 it has been given by internal and external lecturers, specific training in approximately two and a half hour sessions each, related to means of payment (evolution and impacts derived from the new regulation), economic and financial sector environment, analytical big data, artificial intelligence, interest rate Structural Risk, Prevention of Money Laundering and Terrorist Financing, IFRS9 (classification and valuation of assets; new methodology for calculating impairment), the European Banking Industry (main characteristics) and internal models (context and main implications).

Additionally, a reception plan was prepared for new Board of Directors members to inform them about the functioning of KUTXABANK, S.A., its Governing Bodies, business model Global Risk Control, liquidity, policy and regulatory aspects, enter alia.

## F.2 Risk assessment in financial reporting

State, at least:

### F.2.1. The key features of the risk identification process, including error and fraud risks, with respect to:

- Whether the process exists and is documented.

The Entity has a Policy for identifying processes, significant areas and risks associated with financial reporting, which includes error and fraud risks.

The process of identifying risks with a significant potential impact on financial statements is focused on identifying the critical management processes that affect the elaboration of financial information and the areas or items of the financial statements where related risks arise. Quantitative factors (balance and granularity) and qualitative factors (processes' degree of automation, standardisation of operations, level of accounting complexity, changes with respect to the previous year, control weaknesses identified, etc.) are considered in the analysis of processes and areas.
At the same time, identified risks are subject to a process of prioritisation, through the use of a methodology that was improved and amplified in 2015. This methodology determines the theoretical risk of every process (based on an assessment of an event's impact and frequency), in order to then determine the perceived risk (based on an expert opinion on documented processes and controls, the automation and use of systems, the absence of incidents in the past and whether the process is well-known and matured. Finally, the mitigated risk is determined once the specific controls implemented in the Entity have been considered. In this regard, 231 risks have been assessed, corresponding to 15 interdepartmental processes and business processes of the Kutxabank group.

- Whether the process covers all the objectives of financial reporting (existence and occurrence; completeness; valuation; presentation, breakdown and comparability; and rights and obligations), whether the information is updated and how often.

The process of risk evaluation covers all financial reporting objectives: (i) existence and occurrence; (ii) completeness; (iii) valuation; (iv) presentation; (v) breakdown and comparability; and (vi) rights and obligations.

The scope of the risk identification process is reviewed annually, using the Consolidated Public Statements at 31 December as a basis. However, when unforeseen circumstances arise throughout the year, highlighting possible errors in the financial reporting or substantial changes in the Entity’s operations, the Finance Department assesses whether there are risks that should be added to those previously identified.

- The existence of a process for identifying the scope of consolidation, taking into account aspects including the possible existence of complex corporate structures, as well as instrumental or special-purpose entities.

The possible risks relating to the correct identification of the scope of consolidation are documented in the “Consolidation Process”, which is one of Kutxabank’s three critical processes and is reviewed annually.

- Whether the process considers the effects of other types of risks (operational, technological, financial, legal, reputational, environmental, etc.) insofar as they impact the financial statements.

The risk identification process considers both routine transactions as well as those that are less frequent and potentially more complex, along with the effects of other types of risks (operational, technological, financial, legal, reputational, environmental, etc.) insofar as they impact the financial statements.

- Which of the entity's governing bodies supervises the process.

The implementation of the risk identification and control procedure is the responsibility of the Finance Department, while it is supervised by the Audit and Compliance Committee through the Internal Control function.

## F.3. Control activities

State whether at least the following exist, and indicate their primary features:

F.3.1. Procedures for the review and authorisation of financial information and the description of the ICFR to be disclosed to securities markets, indicating who is responsible for it, and the documentation describing the activity and controls flows (including those concerning risk of fraud) for the different types of transactions that may materially impact the financial statements, including the accounting close procedure and the specific review of the relevant judgements, estimates, valuations and projections.

KUTXABANK, S.A.'s review and authorisation procedures for financial information that is disclosed to securities markets begins with their review by Financial Management. Additionally, the preparation and presentation process of regulated financial information is monitored by the Audit and Compliance Committee, in accordance with the provisions of article 3 of its Regulations, in order to ensure the correct application of accounting standards and the reliability of the financial information, prior to their formulation by the Board of Directors. In accordance with article 5 of the Regulations of the Board of Directors, this Body has, inter alia, the powers to formulate the annual accounts, the management report and the proposed allocation of the KUTXABANK, S.A.'s profits; to ensure the integrity of the accounting and financial information systems, including financial and operational control and compliance with applicable legislation; and to monitor the process of disseminating information and communications pertaining to the KUTXABANK, S.A..

With regard to activities and controls directly related to transactions that may have a material effect on the financial statements, KUTXABANK, S.A. has risk and control Procedures and Guidelines for significant processes and areas affecting the elaboration and preparation of financial reports.

The Procedures include the functions involved in the process, the systems involved and the description of the process. Additionally, the risk and control guidelines also encompass the following fields:

. Description of risk
. Control activity
. Control classification: key/standard
. Control category: preventive/detective
. Method: manual/combined/automatic
. System supporting the control
. Person responsible for the control procedure
. Frequency of the control procedure
. Evidence of the control procedure.

Below is a list of the significant processes associated with the financial areas of the Entity (distinguishing between interdepartmental processes and business processes) for which the aforementioned documentation is available.

- Interdepartmental Processes
. Accounting Close of the Parent Company and important subsidiaries
. Consolidation
. General IT Controls
. Annual Accounts
. Judgments and Estimates

- Business Processes:
. Credit Investment
. Creditors
. Financial instruments

. Property assets received in payment of debt
. Pension commitments
. Corporation Tax
. Insurance activity
. Solvency ratio calculation

The above-mentioned descriptive documentation includes:

Description of activities relating to the process from its very start, indicating specific components of particular products or operations.

The identification of significant risks with a material impact on the financial statements of the Entity.

The identification of controls and their corresponding descriptions, as well as their connection to the previously-identified risks.

Activities and controls are designed for the purpose of ensuring the correct recording, valuation, presentation and breakdown of transactions that have occurred.

As part of its ICFR assessment process, KUTXABANK, S.A. has a half-yearly process of internal certifications for key identified control, the objective of which is to ensure the reliability of financial reporting. To that end, each manager for key controls certifies the effective implementation of those controls for the period in question. The Group's Department of Regulatory Compliance and Control submits the outcomes of the certification process to the Audit and Compliance Committee and to the Board of Directors. Following this internal certification process on key controls at KUTXABANK, S.A. in the 2017 financial year no incidents were detected that might have any material effect on the reliability of financial reporting.

The Internal Audit Department carries out supervisory duties, as described in subsequent sections.

In regard to the reviewing of relevant judgements and estimates, KUTXABANK, S.A. reports in its annual accounts on the main areas where there are parameters for judgements or estimates and on the key assumptions used by KUTXABANK, S.A. in regard thereto. In this context the main estimates made refer to impairment losses on certain financial assets, actuarial calculations concerning liabilities and pension commitments, the useful lifetimes of tangible and intangible assets, the fair value of unlisted financial assets and the fair value of real estate assets.

KUTXABANK, S.A. also has a general policy concerning the making of judgements and estimates which addresses all the aspects to be taken into account and the responsibilities for their preparation and review.

### F.3.2 Internal control procedures and policies for IT systems (including secure access, monitoring changes, their operation, operational continuity and segregation of functions) that support the entity's key processes for the preparation and disclosure of financial information.

KUTXABANK, S.A. uses IT systems to keep a proper record and control of its operations, and is therefore highly dependent on the correct functioning of these systems. These systems are subject to policies and procedures of internal control, including:

1.- A Data Security Management System: This system defines, among other policies, those regarding access to data systems and controls (both internal and external) that can ensure the correct application of all policies defined. For designing and implementing applications, a methodological framework is defined, which establishes various control points for ensuring that the solution obtained meets requirements requested by the user, and that the level of quality complies with the necessary reliability, efficiency and maintenance standards. There is a methodology for requesting, designing and implementing the KUTXABANK, S.A.'s business applications.

Any changes to infrastructures or applications are managed through the internal methodology that sets out a procedure for their approval, and which defines the impact and possibility of reverting to the previous situation, should any type of incident be detected.

The Entity's IT Department has policies in place to safeguard security with regard to access permissions by segregating functions and specifying roles and profiles while it also ensures continuity of IT operations, through setting up backup centres and carrying out regular operational tests.

2.- Operational and business continuity: The organisation's Business Continuity Plans envisage the availability of alternative locations where critical personnel can be sent should there be a serious contingency that prevents them from accessing their usual workplaces. IT Contingency Plans are based on mirrored back-up centres, extended to host and distributed systems. These plans are regularly tested and checked to ensure that they are operational and are running properly.

The main service providers (infrastructures, telecommunications, etc.) have put highly competent security systems into place based on best practices in the sector. Compliance with Service Level Agreements (SLA) is regularly checked by the Entity.

In the framework of ICFR, the Entity has a General IT Controls Process in place, with its corresponding risk and controls procedure and matrix, where risks and controls pertaining to access security, monitoring changes, their operation, operational continuity and segregation of functions are detailed.

### F.3.3 Internal control policies and procedures for overseeing the management of outsourced activities, and for the appraisal, calculation or valuation services commissioned from independent experts, when these may materially affect the financial statements.

The Company has a Policy on outsourcing services and functions essential and relevants approved by the Board of Directors, the objective of which is to establish the principles, rules, procedures and compulsory controls in the different stages of the outsourcing process. The tasks of the Internal Audit Department include carrying out periodic audits on compliance with this Policy, and the Department of Regulatory Compliance, in turn, incorporates compliance with this procedure in the event of outsourcing activities. This report, drawn up by the Group's Department of Regulatory Compliance and Control, is submitted to the Audit and Compliance Committee, detailing the conclusions concerning approved outsourcing and any incidents arising in the implementation of this policy.

KUTXABANK, S.A. has no outsourced activities with a significant impact on financial information; nevertheless, KUTXABANK, S.A. consistently uses appraisal reports by independent experts on operations that could potentially have a material effect on the financial statements.

In 2017, outsourced activities relating to appraisals and calculations by independent experts were related to:

-Valuations of structured and derivative financial instruments.

-Calculation of actuarial studies on commitments held with employees.

-Appraisals performed on foreclosed properties and on properties being used as collateral for credit portfolio transactions with KUTXABANK, S.A.

KUTXABANK, S.A. has put controls in place at all levels in order to mitigate risks associated with these activities. These controls are carried out by the departments responsible for the operations and their purpose is to verify their competence, skill, accreditation or independence, as well as the validity of the data and methods adopted and the reasonableness of the assumptions used.

## F.4. Information and Communication

State whether at least the following exist, and indicate their primary features:

### F.4.1. A specific function in charge of setting out and keeping accounting policies updated (accounting policy department or area) and dealing with queries or conflicts stemming from their interpretation, which is in regular contact with the organisation's operations managers, as well as an updated accounting policies manual that is reported to the units through which the entity operates.

The Finance Department, with the support of the areas reporting thereto, is responsible for identifying, defining and communicating accounting Policies affecting the KUTXABANK, S.A., including the Group's subsidiaries, and responding to accounting enquiries from the KUTXABANK, S.A.'s subsidiaries and business units.

The KUTXABANK Group's subsidiaries and associated investee companies report accounting and supplementary information quarterly for consolidation at KUTXABANK Group level. The Department of Financial Management of Subsidiaries and Consolidation watches over the subsidiaries of the Group to ensure that they follow the guidelines for booking and the accounting policies set by KUTXABANK, S.A. This area analyses and reviews information from subsidiaries and associated investee companies and if necessary gives notice directly (in the case of subsidiaries) or through the Department of Investee Companies (in the case of associated companies) of any incidents that may be detected on reviewing the information reported.

In the event of regulatory changes affecting financial reporting and which have an impact on the financial statements, it is the responsibility of the Finance Department and specifically the Accounting and Statistics Area to circulate them to staff in the affected areas.

KUTXABANK, S.A. has an updated Accounting Policies Manual, approved by the Finance Department and the

General Management of the KUTXABANK, S.A., in order to ensure that the KUTXABANK Group's accounting policies are followed. This Manual is updated whenever there are regulatory changes.

The accounting regulation framework that specifies the policies applicable to the KUTXABANK Group, and enables the financial statements to reflect a fair view of its equity and financial situation, includes: (i) International Financial Reporting Standards, and (ii) Circular 4/2004 of 22 December issued by the Bank of Spain, and its subsequent updates.

### F.4.2. Mechanisms in standard format for the capture and preparation of financial information, which are applied and used in all the units of the entity or group, and which support its main financial statements and accompanying notes, as well as information concerning ICFR.

The process for generating the consolidated financial information for the KUTXABANK Group is carried out by the Departments of Finance. To do this, there is a tool into which financial information from banks is automatically uploaded, which is prepared using a comprehensive accounting tool that is integrated with the rest of the business applications. To carry out the consolidation process, the KUTXABANK Group's subsidiaries have access to the same consolidation software as the Entity, through which they upload financial information so that all balances are dumped in a uniform accounts plan for the KUTXABANK Group.

Financial information from subsidiaries is reported following the guidelines and formats established and provide the input for the process of preparing the KUTXABANK Group's financial statements. Additionally, companies send the Consolidation Department the supplementary information needed to check and compare the information provided and to harmonise and standardise accounting criteria for the European Central Bank or the Bank of Spain.

The Department of Financial Management of Subsidiaries and Consolidation is responsible for reviewing the financial information reported to the Department quarterly by subsidiary companies and information received from the Real Estate & Investee Companies Department, and for making any standardisation adjustments that it deems necessary. A number of controls and procedures are in place to ensure the reliability and proper processing of financial information received from companies, including analysis of significant balances, transactions and economic events, reasonableness and consistency of trends and presentation, the obtaining and reconciling of inventories, the reviewing and updating of consolidation entries, etc. There are also procedures and controls in place for validating the results of the consolidation process, including analysis of changes in results compared to budgets and controls specific to Bank of Spain statements, in which the various balance sheet and income statement items are correlated.

Regarding the drawing up of six-monthly and annual financial statements and their explanatory notes, KUTXABANK Group has defined a process to control that the financial information published has been prepared from the KUTXABANK Group accounting records and in accordance with the applicable regulations and that give a true reflection of KUTXABANK Group's financial and equity situation and of the results obtained. The aforementioned process involves the participation of different Business Areas in the Entity and is coordinated and supervised by the Management Control Division. For this task KUTXABANK Group has a tool which documents the entire revision process.

For this purpose, every six months, KUTXABANK Group companies prepare the six-monthly consolidation packages needed to draw up certain breakdowns of half-yearly financial statements and annual accounts. These packages must be validated by the auditors of the main investees, which are asked to provide a number of reports and procedures concerning the information reported for consolidation of the KUTXABANK Group. These include a review of accounting policies and of the accuracy of the breakdowns sent in the consolidation packages.

## F.5. Supervision of the system's operation

Give information, describing the key features of at least:

### F.5.1. The ICFR supervision activities carried out by the Audit Committee, and whether the entity has an internal audit function whose powers include providing support to the Audit Committee in its task of supervising the internal control system, including the ICFR. Likewise, give information on the scope of the ICFR assessment carried out during the year and of the procedure by which the person in charge of performing the assessment communicates its results, whether the Entity has an action plan listing the possible corrective measures, and whether its impact on the financial reporting has been considered.

At KUTXABANK, S.A. the Internal Control Unit is set up as a unit of the KUTXABANK Group Regulatory Compliance and Internal Control Area. This Area reports to and supports the Audit and Compliance Committee in its task of supervising the process of preparing and presenting financial information. The assessment plan and the results of the ICFR supervision are presented every six months and annually to the Audit and Compliance Committee. The report drawn up by the Internal Control Unit details the scope of the work performed, the results obtained, the potential effects of any incidents and the plans of action derived therefrom.

Internal Control has an Internal Control Plan which is integrated into the Regulatory Compliance and Control Plan of the KUTXABANK Group approved by the Audit and Compliance Committee. This plan envisages testing in the areas considered relevant at KUTXABANK, S.A., covering all areas over the course of the three-year term of the Plan, with the exception of certain areas or processes considered to be of special relevance, such as critical accounting closing processes, annual accounts and general IT controls.

The Audit and Compliance Committee has entrusted the task of reviewing and controlling systems for internal control of financial reporting to the Group Regulatory Compliance and Internal Control Area of the KUTXABANK Group. Additionally, the Audit and Compliance Committee has assessed and validated the scope of the review process for systems of internal control of financial reporting and has been informed of the supervision carried out in 2017 on ICFR.

The scope of the assessment carried out for the 2017 financial year included supervising the formal operation of the ICFR implemented, reviewing key controls for interdepartmental business procedures planned for the year, monitoring plans of action from previous years and monitoring plans of actions proposed by external and internal auditors for this year. The results of the process of ICFR internal certification of controls are also reported.

The assessment process for the 2017 financial year detected weaknesses in control and opportunities for improvement which have given rise to plans of action accordingly.

Additionally, the Internal Audit function reports to the Office of the Chair. This area is tasked with examining and assessing the systems in place for ensuring compliance with policies, plans, procedures, rules and regulations and thus efficiency and effectiveness of internal control systems. It also puts forward suggestions for improving them. Internal Audits has a three-year plan for monitoring ICFR, which consists of issuing a report on the status of ICFR, the potential impact of identifying weaknesses and possible plans for additional work and specific control measures needed to mitigate the risks that may come to light.

### F.5.2. State whether a discussion procedure is in place whereby the auditor (in accordance with the provisions of the Technical Standards on Auditing), the internal audit function and other experts can inform senior management and the audit committee, or the directors of the entity, about significant internal control weaknesses encountered during the review processes for the annual accounts, or any others within their remit. Also, indicate whether the entity has an action plan to correct or mitigate the weaknesses found.

The Audit and Compliance Committee meets at least twice a year and usually more frequently, as reported above, to obtain and analyse the information needed to perform the tasks entrusted to it by the Board of Directors.

The Internal Audits area submits a report to top management, indicating any significant weaknesses detected in the internal control system and giving its conclusions concerning the procedures and/or areas reviewed. This report includes a request that the person responsible for the area reviewed draw up an action plan to correct any incidents detected. Moreover, the head of Internal Audits informs the Audit and Compliance Committee of the content of the said report.

The external auditor presents the results and conclusions reached at both the preliminary stage of the review process and on completing the audit, including any weaknesses in internal control that have been identified. KUTXABANK, S.A. must then draw up action plans to correct or mitigate the weaknesses pointed out. Once the account audit is completed, the external auditor presents the Annual Accounts, the Bank of Spain Complementary Report that assesses the financial information process and the additional Report for the Company's auditing committee to the Auditing and Compliance Committee and to the Board of Directors. To carry out this process the Audit and Compliance Committee first receives the documentation, which it analyses and reviews together with the Financial Management to ensure that the accounting standards in force have been applied correctly and that the financial reporting is reliable.

During the course of the audit, the auditor of KUTXABANK, S.A. has access to Senior Management, with which it holds regular meetings to obtain the information needed to carry out its work and to report any weaknesses in control detected.

Additionally, any ICFR weaknesses detected, any proposals made for correcting weaknesses and the status of actions already taken are assessed during this discussion process. The Audit and Compliance Committee and the Board of Directors thus review and approve the action plans proposed by Internal Control every six months within the ICFR framework.

## F.6. Other relevant information

No relevant issues to be reported here.

### F.7. External auditor's report

Report by:

F.7.1. State whether the ICFR information disclosed to the markets has been reviewed by the external auditor, in which case the entity should attach the corresponding report as an Annex. Otherwise, explain the reasons why it has not.

KUTXABANK, S.A. has submitted the information on ICRF contained in section F of the Annual Corporate Governance Report (ACGR) for the 2017 financial year for review by the external auditor. The resulting report concludes that the procedures applied to information on ICRF do not reveal any inconsistencies or incidents that could affect it. Once it is formally issued this report will be included as an Annex to this ACGR.

## G OTHER RELEVANT INFORMATION

If there is any significant aspect of corporate governance of the entity or the companies in the group that is not covered by the other sections of this Report, but which should be included to provide more complete and reasoned information about the governance structure and practices in the entity or its group, describe it briefly.

In this section you may include any other information, explanations or qualifications relating to earlier sections of the report, insofar as they are relevant and not repetitive.

Specifically, indicate whether the entity is subject to non-Spanish legislation regarding matters of corporate governance and, if so, include any information that must be disclosed and which is not covered by this report.

The entity may also indicate if it has voluntarily acceded to other codes of ethical principles or good practice, whether international, sectoral or in any other sector. If so, the entity should indicate the corresponding code and date of accession.

There are no relevant principles or matters concerning corporate governance to be added to this Annual Corporate Governance Report.

Not withstanding the foregoing, in relation to section “C.1.2 Complete the following table of the member of the board or administrative body, and their different status” it should be noted that the aforementioned table identifies the directors with a valid mandate on 31/12/2017. Mr. Luis Viana Apraiz was a KUTXABANK, S.A. a board member until 28 March 2017.

In relation to section “C.1.8 State whether the individual and consolidated annual accounts submitted to the board of directors are previously certified”, the following must be highlighted:

The Audit and Compliance Committee is, inter alia, responsible for supervising the process of elaborating and presenting regulated financial information and reporting, in advance and among other matters, any financial information that the KUTXABANK, S.A. must periodically make public to the Board of Directors.

In relation to the section “C.2.2 Provide details regarding all committees of the Board of Directors or governing body and their members, as well as the number of executive, proprietary, independent and other external directors integrated therein (entities that do not have the legal form of a capital company will not fall under the category of director in the corresponding table, and in the accompanying text, the category of each director will be explained in accordance with their legal statuses and the manner in which such directors comply with the composition conditions of the audit committee as well as the committees for appointments and remunerations)”, it is relevant to highlight the following:

Mr. Jorge Hugo Sánchez Moreno was appointed member of KUTXABANK S.A.’s Executive Committee and Risk Control Committee by the Board of Directors, on 27 April 2017. The aforementioned appointment was dependent upon the effective appointment, by the General Shareholders' Meeting, of Mr. Sánchez as member of the Board of Directors, which took place on 28 July 2017.

In relation to section "E.3 Describe the key risks that may affect the achievement of business objectives", the description of the most relevant risks and the relationship continues as follows:

Risk in real estate activity: possibility of incurring value losses as a result of adverse circumstances linked to the real estate subsidiaries upon which KUTXABANK Group exercises management control, as well as the totality of the real estate assets present in KUTXABANK Group's balance sheet, independent of its origin and/or objective.

Risk in investee companies: possibility of incurring value losses as a result of the impairment of equity stakes in companies not directly related to the Bank's activity, and in which its presence does not respond to operational reasons nor its trading activity. This management field excludes the risks linked to shares controlled by KUTXABANK Group corresponding to companies dedicated to banking, insurance and/or real estate activities.

Strategic risk: possibility of incurring in value losses as a result of adverse circumstances affecting its strategic position in the markets in which it carries out its activities.

Risk of banking business: possibility of incurring in value losses as a result of an impairment in KUTXABANK Group's commercial position that affect its capacity to obtain margins from its relations with its customers on a recurrent basis.

Concentration risk: possibility of incurring in value losses as a result of its investment level (credit, financial, or of any other kind) in certain activity sectors, geographical areas, or economic groups, determining the Bank's excessive dependence on the evolution of any of the aforementioned elements.

Regarding the section "Identify the director member of the Audit and Compliance Committee who has been appointed taking into consideration his/her knowledge and experience in accounting, auditing or in both" of heading C.2.2, point out that Ms. María Victoria Mendía Lasa as well as Ms. Roxana Meda Inoriza were appointed considering their knowledge and experience in terms of accounting, auditing or in both albeit the form only allows one person to be indicated.

In a separate document, the degree of follow-up of each of the recommendations of the Unified Code of Good Governance of listed companies (version approved by the Board of the CNMV-2015-) is indicated in detail, despite the fact that In consideration that KUTXABANK, SA, SA Is not a listed company

This annual corporate governance report has been approved by the board of directors of the entity at its meeting on 2018/02/22.

Indicate any directors or members of the management body who have voted against or abstained in connection with the approval of this Report.

1. The Articles of Association of listed companies should not limit the maximum number of votes that may be cast by a single shareholder or contain other restrictions that make it difficult to obtain control of the company by purchasing its shares on the stock market.

   KUTXABANK, S.A. complies with this recommendation, given that the Articles of Association do not contain any limitation or restriction on them.

2. When the parent company and a subsidiary company are listed, both should define publicly and accurately:

   a) the respective fields of business and any business relations between them, as well as those between the subsidiary and the other companies in the group;
   b) the mechanisms for resolving any conflicts of interest that may arise.

   KUTXABANK, S.A. is not a listed company and therefore this recommendation is not applicable thereto, notwithstanding the mechanisms already expressed in the Annual Corporate Governance Report for 2017, which KUTXABANK uses for managing potential conflicts of interest.

3. During the annual general meeting the chairman of the board should verbally inform shareholders, in sufficient detail, of the most relevant aspects of the company's corporate governance, supplementing the written information circulated in the annual corporate governance report. In particular:
   a) Any changes that have taken place since the previous annual general meeting.
   b) The specific reasons for the company not following a given Good Governance Code recommendation, and any alternative procedures followed in its stead.

   KUTXABANK, S.A. is not a listed company and therefore this recommendation is not applicable thereto, notwithstanding the information that the Chairman of the Board of Directors provided, in various general shareholders' meetings (both ordinary and extraordinary), with respect to the entity's corporate governance.

4. The company should draw up and implement a policy of communication and contacts with shareholders, institutional investors and proxy advisors, which fully complies with market abuse regulations and accords equitable treatment to shareholders in the same position.
   This policy should be disclosed on the company's website, complete with details of how it has been put into practice and the identities of the relevant interlocutors or those charged with its implementation.

   KUTXABANK, S.A. is not a listed company and therefore this recommendation is not applicable thereto. Nevertheless, KUTXABANK, S.A. offers identical treatment to the Company's shareholders, who have access to information under the terms of transparency provided for by law.

5. The board of directors should not make a proposal to the general meeting for the delegation of powers to issue shares or convertible securities without pre-emptive subscription rights for an amount exceeding 20% of capital at the time of such delegation.

When a board approves the issuance of shares or convertible securities without pre-emptive subscription rights, the company should immediately post a report on its website explaining the exclusion as envisaged in company legislation.

KUTXABANK, S.A. is not a listed company and therefore this recommendation is not applicable thereto. In any case, none of the indicated cases took place in 2017.

6. Listed companies drawing up the following reports, on a voluntary or compulsory basis, should publish them on their website well in advance of the annual general meeting, even if their distribution is not obligatory:

    a) Report on auditor independence.
    b) Reviews of the performance of the audit committee and the appointments and remuneration committees.
    c) Audit committee report on third-party transactions.
    d) Report on corporate social responsibility policy.

    KUTXABANK, S.A. is not a listed company and therefore this recommendation is not applicable thereto, without prejudice to the information that KUTXABANK, S.A. makes publicly available on its corporate website, under the legally required terms, as well as information provided to shareholders prior to the corresponding general meetings.

7. The company should broadcast its general shareholders' meetings live on the corporate website.

    KUTXABANK, S.A. is not a listed company and therefore this recommendation is not applicable thereto, without prejudice to information regarding resolutions adopted by the general shareholders' meeting that is made available in the annual corporate governance report for the corresponding year, press notes and, where relevant, relevant facts that are communicated.

    Since there are three sole shareholders, meetings are usually held universally, with the attendance, in sum, of all the shareholders and are not broadcast through its website.

8. The Audit and Compliance Commission should strive to ensure that the board of directors can present the company's accounts to the general meeting without limitations or qualifications in the auditor's report. In the exceptional case that qualifications exist, both the chairman of the audit committee and the auditors should give a clear account to shareholders of their scope and content.

    KUTXABANK, S.A. fulfils this recommendation, without any of the indicated exceptional circumstances having taken place to date.

    The Audit and Compliance Committee ensures that the Board of Directors presents the accounts to the general shareholders' meeting with neither limitations nor caveats in the audit report, but there has been no exceptional premise in which the aforementioned caveats or limitations have existed.

9. The company should disclose its conditions and procedures for admitting share

ownership, the right to attend general meetings and the exercise or delegation of voting rights, and display them permanently on its website. Such conditions and procedures should encourage shareholders to attend and exercise their rights and be applied in a non-discriminatory manner.

Given that there are only three shareholders, Meetings are generally universal; without prejudice to which, such shareholders are made aware of any necessary information far enough in advance of meetings.

The requirements and procedures that KUTXABANK, S.A. accepts as evidence of ownership of shares, entitlement to attend general meetings of shareholders and for the exercising or delegating of voting rights are set out in its articles of association and, by default, in Royal Legislative Decree 1/2010 of 2 July approving the reformulated wording of the Companies Act [Ley de Sociedades de Capital]. The shareholders are aware of their rights as such.

10. When an accredited shareholder exercises the right to supplement the agenda or submit new proposals prior to the general meeting, the company should:

    a) Immediately circulate the supplementary items and new proposals.
    b) Disclose the model of attendance card or proxy appointment or remote voting form duly modified so that new agenda items and alternative proposals can be voted on in the same terms as those submitted by the board of directors.
    c) Put all these items or alternative proposals to the vote, applying the same voting rules as for those submitted by the board of directors, with particular regard to presumptions or deductions about the direction of votes.
    d) After the general meeting, disclose the breakdown of votes on such supplementary items or alternative proposals.

    Given that there are only three shareholders, Meetings are generally universal, without prejudice to such shareholders receiving the required information regarding the agenda far enough in advance of the meetings, as well as proposals put forth under the prescribed legal terms.

11. In the event that a company plans to pay for attendance at the general meeting, it should first establish a general, long-term policy in this respect.

    There are no plans to pay for attendance at general meetings.

12. The Board of Directors should perform its duties with unity of purpose and independent judgement, according the same treatment to all shareholders in the same position. It should be guided at all times by the company's best interest, understood as the creation of a profitable business that promotes its sustainable success over time, while maximising its economic value.
    In pursuing the corporate interest, it should not only abide by laws and regulations and conduct itself according to principles of good faith, ethics and respect for commonly accepted customs and good practices, but also strive to reconcile its own interests with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as with the impact of its activities on the broader community and the natural environment.

KUTXABANK, S.A. meets this recommendation. KUTXABANK, S.A. implements a management model that integrates economic prosperity objectives, social equality and environmental quality in equal measure. This triple commitment is reflected in a financially sound business model, which aligns its processes and operations with economic sustainability; with the will to proactively preserve and protect the environment whilst trying to minimise the impacts generated by its activities; and with the creation of economic and social value, by implementing actions of collaboration and support and through the social work carried out by the three Bank Foundations that comprise the shareholders.

13. The Board of Directors should have the optimal size to ensure its effective functioning and maximise participation, which means that it is advisable that it should have between five and 15 members.

    The Board of Directors has 16 members, with a range of profiles that complement one another, for the effective governance of KUTXABANK, S.A.

14. The board of directors should approve a director selection policy that:

    a) Is concrete and verifiable
    b) Ensures that appointment or re-election proposals are based on a prior analysis of the board's needs.
    c) Favours a diversity of knowledge, experience and gender.

    The results of the prior analysis of board needs should be written up in the appointments committee's explanatory report, to be published when the general meeting is convened that will ratify the appointment and re-election of each director.

    The director selection policy should pursue the goal of having at least 30% of total board places occupied by women directors before the year 2020.

    The appointments committee should run an annual check on compliance with the director selection policy and set out its findings in the annual corporate governance report.

    KUTXABANK, S.A. meets this recommendation, given that it has: (i) a policy for assessing the suitability of members of the Board of Directors, managing directors and similar positions, managers responsible for internal control functions and other key positions in KUTXABANK, S.A., in accordance with the provisions of the applicable regulations (Act 10/2014 of 26 June on the planning, supervision and solvency of credit institutions and the regulations for its implementation); and (ii) a policy for the selection of candidates to serve as members of the Board of Directors. These policies ensure that proposals for appointment or re-election are based on prior analysis of the needs of the Board of Directors and are conducive to diversity in expertise, experience and gender. KUTXABANK, S.A. also has a policy concerning targets for representation of the gender less represented on the Board of Directors of KUTXABANK, S.A., though it is not an expressly stated objective of that policy that the number of female board members should be at least 30% of the total membership of the Board of Directors by the year 2020. Nevertheless, it does include the need of increasing the percentage of women in the aforementioned Board, that currently hold a representation of 18.75%, this objective is contingent upon the evolution and existence of vacancies.

15. Proprietary and independent directors should constitute an ample majority on the board of directors, while the number of executive directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.

    KUTXABANK, S.A. meets this recommendation. In accordance with the Articles of Association (article 25), the Board of Administration, whilst exercising its power to make proposals to general meetings and to elect members to cover vacancies, will procure that the number of external or non-executive directors represents a broad majority over executive directors, and that there is a reasonable number of independent directors therein, ensuring that they represent at least a third of directors. All of these aspects are met by the Entity, as set out in the Annual Corporate Governance Report corresponding to 2017 financial year.

16. The percentage of proprietary directors out of all non-executive directors should be no greater than the proportion between the ownership stake of the shareholders they represent and the remainder of the company's capital.
    This criterion can be relaxed:
    a) In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.
    b) In companies with a plurality of shareholders represented on the board but not otherwise related.

    KUTXABANK, S.A. meets this recommendation. KUTXABANK, S.A. has only three shareholders, who hold 100% of the share capital, and all of whom are represented by proprietary directors. All share capital is represented in the Board of Directors.

17. Independent directors should be at least half of all board members.

    However, when the company does not have a large market capitalisation, or when a large cap company has shareholders individually or concertedly controlling over 30% of capital, independent directors should occupy, at least, a third of board places.

    KUTXABANK, S.A., has at least one shareholder who controls more than 30% of the company capital. KUTXABANK S.A., has at least 6 independent board members out of a total of 16, meaning the number of independent board members represents 37.5% of the board members.

18. Companies should disclose the following director particulars on their websites and keep them regularly updated:

    a) Background and professional experience.
    b) Directorships held in other companies, listed or otherwise, and other paid activities they engage in, of whatever nature.
    c) Statement of the director class to which they belong, in the case of proprietary directors indicating the shareholder they represent or have links with.
    d) Dates of their first appointment as a board member and subsequent re-elections.

e) Shares held in the company, and any options on the same.

KUTXABANK, S.A. partially meets this recommendation. In order to respect the privacy of the directors, the entity does not share all the information referred to in this recommendation on its website since the entity is not a listed company, its shareholders do not deem it necessary and it is not legally required to do so.

19. Following verification by the appointments committee, the annual corporate governance report should disclose the reasons for the appointment of proprietary directors at the urging of shareholders controlling less than 3% of capital; and explain any rejection of a formal request for a board place from shareholders whose equity stake is equal to or greater than that of others applying successfully for a proprietary directorship.

    None of the indicated circumstances have occurred to date.

20. Proprietary directors should resign when the shareholders they represent dispose of their ownership interest in its entirety. If such shareholders reduce their stakes, thereby losing some of their entitlement to proprietary directors, the latters' number should be reduced accordingly.

    None of the indicated circumstances have occurred to date.

21. The Board of Directors should not propose the removal of independent directors before the expiry of their tenure as mandated by the Bylaws, except where they find just cause, based on a proposal from the appointments committee. In particular, it will be understood that there is just cause when the adviser pass to occupy new posts or it contracts new obligations that they impede him to dedicate the necessary time to the payment of the functions specific to the charge of adviser, break the duties inherent to its charge or it incurs in some circumstances that they do him to lose its condition of independent, in accordance with that established in the applicable law. The removal of independent directors may also be proposed when a takeover bid, merger or similar corporate transaction alters the company's capital structure, provided the changes in board membership ensue from the proportionality criterion set out in recommendation 16.

    Thus far KUTXABANK S.A., has not proposed the dismissal of any independent board member before the compliance to the statutory period for which the member has been appointed, having occurred no just cause justifying dismissal.

22. Companies should establish rules obliging directors to disclose any circumstance that might harm the organisation's name or reputation, tendering their resignation as the case may be, and, in particular, to inform the board of any criminal charges brought against them and the progress of any subsequent trial.
    The moment a director is indicted or tried for any of the offences stated in company legislation, the board of directors should open an investigation and, in light of the particular circumstances, decide whether or not he or she should be called on to resign. The board should give a reasoned account of all such determinations in the annual corporate governance report.

    KUTXABANK, S.A. meets this recommendation, without any of the indicated circumstances having occurred to date.

By virtue of the provisions of Article 9 of the regulations governing the Board of Directors, directors must resign from their posts when, among other reasons, (i) they may damage the credit and reputation of KUTXABANK, S.A.; and (ii) should any proceedings be filed against them involving a hearing by the Committee concerning any infringement classed as an offence under law.

They are also under obligation to report any such circumstances to the Board, particularly if they are cited as parties under investigation in criminal proceedings.

23. Directors should express their clear opposition when they feel a proposal submitted for the board's approval might damage the corporate interest. In particular, independents and other directors not subject to potential conflicts of interest should strenuously challenge any decision that could harm the interests of shareholders lacking board representation.

    When the board makes material or reiterated decisions about which a director has expressed serious reservations, he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next recommendation. The terms of this recommendation also apply to the secretary of the board, even if he or she is not a director.

    KUTXABANK, S.A. meets this recommendation, without any of the indicated circumstances having occurred to date, without prejudice to the existence of appropriate debates in the board of directors and its delegated committees.

24. Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the board of directors. Whether or not such resignation is disclosed as a material event, the motivating factors should be explained in the annual corporate governance report.

    KUTXABANK, S.A. partially meets this recommendation. In accordance to the provisions in article 9.2 of the Board's regulations, when board members resign from their position before their tenure expires, they must state their reasons in a letter to be sent to the secretary or assistant secretary, who will render account of it in the next Board session, or directly before the Board itself.

    In the session of 30 March 2017, the Board of Directors acknowledged the contents of the letter sent by Mr. Luis Viana Apraiz, on 28 March, submitting his resignation as member of KUTXABANK S.A.'s Board of Directors (and, as a result, as member of the Executive Committee and as Deputy Vice-Chair of the Board of Directors).
25. The nomination committee should ensure that non-executive directors have sufficient time available to discharge their responsibilities effectively.
    The board of directors' regulations should lay down the maximum number of company boards on which directors can serve.

    KUTXABANK, S.A. meets this recommendation. In line with current regulations, KUTXABANK, S.A. has a policy in place for assessing the suitability of the members of the Board of Directors, general managers and similar staff, persons responsible for internal control functions and other key posts for the day to day running of the operations of KUTXABANK, S.A. The object is to set the criteria to be taken into account by the Company in assessing the suitability of Board Members, general managers and similar staff, persons responsible for internal control functions and other key posts for the day to day running of the operations of the Bank.

Said policy, which was approved by the Company's Board of Directors, must be understood as being complementary to the indications of the Articles of Association, the Regulations of the Board of Directors, regulations from delegated committees, and the Company's Policy for Conflicts of Interest.

In this regard, for evaluating for the suitability of members of the board of directors, managing directors or similar positions, managers for matters regarding internal control and other key positions in the Company, their commercial and professional repute will be taken into consideration, along with their knowledge and experience. As for members of the Board of Directors, aspects pertaining to good governance will also be evaluated, using indicators such as dedication capacity, independence and the presence of conflicts of interest. It is all in compliance with the sectoral legislation, which is also applicable given its status as a credit institution.

26. The board should meet with the necessary frequency to properly perform its functions, eight times a year at least, in accordance with a calendar and agendas set at the start of the year, to which each director may propose the addition of initially unscheduled items.

    KUTXABANK, S.A. meets this recommendation, as the Board met 11 times during the year.

27. Director absences should be kept to a strict minimum and quantified in the Annual Corporate Governance Report. In the event of absence, directors should delegate their powers of representation with the appropriate instructions.

    KUTXABANK, S.A. meets this recommendation partially, given that the Annual Corporate Governance Report does not contain a section featuring the information indicated.

    However, directors failed to attend only when it was essential for them to be elsewhere, and in most cases issued proxies with instructions. Absences are also recorded in the assessment report on the Board of Directors that is drawn up each year.

28. When directors or the secretary express concerns about some proposal or, in the case of directors, about the company's performance, and such concerns are not resolved at the meeting, they should be recorded in the minute book if the person expressing them so requests.

    KUTXABANK, S.A. meets this recommendation.

29. The company should provide suitable channels for directors to obtain the advice

they need to carry out their duties, extending if necessary to external assistance at the company's expense.

KUTXABANK, S.A. meets this recommendation.

30. Regardless of the knowledge directors must possess to carry out their duties, they should also be offered refresher programmes when circumstances so advise.

    KUTXABANK, S.A. meets this recommendation. In particular, KUTXABANK had a training programme for Directors for the 2016 financial year, which was approved by the Board of Directors, in addition to a reception plan for the new Director incorporated this year.

31. The agendas of board meetings should clearly indicate on which points directors must arrive at a decision, so they can study the matter beforehand or gather the material they need.
    For reasons of urgency, the chairman may wish to present decisions or resolutions for board approval that were not on the meeting agenda. In such exceptional circumstances, their inclusion will require the express prior consent, duly minuted, of the majority of directors present.

    KUTXABANK, S.A. meets this recommendation. The agenda for meetings clearly sets out the points on which the Board of Directors must reach a decision or pass a resolution. When reasons of urgency lead the Chair to put decisions or resolutions to the Board that are not listed in the agenda for the meeting, the express prior consent of a majority of the directors in attendance is required. This is duly recorded in the minutes.

32. Directors should be regularly informed of movements in share ownership and of the views of major shareholders, investors and rating agencies on the company and its group.

    KUTXABANK, S.A. meets this recommendation, and no such movements among shareholders have occurred to date.

33. The chairman, as the person charged with the efficient functioning of the board of directors, in addition to the functions assigned by law and the company's bylaws, should prepare and submit to the board a schedule of meeting dates and agendas; organise and coordinate regular evaluations of the board and, where appropriate, the company's chief executive officer; exercise leadership of the board and be accountable for its proper functioning; ensure that sufficient time is given to the discussion of strategic issues, and approve and review refresher courses for each director, when circumstances so advise.

    KUTXABANK, S.A. meets this recommendation, though there is also a Coordinating Director at the Entity whose functions (aside from those attributed to the Appointments Committee) include organising and coordinating regular assessments of the Board of Directors, the Chair and the Managing Director.

    The Chair, among other functions, is responsible for the management of the Board and the effectiveness of its operation, ensuring sufficient discussion time is given to strategic issues and, when applicable, collaborating in the proposals of the training programmes of the Directors.

34. When a Coordinating Director has been appointed, the Articles of Association or Regulations of the Board of Directors should grant him or her the following powers, over and above those conferred by law: chair the board of directors in the absence of the chairman and vice chairmen; give voice to the concerns of non-executive directors; maintain contacts with investors and shareholders to hear their views and develop a balanced understanding of their concerns, especially those pertaining to the company's corporate governance; and coordinate the chairman's succession plan.

    KUTXABANK, S.A. partially meets this recommendation, focussing on the functions of the Coordinating Director, enter alia, mentioned above, in maintaining the appropriate dialogue with the external directors and in the implementation, where applicable, of the succession plan of the Chair, in the terms, inter alia, of the annual plan of his function approved by the Board of Directors.

35. The board secretary should strive to ensure that the board's actions and decisions are informed by the governance recommendations of the Good Governance Code that is applicable to the company.

    KUTXABANK, S.A. meets this recommendation.

36. The full board of directors should conduct an annual evaluation, adopting, where necessary, an action plan to correct weakness detected in:

    a) The quality and efficiency of the board's operation.

    b) The performance and membership of its committees.

    c) The diversity of board membership and competences.

    d) The performance of the chairman of the board of directors and the company's chief executive.

    e) The performance and contribution of individual directors, with particular attention to the chairmen of board committees.

    The evaluation of board committees should start from the reports they send to the board of directors, while that of the board itself should start from the report of the appointments committee.

    Every three years, the board of directors should engage an external facilitator to aid in the evaluation process. This facilitator's independence should be verified by the appointments committee.

    Any business dealings that the facilitator or members of its corporate group maintain with the company or members of its corporate group should be detailed in the annual corporate governance report.

    The process followed and areas evaluated should be detailed in the annual corporate governance report.

    KUTXABANK, S.A. partially meets this recommendation, as, so far, an external facilitator has not been engaged every 3 years.

37. When an executive committee exists, its membership mix by director class should resemble that of the board. The secretary of the board of directors should also act as secretary to the executive committee.

    KUTXABANK, S.A. partially meets this recommendation. There is an Executive Committee, in which the post of secretary is held by the Secretary to the Board of Directors. However the participation structure of the different types of director is not exactly similar to that of the Board of Directors itself, as has been detailed in the Annual Corporate Governance Report corresponding to 2017.

38. The board of directors should be kept fully informed of the business transacted and decisions made by the executive committee. To this end, all board members should receive a copy of the committee's minutes.

    KUTXABANK, S.A. meets this recommendation. The Board of Directors always receives reports of the items discussed and the decisions made by the Executive Committee. The minutes of its meetings are available to directors.

39. All members of the audit committee, particularly its chairman, should be appointed with regard to their knowledge and experience in accounting, auditing and risk management matters. A majority of committee places should be held by independent directors.

    KUTXABANK, S.A. meets this recommendation.

40. Companies should have a unit in charge of the internal audit function, under the supervision of the audit committee, to monitor the effectiveness of reporting and control systems. This unit should report functionally to the board's non-executive chairman or the chairman of the audit committee.

    KUTXABANK, S.A. meets this recommendation, having internal audit, regulatory compliance and group control, and global risk control units in place, with direct access to the Board of Directors.

41. The head of the unit handling internal audit function should present an annual work programme to the audit committee, inform it directly of any incidents arising during its implementation and submit an activities report at the end of each year.

    KUTXABANK, S.A. meets this recommendation.

42. The audit committee should have the following functions over and above those legally assigned:

    1. With respect to internal control and reporting systems:

       a) Monitor the preparation and the integrity of the financial information prepared on the company and, where appropriate, the group, checking for compliance with legal provisions, the accurate demarcation of the consolidation perimeter, and the correct application of accounting principles.

b) Monitor the independence of the unit handling the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the service's budget; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks to which the company is exposed; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.

c) Establish and supervise a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

2. With regard to the external auditor:

a) Investigate the issues giving rise to the resignation of the external auditor, should this arise.

b) Ensure that the remuneration of the external auditor does not compromise its quality or independence.

c) Ensure that the company notifies any change of external auditor to the CNMV as a material event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.

d) Ensure that the external auditor has a yearly meeting with the board in full to inform it of the work undertaken and developments in the company's risk and accounting positions.

e) Ensure that the company and the external auditor adhere to current regulations on the provision of non-audit services, limits on the concentration of the auditor's business and other requirements concerning auditor independence.

KUTXABANK, S.A. meets this recommendation where it is and has been applicable, without any change or waiver of the external auditor.

43. The audit committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.

KUTXABANK, S.A. meets this recommendation.

44. The Audit Committee should be informed of any fundamental changes or corporate transactions the company is planning, so the committee can analyse the operation and report to the board beforehand on its economic conditions and accounting impact and, when applicable, the exchange ratio proposed.

Thus far the indicated circumstances have not taken place. In year 2017, take-over merger of KUTXABANK S.A., as absorbing company, and Kartera 2, S.L.U. and Kartera 4, S.A.U., as absorbed companies, was not dealt with in the Audit and Compliance Committee due to it being and operation with companies wholly owned by KUTXABANK S.A. and merely instrumental.

45. Risk control and management policy should identify, at least:

  a) The different types of financial and non-financial risk the company is exposed to (including operational, technological, financial, legal, social, environmental, political and reputational risks), with the inclusion under financial or economic risks of contingent liabilities and other off-balance-sheet risks.
  b) The determination of the risk level the company sees as acceptable.
  c) The measures in place to mitigate the impact of identified risk events should they occur.
  d) The internal control and reporting systems to be used to control and manage the above risks, including contingent liabilities and off-balance-sheet risks.

KUTXABANK, S.A. meets this recommendation.

46. Companies should establish a risk control and management function held by one of the company's internal departments or units and under the direct supervision of the audit committee or another dedicated board committee. This function should be expressly charged with the following responsibilities:

  a) Ensure that risk control and management systems are functioning correctly and, specifically, that major risks the company is exposed to are correctly identified, managed and quantified.

  b) Participate actively in the preparation of risk strategies and in key decisions about their management.

  c) Ensure that risk control and management systems are mitigating risks effectively in the frame of the policy drawn up by the board of directors.

KUTXABANK, S.A. meets this recommendation.

47. Appointees to the nomination and remuneration committee – or of the nomination committee and remuneration committee, if separately constituted – should have the right balance of knowledge, skills and experience for the functions they are called on to discharge. The majority of their members should be independent directors.

KUTXABANK, S.A. meets this recommendation, albeit, the independent members are 50% of the total.

48. Large cap companies should operate separately-constituted appointments and remunerations committees.

KUTXABANK, S.A. meets this recommendation.

49. The Appointments Committee should consult with the company's Chairman and chief executive, especially on matters relating to executive directors.
When there are vacancies on the board, any director may approach the appointments committee to propose candidates that it might consider suitable.

KUTXABANK, S.A. meets this recommendation.

50. The remunerations committee should operate independently and have the following functions, in addition to those assigned by law:

    a) Propose standard conditions for senior officer contracts to the board of directors.

    b) Monitor compliance with the remuneration policy set by the company.

    c) Periodically review the remuneration policy for directors and senior officers, including share-based remuneration systems and their application, and ensure that their individual compensation is proportionate to the amounts paid to other directors and senior managers in the company.

    d) Ensure that conflicts of interest do not undermine the independence of any external advice the committee engages.

    e) Verify the information on director and senior officers' pay contained in corporate documents, including the annual directors' remuneration statement.

    KUTXABANK, S.A. meets this recommendation.

51. The remunerations committee should consult with the company's chairman and chief executive, especially on matters relating to executive directors and senior officers.

    KUTXABANK, S.A. meets this recommendation.

52. The terms of reference of supervision and control committees should be set out in the board of directors regulations and aligned with those governing legally mandatory board committees as specified in the preceding sets of recommendations. They should include at least the following terms:

    a) Committees should be formed exclusively by non-executive directors, with a majority of independents.
    b) They should be chaired by independent directors.
    c) The board should appoint the members of such committees with regard to the knowledge, skills and experience of its directors and each committee's terms of reference; discuss their proposals and reports; and provide report-backs on their activities and work at the first board plenary following each committee meeting.
    d) They may engage external advice, when they feel it necessary for performing their functions.
    e) Meeting proceedings should be minuted and a copy made available to all board members.

    KUTXABANK, S.A. meets this recommendation in the delegated committees with control functions that are currently constituted.

53. The task of supervising compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy should be assigned to one board committee or split between several, which could be the audit committee, the appointments committee, the corporate social responsibility committee, where one exists, or a dedicated committee established ad hoc by the board under its powers

of self-organisation, with at the least the following functions:

a) Monitor compliance with the company's internal codes of conduct and corporate governance rules.
b) Oversee the communication and relations strategy with shareholders and investors, including small and medium-sized shareholders.
c) Periodically evaluate the effectiveness of the company's corporate governance system, to confirm that it is fulfilling its mission to promote the corporate interest and catering, as appropriate, to the legitimate interests of remaining stakeholders.
d) Review the company's corporate social responsibility policy, ensuring that it is geared to value creation.
e) Monitor corporate social responsibility strategy and practices and assess compliance therewith.
f) Monitor and evaluate the company's interaction with its stakeholder groups.
g) Evaluate all aspects of the non-financial risks the company is exposed to, including operational, technological, legal, social, environmental, political and reputational risks.
h) Coordinate non-financial and diversity reporting processes in accordance with applicable legislation and international benchmarks.

KUTXABANK, S.A. partially meets this recommendation. The functions indicated are held by the Board of Directors itself or by one of its Delegated Committees.

54. The corporate social responsibility policy should state the principles or commitments the company will voluntarily adhere to in its dealings with stakeholder groups, specifying at least:

a) The goals of its corporate social responsibility policy and the support instruments to be deployed.

b) The corporate strategy with regard to sustainability, the environment and social issues.

c) Concrete practices in matters relative to: shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts.

d) The methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks.

e) The mechanisms for supervising non-financial risk, ethics and business conduct.

f) Channels for stakeholder communication, participation and dialogue.

g) Responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.

KUTXABANK, S.A. meets the recommendations pertaining to objectives, strategies and practices, whilst developing a process to implement specific monitoring methods for said practices, primarily pertaining to reputational risk.

55. The company should report on corporate social responsibility developments in its directors' report or in a separate document, using an internationally accepted methodology.

KUTXABANK, S.A. meets this recommendation.

56. Director remuneration should be sufficient to attract individuals with the desired profile and compensate the commitment, abilities and responsibility that the post demands, but not so high as to compromise the independent judgement of non-executive directors.

KUTXABANK, S.A. meets this recommendation

57. Variable remuneration linked to the company and directors' performance, the award of shares, options or any other right to acquire shares or to be remunerated on the basis of share price movements, and membership of long-term savings schemes, such as pension plans, should be confined to executive directors.
The company may consider the share-based remuneration of non-executive directors, provided they retain such shares until the end of their mandate. This condition, however, will not apply to shares that the director must dispose of to defray costs related to their acquisition.

KUTXABANK, S.A. meets this recommendation.

58. In the case of variable awards, remuneration policies should include limits and technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector, or circumstances of that kind.

In particular, variable remuneration items should meet the following conditions:

a) Be subject to predetermined and measurable performance criteria that factor the risk assumed to obtain a given outcome.

b) Promote the long-term sustainability of the company and include non-financial criteria that are relevant for the company's long-term value, such as compliance with its internal rules and procedures and its risk control and management policies.

c) Be focused on achieving a balance between the delivery of short, medium and long-term objectives, such that performance-related pay rewards ongoing achievement, maintained over sufficient time to appreciate its contribution to long-term value creation. This will ensure that performance measurement is not based solely on one-off, occasional or extraordinary events.

KUTXABANK, S.A. meets this recommendation.

59. A major part of variable remuneration components should be deferred for a long enough period to ensure that predetermined performance criteria have effectively been met.

KUTXABANK, S.A. meets this recommendation.

60. Remuneration linked to company earnings should take into account any qualifications stated in the external auditor's report that reduces their amount.

KUTXABANK, S.A. meets this recommendation.

61. A major part of executive directors' variable remuneration should be linked to the award of shares or financial instruments whose value is linked to the share price.

This recommendation is not applicable to KUTXABANK S.A., as it does not remunerate executive board members through the distribution of shares.

62. Following the award of shares, share options or other rights on shares derived from the remuneration system, directors should not be allowed to transfer a number of shares equivalent to twice their annual fixed remuneration, or to exercise the share options or other rights on shares for at least three years after their award.
The above condition will not apply to any shares that the director must dispose of to defray costs related to their acquisition.

This recommendation is not applicable to KUTXABANK, S.A., as executive directors are not remunerated in the form of shares.

63. Contractual arrangements should include provisions that permit the company to reclaim variable components of remuneration when payment was out of step with the Director's actual performance or based on data subsequently found to be misstated.

KUTXABANK, S.A. meets this recommendation as required under the relevant regulations.

64. Termination payments should not exceed a fixed amount equivalent to two years of the director's total annual remuneration and should not be paid until the company confirms that he or she has met the predetermined performance criteria.

KUTXABANK, S.A. meets this recommendation on the terms required under the relevant regulations.

Deloitte.

Deloitte, S.L.
Ercilla, 24
48011 Bilbao
España

Tel: +34 944 44 70 00
www.deloitte.es

*Translation of a report originally issued in Spanish. In the event of a discrepancy, the Spanish-language version prevails.*

AUDITOR'S REPORT ON THE INFORMATION RELATING TO THE SYSTEM OF INTERNAL CONTROL OVER FINANCIAL REPORTING (ICFR) OF KUTXABANK, S.A. FOR 2017

To the Directors,

As requested by the Board of Directors of Kutxabank, S.A. ("the Entity") and in accordance with our proposal-letter of 28 December 2017, we have applied certain procedures to the information relating to the ICFR system contained in the accompanying Annual Corporate Governance Report of Kutxabank, S.A. for 2017, which summarises the internal control procedures of the Entity in relation to its annual financial reporting.

The Board of Directors is responsible for adopting the appropriate measures in order to reasonably guarantee the implementation, maintenance and supervision of an adequate internal control system and for making improvements to that system and for preparing and establishing the content of the accompanying information relating to the ICFR system.

It should be noted in this regard, irrespective of the quality of the design and operational effectiveness of the internal control system adopted by the Entity in relation to its annual financial reporting, that the system can only permit reasonable, but not absolute, assurance in connection with the objectives pursued, due to the limitations inherent to any internal control system.

In the course of our audit work on the financial statements and pursuant to Technical Standards on Auditing, the sole purpose of our assessment of the internal control of the Entity was to enable us to establish the scope, nature and timing of the audit procedures to be applied to the financial statements of Kutxabank, S.A. Therefore, our assessment of internal control performed for the purposes of the aforementioned audit of financial statements was not sufficiently extensive to enable us to express a specific opinion on the effectiveness of the internal control over the regulated annual financial reporting.

For the purpose of issuing this report, we applied exclusively the specific procedures described below and indicated in the *Guidelines on the Auditor's Report on the Information relating to the System of Internal Control over Financial Reporting of Listed Companies*, published by the Spanish National Securities Market Commission (CNMV) on its website, which establish the work to be performed, the minimum scope thereof and the content of this report. Since the work resulting from such procedures has, in any case, a reduced scope that is significantly less extensive than that of an audit or a review of the internal control system, we do not express an opinion on the effectiveness thereof, or on its design or operating effectiveness, in relation to the Entity's annual financial reporting for 2017 described in the accompanying information on the ICFR system. Therefore, had we applied procedures additional to those established in the aforementioned Guidelines or performed an audit or a review of the system of internal control over the regulated annual financial reporting, other matters or aspects might have been disclosed which would have been reported to you.

Also, since this special engagement does not constitute an audit of financial statements and is not subject to the Consolidated Spanish Audit Law, approved by Legislative Royal Decree 1/2011, of 1 July, we do not express an audit opinion in the terms provided for in that Law.

The procedures applied were as follows:

1. Perusal and understanding of the information prepared by the Entity in relation to the ICFR system - disclosure information included in the directors' report- and assessment of whether this information addresses all the information required in accordance with the minimum content described in section F, relating to the description of the ICFR system, of the model Annual Corporate Governance Report established in CNMV Circular no. 7/2015, of 22 December 2015.

Deloitte, S.L. Inscrita en el Registro Mercantil de Madrid, tomo 13.650, sección 8ª, folio 188, hoja M-54414, inscripción 96ª. C.I.F.: B-79104469.
Domicilio social: Plaza Pablo Ruiz Picasso, 1, Torre Picasso, 28020, Madrid.

2. Inquiries of personnel in charge of preparing the information detailed in point 1 above for the purpose of: (i) obtaining an understanding of the preparation process; (ii) obtaining the information required to assess whether the terminology used complies with the definitions of the reference framework; and (iii) obtaining information on whether the control procedures described have been implemented and are in use at the Entity.

3. Review of the explanatory documents supporting the information detailed in point 1 above, including mainly documents directly made available to those responsible for describing the ICFR system. In this respect, the aforementioned documentation includes reports prepared by the Internal Audit Department, senior executives or other internal or external experts providing support functions to the Audit Committee.

4. Comparison of the information detailed in point 1 above with the knowledge of the Entity's ICFR system obtained through the procedures applied during the financial statement audit work.

5. Perusal of minutes of meetings of the Board of Directors, the Audit Committee and other committees of the Entity in order to assess the consistency between the ICFR system issues addressed thereat and the information detailed in point 1 above.

6. Obtainment of the representation letter in connection with the work performed, duly signed by those responsible for preparing and formulating the information detailed in point 1 above.

The procedures applied to the information relating to the ICFR system did not disclose any inconsistencies or incidents that might affect the information.

This report has been prepared exclusively in the context of the requirements of Article 540 of the Consolidated Spanish Limited Liability Companies Law, amended by Sustainable Economy Law 2/2011, of 4 March, and of CNMV Circular no. 7/2015, of 22 December 2015, for the purposes of the description of the ICFR system in Annual Corporate Governance Reports.

DELOITTE, S.L.

Pablo Mugica
23 February 2018