Security classification: SRB-GREEN

Valuation Report

for the purpose of Article 20(5)(a) of Regulation (EU) No 806/2014

informing the determination of whether the conditions for resolution or the conditions for the write down or conversion of capital instruments are met ("Valuation 1")

Banco Popular Español

05 June 2017

Single Resolution Board

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1. SCOPE AND INFORMATION BASIS

1.1 SCOPE OF THE VALUATION

This Valuation Report summarises the results of a *valuation 1*, which has been performed by the Single Resolution Board in line with Article 20 of Regulation (EU) No 806/2014 ("SRMR") for the purpose of informing the determination of whether Banco Popular S.A. ("GBP") meets the conditions for resolution or the conditions for the write down or conversion of capital instruments pursuant to Article 20(5)(a) of the SRMR ("Valuation 1"). In particular, the report should support the determination of whether GBP is *failing or likely to fail* pursuant to Article 18(1) (a) of the SRMR. It should be noted that the valuation described in this report addresses the circumstances of Article 18(4)(a) (b) and (c) of the SRMR leading to the decision that an institution is *failing or likely to fail*:

a) *the institution infringes or there are objective elements to support a determination that the institution will, in the near future, infringe the requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation by the competent authority including but not limited to because the institution has incurred or is likely to incur losses that will deplete all or a significant amount of its own funds;*

b) *the assets of the institution are or there are objective elements to support a determination that the assets of the institution will, in the near future, be less than its liabilities;*

c) *the institution is or there are objective elements to support a determination that the institution will, in the near future, be unable to pay its debts or other liabilities as they fall due.*

The Valuation Report has been drafted taking into account Article 6 of the *Final Draft RTS on valuation before resolution* (EBA/RTS/2017/05) and the valuation methodology criteria of chapter II of that RTS, under the limitations of the available time and information restrictions at the valuation date. The classification as an interim *valuation* pursuant to Article 36(9) of the Directive 2014/59/EU implies that the valuation does not constitute either an audit or a review performed in accordance with International Standards on Auditing or International Standards on Review Engagements or relevant national standards or practices and consequently the Single Resolution Board does not express any assurance for the accuracy of the results expressed in this report. The report should rather be understood as a best effort of the Single Resolution Board to assess the current solvency situation of GBP on the basis of all available information and the time constraints at the valuation date.

Due to the fast deterioration of GBP's liquidity ratios, as a result of significant withdrawals of deposits over the last days, the Single Resolution Board decided, in consultation with the European Central Bank as the competent supervisory authority, to conduct an urgent provisional valuation on the basis of available public and supervisory information.

In accordance with Article 36(10) of the Directive 2014/59/EU, the Single Resolution Board will, in case of a resolution of GBP, arrange if needed an ex-post definitive valuation by an independent valuer as soon as practicable.

1.2 SOURCES OF INFORMATION AND VALUATION DATE

The provisional valuation, of which the outcome is summarised in this report, is the result of an assessment of all relevant public and non-public supervisory information that was available to the Single Resolution Board.

Due to limited access to relevant data, the Single Resolution Board decided to use the last 31 March 2017 quarterly report on a consolidated basis.

In particular, as all available information as of 5 June 2017 is taken into account when deciding about potential adjustments to the financial statement figures, the reference date of the valuation in accordance with Article 2 of the *Final Draft RTS on valuation before resolution* (EBA/RTS/2017/05) shall be the 31 of March 2017, which is *as close as possible to the expected date of the decision by the resolution authority to put the entity in resolution.*

In accordance with Article 4 of the *Final Draft RTS on valuation before resolution* (EBA/RTS/2017/05), the sources of the information for the provisional valuation were the following:

a) the financial statements as of 31 March 2017 and 31 December 2016;

b) FINREP/COREP data as of 31 March 2017;

c) ECB onsite inspection information [redacted];

d) ECB Supervisory Board Update [redacted]

e) Capital plan assessment and credit risk potential impact [redacted]

f) relevant market data, e.g. equity research reports and Moody's report;

g) Discussions with the ECB;

2. PROVISIONAL VALUATION METHODOLOGY AND OUTCOME

In this section the necessary adjustments to fairly represent the financial position of GBP are presented. Due to the urgency in the circumstances of the case for the provisional valuation, the SRB focused on areas subject to significant valuation uncertainty which have a significant impact on the overall results of the valuation. To challenge the assumptions, data, methodologies and judgements, on which GBP based its valuation for financial reporting obligations, the SRB relied on the sources of information set out in Section 1.2.

Adjustments:

It is recalled that the ECB (i.e. SSM) is conducting an on-site inspection [redacted] Moreover, the equity research reports of different analysts and rating agencies present a shortfall to peers coverage ratio. In addition, the entity is also conducting an internal review of the coverage of the assets which, while not final at this stage, apparently shows a coverage shortfall. [redacted]

On the basis of the above, it seems clear that there is a coverage shortfall perception by the market, the supervisory authority and the entity itself. In terms of the extent of the amount of the shortfall, since the figures of the different sources of information vary significantly, the potential adjustments are mainly substantiated on the basis of the most recent figures provided by the ECB (i.e. SSM) [redacted]. Given that the audited accounts did not mention this potential shortfall, that the recent Q1 accounts are not audited, [redacted], the following adjustments to the accounts should be considered as provisional.

Please note that the economic valuation (valuation 2) results could show economic adjustments higher than those reflected in the consolidated balance sheet below. In fact, the rank of adjustments considered in terms of shortfall of asset coverage include different adjustments on loans and non-current assets classified as held for sale in higher amounts than those considered in this report. Moreover, on the course of the valuation 2 exercise, a potential shortfall on provisions for legal claims have been detected as well as a potential contingent liability regarding potential claims referred to the last capital increase issuances. However, these adjustments have been made under an economic valuation perspective which may not correspond to the purpose of the present exercise.

Finally, the materialization of the elements mentioned may have an impact on the results of the group, which may be negative for 2017. This potential negative profitability could also impact the book value of the Goodwill and the non-protected deferred tax assets. As a consequence, the overall impact of the potential adjustments on the balance sheet could imply additional losses for an amount circa [redacted]. At this stage the SRB does not have an updated business plan covering at least the following five years to assess those aspects. For this reason this last adjustments have not been reflected in the template below. However, please note that this adjustments could not have a significant impact from a solvency perspective, given these assets have already been deducted from the available regulatory capital instruments.

(Amounts in euros thousand)	31.12.16(*)		Potential Adjustments Valuation 1		31-03.17
	Re-expressed	31.03.17	Low Adjustment	High Adjustment	Re-expressed
ASSETS					
Cash and cash balances at central banks	3.278.808	6.177.314			6.177.314
Financial assets held for trading	2.103.849	2.258.941			2.258.941
Financial assets designated at fair value through profit or loss	553.790	586.033			586.033
Available-for-sale financial assets	15.384.097	13.219.484			13.219.484
Loans and receivables:	98.799.712	94.479.733			93.705.733
Deposits at credit institutions	4.159.264	3.213.165			3.213.165
Loans and advances to other debtors	94.038.481	90.723.198			89.949.198
of which performing (***)		82.170.190			82.170.190
of which non-performing (***)		8.553.008	- 501.000	- 774.000	7.779.008
Fixed Income	601.967	543.370			543.370
Held-to-maturity investments	4.583.511	7.360.242			7.360.242
Derivatives – Hedge accounting	295.219	248.079			248.079
Fair value changes of the hedged items in portfolio hedge of interest rate risk	265.519	260.168			260.168
Investments in subsidiaries, joint ventures and associates	1.865.142	1.908.364			1.908.364
Assets under reinsurance and insurance contracts	17.543	17.707			17.707
Tangible assets	2.192.793	2.228.600			2.228.600
Intangible assets	2.612.566	2.610.689			2.610.689
Tax assets	5.185.919	5.198.770	789.000	1.017.600	6.216.370
Other assets	1.691.613	1.780.098	-346.000	-346.000	1.434.098
Non-current assets and disposal groups classified as held for sale	8.855.719	8.780.229	-1.783.000	-2.272.000	6.508.229
Total assets	**147.685.800**	**147.114.451**			**144.740.051**

(Amounts in euros thousand)	31.12.16(*) Re-expressed	31.03.17	Potential Adjustments Valuation 1 Low Adjustment	High Adjustment	31-03.17 Re-expressed
LIABILITIES					
Financial liabilities held for trading	1.643.755	1.553.030			1.553.030
Financial liabilities designated at fair value through profit or loss	604.707	609.730			609.730
Financial liabilities measured at amortised cost	131.184.666	131.198.929			131.198.929
Liabilities of credit institutions	30.190.707	35.904.196			35.904.196
Of which interbank deposits	1.881.236	2.302.042			2.302.042
Deposits from other creditors	82.840.947	78.884.692			78.884.692
Debt certificates including bonds	15.024.126	13.120.932			13.120.932
Subordinated liabilities	2.039.472	2.031.114			2.031.114
Other financial liabilities	1.089.414	1.257.995			1.257.995
Derivatives – Hedge accounting	1.201.865	1.045.838			1.045.838
Fair value changes of the hedged items in portfolio hedge of interest rate risk	-	-			0
Liabilities under insurance and reinsurance contracts	484.284	469.937			469.937
Provisions	534.886	448.507			448.507
Tax liabilities	397.348	400.131			400.131
Share capital repayable on demand		-			0
Other liabilities	787.184	611.748			611.748
Liabilities included in disposal groups classified as held for sale	-	-			0
Total liabilities	**136.838.695**	**136.337.850**			136.337.850
EQUITY					
Total equity	11.124.393	11.068.555			8.694.155
Capital, reserves and retained earnings	14.735.709	11.205.605	-1.841.000	-2.374.400	8.831.205
Profit attributed to the controlling company	-3.611.316	-137.050			-137.050
Interim dividends (-)	-	-			0
Other comprehensive income and accumulated	-289.278	-303.750			-303.750
Minority interests (non-controlling interests)	11.990	11.796			11.796
Net asset value	**10.847.105**	**10.776.601**			**8.402.201**
Total liabilities and equity	**147.685.800**	**147.114.451**			**144.740.051**

*Information for December 2016 restated as a result of the Material Event Notice filed with the CNMV (Spanish Securities Market Commission) on 3 April 2017.

(**) Information for December 2016 restated by SRB following [redacted]

(***) Disclosure performing and non performing loans based in Deloitte Valuation 2 information.

2.1 OWN FUNDS / CAPITAL ADEQUACY

Euro thousand	31/12/2016	31/03/2017	Change in %
Own Funds	8,435,476	7,252,624	-16,3
o/w CET 1 Capital	7,798,692	6,100,070	-21,8
o/w Additional Tier 1 Capital		516,698	
o/w Tier 2 capital	636,784	635,856	-0,1
Total risk exposure amount	64,224,720	60,886,778	-5,5%
CET 1 Capital ratio	12.14	10.02	-21,2
T1 Capital ratio	12.14	10.87	-11.7
Total Capital ratio	13.13	11.91	-10.2
Total SREP capital requirements	11,375		

Source: COREP

The ECB in the ELA solvency assessment of the bank states the following: [redacted]

[redacted]

- [redacted]

[redacted]

[redacted]

If the potential aforementioned adjustment coming from the shortfall on provisions materializes, the CET 1 Capital Ratio and the Total Capital Ratio would decrease – *ceteris paribus* – by [redacted]. It should be highlighted the potential shortfall is not clearly established yet, as the impact on the risk weighted assets is not known.

Having said that, if the bank does not take additional measures in the following months the potential shortfall of provisions could position the bank under the minimum capital requirements (Pilar I + Pilar II). The management of the bank has been considered the potential sale of the bank itself or a capital increase as solutions for these problems. A current private sale process is on-going. Therefore there are clear indications that the solvency of the bank is under stress conditions, and the markets take this situation into account as the bank liquidity conditions shows up. However, at this stage there is no information from the competent authority that indicates the bank is may not complying with its solvency requirements.

2.2 LIQUIDITY

For the sake of completeness, it is noted that the liquidity of the group is the key factor that is triggering the failure of the bank. Following the information provided by the ECB (i.e. SSM), the bank has been confronted with significant cash outflows across all customer segments between 31 March and 1 June 2017 which have led to severe deterioration of both the deposit base (€[redacted] out of €[redacted]), and the counterbalancing capacity[1] (CBC, by €[redacted] out of €[redacted]). Sparked by a deterioration of the reputation of the institution as a result of media coverage and of the announcement made by the bank on the need to proceed to either a capital increase or an M&A transaction due to the deteriorating financial

[1] Ex-WiZink (a joint venture, and hence, its liquidity is not available to cover needs of Group Banco Popular). Counterbalancing capacity" represents the stock of unencumbered assets or other funding sources which are legally and practically available to the institution at the reporting date to cover potential funding gaps

situation, together with the impact of subsequent rating downgrades, deposit outflows exceeded €500M in a single day repeatedly over the course of the past weeks (12.05, 16.05, 22.05, 23.05, 31.05 and 01.06) in the context of a steady reduction of funding with a limited liquidity buffer.

As a consequence of significant liquidity outflows and various rating downgrades, the Supervised Entity's CBC has dropped from €[redacted] on 31 March to €[redacted] on 1 June, a depletion of some [redacted]%, which covered about [redacted]% of the remaining deposit base. Further coverage in the media on potential wind-down, have increased the uncertainty of the development of the CBC in the following days.

As a result of significant deposit outflows and a material drop in HQLA, the Supervised Entity on 12 May breached the LCR requirement of 80% and has not managed to re-establish compliance with the regulatory limit since. Moreover, according with the competent authority the Supervised Entity is unable to provide credible plans to reverse the on-going liquidity outflows and remediate the breach in the foreseeable future. In fact, still persistent deposit outflows is observable.

At the closing of this report, the entity has required emergency liquidity assistance (ELA).

3. CONCLUSIONS OF THE PROVISIONAL VALUATION

Based on the assessment described in the second chapter, and subject to the time and information limitations described in the first chapter, the provisional valuation does not indicate that - at the valuation date - the bank is insolvent. In particular, the resolution authority has no indication for considering GBP does either infringe capital requirements for continuing authorisation in a way that would justify the withdrawal of the authorisation pursuant to Article 32(4)(a) of the Directive 2014/59/EU or that its assets, in the near future, will be less than its liabilities, pursuant to the Article 32(4)(b) of the Directive 2014/59/EU.

However, the capital plan, as assessed by the ECB, and the potential asset coverage shortfall shows that GBP might infringe capital requirements due to phasing-in of CRR capital instruments until 2019 if it fails to raise capital or deleverage. As this capital plan assumes a forward looking perspective, and incorporates future regulatory requirements, the resolution authority should not take this information into account for the purpose of assessing the FOLTF.

In addition, it should be highlighted that the solvency of the entity is under stress conditions and the markets are discounting a shortfall of the coverage of non-performing loans, as well as the implementation of the future regulation, which is affecting the liquidity conditions of the group. In this sense, in the case that the shortfall of coverage materialises and no additional measures to increase the capital are in place, a breach on the capital requirements is expected.

Finally, please note that the liquidity and funding conditions of GBP is triggering the *fail or likely to fail* assessment as clearly stated in the SSM notification. In this regard, we do not have further considerations to those included in the likely to fail assesment of the SSM.