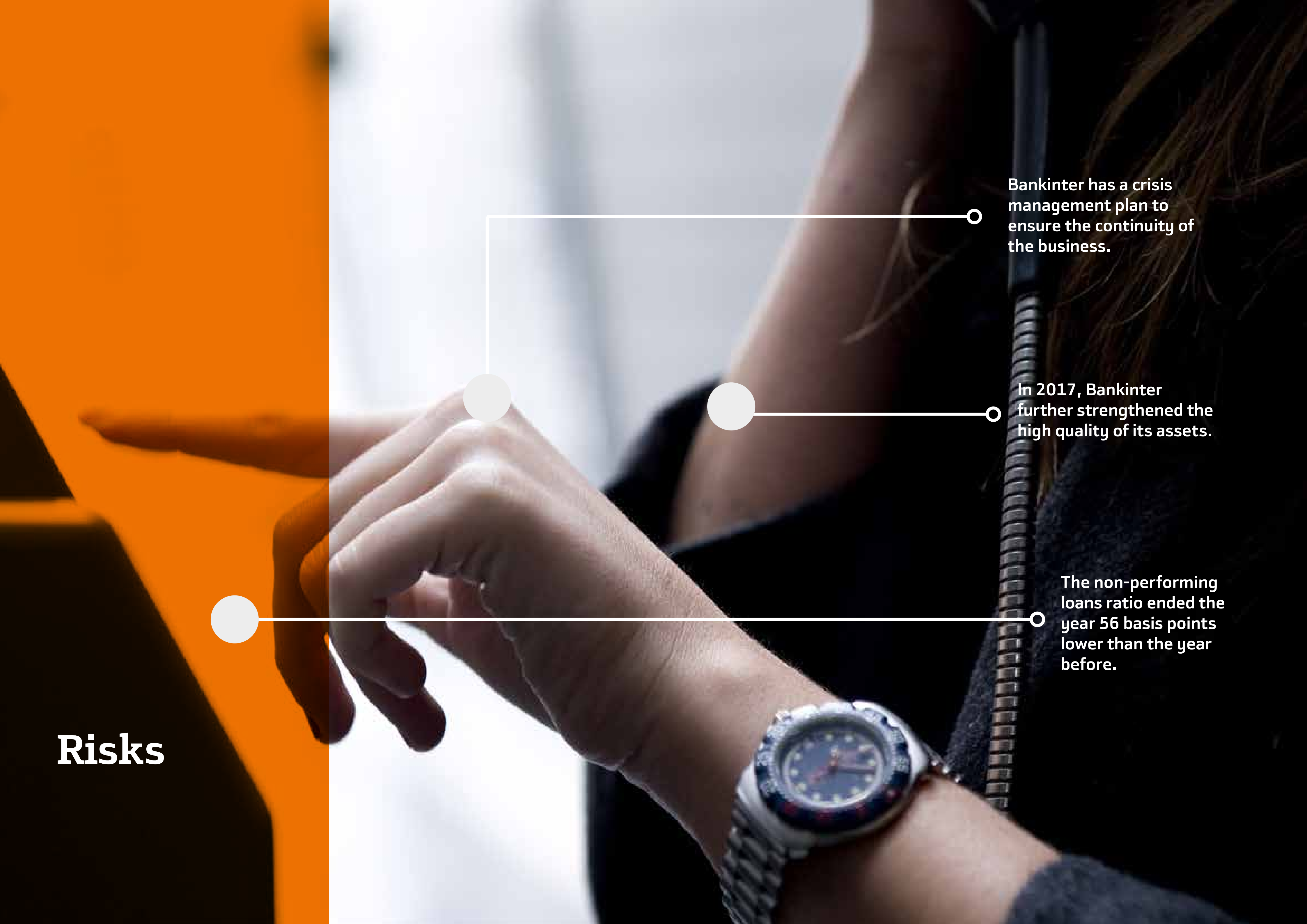
Risks



Bankinter has a crisis management plan to ensure the continuity of the business.

In 2017, Bankinter further strengthened the high quality of its assets.

The non-performing loans ratio ended the year 56 basis points lower than the year before.

Risk management

Healthy assets and moderate growth

In 2017, Bankinter further strengthened the high quality of its assets, which is one of its main hallmarks in relation to risks, and maintained its trend of moderate growth in loans against a favourable economic backdrop.

Risk management is one of the central cornerstones of Bankinter's competitive strategy. The Bank has a risk management model of proven effectiveness that is in line with regulatory standards and best international practices, in proportion to the scale and complexity of its business activities.

The ultimate responsibility for risk management rests with the board of directors, which approves the risk strategy and, in particular, defines the risk appetite framework, which establishes:

- The type and levels of the different risks that the Group considers reasonable to take on in developing its business strategy.
- A set of metrics and key indicators to monitor and manage risks. They cover variables such as risk levels and cost, return, liquidity and capital. A tolerance level and thresholds are established for each metric which, if reached, trigger the adoption of corrective measures.

The risk strategy is divided into categories:

- **Risk appetite statement.** Bankinter carries out its business activities with a prudent risk profile, pursuing a stable balance sheet and a recurring and sound income statement, to maximise the bank's long-term value.
- **Risk management principles.** The risk appetite and tolerance that the Group assumes are in line with, among others, the following principles:

- Strategies, policies, organisation and management systems are prudent and adjusted to the size, environment and complexity of Bankinter's activities, based on quality banking practices.
- The Bank's actions respect and are in line with established requirements, thresholds and regulatory restrictions, ensuring proper compliance with current legislation at all times.
- Maintenance of a low or moderate exposure to credit risk, with a non-performing loan ratio in the lowest range of the Spanish financial system.
- Appropriate hedging of problem assets.
- Appropriate return on capital invested to ensure minimum return on the risk-free rate throughout the cycle.
- Maintenance of a low level of market risk, so that losses incurred in stress scenarios have a limited impact on Bankinter's income statement.
- Growth in the priority strategic segments of medium-sized and large enterprises.
- Balance of the loan book of individuals and legal entities.
- Balanced growth in retail funds.

- Diversification of wholesale funding sources, from the viewpoint of both instruments and markets, and the maintenance of a balanced maturity profile.
- Optimisation of retail funding costs, maintaining a balance between the loan book yield and market interest rates.
- Use of a risk diversification policy to avoid excessive concentration levels that might translate into difficulties for Bankinter.
- Limitation on business activities in industries that may pose a risk to the Bank's sustainability, such as industries related to property development or construction, or that may have a negative impact on its reputation and/or respectability.
- Moderate appetite for interest rate risk.
- Maintain a very small structural position in foreign currencies.
- Strengthened control of the Bank's reputational position (for example, good corporate governance and systemic risks).
- Desire to round out the level of service that Bankinter offers its customers, both in private banking and corporate banking, offering limited-risk investment banking services.
- Optimisation of the cost-to-income ratio.
- Maximisation of the creation of shareholder value across the economic cycle, through both dividends and increases in share price, built on a strong capital and liquidity base.
- Maintenance of Common Equity Tier 1 (CET1) within the fluctuation band set by the Bank and higher than the regulatory minimums. Bankinter also has a corporate governance model that is in line with the most demanding supervisory standards. To stimulate and reaffirm its solid risk culture, it has a highly qualified team supported by advanced information systems.

Regulation and supervision

It was a very intense year for regulation and supervision, and required a major commitment of resources, as new regulations came into force, preparation was made for the introduction of others and major transversal supervision exercises were carried out. Among the projects undertaken, the following are of particular note:

Adaptation to the new IFRS 9 accounting standard. This was the project in 2017 with the greatest scope and the one which required the greatest effort. It involved the updating of all provisions models, the development of new models and procedures for the determination of the significant increase in risk and the projection of expected losses over the lifetime horizon of the transactions under different macroeconomic scenarios. This also translated into the construction of new IT systems for the classification of exposures, calculation of coverage and its accounting recognition. The adaptation will be in full operation from 1 January 2018.

Review of internal models. An assessment was made during the year of the governance and management of Bankinter's internal models, within the framework of the ECB's TRIM (Targeted Review of Internal Models), the objective of which was to ensure compliance with the regulations and to harmonise their interpretation and the supervisory practices in relation to models. The results of the review were satisfactory and enabled lines of improvement to be identified and embarked upon, to a large extent linked to the standardised interpretation of the regulations.

Compliance with data aggregation standards. Bankinter made a major effort to adapt its IT infrastructure in order to satisfy the principles of risk data aggregation (RDA), full compliance with which is required before the end of 2018. RDA is the standard approved by the BCBS to improve the capacity of banks in the treatment and reporting of risks, with the final aim of improving their decision-making and management.

Credit risk

Credit risk is the possibility of incurring losses if debtors fail to meet their contractual obligations. Changes in credit risk are conditional on the economic and financial environment.

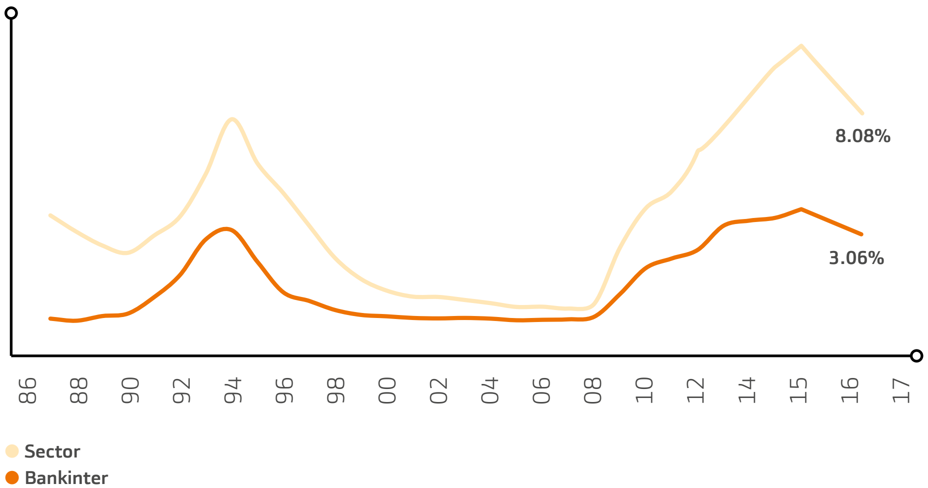
2017 was characterised by significant economic growth in Spain, despite ongoing financial deleveraging and stagnant lending across the financial system to households and non-financial entities with respect to the previous year, according to the Bank of Spain Statistical Bulletin. Within this scenario, Bankinter's trend towards moderate growth remained for another year. Lending to customers was up by 3.8% whilst computable risk (including off-balance-sheet risk) grew by 2.7%.

Non-performing loans

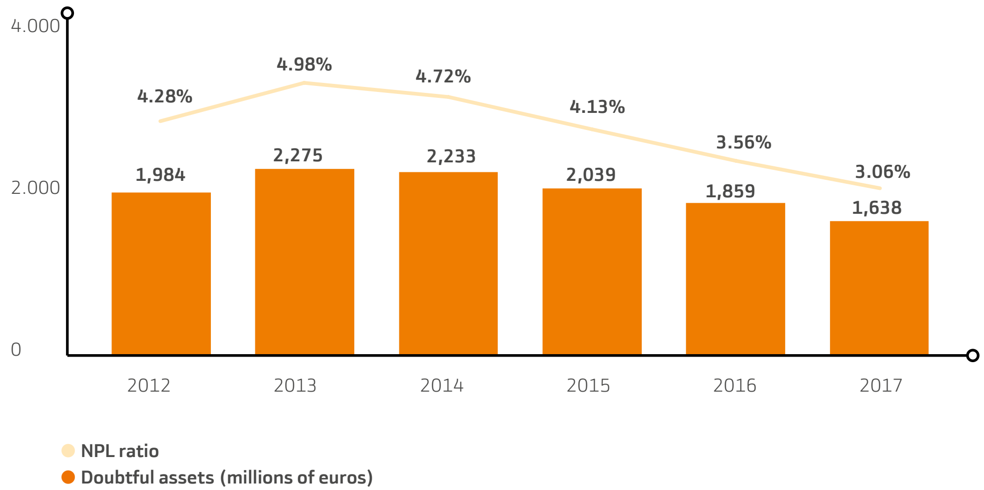
The non-performing loan ratio ended the year at 3.45%, a 56 basis-point or 14% decrease with respect to 2016. The non-performing loan ratio in Spain at year-end (3.06%) is 38% of the median for the industry (8.08% according to Bank of Spain data from November 2017). At year-end 2017, the foreclosed asset portfolio was 412 million euros, which was 0.7% of the total credit risk, a reduction of 21% in the financial year.

Asset quality				
Thousands of euros	**31-12-17**	**31-12-16**	**Variation**	**%**
Computable risk	58,824,461	57,308,266	1,516,195	2.65
Doubtful risk (includes contingent risk)	2,029,908	2,296,743	-266,835	-11.62
Credit risk provisions	903,865	1,130,626	-226,761	-20.06
NPL ratio (%)	3.45	4.01	-0.56	-13.97
Coverage ratio (%)	44.53	49.23	-4.70	-9.55
Foreclosed assets	411,556	523,453	-111,898	-21.38
Provision for foreclosures	186,130	220,433	-34,302	-15.56
Foreclosed asset coverage (%)	45.23	42.11	3.11	7.41

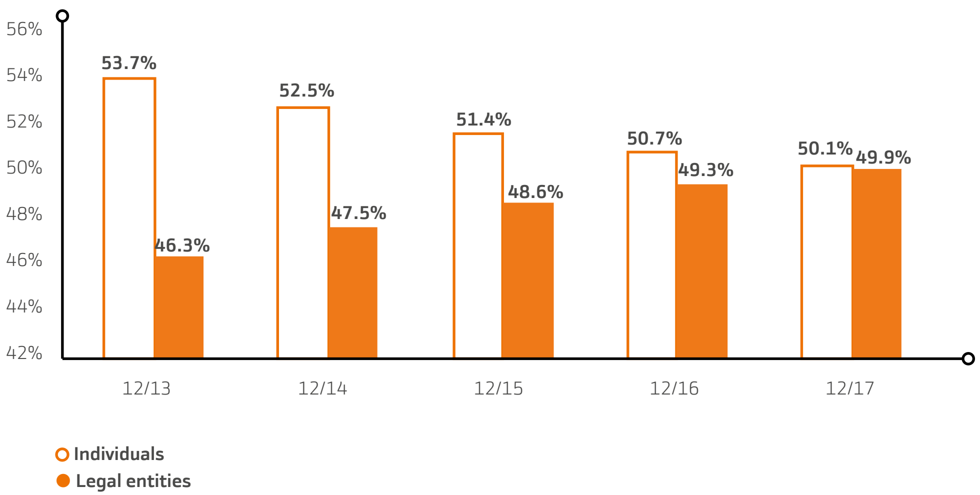
Evolution of NPL ratio (%) - Spain



Evolution of doubtful assets and NPL ratio - Spain



Evolution of the loan book



NPL ratio

-14%

Distribution of the portfolio

Over the years, Bankinter has tried to balance the distribution of its loan book between individuals and legal entities. Computable risk for individuals was 50.1% of the total, and that for legal entities was 49.9%. The most important characteristics are described below by segments:

Individuals. In 2017, the housing market and the financial situation of households continued to improve thanks to the good macroeconomic environment and, in particular, the trend in employment. Against this backdrop, lending to individuals grew by 1.0%, driven in particular by the growing momentum of consumer finance. The individual loan book amounted to 25.57 billion euros at year-end, with a non-performing loan ratio of 2.7%.

The residential mortgage loan book for individuals showed a loan-to-value (LTV) ratio of 61% at 2017 year-end and 87% of these loans are secured by the primary residence of the owners. The non-performing loan ratio of this portfolio was 2.5% at year-end. The average effort (measured as the proportion of income that the customer allocates to paying mortgage loan instalments) remained at very low levels (22%).

Corporate banking. The computable risk in corporate banking grew by 3.1% to 14,588 million euros, with a non-performing loans ratio of 1.2%. Bankinter pays close attention to this segment, the business activities of which are more international and less exposed to Spain's economic cycle and which has a solid competitive position based on specialisation, knowing the customer, flexibility and quality of service.

Small and medium enterprises. The small and medium enterprises segment recorded growth of 2.4%, its loan book stood at 11.127 billion euros with a non-performing loan ratio of 6.1%. The Bank applies automated decision-making models for managing this segment, along with teams of highly-experienced risk analysts.

Consumer finance. This business, operated through Bankinter Consumer Finance, had an excellent performance in the financial year, with growth of 38% up to 1.43 billion euros, 2.4% of credit risk. The risk-adjusted margin, and the non-performing loans ratios and costs, are controlled and are in line with the typical levels in this type of business.

Developers. Bankinter maintains a very limited risk appetite in this segment, which enables the Bank to be very selective in its operations, which focus on first-class projects, in established areas, undertaken by solid development companies with a long history. Developer lending was 1.31 billion euros, representing 2.2% of the Bank's credit risk, which is well below the average exposure of the Spanish banking system.

Portugal. The Portuguese loan book contributed a risk of 5.274 billion euros to the balance sheet at year-end, with a non-performing loan ratio of 7.4%, and with provisions recognised for 79.7% of doubtful assets. In carrying out the business in Portugal, the Bank's usual high lending standards are applied.

Over the years, the Bank has tried to balance the distribution of its loan book between individuals and legal entities.

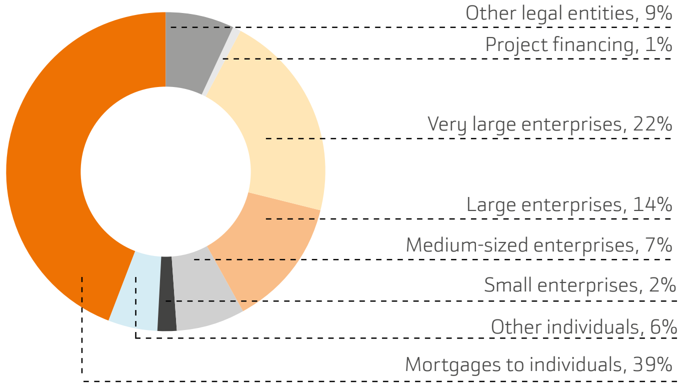
Risk quantification models

Bankinter has used internal rating models as a tool for supporting its decisions regarding credit risk since the 90s. These models enable the Bank to assess the credit quality or solvency of transactions and customers and provide quantitative measurements of its credit risk. These models are mainly used to support approvals, set prices, quantify the coverage for impairment or provisions, monitor loan books, support recovery and facilitate active management of the loan books' risk profile.

The internal rating models provide homogeneous classes of solvency or internal ratings that group together customers/ transactions with comparable credit risk. These models are also calibrated to assess expected and unexpected losses of capital. These metrics are fundamental for managing and monitoring credit risk at Bankinter.

Bankinter has rating models both for retail segments (mortgages, consumer spending, SMEs and so on) and wholesale segments, such as corporate banking. These statistical models are developed using customer, operational and macroeconomic information, combined in the wholesale segment with expert analysis. The models are updated and monitored on a regular basis to ensure their power of discrimination, stability and accuracy under a strict governance structure. The models committee and the executive risk committee are responsible for approving Bankinter's models. The risk committee also receives information on a regular basis on the status and monitoring of these models.

Exposure at default distribution according to internal categories



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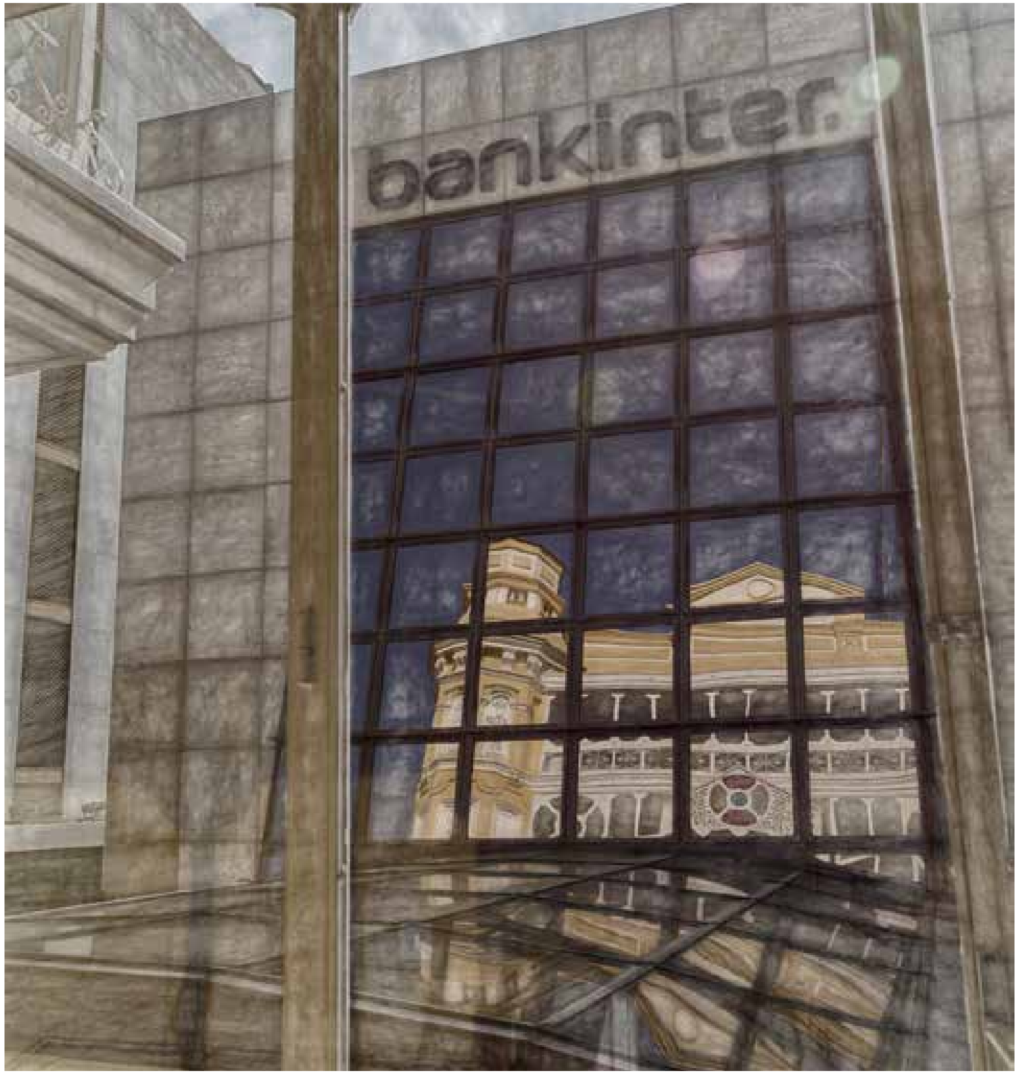


Structural and market risks

From the viewpoint of structural and market risks, last year was characterised by low inflation in the main economies and by the actions of central banks, which provided liquidity and intervened in the public debt financial markets. In certain markets, the systematic purchases of public debt by central banks triggered a reduction in market depth.

Structural interest rate risk

Structural interest risk is defined as the Bank's exposure to changes in market interest rates, deriving from the different timing structure of maturities and repricing of global balance sheet items.

Bankinter actively manages this risk with the aim of safeguarding its net interest income and preserving its economic value.

The exposure of net interest income to different scenarios of interest rate changes is analysed monthly using dynamic simulation measures. With a more long-term outlook, the Bank also analyses the sensitivity of its economic value to movements in interest rates.

The interest rate risk exposure of net interest income of parallel changes of ±100 basis points in market interest rates is +10.9/-11.7%, for a 12-month horizon.

The sensitivity of the economic value to parallel increases of 100 basis points was +13.0% of its own funds at year-end 2017. Given the current level of interest rates, the limit for parallel downward shifts was set at 25 basis points and the change in the economic value would be around -2.9% of own funds.

The Bank's working assumption is used to calculate both measures, which considers negative interest rates, except for those items with a Euribor floor.

Interest rate risk exposure (12 months)

+ 10.9/ -11.7%

Liquidity risk

Structural liquidity risk is associated with the Bank's ability to meet its payment obligations and fund its lending activities. The Bank actively monitors liquidity and its forecasts, as well anticipating the measures to be taken in both normal and exceptional market situations resulting from internal causes or market behaviour.

The measures used for liquidity risk control include monitoring changes in the liquidity gap or map, and specific information and analysis of the balances resulting from sales transactions, wholesale maturities, interbank assets and liabilities and other sources of funding. These analyses are performed under normal market conditions or simulating different scenarios of liquidity needs that could stem from different business conditions or market variations.

In 2017 the commercial gap (the difference between customer loans and deposits) remained at similar levels to the previous year, increasing slightly by 55 million euros. The percentage of loans and receivables financed by customer funds at year-end stood at 90.6%. With regard to wholesale funding, the maturity dates in 2017 were partially replaced, thus reducing dependence on wholesale markets by 600 million euros.

The measures used for liquidity risk control are the monitoring of changes in the liquidity gap or map.

Market risk

Market risk is the possibility of incurring losses as a result of changes in the market prices of on- and off-balance-sheet positions of the trading portfolio. Bankinter measures value at risk using the historical VaR methodology using one-year data and a 95% confidence interval.

An asset portfolio's value at risk (VaR) is the estimated maximum potential loss that could be incurred for a specific time horizon with a particular confidence level. Given the instability in recent years, Bankinter maintained the VaR limits from the previous year.

The following chart details the VaR values of the trading positions at year-end 2017.

Moreover, the VaR of the portfolio positions of the subsidiary Línea Directa Aseguradora are monitored on a monthly basis using historical simulation methodologies. The VaR of the Línea Directa Aseguradora portfolio at 31 December was 1.8 million euros. The risk that may be incurred by the subsidiary Bankinter Luxembourg is also monitored. Using this same methodology, the VaR for 2017 was estimated at 0.1 million euros.

Stress testing is a complementary test to VaR. Stress test estimates quantify the potential loss that extreme changes in risk factors could cause to the portfolio's value. The scenarios are obtained based on analysing the behaviour of these risk factors (interest rates, stock markets, exchange rates, credit spreads and volatility) in historical situations and simulating their impact. The changes observed in major historical crises are also simulated.

The following table details the estimated data of the stress tests on the Bank's trading positions at the end of 2017, performed under a scenario of extreme changes in the different risk variables.

2017 VaR *trading*

million euros	Latest
Interest rate VaR	0.57
Equity VaR	0.44
Exchange rate VaR	0.03
Volatility rate VaR	0.44
Credit VaR	0.00
Total VaR	**0.61**

***Stress testing* 2017**

million euros	Medium	Latest
Interest rate stress	2.85	5.00
Equity stress	3.36	0.99
Exchange rate stress	0.57	1.02
Volatility stress	6.35	11.90
Credit stress	0.00	0.00
Relative credit stress	3.34	5.20
Total stress	**16.48**	**24.11**

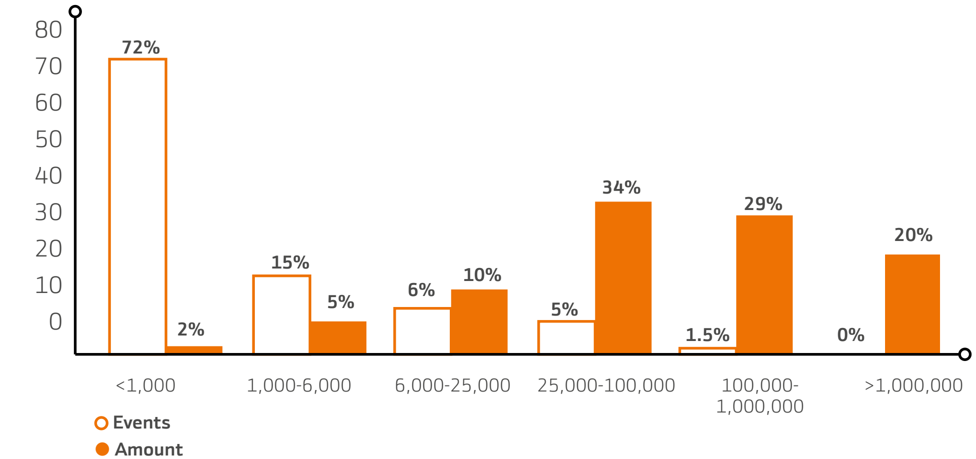
Operational risk

Operational risk is the risk of incurring losses due to failures of processes, people or internal systems; or due to external events (such as natural disasters), including legal risks.

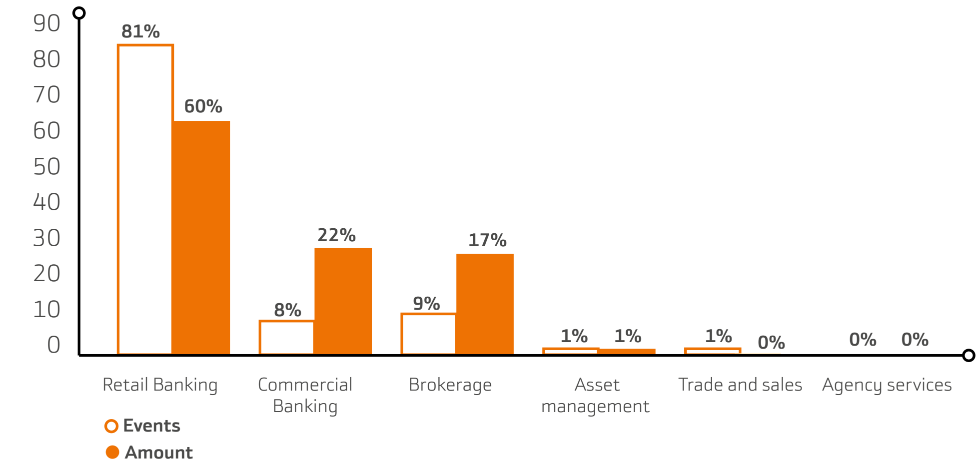
Bankinter's operational risk management model is known as the standard method in accordance with solvency regulations in force. This method requires the existence of systems for identifying, measuring and managing operational risks, prior authorisation from the Bank of Spain and an annual audit. Bankinter ensures access to best sector management practices by participating in the Spanish Operational Risk Consortium, which is a forum of financial institutions to exchange experiences regarding operational risk management.

With regard to loss events, Bankinter's operational risk profile is summarised in the following charts.

Percentage breakdown by amount intervals



Percentage breakdown by line of business



Reputational risk

The purpose of managing reputational risks consists in its identification and control in such a way as to reduce its likelihood and mitigate its potential impact and the Bank has various tools available to do this.

Since 2009, the Bank has used a system to diagnose and regularly measure its main stakeholders' perceptions and expectations. This system, based on the RepTrak® methodology, enables Bankinter to identify its key reputation drivers and actively influence those which most concern it.

One of the most important aspects in preventing reputational risks is to understand market and environment trends, and monitor what is being said about the Bank in the mass media and on social networks. Bankinter therefore has a comprehensive system for monitoring, analysing and assessing its reputational impact. .

In addition, the information obtained through these reports is used to identify a reputational risk map for prioritising these risks. These risks are prioritised based on two variables: the impact on the perception of its stakeholders and the probability of occurrence.

The Bank's products committee identifies and assesses potential reputational risks prior to launching a new product or service.

In accordance with the directives set by the European Banking Authority, this risk is monitored on a quarterly basis using a series of internal and external indicators with reputational impact.

Lastly, it merits mention that the Bank's corporate reputation department has developed a crisis management plan, for the purpose of establishing communication channels and action protocols for any emergency or crisis, in order to protect the Bank's reputation and ensure business continuity.

More detailed information on the Group's risks can be found in the consolidated legal report, the Pillar III report and the annual corporate governance report for the year.

Regulatory compliance and professional ethics

An instrument of change in a new reality

One of the Bankinter Group's essential corporate aspects and the basis of its organisation is strict compliance with all legal provisions.

The attainment of business targets must be compatible at all times with compliance not only with the legislation in force but also with the best practices and standards required for its business activity. This issue therefore represents not only a legal obligation for Bankinter, but also an ethical commitment.

This commitment also serves as a reflection for Bankinter's transformation into a cutting-edge institution that has adapted to the new reality of the financial services industry. Bankinter assumes the responsibilities arising from regulatory compliance not only as an obligation but also as an instrument to change the way in which it relates to customers and bring the Bank's business model into line with new financial consumption habits and the growing reporting requirements.

In recent years, as a result of the economic and financial crisis, the entry into force of several highly complex regulations and the launch of the new supervisory architecture have turned the regulatory compliance function into a strategic area and have obliged the Bank to strengthen its available resources.

The purpose of the compliance function is to assess and provide guidelines for the banking group's lines of business that help define its strategy, ensuring compliance with applicable legislation at all times.

In 2017 the Bank therefore developed three basic areas of the compliance function: control and advisory services regarding regulatory compliance in relation to investment and banking products, and the prevention of money laundering and the financing of terrorism. In relation to the compliance control function, a methodology was developed based on the risk approach that enables the risk of default in each area of activity to be assessed in relation to the provision of investment and banking services. With regard to the prevention of money laundering and the financing of terrorism, in 2017 Bankinter strengthened the software tools used in this function and the training of its sales personnel in this connection, thus helping to consolidate the culture of regulatory compliance that characterises the Bank.

The regulatory compliance function is integrated in Bankinter through an internal institutional framework that is first formed by the regulatory compliance committee, as the senior management body that monitors the Bank's policies in this regard. The committee executes the policies in relation to the regulatory and regulatory compliance matters that are established by the audit and regulatory compliance committee of the board of directors.

The regulatory compliance function is also completed by the following bodies:

The products committee. Approves the launch, modification or cancellation of products and services offered to retail customers.

The internal control body. Establishes policies regarding the prevention of money laundering and the financing of terrorism, in accordance with Law 10/2010, and ensures compliance with them.

This organisational structure enables the Bank to adequately manage the risk of failing to comply with regulations, which involves significant reputational risk, with a potential negative impact on the relationship with customers, markets, employees and the authorities. In particular, failure to comply with regulations may lead to sanctions, damages or cancellation of contracts, with the resulting damage to the Bank's image

Priority of regulatory changes

In 2018 the regulatory compliance area will continue to focus its efforts on the subsequent entry into force of the MiFID 2 Directive and its implementing regulations, the MIFIR Regulation (relating to markets in financial instruments) and PRIIPs Regulation (relating to documents with key information relating to packaged retail and insurance-based investment products), given its cross-sector impact on the provision of investment services by the various Group companies. This regulation, the main purpose of which is to provide greater transparency in the provision of investment services and in financial markets, represents a challenge not only from a regulatory point of view but also from the perspective of the Group's strategy, given that it entails the professionalisation of investment services and introduces significant changes to the structure of revenue arising from the provision of said services. In 2018, the adaptation to MiFID 2, MIFIR and PRIIPs becomes a priority and the regulatory compliance area will mainly focus its efforts on advising the Group on the adaptation work and on the analysis and decisions that need to be adopted as a result of European regulatory changes and how these changes will be transposed into Spanish law.

Professional ethics

Over the years, Bankinter, S.A. has demonstrated its commitment to a zero-tolerance policy regarding crime, having adopted all measures necessary to transmit this commitment and its obligation to prevent, detect and pursue crime in all its forms and in all its ramifications to all levels of the Bank's structure.

On 21 October 2015, the board of directors of Bankinter, S.A., in accordance with the reform of the Criminal Code, approved by Organic Law 1/2015, of 30 March, which entered into force on 1 July 2015, approved the creation of a Crime Prevention and Professional Ethics Committee, which is responsible for overseeing the functioning of and compliance with the criminal risk prevention model and has autonomous powers of initiative and control.

This committee reports directly to the board of directors on an annual basis through the audit and regulatory compliance committee.

In 2017 the Crime Prevention and Professional Ethics Committee focused on the following activities:

- Approval of the Code of Professional Ethics for Bankinter Group employees.
- Approval of the Code of Professional Ethics for agents.
- Promoting the existence of the whistleblowing channel as much as possible and encouraging its use to notify the CP&PEC of irregular conduct.
- Final implementation of the Criminal Prevention and Professional Ethics Subcommittee in Portugal.
- Advances in the risk map: update of existing controls

Data protection

Total guarantee for customers

Bankinter Group guarantees its customers personal data protection and confidentiality of information.

Data protection

All contracts obtain the consent of customers to process their data; they give details of the identity and address of the data controller, the purpose and the recipients of this data and offer the opportunity of objecting to the use and sharing of their data with other Group entities for commercial purposes.

The data protection clause notifies customers of the rights they have available to them in relation to access, correction, deletion and objection to processing and how to exercise these rights through quick and simple communication procedures, including telephone banking.

Confidentiality

Bankinter guarantees that data is transmitted using suitable, reliable and secure channels, in the interest of integrity and confidentiality of the transactions carried out by customers. The security measures are reviewed on a regular basis, through audits on its own systems and on those of the Bank's providers who may have access to personal data.

To help ensure these commitments are met, there is a mandatory online training course for all Group employees. The Bank's services are immersed in a continuous process of strengthening and innovation in relation to the strict internal data protection measures concerning its customers' data.

At the close of 2017, the Bank had only received two sanctions from the Data Protection Agency for processing data without the consent of the owner, which involved fines totalling 46,000 euros.

The Bankinter Group is currently working to implement the new EU General Data Protection Regulation, which is due to enter into force on 25 May 2018.

Information security

New model to combat cybercrime

Information security is a top priority of Bankinter, which aims to guarantee a high level of confidentiality, integrity and availability for its customers, employees, shareholders and suppliers. With this objective, in 2017 the Bank carried out certain organisational adjustments and planned a new strategy to strengthen the security structure. The security masterplan was reorganised in order to implement these changes and its duration was extended until 2019.

The model for combatting cybercriminals is based on three lines of defence, the first line is technology, business, operations and so on; the second line is risk control and regulatory compliance; and the third line is the audit department which monitors that the first and second lines act independently and are focused on continuous improvement.

From an organisational viewpoint, three management areas have been created within the data security department:

Technological risks: Focussed on regulatory compliance, policies, business continuity plan and risk analysis, among others.

Cybersecurity: Its priority is the protection of customer data, simulation of constant attacks on our systems and continuous improvement in combatting cyberattacks.

Security monitoring and e-fraud prevention: Where communications and transactions are monitored and the security of applications is analysed.

With this new structure, in 2017 Bankinter began a protection strategy with various phases. Firstly, the basis of the new strategy was created, optimising procedures such as network access control and data protection to prevent data leaks.

After this phase, which is expected to last until the first quarter of 2018, a series of processes will be rolled out, which include: attacks against our infrastructure, forensic data analysis or advanced intrusion detection systems, among others. Finally, more complex projects will be undertaken, with more advanced technology, and a review made of the complex external subcontracting regime in relation to cybersecurity.

One of the most important objectives for 2018, is the implementation of an adaptive security system, which offers customers the possibility of deciding how to manage their own security (whether or not to make overseas transfers, restrict their credit card activity and so on), depending on their risk sensitivity.

Awareness plans

The activity of the information security department is completed by the development of awareness plans for users, who are the weakest link in the security chain. The Bank provides online training programmes and carries out simulations to obtain confidential information (passwords, personal details and so on) through emails, text messages or telephone calls. The aim is to discover people's reaction in situations that can be exploited by cybercriminals.

The growing importance of information security highlights the rapid expansion of cybercrime, the activities of which have evolved and become much more dangerous. Initially it involved the actions of individual hackers, who were not only motivated by money. Nowadays, cybercrime has created large and sophisticated business structures that are capable of attacking entire economic sectors.

The theft of confidential big data from companies, the denial-of-service attacks and phishing (using the identity of companies or public bodies in order to obtain confidential information from the victim) are the main strategies used by cybercriminals. Financial institutions are particularly exposed to this kind of manipulation and fraud as a result of their permanent contact with the public and the nature of their business, part of which involves payment systems.

One of the key objectives for 2018 is the implementation of an adaptive security system.