4. Leverage ratio

4.1. Leverage Ratio definition and composition

The leverage ratio (LR) is a regulatory measure (not risk-based) complementing capital designed to guarantee the soundness and financial strength of institutions in terms of indebtedness.

In January 2014, the Basel Committee on Banking Supervision published the final version of the "Basel III leverage ratio framework and disclosure requirements", which has been included through a delegated act that amends the definition of leverage ratio in the CRR regulation.

Pursuant to Article 451, section 2 of the CRR, on June 15, 2015 the EBA published the final draft of the Implementing Technical Standard (ITS) on disclosures of the Leverage Ratio for breaking down the leverage ratio, which has been applied in this report.

The leverage ratio is defined as the quotient of eligible Tier 1 bank capital and exposure.

Described below are the elements making up the leverage ratio, in accordance with the "EBA final draft Implementing Technical Standards on disclosure of the leverage ratio under Article 451(2) of Regulation (EU) No. 575/2013 (Capital Requirements Regulation – CRR) - Second submission following the EC's Delegated Act specifying the LR" published by the EBA on June 15, 2015:

- Tier 1 capital (letter h in the following table): Section 2.2. of this Document presents details of the bank capital, calculated based on the criteria defined in the CRR.
- Exposure: As set out in Article 429 of the CRR, the exposure measurement generally follows the book value subject to the following considerations:
  - On-balance sheet exposure other than derivatives is included net of allowances and accounting valuation adjustments.
  - Measurement of the Group's total exposure is composed of the total assets as per financial statements adjusted for reconciliation between the accounting perimeter and the prudential perimeter.

Total exposure for the purpose of calculating the Group's leverage ratio is composed by the sum of the following items:

- Asset Balance: the asset balance corresponding to the financial statements.
- Adjustments for reconciliation between the accounting perimeter and the solvency perimeter: the balance resulting from the difference between the accounting balance sheet and the regulatory balance sheet is included.
- Exposure in derivatives: in adittion to the account balance (or replacement cost), which is adjusted by the cash variation margin, the netting effects (as permitted by the CRR) and the notional cash amounts, the exposure also includes and add-on to collect the future potential credit risk.
- Securities Financing Transactions (SFTs): as well as the book value, the difference between this and the exposure value is included, corresponding to an additional counterparty risk surcharge, determined in accordance with Article 429 of the CRR.
- Off-balance sheet items: these correspond to risk and contingent liabilities and commitments, mainly collateral and undrawn balances. A minimum floor is applied to conversion factors (CCFS) of 10% in line with the provisions of CRR Article 429.10 (a).
- Tier 1 deductions: all those amounts of assets that have been deducted in the determination of the eligible Tier 1 capital are deducted, in order not to duplicate exposure. The main deductions are intangible assets, loss carry forwards and other deductions defined in Article 36 of the CRR and indicated in section 2.1 of this report.

The table below shows a breakdown of the items making up the leverage ratio as of December 31, 2019 and December 31, 2018.

Table 81. LRSum - Summary reconciliation of accounting assets and exposure corresponding to the Leverage Ratio (Million Euros)

Summary table of accounting assets and leverage ratio exposure conciliation	12-31-2019 Phased-in	12-31-2019 Fully Loaded	12-31-2018 Phased-in	12-31-2018 Fully Loaded
(a) Total assets as published financial statements	698,690	698,690	676,689	676,689
(b) Adjustment for entities which are consolidated for accounting purposes but are outside the scope of regulatory consolidation	(21,636)	(21,636)	(19,570)	(19,570)
(Adjustment for fiduciary assets recognized on the balance sheet pursuant to the operative accounting framework but excluded from the leverage ratio exposure measure in accordance with Article 429 (13) of Regulation (EU) No 575/2013)				
(c) Adjustments for derivative financial instruments	(7,124)	(7,124)	(7,410)	(7,410)
(d) Adjustments for securities financing transactions "SFTs"	1,840	1,840	3,193	3,193
(e) Adjustment for off-balance sheet items[1]	67,165	67,165	61,409	61,409
(f) (Adjustment for intragroup exposures excluded from the leverage ratio exposure measure in accordance with Article 429 (7) of Regulation (EU) No 575/2013)	-	-	-	-
(g) Other adjustments	(7,847)	(8,656)	(9,012)	(10,080)
Leverage ratio total exposure measure	**731,087**	**730,279**	**705,299**	**704,231**
(h) Capital Tier 1	49,701	48,775	45,947	45,047
Leverage ratio total exposure measure	**731,087**	**730,279**	**705,299**	**704,231**
Leverage ratio	**6.80%**	**6.68%**	**6.51%**	**6.40%**

[1] This corresponds to off-balance sheet exposure after application of the conversion factors obtained in accordance with Article 429.10 of the CRR.

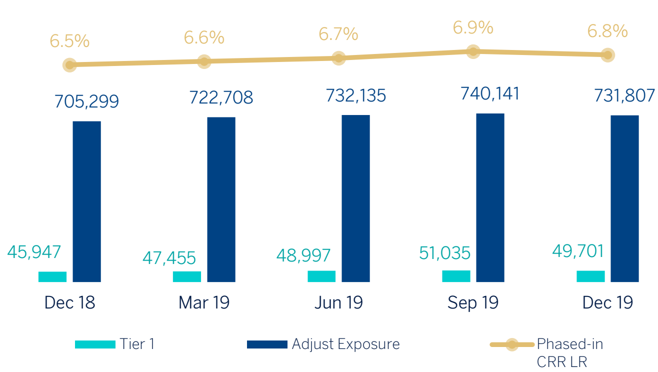
As shown above, the Group maintains a phased-in leverage ratio of 6.80% and a fully loaded ratio of 6.68%, well above the minimum level required.

4.2. Evolution of the ratio

The phased-in leverage ratio has increased during the year by 28 basis points. Breaking down by components, Tier 1 increases by approximately €3.75 billion, with an impact of +53 basis points and, exposures increase by approximately €26.0 billion with an impact of -25 basis points.

The leverage level reflects the nature of the business model that is geared toward the retail sector.

Chart 27. Trends in the leverage ratio



4.3. Governance

The activities making up the Group's regulatory reporting include monthly measurement and control of the leverage ratio by assessing and monitoring this measurement in its more restrictive version (fully loaded), to guarantee that leverage remains far from the minimum levels (which could be considered risky levels), without undermining the return on investment.

The estimates and development of the leverage ratio are reported on a regular basis to different governing bodies and committees to guarantee adequate control of the entity's leverage levels and ongoing monitoring of the main capital indicators.

In line with the risk appetite framework and structural risk management, the Group operates by establishing limits and operational measures to achieve a sustainable development and growth of the balance sheet, maintaining tolerable risk levels at all times. This can be seen in the fact that the regulatory leverage level itself is well above the minimum required levels.