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Single Resolution Board

Addendum to Hippocrates Provisional Valuation Report

[Sale of Business scenario]

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1. Executive Summary

1.1. Outcome of the alternative insolvency scenario

The valuation must include an estimate of the recoveries which shareholders and creditors would expect to receive in the event that Hippocrates were wound up under normal insolvency proceedings. This will assist the SRB in evaluating the risk that Hippocrates' shareholders and/or creditors are ultimately assessed to have received worse treatment than if Hippocrates had entered into a normal insolvency proceeding.

The appropriate insolvency proceeding is governed by Law 22/2003, on insolvency (the ***Spanish Insolvency Law***). There is no specific law governing bank insolvencies in Spain. The Spanish Insolvency Law promotes the sale of the business as a whole to preserve value. If Hippocrates' banking license were to be revoked making the business non-viable, liquidation would be likely to begin immediately. Liquidation consists of an accelerated realisation of the assets, with no minimum binding price. Creditors must be paid in accordance with the order stablished hierarchy settled by Spanish Insolvency Law.

We have performed an initial estimated outcome statement for a liquidation scenario focused on the parent company only reflecting limited data ant time for our analysis.

The information available to us has not been sufficient to construct a detailed and reliable estimate of the creditor hierarchy. This is due principally to the limited availability of information on a legal entity level, reconciliation issues with the liability data template (***LDT***), a lack of clarity on intragroup assets and liabilities, and to the fact that the deteriorating liquidity position of the entity is likely to result in significant changes to the liability structure between the date of the most recent information available to us and the resolution date.

Our methodologies and assumptions for this analysis are outlined in chapter 3 below. The table below shows our best and worst case estimates for potential total recoveries and implied losses.

(€ billion)	Worst	Best
Total recovery available for creditors	107,7	111,6
Implied losses (for consolidated liabilities and equity as of March 2017)	-31,1	-27,2

2. Liquidation scenario simulation

2.1. Purposes of this simulation

According to article 36 of the BRRD, article 5 of Law 11/2015 and article 7 of Royal Decree 1012/2015, a valuation is required to determine whether compared to the resolution action Hippocrates´ shareholders and/or creditors would have received a better treatment had Hippocrates entered into an ordinary insolvency proceeding provided for under Spanish Insolvency Law.

2.2. Liquidation strategy explanation

The aim of the liquidation stage is to maximise asset recoveries for the purposes of repaying creditors. Spanish Insolvency Law promotes the sale of the business as a whole considering it as the best strategy to minimise the loss of value that the liquidation process entails. Where that cannot be done, then assets should be packaged into portfolios or sold piecemeal.

An insolvent liquidation process is by its nature value destructive (assets sold at distressed prices, costs of the process are high, etc.); this is exacerbated in the case of an unplanned process.

The process for liquidations in Spain under Spanish Insolvency Law is set out in Annex II.

The changes related to the 18 months' practitioners' fee cap are untested in the courts but may act as a disincentive to a liquidator to run a long term process. For an entity such as Hippocrates, a very short period of 18 months may not be feasible. A process condensed over a short period risks market saturation which would depress prices.

2.3. Creditor hierarchy

Settlement of the debtor's liabilities will be in accordance with the order established in the Report prepared by the insolvency liquidator (foreseen in article 75 of the Spanish Insolvency Law), and in any event according to the hierarchy settled by the said Spanish Insolvency Law:

Entity	
1	Income from secured assets will be applied to the secured credits up to their value.
2	Credits against estate: costs of the process (including: fees of the insolvency practitioner, compensation from collective dismissal, salaries after the declaration of insolvency, any cost rise during the process, etc.)
3	Privileged credits
4	Unsecured creditors
5	Subordinated creditors

It is important to note that under Spanish Insolvency law, intra group debts are subordinated behind unsecured creditors.

2.4. Methodology and hypothesis

The liquidation process in Spain is heavily court-driven which would impact on any asset realisation strategy. The liquidation will be subject to Spanish Insolvency Law and will be monitored by a Spanish court, who would appoint the insolvency practitioners from the list proposed by the FROB.

As a result of the liquidation process, certain expenses may arise (legal advisors, court agent -*procurador*-, insolvency administrator, collective dismissal, etc.) which may be material in addition to the foreseen loss of value as a result of the accelerated sale of assets by the insolvency administrator.

The liquidation analysis has to be carried out on an individual basis (i.e. by legal entities), since a group liquidation is not possible under Spanish law and to reflect the different ranking of claims. Our hypothesis would be that an insolvency would be triggered, first, at the parent level (by withdrawal of the banking licence or petition by the directors to the bankruptcy court).

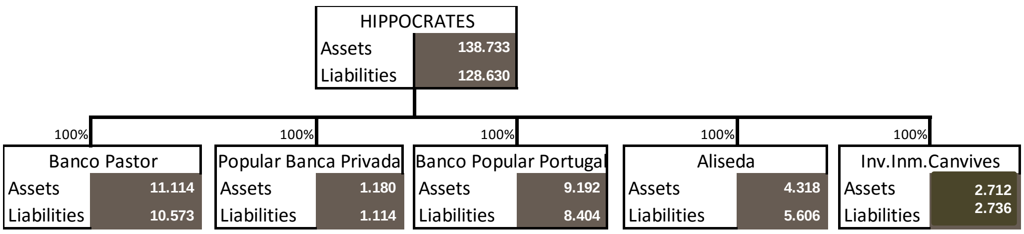
Main outcomes and sources of uncertainty

While noting the recent law changes imply an accelerated process (max 18 months), we have modelled the scenario of a 3 year liquidation process on the basis that the liquidator is still required to maximise realisations and, given the complexity, the Court may be willing to approve a liquidation plan over this period. We note that this is a fundamental assumption as it has not been tested and that on a strict reading of the law the fee cap appears unavoidable. In determining this approach, we consider it to be the more “prudent” basis for the purposes of the report as it would present a higher recovery to creditors as the counterfactual for other resolution tools.

2.5. Legal entity basis

Given the financial interconnectedness between Hippocrates and its subsidiaries, a liquidation appointment at the parent level may likely lead to insolvent liquidations at certain subsidiaries also, since those entities would no longer be able to call back funds required for day to day purposes, or due to the withdrawal of their banking license.

We note that Hippocrates’ subsidiaries can be classified into two groups: those that provide finance services and those which provide supplementary services (i.e. portfolio management, real estate companies, etc.) Given that the parent company represents approximately 90% of the group’s assets, the subsidiaries that are relevant to be considered in an insolvency scenario of the group are the following:



*In million euros

The main consequences of a Company being declared insolvent, are that (i) its assets and liabilities are frozen, and (ii) payments of its debts is subject to the creditors rank provided for in Spanish Insolvency Law.

If certain companies within the same group are declared insolvent at the same time, the main issue is the treatment of intragroup credits within the scope of the insolvency proceeding. Further to Spanish Insolvency Law, those intragroup credits are qualified as subordinated, and rank junior to other subordinated claims. In the case at hand this is quite relevant given that, save as for the shareholders of the insolvent company, any creditor shall rank ahead of those intragroup claims.

Likewise, as a result of the existence of such intragroup debts, companies within the group may hold creditor and debtor positions at the same time. Treatment of such intragroup debts within the insolvency proceeding may imply an increase on the assets or a decrease on the liabilities.

In addition, if as a consequence of the liquidation process, taxable income was recognised in Hippocrates, and that income was higher that the tax-deductible expenses recorded in the same fiscal year, an additional part of the Non Protected DTAs could be used. However, given that the accounting treatment for this process has not been assessed in the current report, there is no information available about the estimated accounting impact.

With respect to Hippocrates, the impact of the insolvency proceeding, in terms of how losses are allocated is summarised below:

Allocation of write downs	Adjustments (*) (Euro billion)	
	Best case	Worst case
Total insolvency adjustments, costs & contingencies paid	**27.2**	**31.1**
Equity (100% shortfall)	10.1	10.1
Subordinated debt – Intra group (100% shortfall)	12.1	12.1
Subordinated debt – external (100% shortfall)	2.3	2.3
Unsecured (9% – 20% shortfall)	2.7	6.6
Allocated write down	**27.2**	**31.1**

We analyse below the impact of the insolvency proceeding of the parent in the following subsidiaries:

i. **Banco Pastor**

On the balance sheet, appears that the entity has customer deposits for a total amount of €11.114m. Simultaneously, Banco Pastor has deposits of €6.072m on its parent company, Hippocrates.

Under an insolvency proceeding the intra-group credits are considered as subordinated to the rest of the credits (except the AT1), according to the Spanish Insolvency Law. That means that Banco Pastor would never recover the aforementioned deposit and would need to make a provision reducing its recoverable assets to an amount around €4.936m.

With the elimination of the mentioned balancing item, the total asset would fall to, practically, the half of the customer's deposits amount. On this scenario it would be impossible to Banco Pastor to avoid its own insolvency proceeding.

ii. **Popular Banca Privada**

On the balance sheet, appears that the entity has customer deposits to a total amount of €334m. At the same time, Popular Banca Privada deposited €539m on its parent company, Hippocrates.

As we mentioned before the intragroup credits would be considered subordinated which means that Popular Banca Privada will lose that deposit and will reduce its assets to an amount around €641m.

The elimination of the mentioned item from the balance sheet would produce the fall of the total asset to less than its customer deposit. Again, it would be impossible to avoid its own insolvency proceeding.

iii. Banco Popular Portugal

Considering the effects of the individual basis analysis, the assets of the entity would be reduced to an amount between €9.192m and €8.225m.

The customer deposits of the entity raises to a total amount of €4.711m, while the total liabilities represent an amount of €8.404m.

Banco Popular Portugal has been receiving funds only from Hippocrates. As a consequence, the insolvency declaration of the parent company would not have a severe impact on the balance sheet of the Portuguese entity, making the maintenance of the economic activity an existing possibility. However, the financial stability would be seriously compromised and the access to external finance would be tough.

iv. Aliseda

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v. Inv. Inm Camvives

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2.6. Estimated assets realisations

We set out below a summary of our analysis which shows the adjustments applied to asset values in a liquidation.

Area	Adjustments (*) (Euro billion)	
	Best case	Worst case
Total gross assets per 31 March 2017	138.8	138.8
Total gross assets	**138.8**	**138.8**
Loans and receivables	(14.5)	(18.2)
Real estate assets	(1.7)	(1.9)
Deferred tax assets	(3.1)	(3.1)
Intangible assets	(1.2)	(1.2)
Equity and Fixed Income	(0.4)	(0.4)
Joint ventures, associates and subsidiaries	(1.2)	(1.5)
Total adjustments	**(22.1)**	**(26.2)**
Subtotal – estimated asset realisations	**116.7**	**112.6**
Costs	(1.4)	(1.4)
Total net realisations for creditors	**115.3**	**111.2**

The principal driver to the value destruction is the level of potential discounting on loan book realisations (NPL assumed sold in year 1, performing loan (***PL***) is assumed to run off over 3 years with a sale of the rump at the end of the period assumed at a high discount consistent with our expectation in a liquidation scenario with lack of warranties on any sale, lack of other options, etc.). Other key adjustments are summarised below:

- We have calculated an adjustment for real estate assets on the same basis as for a purchaser but with a higher discount rate considering the forced sale from liquidation.
- DTAs, the amount recoverable in liquidation is assumed to be limited to the protected amount which has been confirmed as receivable in liquidation.
- Intangibles have all been written off reflecting no future going concern basis and no value to assets such as software.
- Equity and fixed income assets have been adjusted to fair value.
- JVs, associates and subsidiaries – we have assessed the key investments and considered that those with significant business with third parties will be sold and generate a profit in some cases. Where the entities are more reliant on Hippocrates' business, we have concluded that there would be no cash received.

2.7. Estimated recoveries to creditors

We have allocated the estimated recoveries from the best case scenario above through the creditor hierarchy for the group as shown below to identify where the value breaks and shortfall to creditors. In addition, the LDT had considerable data and reconciliation shortcomings.

Creditor Hierarchy	Hippocrates (solo) as at 31 March 2017 (€'m)	Adjustment (contingent liabilities)	Total	Allocation of Best case expected realisations	Implied % shortfall
Secured	43.3		43.3	43.3	
- *Of which intergroup*	*0.7*				
Covered	29.2		29.2	29.2	
Tax, employee	0.9		0.9	0.9	
Preferential	12.3		12.3	12.3	
Deposits not covered and not preferential	23.7		23.7	29.6	9% shortfall
Other unsecured	4.8	4.0	8.8		
Subordinated – Intergroup	12.1		11.1		100% shortfall
Subordinated - Other	2.3		2.3		100% shortfall
	128.6	4.0	132.6	115.3	

Figures for the creditor hierarchy above are from the Liability Data Template as at 31 March 2017 we note several differences and inconsistencies within the LDT.