

31. August 2018 – Neuss, Germany

Rating Action:

Creditreform Rating upgrades Instituto de Crédito Oficial (Group) long-term issuer rating by one notch to A- (Outlook: stable).

Creditreform Rating (CRA) has upgraded Instituto de Crédito Oficial's (Group) (hereafter ICO) long-term issuer rating to 'A-' from 'BBB+' and affirms the short-term rating at 'L2'. The rating outlook is stable.

At the same time, we upgrade ICO's 'senior unsecured' debt instruments to 'A-' from 'BBB+'.

Key Rating Drivers

CRA has revised the rating of ICO and its bank capital and debt instruments as a result of its periodic monitoring process for the following reasons:

- Upgrade of CRA's long-term sovereign rating of the Kingdom of Spain to "A-" from "BBB+" as we see an extraordinary probability of support by the government of Spain

Rating Rationale

ICO's credit rating upgrade was primarily driven by our opinion that there is an extraordinary probability of support by the Kingdom of Spain in the event of financial distress. This owes to the fact that ICO is attached to the Ministry of Economy and Finance in Spain, as well as to its government-backed debt and its role in the economy of Spain. We assume therefore an almost certain public interest on the part of the Kingdom of Spain in the business operations of the bank. The upgrade of ICO's long-term issuer rating follows the upgrade of the long-term sovereign rating of the Kingdom of Spain by one notch to 'A-' from 'BBB+' (CRA: 27.07.2018).

Outlook

We consider the outlook of ICO's long-term issuer rating and its bank capital and debt instruments as stable. This reflects our view of ICO's role in the economy of Spain and its public backed debt. However, we will observe the development of ICO's role in the economy of Spain, as well as the legal framework for the banking sector in Spain in general.

In addition, we assume a stable political and economic environment in ICO's markets of operations.

Scenario Analysis

In a scenario analysis, ICO's rating developed significantly better in the "best case" scenario and considerably worse in the "worst case" scenario. The ratings of bank capital and senior unsecured debt would behave similarly based on our rating mechanism. These ratings are especially sensitive to changes in total equity and to the bank capital and debt structure in general. In addition, the banks' long-term issuer rating as well as the rating of its bank capital and senior unsecured debt is explicit sensitive to changes in the rating of the Kingdom of Spain.

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CRA's rating actions at a glance

Instituto de Crédito Oficial:

- Long-term Issuer Rating upgraded to 'A-' from 'BBB+', stable outlook
- Short-term rating affirmed at 'L2'
- Senior unsecured debt instruments upgraded to 'A-' from 'BBB+'

Ratings Detail

Bank ratings

The bank ratings are dependent on a host of quantitative and qualitative factors. An improvement in either sub-category may result in a higher rating score.

LT Issuer / Outlook / Short-Term **A- / stable / L2**

Bank Capital and Debt Instruments Ratings

The ratings for bank capital and debt instruments are inter alia dependent on subordination and relative size of the instrument class, based on the long-term issuer rating of the bank.

Senior unsecured debt: **A-**
 Tier 2 (T2): -
 Additional Tier 1 (AT1): -

Ratings Detail and History

Ratings			
Bank Issuer Ratings			
Instruments	Rating Date	Publication Date	Ratings
LT Issuer / Outlook / Short-Term (Initial Rating)	13.07.2018	23.07.2018	BBB+ / stable / L2
LT Issuer / Outlook / Short-Term	31.08.2018	04.09.2018	A- / stable / L2
Bank Capital and Debt Instruments			
Type	Rating Date	Publication Date	Ratings
Senior Unsecured / T2 / AT1 (Initial Rating)	13.07.2018	23.07.2018	BBB+ / - / -
Senior Unsecured / T2 / AT1	31.08.2018	04.09.2018	A- / - / -

Figure 1: Ratings Detail and History

Appendix

Income Statement	2014	%	2015	%	2016	%	2017	%
Income (€000)								
Net Interest Income	578,872	102.8%	99,151	119.3%	25,625	-42.2%	-69,107	-304.1%
Net Fee & Commission Income	9,827	1.7%	46,449	55.9%	47,660	-78.6%	53,106	233.7%
Net Insurance Income	0	0.0%	0	0.0%	0	-0.0%	0	0.0%
Net Trading Income	-30,569	-5.4%	-66,839	-80.4%	-138,761	228.7%	32,259	142.0%
Equity Accounted Results	1,616	0.3%	1,901	2.3%	1,579	-2.6%	1,245	5.5%
Dividends from Equity Instruments	568	0.1%	353	0.4%	552	-0.9%	173	0.8%
Rental Revenue	1,188	0.2%	1,057	1.3%	913	-1.5%	1,035	4.6%
Lease and Rental Revenue	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Other Income	1,771	0.3%	1,034	1.2%	1,758	-2.9%	4,012	17.7%
Operating Income	563,273	100%	83,106	100%	-60,674	100%	22,723	100%
Expenses (€000)								
Depreciation and Amortisation	4,966	5.3%	4,940	10.3%	5,260	-9.7%	6,040	15.0%
Personnel Expense	19,780	21.0%	20,797	43.4%	20,505	-37.8%	20,641	51.2%
Occupancy & Equipment	1,080	1.1%	992	2.1%	980	-1.8%	780	1.9%
Tech & Communications Expense	4,429	4.7%	4,423	9.2%	4,806	-8.9%	4,993	12.4%
Marketing and Promotion Expense	974	1.0%	1,736	3.6%	873	-1.6%	987	2.4%
Other Provisions	54,742	58.0%	5,265	11.0%	-96,598	177.9%	-3,843	-9.5%
Other Expense	8,365	8.9%	9,780	20.4%	9,885	-18.2%	10,739	26.6%
Operating Expense	94,336	100%	47,933	100%	-54,289	100%	40,337	100%
Operating Profit & Impairment (€000)								
Pre-impairment Operating Profit	468,937		35,173		-6,385		-17,614	
Asset Write-downs	354,984		-17,544		-457,861		-166,423	
Net Income (€000)								
Non-recurring Revenue	0		0		0		0	
Non-recurring Expense	0		0		0		0	
Pre-tax Profit	113,953		52,717		451,476		148,809	
Income Tax Expense	33,214	29.1%	18,873	35.8%	134,457	29.8%	45,709	30.7%
Discontinued Operations	0		0		0		0	
Net Profit	80,739		33,844		317,019		103,100	

Figure 2: Group income statement
(Source: S&P Global Market Intelligence)

Income Ratios (%)	2014	%	2015	%	2016	%	2017	%
Return on Average Assets (ROAA)	0.09	0.01	0.05	-0.04	0.57	0.52	0.23	-0.34
Return on Equity (ROAE)	1.71	-0.11	0.66	-1.06	5.74	5.08	1.87	-3.87
RoRWA	0.36	0.07	0.18	-0.18	1.87	1.69	0.61	-1.26
Net Interest Margin	0.62	-0.05	0.14	-0.49	0.05	-0.09	-0.15	-0.20
Cost income Ratio ex. Trading	15.89	0.84	31.97	16.08	-69.52	-101.49	NM	NA
Cost income Ratio	16.75	2.14	57.68	40.93	NM	NA	177.52	NA
<i>Change in 3-Points</i>								

Figure 3: Group key earnings figures
(Source: S&P Global Market Intelligence)

Assets (€000)	2014	%	2015	%	2016	%	2017	%
Cash and Balances with Central Banks	21,786	0.0%	452,440	0.7%	437,826	0.9%	2,306,411	5.5%
Net Loans to Banks	38,788,520	46.2%	26,932,816	43.3%	19,164,816	39.2%	16,077,669	38.1%
Net Loans to Customers	19,700,715	23.5%	14,913,314	24.0%	13,397,810	27.4%	11,191,383	26.5%
Total Securities	25,073,918	29.8%	19,458,791	31.3%	15,456,327	31.6%	12,165,917	28.8%
Financial Assets	83,584,939	99%	61,757,361	99%	48,456,779	99%	41,741,380	99%
Equity Accounted Investments	54,275	0.1%	55,929	0.1%	57,750	0.1%	58,860	0.1%
Other Investments	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Insurance Assets	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Non-current Assets HFS & Discontinued Ops	0	0.0%	0	0.0%	0	0.0%	22	0.0%
Tangible and Intangible Assets	94,035	0.1%	93,194	0.1%	91,348	0.2%	97,921	0.2%
Tax Assets	265,661	0.3%	248,339	0.4%	222,547	0.5%	264,512	0.6%
Total Other Assets	10,153	0.0%	29,770	0.0%	36,860	0.1%	38,052	0.1%
Total Assets	84,009,063	100%	62,184,593	100%	48,865,284	100%	42,200,747	100%

Figure 4: Development of assets
(Source: S&P Global Market Intelligence)

Asset-Quality (%)	2014	%	2015	%	2016	%	2017	%
Non-Performing Loans (NPL) / Loans	NA	NA	10.10	NA	9.10	-1.00	7.80	-1.30
NPL / RWA	12.89	1.42	17.10	4.21	14.83	-2.27	NA	NA
Potential Problem Loans / NPL	32.29	-4.66	36.68	4.40	38.10	1.42	NA	NA
Reserves / Impaired Loans	133.31	10.24	126.09	-7.22	104.45	-21.64	104.77	0.32
Net Write-offs / Risk-adjusted Assets	NA	NA	NA	NA	NA	NA	NA	NA
Risk-weighted Assets/ Assets	24.64	1.27	25.93	1.29	36.32	10.39	38.20	1.88
Change in %-Points								

Figure 5: Development of asset quality
(Source: S&P Global Market Intelligence)

Liabilities (€000)	2014	%	2015	%	2016	%	2017	%
Total Deposits from Banks	17,981,029	22.7%	11,633,435	20.5%	13,375,016	31.0%	11,495,137	31.2%
Total Deposits from Customers	2,839,377	3.6%	1,056,619	1.9%	1,003,960	2.3%	848,733	2.3%
Total Debt	55,143,517	69.7%	41,835,142	73.6%	26,954,455	62.4%	22,845,774	61.9%
Derivative Liabilities	641,152	0.8%	420,506	0.7%	468,584	1.1%	524,499	1.4%
Securities Sold, not yet Purchased	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Other Financial Liabilities	2,101,449	2.7%	1,514,722	2.7%	1,051,930	2.4%	857,380	2.3%
Total Financial Liabilities	78,706,524	100%	56,460,424	99%	42,853,945	99%	36,571,523	99%
Insurance Liabilities	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Non-current Liab. HFS & Discontinued Ops	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Unit-Linked Insurance and Investment Contr.	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Tax Liabilities	21,782	0.0%	40,416	0.1%	66,837	0.2%	15,447	0.0%
Non-current Asset Retirement Obligations	216	0.0%	343	0.0%	365	0.0%	423	0.0%
Other Provisions	327,073	0.4%	335,574	0.6%	238,895	0.6%	304,242	0.8%
Total Other Liabilities	26,792	0.0%	6,162	0.0%	8,066	0.0%	4,119	0.0%
Total Liabilities	79,082,387	94.1%	56,842,919	91.4%	43,168,108	88.3%	36,895,754	87.4%
Total Equity	4,926,676	5.9%	5,341,674	8.6%	5,697,176	11.7%	5,304,993	12.6%
Total Passiva	84,009,063	100%	62,184,593	100%	48,865,284	100%	42,200,747	100%
Deposits from Customers Growth*	55.97	NA	-62.79	-118.75	-4.98	57.80	-15.46	-10.48
Change in %-Points								

Figure 6: Development of refinancing and capital adequacy
(Source: S&P Global Market Intelligence)

Capital (€000)	2014	%	2015	%	2016	%	2017	%
Total Capital	4,947,515	4.59	5,302,816	7.18	5,225,180	-1.46	5,297,722	1.39
Total Risk-weighted Assets	20,699,756	-13.36	16,124,853	-22.10	17,746,746	10.06	16,119,064	-9.17
Capital Ratios (%)								
Core Tier 1 Ratio	23.32	4.81	32.15	8.83	29.33	-2.83	32.74	3.42
Tier 1 Ratio	23.32	4.81	32.15	8.83	29.33	-2.83	32.74	3.42
Total Capital Ratio	23.90	4.10	32.89	8.98	29.44	-3.44	32.87	3.42
Leverage Ratio	5.00	NA	7.36	2.36	9.48	2.12	11.00	1.52
Fully Loaded: Common Equity Tier 1 Ratio	NA	NA	NA	NA	NA	NA	NA	NA
Fully Loaded: Tier 1 Ratio	NA	NA	NA	NA	NA	NA	NA	NA
Fully Loaded: Risk-weighted Capital Ratio	NA	NA	NA	NA	NA	NA	NA	NA
Total Equity/ Total Assets	5.86	1.47	8.59	2.73	11.66	3.07	12.57	0.91
Change in %-Points								

Figure 7: Development of capital ratios
(Source: S&P Global Market Intelligence)

Liquidity (%)	2014	%	2015	%	2016	%	2017	%
Liquidity Coverage Ratio	NA	NA	NA	NA	NA	NA	NA	NA
Interbank Ratio	215.72	52.33	231.51	15.79	143.29	-88.22	139.86	-3.42
Loan to Deposit (LTD)	693.84	-821.31	1411.42	717.58	1334.50	-76.92	1318.60	-15.90
Change in %-Points								

Figure 8: Development of liquidity
(Source: S&P Global Market Intelligence)

Regulatory

Creditreform Rating AG was neither commissioned by the rating object nor by any other third party for the rating. The analysis took place on a voluntary basis by Creditreform Rating AG and is to be described in the regulatory sense as an unsolicited rating.

The rating is based on publicly available information and internal evaluation methods for the rated bank. The quantitative analysis is based mainly on the latest annual accounts, interim reports, other investor relations information of the bank, and calculated key figures by S&P Global Market Intelligence. Subject to a peer group analysis were 55 competing institutes.

The information and documents processed met the requirements of the rating system of Creditreform Rating AG as published on the website www.creditreform-rating.de. The rating was carried out on the basis of the rating methodology for unsolicited bank ratings as well as the methodology for the rating of bank capital and unsecured debt instruments in conjunction with Creditreform's basic document "Rating Criteria and Definitions".

On 31 August 2018, the rating was presented by the analysts to the rating committee and adopted in a resolution.

The rating result was communicated to Instituto de Crédito Oficial, and the preliminary rating report was made available to the bank. There was no change in the rating score.

The rating is subject to one-year monitoring from the rating date and is valid until withdrawal of the rating. Within this period, the rating can be updated. At the latest after one year, a monitoring is required to maintain the validity of the rating.

In 2011, Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on this registration, Creditreform Rating AG (CRA) is permitted to issue credit ratings within the EU, and is obligated to comply with the provisions of the CRA-Regulation.

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No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved nor any other natural persons whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or in approving credit ratings and rating outlooks.

In the event of providing ancillary services to the rated entity, CRA will disclose all ancillary services in the credit rating report.

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To prepare this credit rating, CRA has used the following substantially material sources:

1. Transaction structure and participants
2. Transaction documents
3. Issuance documents

There are no other attributes and limitations of the credit rating or rating outlook other than those displayed on the CRA website. Furthermore, CRA considers satisfactory the quality and extent of information available on the rated entity. In regard to the rated entity Creditreform Rating AG regarded the available historical data as sufficient.

Between the time of disclosure of the credit rating to the rated entity and the public disclosure, no amendments were made to the credit rating.

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The date at which the credit rating was initially released for distribution and the date when it was last updated including any rating outlooks is indicated clearly and prominently in the 'Basic Data' card as a "rating action"; initial release is indicated as "initial rating", other updates are indicated as an "update", "upgrade" or "downgrade", "not rated", "confirmed", "selective default" or "default".

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