Creditreform Bank Rating
Instituto de Credito Oficial (Group)

Creditreform Rating

Long-Term Issuer Rating: A-
Outlook: stable

Short-Term Rating: L2

Preferred Sen. Unsec. Debt: A-
Non-Preferred Sen. Unsec. Debt: -
Tier 2 Capital: -
AT1 Capital: -

05 November 2019

Rating Action:

Creditreform Rating affirms Instituto de Credito Oficial (Group) long-term issuer rating at 'A-' (Outlook: stable)

Creditreform Rating (CRA) has affirmed Instituto de Credito Oficial (Group) - in the following ICO - long-term issuer rating at 'A-' and the short-term rating at 'L2'. The rating outlook is stable.

However, adjustments in our rating methodology for bank capital and debt instruments occurred because of legislative alterations in the European Union. As a result, CRA reclassifies its rating of senior unsecured debt to preferred senior unsecured debt and affirms it at 'A-'. We do not assign any rating to AT1 Capital, Tier 2 Capital and Non-preferred Senior Unsecured debt due to the lack of these capital and debt instruments.

Please find a complete list of rating actions regarding the bank at the end of this rating update. In addition, we refer to the more detailed report of the Group from 13.07.2018 and the Rating Update from 31.08.2018 on our homepage.

Key Rating Drivers

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

- Stability through the attachment of the bank to the Ministry of Economy and Business of the Kingdom of Spain
- Explicit, irrevocable, unconditional and direct guarantee of the Spanish State for any of ICO's obligations
- Relatively low earnings figures
- Very strong capitalization

Rating Rationale

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ICO's credit rating affirmation is primarily driven by its status as a government related bank and its close relationship to the Spanish State.

Profitability

ICO's net profit dropped from €103.1m to €75.6m year-over-year. This development is primarily a result of a further increase in the banks negative net interest income. The primary income sources are the net trading income with gains from hedge accounting and net fee and commission income primarily with revenues from the management of diverse funds. Meanwhile, ICO's personnel expense remained roughly unchanged. In addition, the bank benefits from the reversal of asset write-downs amounting to €99.8m. Nonetheless, ICO reveals relatively low earnings figures in a peer group comparison.

Asset Situation and Asset Quality

ICO's asset quality improved significantly year-over-year and reflects the sound performance of the economy in Spain in recent years. In particular, the bank's NPL ratio reduced considerably year-over-year from 4.8% to 2.4%. Moreover, the bank's risk-weighted assets ratio decreased and the bank displays reversals of its write-downs for the forth-consecutive year in a row. The bank's decline in its net loans item is a result of its countercyclical role in the economy of Spain.

Refinancing and Capital Quality

ICO reveals a very strong capitalization. Its regulatory capital figures with a CET1 ratio of 40.7% as well as its leverage ratio of 12.6% are outstanding. In addition, its total equity to total assets ratio outperforms the average of the peer group clearly. The increase in all of these ratios year-over-year is primarily a result of an absolute decrease in risk-weighted assets as well as a decline of total assets while maintaining its equity position.

The ratings of ICO's bank capital and debt instruments are affected due to our rating mechanism. However, due to the lack of AT1 Capital, Tier 2 Capital and Non-preferred Senior Unsecured debt we do not assign any rating to these capital and debt instruments.

Liquidity

In our opinion, the overall liquidity situation of ICO remains satisfactory.

Outlook

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

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 considerably better in the "best case" scenario and substantially 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 are explicitly sensitive to changes in the rating of the Kingdom of Spain.

We could upgrade ICO's long-term issuer credit rating and its bank capital and debt instruments if our rating of the Kingdom of Spain improves while the linkage between the bank and the Spanish State remains at the same, close level. Upward pressure for the rating of the Kingdom of Spain could result primarily from stronger medium-term growth and a credible medium-term fiscal path, leading to sustainably lower general government debt levels.

By contrast, a downgrade of ICO's long-term issuer credit rating and its bank capital and debt instruments is likely if our rating of the Kingdom of Spain worsens while the linkage between the bank and the Spanish State remains at the same, close level. Downward pressure for the rating of the Kingdom of Spain could result primarily from weaker-than-expected medium-term growth or a reversal of past structural reforms.

CRA's rating actions at a glance

Instituto de Credito Oficial (Group):

- Long-Term Issuer Rating affirmed at 'A-', stable outlook
- Short-term rating affirmed at 'L2'
- Senior unsecured debt reclassified to preferred senior unsecured debt and affirmed at 'A-'

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.

Preferred senior unsecured debt (PSU): **A-**
Non-preferred senior unsecured debt (NPS): **-**
Tier 2 (T2): **-**
Additional Tier 1 (AT1): **-**

Ratings Detail and History

Please consult our website www.creditreform-rating.de for additional information regarding the dates of publication.

Figure 1: Rating History

Bank Issuer Rating	Rating Date	Result
LT / Outlook / Short-Term (Initial)	13.07.2018	BBB+ / stable / L2
Rating Update	31.08.2018	A- / stable / L2
Rating Update	05.11.2019	A- / stable / L2
Bank Capital and Debt Instruments	**Rating Date**	**Result**
Senior Unsecured / T2 / AT1 (Initial)	13.07.2018	BBB+ / - / -
Senior Unsecured / T2 / AT1	31.08.2018	A- / - / -
PSU / NPS / T2 / AT1	05.11.2019	A- / - / - / -

Appendix

Figure 2: Group income statement | Source: eValueRate / CRA

Income Statement	2015	2016	2017	%	2018
Income (€000)					
Net Interest Income	99.151	25.625	-69.107	+39,7	-96.518
Net Fee & Commission Income	46.449	47.660	53.106	-8,7	48.477
Net Insurance Income	-	-	-	-	-
Net Trading Income	-66.839	-138.761	32.259	> +100	108.475
Equity Accounted Results	1.901	1.579	1.245	+53,8	1.915
Dividends from Equity Instruments	353	552	173	-	-
Other Income	1.619	1.541	4.868	-76,6	1.137
Operating Income	**82.634**	**-61.804**	**22.544**	**> +100**	**63.486**
Expenses (€000)					
Depreciation and Amortisation	5.047	5.401	-3.836	< -100	5.261
Personnel Expense	20.797	20.505	20.641	+1,9	21.040
Tech & Communications Expense	4.423	4.806	4.993	+9,6	5.470
Marketing and Promotion Expense	1.736	873	987	+12,8	1.113
Other Provisions	5.265	-96.598	-3.843	< -100	1.655
Other Expense	10.775	10.867	11.522	-0,3	11.489
Operating Expense	**48.043**	**-54.146**	**30.464**	**+51,1**	**46.028**
Operating Profit & Impairment (€000)					
Pre-impairment Operating Profit	**34.591**	**-7.658**	**-7.920**	**< -100**	**17.458**
Asset Writedowns	-17.651	-458.002	-156.547	-36,2	-99.872
Net Income (€000)					
Non-Recurring Income	475	1.132	182	-	-
Non-Recurring Expense	-	-	-	-	-
Pre-tax Profit	**52.717**	**451.476**	**148.809**	**-21,2**	**117.330**
Income Tax Expense	18.873	134.457	45.709	-8,9	41.659
Discontinued Operations	-	-	-	-	-
Net Profit (€000)	**33.844**	**317.019**	**103.100**	**-26,6**	**75.671**
Attributable to minority interest (non-controlling interest)	-	-	-	-	-
Attributable to owners of the parent	33.844	317.019	103.100	-26,6	75.671

Figure 3: Group key earnings figures | Source: eValueRate / CRA

Income Ratios (%)	2015	2016	2017	%	2018
Cost Income Ratio (CIR)	58,14	-	135,13	-62,63	72,50
Cost Income Ratio ex. Trading (CIRex)	32,14	-70,36	-313,58	+211,27	-102,31
Return on Assets (ROA)	0,05	0,65	0,24	-0,04	0,21
Return on Equity (ROE)	0,63	5,56	1,94	-0,51	1,43
Return on Assets before Taxes (ROAbT)	0,08	0,92	0,35	-0,03	0,32
Return on Equity before Taxes (ROEbT)	0,99	7,92	2,81	-0,59	2,22
Return on Risk-Weighted Assets (RORWA)	0,21	1,79	0,64	-0,05	0,59
Return on Risk-Weighted Assets before Taxes (RORWAbT)	0,33	2,54	0,92	-0,00	0,92
Net Interest Margin (NIM)	0,05	-0,23	-0,09	+0,12	0,03
Pre-Impairment Operating Profit / Assets	0,06	-0,02	-0,02	+0,07	0,05
Cost of Funds (COF)	2,41	2,04	1,62	-0,01	1,61
Change in %Points					

Figure 4: Development of assets | Source: eValueRate / CRA

Assets (€000)	2015	2016	2017	%	2018
Cash and Balances with Central Banks	452.440	437.826	2.306.411	-27,6	1.669.486
Net Loans to Banks	26.932.816	19.164.816	16.077.669	-22,6	12.436.479
Net Loans to Customers	14.913.314	13.397.810	11.191.383	-10,1	10.061.491
Total Securities	17.549.648	13.979.925	11.454.060	-2,2	11.196.757
Total Derivative Assets	1.909.143	1.476.402	681.915	-12,7	595.009
Other Financial Assets	-	-	29.942	-	-
Financial Assets	**61.757.361**	**48.456.779**	**41.741.380**	**-13,9**	**35.959.222**
Equity Accounted Investments	55.929	57.750	58.860	+3,4	60.858
Other Investments	-	-	-	-	-
Insurance Assets	-	-	-	-	-
Non-current Assets & Discontinued Ops	-	-	22	-	-
Tangible and Intangible Assets	93.194	91.348	97.921	-2,9	95.114
Tax Assets	248.339	222.547	264.512	-61,8	100.986
Total Other Assets	29.770	36.860	38.052	-8,4	34.865
Total Assets	**62.184.593**	**48.865.284**	**42.200.747**	**-14,1**	**36.251.045**

Figure 5: Development of asset quality | Source: eValueRate / CRA

Asset Ratios (%)	2015	2016	2017	%	2018
Net Loans/ Assets	23,98	27,42	26,52	+1,24	27,76
Risk-weighted Assets/ Assets	25,93	36,32	38,20	-3,09	35,11
NPLs / Net Loans to Customers	3,79	3,54	4,80	-2,41	2,39
NPLs / Risk-weighted Assets	10,83	2,67	3,33	-1,45	1,89
Potential Problem Loans / NPLs	209,08	41,04	106,68	+58,18	164,86
Reserves/ NPLs	126,09	358,94	202,98	+149,53	352,51
Reserves/ Net Loans	14,76	12,70	9,75	-1,32	8,42
Net Write-offs/ Net Loans	-0,12	-3,42	-1,40	+0,41	-0,99
Net Write-offs/ Risk-weighted Assets	-0,11	-2,58	-0,97	+0,19	-0,78
Change in %Points					

Figure 6: Development of refinancing and capital adequacy | Source: eValueRate / CRA

Liabilities (€000)	2015	2016	2017	%	2018
Total Deposits from Banks	11.633.435	13.375.016	11.495.137	-17,8	9.447.789
Total Deposits from Customers	1.056.619	1.003.960	848.733	+16,4	988.040
Total Debt	41.835.142	26.954.455	22.845.774	-16,2	19.147.495
Derivative Liabilities	420.506	468.584	524.499	-31,6	358.690
Securities Sold, not yet Purchased	-	-	-	-	-
Other Financial Liabilities	1.514.722	1.051.930	857.380	-17,0	711.847
Total Financial Liabilities	**56.460.424**	**42.853.945**	**36.571.523**	**-16,2**	**30.653.861**
Insurance Liabilities	-	-	-	-	-
Non-current Liabilities & Discontinued Ops	-	-	-	-	-
Tax Liabilities	40.416	66.837	15.447	+54,4	23.854
Provisions	335.917	239.260	304.665	-8,0	280.195
Total Other Liabilities	6.162	8.066	4.119	+54,7	6.371
Total Liabilities	**56.842.919**	**43.168.108**	**36.895.754**	**-16,1**	**30.964.281**
Total Equity	**5.341.674**	**5.697.176**	**5.304.993**	**-0,3**	**5.286.764**
Total Liabilities and Equity	**62.184.593**	**48.865.284**	**42.200.747**	**-14,1**	**36.251.045**

Figure 7: Development of capital ratios | Source: eValueRate / CRA

Capital Ratios (€000)	2015	2016	2017	%	2018
Total Equity/ Total Assets	8,59	11,66	12,57	+2,01	14,58
Leverage Ratio	7,36	9,48	11,00	+1,58	12,58
Phased-in: Common Equity Tier 1 Ratio (CET1)	32,15	29,33	32,74	+7,96	40,70
Phased-in: Tier 1 Ratio (CET1 + AT1)	32,15	29,33	32,74	+7,96	40,70
Phased-in: Total Capital Ratio (CET1 + AT1 + T2)	32,89	29,44	32,87	+7,83	40,70
Change in %Points					

Figure 8: Development of liquidity | Source: eValueRate / CRA

Liquidity (%)	2015	2016	2017	%	2018
Net Loans/ Deposits (LTD)	1411,42	1334,50	1318,60	-300,27	1018,33
Interbank Ratio	231,51	143,29	139,86	-8,23	131,63
Liquidity Coverage Ratio	-	-	-	-	-
Customer Deposits / Total Funding (excl. Derivates)	1,89	2,37	2,33	+0,89	3,23
Net Stable Funding Ratio (NSFR)	-	-	-	-	-
Change in %Points					

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 eValueRate / CRA. Subject to a peer group analysis were 54 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 bank ratings, the methodology for government related banks 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".

The complete presentation of the rating methodologies used by Creditreform Rating AG and the basic document "Rating Criteria and Definitions" is published on the following homepage:

www.creditreform-rating.de/de/regulatory-requirements/.

On 05 November 2019, the rating was presented by the analysts to the rating committee and adopted in a resolution.

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

The rating is valid until withdrawal and is subject to monitoring from the rating date (see cover page). The rating will be comprehensively reviewed at least once every year. Within this period, the rating can be updated.

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

Conflict of Interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person 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 approving credit ratings and rating outlooks.

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

Rules on the Presentation of Credit Ratings and Rating Outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our policy "Rating Committee," all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

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

1. Aggregated data base by eValueRate
2. Annual Report and interim reports
3. Investors relations information and other publications
4. Website of the rated bank

There are no other attributes and limitations of the credit rating or rating outlook other than 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 available historical data as sufficient.

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

The "Basic data" information card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In case where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating and indicates how the different methodologies or these other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

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

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within „Basic data" information card.

In accordance to Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of Creditreform`s default rates are available in the credit rating methodologies disclosed on the website.

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