

PRESS RELEASE

SEPTEMBER 13, 2022

DBRS Morningstar Confirms ICO's Long-Term Ratings at 'A', Stable Trend

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) confirmed Instituto de Crédito Oficial's (ICO or the Bank) ratings, including the Long-Term Issuer Rating at "A" and the Short-Term Issuer Rating at R-1 (low). All ratings have a Stable trend. ICO's Support Assessment remains SA1. See a full list of ratings at the end of this press release.

KEY RATING CONSIDERATIONS

The confirmation of ICO's Long-Term Issuer Rating at "A", Stable trend follows DBRS Morningstar's confirmation of the Kingdom of Spain's Long-Term Foreign and Local Currency rating at "A" with a Stable trend on September 2, 2022. ICO's ratings reflect its statutory ownership and the full guarantee of its liabilities by the Kingdom of Spain as stated in its by-laws under the Royal Decree Act 706/1999. As a result, DBRS Morningstar's support assessment for ICO is SA1 and ICO's Issuer Ratings and trend are equalised with the Long-Term and Short-Term Foreign and Local Currency ratings of the Kingdom of Spain and will move in line with the rating of the Spanish sovereign.

RATING DRIVERS

An upgrade on the Kingdom of Spain's ratings would be reflected in ICO's ratings. Similarly, a downgrade of the Kingdom of Spain's ratings would lead to a downgrade of ICO's ratings. The Long-Term and the Short-Term trends move in line with the trend of the Kingdom of Spain.

RATING RATIONALE

ICO is a credit institution by law and is considered to be a State Finance Agency of Spain. As a public specialized lending institution and the state's financial agency, ICO enjoys a unique and dominant franchise in Spain which contributes to support its current ratings. However, ICO also has a limited business scope, constrained by its business model and its high dependence on the Spanish Government.

The operating environment in Spain suffered a significant deterioration during the coronavirus (COVID-19) pandemic. As a result, the Spanish government approved a scheme of up to EUR 100 billion for SMEs and Corporates (liquidity program) in 2020. This scheme is managed by ICO but the guarantees are provided by the Spanish government; consequently, ICO does not bear the credit risk related to these guarantees. In addition, the Spanish government also approved an additional guarantee loan scheme of up to EUR 40 billion (investment program) to provide funding sources to new investment projects (Real Decreto-ley 25/2020, de 3 de julio). As with the other program, the investment program is managed by ICO, but the guarantees are provided by the Spanish Government. Lastly, in 2022, due to Russia's invasion of Ukraine, the Spanish government also put in place a EUR 10 billion state guarantee loan scheme which is managed by ICO.

In carrying out its public service mandate, ICO's goal is not to maximise profits, however the Bank has never reported a loss in its history. Nevertheless, given its countercyclical nature, profits have shown volatility over time. The Bank's net income totalled EUR 140 million in 2021, up from EUR 79 million in 2020. Net interest income (NII) stood at EUR 105 million in 2021 compared with EUR 22 million in 2020. NII increased in 2021 due to significantly lower wholesale funding costs as new issuances were priced at lower yields than maturing securities, coupled with significant use of short term funding. Net fees totalled EUR 50 million in 2021, and marginally improved from the prior year (+2.2% YoY). As a result, ICO's Total Operating Income increased materially to EUR 207 million in 2021 compared to EUR 104 million (as calculated by DBRS Morningstar) in 2020. Despite the challenging economic situation, ICO reported a net release of total provisions, as these were EUR -33 million in 2021 compared to EUR -51 million in 2020.

DBRS Morningstar views ICO's risk appetite as generally conservative due to the nature of its activities. However, ICO's credit profile is negatively affected by its high single-name concentrations. The Bank's lending is carried out through two different channels. The first channel is indirect lending in which the Bank's operates through credit lines to commercial banks that, in turn, lend the funds to SMEs/entrepreneurs. The indirect lending results in ICO having counterparty credit risk to the participating banks. ICO's total indirect lending totalled EUR 7.1 billion at end-2021. The second channel is direct lending, which typically consists of providing loans to large companies or structured finance projects and represented around EUR 11.3 billion at end-2021. During 2021, both portfolios decreased, with the indirect lending portfolio decreasing by around 24% YoY and the direct portfolio decreasing by around 3.6% YoY. This is explained by the fact that the government guarantees schemes have been utilised, thus reducing the demand for new lending.

Direct loans are the only contributor to the Bank's level of NPLs, as the Bank does not bear the underlying credit risk for the indirect lending. The Bank's NPL ratio decreased to 3.6% at end-2021 from 4.0% at end-2020 (as calculated by DBRS Morningstar), with gross NPLs totalling around EUR 408 million. The Bank's coverage ratio for these NPLs remains very strong at around 153% at end-2021 (as calculated by DBRS Morningstar). DBRS Morningstar expects that the Bank will register an increase in NPLs in coming years due to the challenging economic environment.

ICO's funding structure is reliant on long-term and short-term wholesale funding and funding from multilateral development banks, mainly the European Investment Bank. The Bank has not experienced any notable difficulties in accessing the markets since its creation and has been able to tap the markets on a regular basis, even during the financial crisis and the current COVID-19 crisis. DBRS Morningstar views ICO's capitalisation as robust. ICO's Common Equity Tier 1 capital ratio stood at a solid 37.0% at end-2021 down from 37.2% at end-2020.

ENVIRONMENTAL, SOCIAL, GOVERNANCE CONSIDERATIONS

Credit rating actions on the Kingdom of Spain are likely to have an impact on this credit rating. Consequently, passed-through Social credit considerations affects the ratings of ICO, as the Human Capital and Human Rights factor affects the ratings of the Kingdom of Spain. ESG factors that have a significant or relevant effect on the credit analysis of the Kingdom of Spain are discussed separately at <https://www.dbrsmorningstar.com/issuers/15664>

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>.

Notes:

All figures are in EUR unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (June 23, 2022) <https://www.dbrsmorningstar.com/research/398692>

Other applicable methodologies include the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (May 17, 2022) <https://www.dbrsmorningstar.com/research/396929/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings>

and the DBRS Morningstar Criteria: Guarantees and Other Forms of Support (April 4, 2022) <https://www.dbrsmorningstar.com/research/394683/dbrs-morningstar-criteria-guarantees-and-other-forms-of-support>

The sources of information used for this rating include Morningstar Inc. and Company Documents, and ICO Annual Accounts (2015-2021). DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: <https://www.fca.org.uk/firms/credit-rating-agencies>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/402652>

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Initial Rating Date: February 25, 2013

Last Rating Date: September 10, 2021

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For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

Ratings

Instituto de Crédito Oficial (ICO)

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
13-Sep-22	Long-Term Issuer Rating	Confirmed	A	Stb	EU U
13-Sep-22	Short-Term Issuer Rating	Confirmed	R-1 (low)	Stb	EU U
13-Sep-22	Long-Term Senior Debt	Confirmed	A	Stb	EU U
13-Sep-22	Short-Term Debt	Confirmed	R-1 (low)	Stb	EU U
13-Sep-22	Short-Term Deposits	Confirmed	R-1 (low)	Stb	EU U
13-Sep-22	Long-Term Deposits	Confirmed	A	Stb	EU U

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