

# INFORMATION OF PRUDENTIAL RELEVANCE

31 DECEMBER 2016

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## 1. GENERAL INFORMATION REQUIREMENTS

### 1.1. INTRODUCTION

This report is intended to comply with the market reporting requirements of the Instituto de Crédito Oficial Consolidated Group, established in Part Eight of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms (hereinafter, "the Solvency Regulation").

As of 1 January 2014, Law 10/2014, of 26 June, on the regulation, supervision and solvency of credit institutions replaced the previous body of laws on prudential banking regulation (Law 13/1985, of 25 May, and Banco de España Circular 3/2008). The main purpose of Law 10/2014, of 26 June, was to adapt the Spanish legal system to regulatory changes introduced internationally and within the European Union, directly incorporating the provisions of Regulation (EU) 575/2013 of 26 June (CRR) and duly transposing Directive 2013/36/EU of 26 June (CRD4). These Community regulations have involved substantial changes to the regulations applicable to credit institutions, as aspects such as the rules on supervision, capital requirements and penalties have been extensively amended.

In accordance with the Eighth Additional Provision of Law 10/2014, of 26 June, on the regulation, supervision and solvency of credit institutions, the Instituto de Crédito Oficial (ICO) is subject to Titles II (Solvency of credit institutions), III (Supervision) and IV (Sanctions) of that law, with such exceptions as the regulations provide for, and the provisions regarding the duty of confidentiality.

In accordance with the information disclosure policies approved by ICO, this report has been prepared, on an annual basis, by ICO's Risk and Financial Control Department and approved by its chairman, having been checked by the Internal Audit Department.

Certain information required by current regulations to be included in this report is presented, in accordance with those regulations, by reference to the 2016 consolidated annual accounts of the ICO Group, as that information is stated there and it would therefore be superfluous to repeat it here. The above-mentioned annual accounts and this document "Information of prudential relevance" can be viewed on the ICO website ([www.ico.es](http://www.ico.es)).

## 1.2. INSTITUTO DE CRÉDITO OFICIAL CONSOLIDATED GROUP

The information presented in this report relates to the Consolidated Group of Credit Institutions, whose parent company is the Instituto de Crédito Oficial (hereinafter, "the Group" or "ICO Group").

Entities over which ICO is able to exert control are considered subsidiaries. An entity is considered to control an investee when it is exposed to, or has a right to, variable returns on its holding in the investee and it has the ability to influence such returns through the power it exercises over the investee.

The following requirements must be satisfied for an entity to be considered a subsidiary:

- Control: An investor is considered to have control over an investee when it possesses current rights that give it the capacity to influence significant activities, that is, those having a material impact on the performance of the investee;
- Returns: An investor is exposed, or has a right, to variable returns from its investment in an investee when the returns obtained by the investor, on that investment, may vary according to the financial performance of the investee. The investor's returns may be solely positive, solely negative, or both positive and negative.

Relationship between control and returns: An investor is deemed to control an investee when the investor not only has rights over the investee and is exposed, or has a right, to variable returns from that investment, but also has the capacity to use its power to influence the returns on its investment in the investee.

The annual accounts of the subsidiaries are consolidated with those of ICO by applying the full consolidation method as defined in the regulations. Accordingly, all balances arising from significant transactions between consolidated companies using this method have been eliminated in the consolidation process. ICO is the parent entity of the Group, of which it represents 99%.

Also, third-party holdings in:

- The Group's equity is presented under "Minority interests" in the consolidated balance sheets. As at 31 December 2016 there were no minority interests.
- The consolidated results for the year are presented under "Profit or loss attributable to minority interests" in the consolidated profit and loss account. As at 31 December 2016 there was no profit or loss attributable to minority interests.

The results generated by subsidiaries acquired during a given year are consolidated only from the date of acquisition until the end of that year.

On the other hand, "associates" are considered to be those entities over which ICO is able to exercise significant influence, although they do not form part of a decision-making unit together with ICO, nor are they under joint control. Usually, this ability is evidenced in a (direct or indirect) participating interest equal to or greater than 20% of the voting rights of the investee.

Investments in entities regarded as "associates" are presented in the consolidated annual accounts under "Investments in Joint Ventures and Associates - Associates" in the consolidated balance sheet, valued at acquisition cost, net of any impairment that the holdings may have suffered.

The results generated by transactions between the associate and Group entities are eliminated to the extent of the percentage of the Group's holding in the associate.

The profit or loss obtained during the year by the associate, after the elimination referred to in the previous section, causes the value of the participating interest appearing in the consolidated annual accounts to increase or decrease, as applicable. The amount of this profit or loss is shown under "Share in profit (loss) of companies accounted for using the equity method" in the consolidated profit and loss account.

Changes in the valuation adjustments of the associate subsequent to the acquisition date are recognised as an increase or decrease in the value of the investment. The amounts of these changes are recognised under "Other accumulated comprehensive income" as valuation adjustments in consolidated net equity.

There are no "jointly controlled entities" included in the consolidation Group.

The following summary shows the main differences concerning the consolidation perimeter and the different consolidation methods applied, between the Consolidated Group of ICO Credit Institutions, the information for which is contained in this report, and the ICO Group of Credit Institutions as defined in accordance with the third paragraph of Rule 3 of Banco de España Circular 4/2004, of 22 December.

In preparing the consolidated annual accounts of the ICO Group of Credit Institutions, all subsidiaries are consolidated using the full consolidation method, since they satisfy the requirements for being regarded as consolidated in view of their activity. Consequently, there are

no differences in the consolidation perimeter for the purposes of the application of the solvency requirements.

For the purposes of the preparation of the consolidated annual accounts of the ICO Group of Credit Institutions, holdings in financial institutions that do not satisfy the requirements for being considered subsidiaries, jointly controlled entities or associates are regarded as financial instruments and are accounted for as per the criteria established in Rule 22 of Banco de España Circular 4/2004, of 22 December.

However, for the purposes of the application of the solvency requirements, financial institutions that have not been classified as subsidiaries, jointly controlled entities or associates in accordance with the provisions of Rule 46 of Banco de España Circular 4/2004, of 22 December, in which ICO owns or controls at least 20% of the capital or voting rights, are valued using the equity method for the purposes of preparing the information for the Consolidated Group.

In accordance with the above-mentioned criteria, detailed below are the Consolidated Group's subsidiaries as at 31 December 2016, to which the full consolidation method has been applied for the purposes of preparing the relevant consolidated information:

ENTITY: AXIS PARTICIPACIONES EMPRESARIALES, S.G.E.I.C, S.A S.M.E.

Appendix I to the consolidated annual accounts provides relevant information on the associates included in the Group.

### 1.3 OTHER GENERAL INFORMATION

As at 31 December 2016 there was no material practical or legal impediment to the immediate transfer of own funds or the repayment of liabilities between the Group subsidiaries and the Instituto de Crédito Oficial, nor was there any reason to suppose that such impediments might exist in the future.

As at 31 December 2016 there were no entities belonging to the economic Group and not included in the consolidated Group that were subject to minimum capital requirements individually, in accordance with the different rules applicable to them.

As at 31 December 2016 the holding in AXIS PARTICIPACIONES EMPRESARIALES, S.G.E.I.C, S.A S.M.E. included in the Consolidated Group is not individually subject to the calculation of capital requirements, being included in the ICO consolidated group, which is itself subject to such requirements.

All amounts contained in this report are expressed in thousands of euros.

ICO is not considered a global systemically important institution.

## 2. RISK MANAGEMENT POLICIES AND OBJECTIVES

The information on risk management policies and objectives which must be provided to the market in accordance with the Regulation can be found in Note 5 (Risk Exposure) of the notes to the Instituto de Crédito Oficial Group's 2016 consolidated annual accounts, published on the ICO website. ([www.ico.es](http://www.ico.es)).

## 3. INFORMATION ON ELIGIBLE CAPITAL

### 3.1 SUMMARY OF THE MAIN CHARACTERISTICS AND CONDITIONS OF THE OWN FUNDS COUNTED AS TIER 1 AND TIER 2 CAPITAL

For the purposes of calculating its minimum own funds requirements, the Group considers as tier 1 capital the elements defined as such, taking into account their relevant deductions, in Part Two, Title I, Chapters 1 to 3 of the Solvency Regulation.

Tier 1 capital is characterised by being a component of own funds that can be used immediately and without restriction to cover risks or losses when they arise, the amount of which is recorded free of all foreseeable taxes at the time it is calculated. Tier 1 capital is in principle more stable and durable than tier 2 capital, which is described below. As indicated in section 3.2 below, as at 31 December 2016 the Group's tier 1 capital basically consisted of ICO's equity and its actual and stated reserves.

Tier 2 capital, on the other hand, is the own funds defined in Part Two, Title I, Chapter 4 of the Solvency Regulation, with the limits and deductions established therein. These own funds, although conforming to the definition of own funds established in the current Regulation, are characterised by being, in principle, more volatile or less permanent than elements considered as tier 1 capital.

As broken down in section 3.2 below, as at 31 December 2016 the Group's tier 2 capital comprised solely adjustments for general credit risk using the standardised approach. All items which, in accordance with the provisions of the Solvency Regulation, form part of the ICO Group's eligible capital, are homogeneous as regards their definition and characteristics, and so their content is not described individually.



### 3.2 TOTAL AMOUNT OF OWN FUNDS

The following breakdown shows the eligible own funds of the Consolidated Group at 31 December 2016, indicating each of their components and deductions and broken down into tier 1 and tier 2 capital:

		Amount (€ thousands)
Total eligible own funds		5,225,180
Tier 1 capital		5,204,344
Common equity tier 1 capital		5,204,344
Capital instruments admissible as common equity tier 1 capital		4,312,585
Retained earnings		932,172
Other reserves		117,144
Adjustments to common equity tier 1 capital due to prudential filters		-125,649
Other intangible assets		-9,129
Elements of or deductions from common equity tier 1 capital - Other		-22,779
Additional tier 1 capital		0
Tier 2 capital		20,836
General credit risk adjustments under standardised approach		20,836

### 3.3 RECONCILIATION OF ACCOUNTING CAPITAL WITH REGULATORY CAPITAL

A reconciliation of the accounting capital stated in ICO's financial statements with regulatory capital for solvency purposes as at 31 December 2016 is set out below:

ITEM	(€ thousands)
	<b>2016</b>
Capital	4,312,585
Reserves	950,839
Attributed profit	317,019
TOTAL OWN FUNDS AS PER PUBLISHED BALANCE SHEET	5,580,443
Valuation adjustments	116,733
TOTAL EQUITY AS PER PUBLISHED BALANCE SHEET	5,697,176
Other adjustments to basic own funds	-492,832
Deductions from tier 1 capital	0
TIER 1 CAPITAL	5,204,344

### 4. INFORMATION ON MINIMUM OWN FUNDS REQUIREMENTS

Total minimum own fund requirements by risk type at 31 December 2016 were as follows:

TOTAL OWN FUNDS REQUIREMENTS	(€ thousands)
	<b>2016</b>
Credit, counterparty and free delivery risk	1,336,092
Settlement and delivery risk	0
Position, exchange rate and commodities risk	5,463
Operational risk	48,401
Credit valuation adjustment risk	29,784
TOTAL REQUIREMENTS	1,419,740

## 4.1 MINIMUM OWN FUNDS REQUIREMENTS FOR CREDIT, COUNTERPARTY AND FREE DELIVERY RISK

Below is the amount of the Consolidated Group's minimum own funds requirements for credit risk as at 31 December 2016, which has been calculated, for each of the categories to which the standardised approach (Part Three, Title II, Chapter 2, of the Solvency Regulation) has been applied, as 8% of the risk-weighted exposures:

Total requirements for credit, counterparty and free delivery risk	1,336,092
Standardised approach	1,336,092
Categories of exposure under the standardised approach excluding securitisation positions	1,336,092
Central governments or central banks	109,669
Regional governments or local authorities	
Public sector bodies	334,553
Multilateral development banks	247
International organisations	36
Institutions	376,778
Companies	401,039
Retail exposures	1,339
Exposures secured by mortgages on immovable property	
Exposures in default	10,362
Items associated with particularly high risk	
Covered bonds	
Exposures to institutions and corporates with a short-term credit assessment	
Units or shares in collective investment undertakings (CIUs)	
Equity instruments	92,756
Others	9,313
Securitisation positions under the standardised approach	
*Of which: resecuritisation	

## 4.2 MINIMUM OWN FUNDS REQUIREMENTS FOR SETTLEMENT/DELIVERY RISK

There are no own funds requirements for settlement/delivery risk relevant to the Group (Part Three, Title V, of the Solvency Regulation).

Total amount of own funds requirements for settlement/delivery risk	
Settlement/delivery risk in the non-trading book	
Settlement/delivery risk in the trading book	

## 4.3 MINIMUM OWN FUNDS REQUIREMENTS FOR POSITION, EXCHANGE RATE AND COMMODITIES RISK (MARKET RISK). TRADING BOOK MARKET RISK

Total amount of own funds requirements for position, foreign exchange and commodities risk	5,463
Amount of requirements for position, foreign exchange and commodities risk under the standardised approach	5,463
Traded debt instruments	4,074
Equity instruments	
Currencies	1,389
Commodities	

The calculation is carried out in accordance with Part Three, Title IV, of the Solvency Regulation.

As regards market risk associated with the trading book, it should be noted that the Group considers as such those positions in financial instruments held with the intention of trading or to hedge positions in the trading book. In this regard, there are no differences between the trading book for the purposes of calculating the Group's own funds requirements and the trading book defined according to Banco de España Circular 4/2004, of 22 December, with respect to debt securities or capital instruments.

The total amount of the own funds requirements associated with the trading book as at 31 December 2016 tallies with the position risk on negotiable debt instruments.

#### 4.4 MINIMUM OWN FUNDS REQUIREMENTS FOR OPERATIONAL RISK

Total amount of own funds requirements for operational risk	48,401
Operational risk - basic indicator approach	48,401
Operational risk - standardised approach/alternative standardised approach	
Operational risk - advanced measurement approach	

The Group uses the basic indicator approach to determine the own funds requirements associated with operational risk (Part Three, Title III, of the Solvency Regulation).

#### 4.5 MINIMUM OWN FUNDS REQUIREMENTS FOR CREDIT VALUATION ADJUSTMENT RISK

Total amount of own funds requirements for credit valuation adjustment risk	29,784
Advanced approach	
Standardised approach	29,784
Based on the original exposure approach	

The Group uses the standardised approach to determine the own funds requirements associated with credit valuation adjustment risk (Part Three, Title IV, of the Solvency Regulations).

#### 4.6 INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

In accordance with the provisions of the Solvency Regulation, the Consolidated Group applies a series of risk identification, measurement and aggregation procedures that enable it to define and maintain a level of own funds appropriate to the risks inherent in its activity, the economic environment in which it operates, the management and control of those risks, its governance systems, its strategic business plan and its real possibilities of obtaining more own funds; that is, it carries out an assessment of internal capital, both current and forecast, according to its planning.

In assessing its internal capital, the Group applies the following procedures related to each of its risks:

- Assessment of capital requirements for credit risk: the standardised approach established in the Solvency Regulation for calculating the minimum own funds requirements associated with this risk has been applied.

- Assessment of capital requirements for credit concentration risk: the simplified option is being used, applying the relevant sector and individual concentration indices established by Banco de España.

- Assessment of capital requirements for market risk: the standardised approach established in the Solvency Regulation for estimating the minimum own funds requirements associated with this risk has been used.
- Assessment of capital requirements for operational risk: the basic approach is being applied.
- Assessment of capital requirements for balance sheet structural interest rate risk: the simplified option is being applied.
- Assessment of capital requirements for liquidity risk: The Group estimates no capital requirements associated with this risk, following analysis of its liquidity policy, its settlement control systems and its contingency plans, which show an appropriate liquidity situation and therefore no capital requirement to cover this risk.
- Assessment of capital requirements for strategic and business risk: in 2016 it was assessed as an independent risk, applying the simplified option.
- Assessment of capital requirements for other risks: the capital requirements associated with risks other than those above have been estimated at 5% of the Group's total own funds requirements, under the provisions of the Solvency Regulation.

The Group's total capital needs have been estimated through aggregation of the capital needs associated with each risk, obtained using the above-stated methods.

Furthermore, in order to appropriately plan the Group's future capital needs, the relevant forecasts are made regarding profit to be allocated to reserves and capital consumption deriving from expected business growth in different scenarios, including, inter alia, stress situations.

ICO's capital planning process seeks to determine its future capital requirements over a particular time horizon. For the purposes of this report, the time horizon is three years. This involves estimating the sources and consumption of capital for the next three years, based on ICO's projections for the period in question, which forms the baseline scenario.

In addition to this baseline scenario, ICO has also estimated its capital requirements in an adverse macroeconomic scenario and in several additional stress scenarios, in line with ICAAP guidelines.

The results of the capital planning process include the following information for each scenario:

- Projections for the main balance sheet and profit-and-loss account items.
- Calculations of the capital required and risk-weighted assets (RWA) for each Pillar 1 risk type in each year.
- A comparison of capital requirements and available capital (in both “phase-in” and “fully-loaded” scenarios).
- An action plan to meet any possible capital requirements (as necessary).

In all cases, ICO has an amount of capital which is expected to enable it to comply with its statutory minimum requirements, even in crisis scenarios.

## 5. INFORMATION ON CREDIT RISK

### 5.1 ACCOUNTING DEFINITIONS AND DESCRIPTION OF THE METHODS USED TO DETERMINE CORRECTIONS FOR IMPAIRMENT

The concepts of exposures in default and corrections for impairment referred to in this document are based on the definitions in the Solvency Regulation and Appendix IX of Banco de España Circular 4/2004.

Note 2.7 of the notes to the ICO Group's 2016 consolidated annual accounts describes the methods used by the Group to determine provisions for impairment due to credit risk and calculate the provisions established in relation to contingent risks and obligations associated with that risk.

## 5.2 CREDIT RISK EXPOSURE AND AVERAGE VALUE OF THE EXPOSURES FOR THE FINANCIAL YEAR

As at 31 December 2016, the total value of the Consolidated Group's risk-weighted exposures to credit risk, along with its distribution by counterparty type, was as follows:

Amount of the exposures weighted for credit, counterparty and free delivery risk	16,701,143
Standardised approach	16,701,143
Categories of exposure under the standardised approach excluding securitisation positions	16,701,143
Central governments or central banks	1,370,859
Regional governments or local authorities	
Public sector bodies	4,181,911
Multilateral development banks	3,087
International organisations	448
Institutions	4,709,736
Companies	5,012,982
Retail exposures	16,735
Exposures secured by mortgages on immovable property	
Exposures in default	129,522
Items associated with particularly high risk	
Covered bonds	
Exposures to institutions and corporates with a short-term credit assessment	
Units or shares in collective investment undertakings (CIUs)	
Equity instruments	1,159,448
Others	116,415
Securitisation positions under the standardised approach	
*Of which: resecuritisation	



The average value of the Consolidated Group's risk-weighted exposures to credit risk in 2016, along with its distribution by counterparty type, was as follows:

Average amount of the exposures weighted for credit, counterparty and free delivery risk	17,505,550
Standardised approach	17,505,550
Categories of exposure under the standardised approach excluding securitisation positions	17,505,550
Central governments or central banks	1,399,043
Regional governments or local authorities	
Public sector bodies	4,362,558
Multilateral development banks	3,252
International organisations	1,375
Institutions	5,315,572
Companies	4,877,010
Retail exposures	17,579
Exposures secured by mortgages on immovable property	
Exposures in default	198,361
Items associated with particularly high risk	
Covered bonds	
Exposures to institutions and corporates with a short-term credit assessment	
Units or shares in collective investment undertakings (CIUs)	
Equity instruments	1,214,408
Others	116,392
Securitisation positions under the standardised approach	
*Of which: resecuritisation	

### 5.3 GEOGRAPHICAL DISTRIBUTION OF EXPOSURES

Detailed below are the Consolidated Group's risk-weighted exposures to credit risk, as at 31 December 2016, broken down by geographical areas:

Geographical Area	Amount of exposure <i>(€ thousands)</i>
	<i>2016</i>
Spain	16,165,792
Other EU countries	229,508
Latin America	227,410
USA	42,300
Rest of Europe (non-EU)	8,043
Rest of the world	28,090
<b>Exposure at 31 December 2016</b>	<b>16,701,143</b>

### 5.4 RESIDUAL MATURITY OF EXPOSURES

Below is the distribution by residual maturity of the Consolidated Group's risk-weighted exposures to credit risk as at 31 December 2016, to which the standardised approach for calculating own funds requirements has been applied:

Risk category Residual maturity period at 31 December 2016

(€ thousands)

	On sight	Up to 3 months	Between 3 months and 1 year	Between 1 and 5 years	Over five years	Total
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2016

A) Central governments and central banks	30,227	94,259	191,222	602,877	452,274	1,370,859
B) Regional governments and local authorities	-	-	-	-	-	-
C) Public sector entities	92,208	287,543	583,338	1,839,123	1,379,698	4,181,910
D) Multilateral development banks	68	212	431	1,358	1,018	3,087
E) International organisations	10	31	62	197	148	448
F) Institutions	103,847	323,836	656,965	2,071,251	1,553,838	4,709,737
G) Corporates	110,533	344,686	699,265	2,204,612	1,653,885	5,012,981
H) Retail exposures	369	1,151	2,334	7,360	5,521	16,735
I) Exposures secured by immovable property						
J) Exposures in default	2,856	8,906	18,167	56,961	42,732	129,622
K) High-risk exposures						
L) Covered bonds						
M) Short-term exposures to institutions and corporates						
N) Exposures to collective investment undertakings						
O) Equity instruments					1,159,448	1,159,448
P) Other exposures	2,567	8,005	16,239	51,197	38,408	116,316
Exposure at 31 December 2016	342,685	1,068,629	2,168,023	6,834,936	6,286,870	16,701,143

## 5.5 DISTRIBUTION BY COUNTERPARTY AND GEOGRAPHICAL DISTRIBUTION OF EXPOSURES IN DEFAULT

### Exposures in default by counterparty

Shown below is the value of original risk exposures in default (impaired and past due) as at 31 December 2016, before adjustments and provisions, broken down by counterparty type, together with the amount of impairment losses and provisions for contingent risks and obligations established in relation to those exposures as at that date, and the net amount recognised in relation to them for impairment losses and provisions for contingent risks and obligations during the 2016 financial year (standardised approach for determining own funds requirements for credit risk):

Counterparty	Total impaired exposures	Of which: Past-due exposures	Losses due to impairment and provisions for contingent risks and obligations	Provisions for losses due to impairment and contingent risks and obligations for the year (net)
			<b>2016</b>	<b>(€ thousands)</b>
A) Central governments and central banks				
B) Regional governments and local authorities				
C) Public sector entities				
D) Multilateral development banks				
E) International organisations				
F) Credit institutions and investment firms				
G) Corporates	1,629,204	474,070	1,680,824	-375,631
H) Retail exposures				
I) Exposures secured by immovable property				
J) High-risk exposures				
K) Covered bonds				
L) Short-term exposures to institutions and corporates				
M) Exposures to collective investment undertakings				
N) Equity instruments				
O) Other exposures				
Amounts at 31 December 2016	1,629,204	474,070	1,680,824	-375,631

### Exposures in default by geographical area

The table below shows the value of impaired and past-due original exposures at 31 December 2016, net of adjustments and provisions, broken down by significant geographical areas, together with the amount of impairment losses and provisions for contingent risks and obligations established in relation to them:

Geographical Area			
	<i>(€ thousands)</i>		
	Total impaired exposures	Of which: Past-due exposures	Losses due to impairment and provisions for contingent risks and obligations
			<b>2016</b>
Spain	1,629,204	474,070	1,680,824
Other EU countries			
Latin America			
USA			
Rest of Europe (non-EU)			
Rest of the world			
Amount at 31 December 2016	1,629,204	474,070	1,680,824

### **5.6 CHANGES DURING THE FINANCIAL YEAR IN LOSSES DUE TO IMPAIRMENT AND PROVISIONS FOR CONTINGENT RISKS AND OBLIGATIONS ON ACCOUNT OF CREDIT RISK**

The changes during the 2016 financial year in impairment losses due to credit risk recognised by the Group and the changes in provisions for contingent risks and obligations on account of credit risk are in accordance with Banco de España Circular 4/2004, as regards both the type of loss and provisions established and the method used to calculate them (see section 5.1 above).

The breakdown of the changes made during the 2016 financial year in value corrections due to financial asset impairment (including substandard risk) and in provisions for contingent risks and obligations on account of credit risk, is given below:

Losses due to  
impairment of  
financial assets

Provisions for  
contingent risks  
and obligations

(€ thousands)

Balance at 1 January 2016	2,102,517	184
Provisions charged to profit and loss	73,918	
Recoveries credited to profit and loss	-449,378	-170
Amounts applied during the financial year	-46,699	
Effect of foreign exchange differences	452	
Changes caused by business combinations		
Changes in the consolidation perimeter		
Transfers		
Other movements		
Balances at 31 December 2016	1,680,810	14

Additionally, expenditure recognised in the ICO Group's 2016 consolidated profit and loss account in respect of items transferred directly to bad debts is nil, while credits to the consolidated profit and loss account for the same financial year in respect of the recovery of assets previously recorded as bad debts amounted to €4.222 million.

## 5.7 INFORMATION ON THE GROUP'S COUNTERPARTY CREDIT RISK

Counterparty credit risk is regarded as the credit risk that the Group incurs in derivative financial instrument transactions and transactions with repurchase commitments, securities or commodities lending, in deferred settlement and guarantee financing transactions.

It is controlled by means of a system that combines the administration of transactions and the risks deriving from them in real time, providing operators with up-to-date information on the credit lines available at any given time.

A consumption methodology for counterparty facilities has been defined for derivatives and approved by ICO's competent bodies, based on the valuation of transactions at market prices plus a potential future or add-on risk, which is measured as a percentage of the nominal value of the transaction and calculated as the maximum potential loss (95% confidence interval) during the life of the transaction. The methodology is reviewed periodically (at least once a year), with the add-ons being adjusted at least every six months.

The basic criteria for establishing counterparty facilities are approved by ICO's General Board. These counterparty facilities are divided into two large groups on account of ICO's operational characteristics. On the one hand, counterparty facilities for treasury operations. On the other, the counterparty facilities for mediation transactions, in which ICO finances various investment projects through framework programmes subscribed with various entities operating in Spain, such as the 'Líneas Pyme' SME facilities, for example.

In order to mitigate counterparty risk exposure, the Group signs ISDA and CMOF (Financial Transaction Framework Agreement) contracts with the counterparties and, where applicable, the relevant collateral annexes.

Regarding the management of collateral, in the case of derivatives, for entities subject to collateral agreements, the position is valued periodically (usually from day to day) and the parameters agreed in the collateral agreement are applied to that valuation to obtain an amount of (cash) collateral to be received from or returned to the counterparty.

These amounts (margin calls) are carried out on a weekly basis. The counterparty receiving the margin call reviews the valuation and discrepancies may arise in the process. Where such discrepancies are significant, they are analysed in detail.

A distinctive characteristic of the collateral agreements signed by ICO with the counterparties is that they are "one way", such that only ICO's counterparties are required to deposit collateral.

100% of the collateral received is cash and, therefore, value adjustments for collateral impairment are not applicable.

Regarding the correlation between the guarantee and the guarantor in the derivatives, due to the fact that cash is received as collateral, there is no risk of adverse effects due to the existence of correlations.

Below is a breakdown of the Group's counterparty credit risk exposure for its derivative transactions as at 31 December 2016, using the mark-to-market valuation method, estimated as the amount of the Group's credit exposure due to these financial instruments, net of the effects of the relevant contractual netting agreements and guarantees received from the transaction counterparties:

	<i>Amount (€ thousands)</i>
	<b>2016</b>
Exposure value: mark-to-market valuation method	1,610,350
Less: Effect of netting agreements	-754,549
Credit exposure after netting	855,801
Less: Effect of collateral received	-12,959
Credit exposure in derivatives after netting and collateral at 31 December 2016	842,842

The value of the exposure has been calculated using the mark-to-market method (Part Three, Title II, Chapter 6, of the Solvency Regulation).

## 6. CREDIT RISK: CREDIT RATINGS

### 6.1 IDENTIFICATION OF THE EXTERNAL RATING AGENCIES USED

For all categories of credit risk exposure to which the standardised approach is being applied, the following are the external rating and export credit agencies whose ratings were being used by the Group as at 31 December 2016 (ECAIs recognised by Banco de España):

- Moody's
- Standard & Poor's
- Fitch Ratings
- D.B.R.S.

### 6.2 DESCRIPTION OF THE PROCESS OF ASSIGNING EXTERNAL CREDIT RATINGS FOR DETERMINING CREDIT RISK WEIGHTED EXPOSURES

The assignment rules defined in the Solvency Regulation are applied:

- When only one credit rating is available for a rated exposure, this rating will be used to determine the risk weighting.
- When there are two credit ratings for a rated exposure and these ratings correspond to two different risk weightings, the higher risk weighting will be applied to the exposure.
- When there are more than two credit ratings for a rated exposure, the two ratings that provide the lowest weightings shall be used. In the event that they are not equal, the higher of the two will be applied.



### 6.3 EFFECT ON RISK EXPOSURES OF APPLYING RISK REDUCTION TECHNIQUES AND EXPOSURES DEDUCTED DIRECTLY FROM OWN FUNDS

Below is a breakdown of the Group's credit risk exposures as at 31 December 2016, estimated using the standardised approach, before and after applying the risk reduction techniques permitted by the Solvency Regulation, broken down by exposure category and credit quality (measured based on the percentage applied to calculate the amount of the risk-weighted exposure):

Risk category	(€ thousands)	
	Positions before applying risk reduction techniques	Positions after applying risk reduction techniques
		<b>2016</b>
Central governments and central banks	15,840,936	15,313,450
Regional governments and local authorities	2,400,873	2,400,886
Public sector entities	3,562,648	4,186,525
Multilateral development banks	15,435	15,435
International organisations	2,239	2,239
Institutions	23,993,027	23,993,027
Companies	5,715,389	5,618,985
Retail exposures	24,035	24,035
High-risk exposures		
Covered bonds		
Short-term exposures to institutions and corporates		
Exposures in default	129,522	129,522
Exposures in the form of CIUs		
Equity instruments	473,385	473,385
Other exposures	116,415	116,415
<b>TOTAL EXPOSURES</b>	<b>52,273,904</b>	<b>52,273,904</b>

Risk weightings	(€ thousands)	
	Positions before applying risk reduction techniques	Positions after applying risk reduction techniques
Weighting 0%	15,445,069	15,787,551
Weighting 10%		
Weighting 20%	23,655,196	23,655,196
Weighting 35%		
Weighting 50%	910,148	910,148
Weighting 75%	24,035	24,035
Weighting 100%	11,742,927	11,400,444
Weighting 150%	39,154	39,154
Weighting 250%	457,375	457,376
<b>TOTAL EXPOSURES</b>	<b>52,273,904</b>	<b>52,273,904</b>

The Group has no credit risk positions deducted directly from own funds.

## 7. CREDIT RISK: CREDIT RISK REDUCTION TECHNIQUES

### 7.1 GENERAL INFORMATION FOR CREDIT RISK

The Group generally applies the credit risk reduction techniques referred to in the Solvency Regulation (Part Three, Title II, Chapter 4), depending on the guarantees received for risk positions.

These guarantees can be personal (including credit derivatives) or collateral (including those of a financial nature) and are valued for these purposes by reference to the credit enhancement provided by the guarantor's external rating (in the case of personal guarantees) or by market parameters in the case of collateral.

### 7.2. POLICIES AND PROCESSES FOR OFFSETTING POSITIONS AND VALUING COLLATERAL FOR COUNTERPARTY RISK

The concept of netting refers to the possibility of offsetting between contracts of the same type, under the umbrella of a framework agreement, such as the ISDA or other similar agreement. This consists of the offsetting of positive and negative market values of derivatives transactions entered into with a particular counterparty, such that, in the event of default by that counterparty, a single flow to pay or be paid is generated, as opposed to a number of positive or negative values for each transaction. In this way, since market value is one of the components of counterparty risk, by obtaining a net market value for the transactions the risk is reduced.

An important aspect of framework agreements is that they involve a single legal obligation which encompasses all the transactions covered, which makes it possible to offset the risks of all the transactions covered by that agreement with any one counterparty.

Netting clauses are included regardless of whether they can be executed directly, to make it possible to apply the various applicable laws, so the inclusion of such agreements does not imply that netting is automatically taken into account when calculating the counterparty risk exposure with the various counterparties. Such exposures are calculated in accordance with the applicable regulations in each of the jurisdictions involved.

As regards collateral, the Group enters into collateral agreements to manage its exposures to counterparty risk. These agreements involve a set of instruments, in the form of cash deposited by a counterparty in favour of another to guarantee/reduce any counterparty credit risk there may be, resulting from the portfolios of transactions where there is risk between them.

The nature of these agreements is diverse and the ultimate goal, as with the technique of netting, is to reduce counterparty risk by recovering some or all of the profits (credit granted to the counterparty) generated at a given moment in time by the transaction (valued at market prices).

### 7.3. QUANTITATIVE INFORMATION

The following table shows the distribution of the Group's credit risk exposure as at 31 December 2016, broken down according to whether or not credit risk reduction techniques are applied, and, where applicable, the reduction technique used (the exposure data refer to exposure prior to application of the relevant risk reduction technique):

VALUE OF THE EXPOSURE	(€ thousands)
	<b>2016</b>
A) Exposures to which a credit risk reduction technique is not applied	46,615,516
B) Exposures to which a credit risk reduction technique is applied	5,658,388
- On-balance sheet netting agreements	-
- Master netting agreements covering repurchase transactions, securities or commodities lending or borrowing transactions or other capital-market driven transactions	-
- Collateral (1)	
- Other collateral (2)	52,595
- Personal guarantees	5,605,793
- Credit derivatives	-

(1) Includes transactions secured by debt securities, shares, receivables and ownership rights to immovable property allowed by the Solvency Regulation as credit risk reduction techniques.

(2) Includes cash deposits, certificates of deposit and similar instruments held with third-party entities other than those of the Group and pledged in favour of entities of the Group, life insurance policies pledged in favour of Group entities issued by insurance companies recognised as providers of cover and debt securities issued by other institutions not included in point (1) above which would receive a maximum weighting of 50%, which must be repurchased at a predetermined price by the issuing institutions at the request of the holder of the securities.

The exposures to which risk reduction techniques are applied are shown below, classified by risk category:

Risk category	Covered by other collateral	Covered by personal guarantees	TOTAL
<i>€ thousands 2016</i>			
Central governments and central banks		916,514	916,514
Regional governments and local authorities		2,056,016	2,056,016
Public sector entities		2,526,566	2,526,566
Multilateral development banks			
International organisations			
Institutions			
Companies	49,846	96,403	146,249
Retail exposures			
High-risk exposures			
Covered bonds			
Short-term exposures to institutions and corporates			
Exposures in default	2,749	10,294	13,043
Exposures in the form of CIUs			
Equity instruments			
Other exposures			
<b>TOTAL EXPOSURES</b>	<b>52,595</b>	<b>5,605,793</b>	<b>5,658,388</b>

## 8. SECURITISATION TRANSACTIONS

### 8.1 GENERAL INFORMATION ON SECURITISATION

As at 31 December 2016, ICO did not have any securitisation positions on its balance sheet (Part Three, Title II, Chapter V, of the Solvency Regulation).

### 8.2 EXPOSURES IN SECURITISATION TRANSACTIONS AND AMOUNT OF SECURITISED ASSETS

As at 31 December 2016, the Group had no securitisation transaction positions to which it would apply the treatment provided for in Chapter Four, Section Four, of the Solvency Circular for the purposes of calculating its own funds requirements for credit risk.

## 9. MARKET REPORTING REQUIREMENTS: INFORMATION ON REMUNERATION

ICO is configured as a public business entity and, consequently, is subject to Royal Decree 451/2012, of 5 March, which regulates the remuneration of senior executives and management in the public business sector and other entities. It is also subject to the approval of the Inter-ministerial Remuneration Committee as regards setting the pay of those of the entity's personnel who are not covered by a collective agreement. Accordingly, the remuneration of ICO's executives is limited by the regulations referred to above, which prevents different remuneration measures from being approved by the competent bodies.

In accordance with the Eighth Additional Provision of Law 10/2014, of 26 June, on the regulation, supervision and solvency of credit institutions, Title I of that law, which sets out corporate governance rules and remuneration policy, does not apply to ICO.

## 10. INFORMATION ON PARTICIPATIONS AND CAPITAL INSTRUMENTS NOT INCLUDED IN THE TRADING BOOK

Note 2.1 to the Group's consolidated annual accounts for 2016 includes a description of the portfolios into which the participations and capital instruments held by the Group are classified, together with the accounting recognition and valuation criteria applied to each. That note also indicates the models and assumptions applied to determine the value of the instruments included in each portfolio. During the 2016 financial year there were no changes having a significant effect on the practices and assumptions used by the Group to value its participations and capital instruments.

The Group holds participations and capital instruments for various different purposes. In this respect, it holds participations in entities with varying degrees of involvement in their management and decision-making processes, with which it seeks to achieve the objectives making up the Group's strategy and objectives, as a whole and/or where the intention is to maintain a lasting presence as a shareholder ("strategic participations"). It also holds participations in other entities with different objectives, basically consisting of maximising the income obtained through their management, in coordination with the Group's risk management objectives and strategies ("available-for-sale portfolios").

In general, the participations and capital instruments held by the Group for strategic purposes are accounted for as Group companies, associates and jointly controlled entities, whereas participations held for sale and not forming part of the trading portfolio are classified as available-for-sale financial assets.

Appendix 1 to the notes to the 2016 consolidated annual accounts includes a detailed description of the ICO Group's participations, with information on the investee entities, the carrying value of those participations and their fair value.

Note 8 to the consolidated annual accounts for the financial year 2016 indicates the types, nature and amounts of exposures in available-for-sale participations and capital instruments.

Gains or losses recognised in equity during the period are included in that note and in Note 21 to the Group's consolidated annual accounts for the 2016 financial year.

There were no unrealised gains or losses not recognised in the balance sheet during financial year 2016.

There were no gains or losses during 2016 as a result of the sale or settlement of capital instruments not included in the trading portfolio.

## 11. INTEREST RATE RISK IN POSITIONS NOT INCLUDED IN THE TRADING BOOK

Interest rate risk is the risk to which the Group is exposed by having asset and liability transactions at different interest rates (fixed, variable or pegged to different indices) and with different maturities, such that upward or downward movements in the reference interest rates for those transactions can produce asymmetric effects on its assets and liabilities, which in turn affect the Group's profit and loss account and capital.

Interest rate risk is managed by the Group in an integrated manner for all its entities having significant positions exposed to this risk. The Group measures and analyses this risk taking into account the following aspects and based on the following premises:

- The risk is measured and analysed constantly.
- The effects that changes in the interest rates of the different currencies to which there are significant exposures could have on the Group's results and the various profit and loss account margins is analysed.
- The analyses include all positions that are sensitive to interest rate risk, including interest rate derivatives, whether implicit or explicit.
- To measure the risk, an analysis is carried out of the possible effects/deviations of the intermediation margin and net asset value, now calculated based on changes of +/- 200 bps relative to the base curve, with a floor of 0% in each significant currency, on the value of the central scenario, calculated based on the base curve and by simulating values.
- Separate measurements are carried out of the interest rate for each position held in each currency and aggregate measurements of the interest rate for all of them.

On the basis of the above analyses, the Group takes the necessary steps to ensure optimum management of this risk.



Note 5 of the notes to the Group's 2016 consolidated annual accounts includes information regarding the Group's level of exposure, in terms of equity and in the profit and loss account, for the purposes of reasonable future changes in the level of prevailing interest rates, with a breakdown by the most significant currencies. The information takes into account the effects of hedging, analysing the result of an increase or decrease of 200 basis points, with a floor of 0%, in the interest rates, and includes certain information on interest rate sensitivity and the criteria that have been applied to prepare the information, with all the significant assumptions used.

## 12. CAPITAL BUFFERS

As at 31 December 2016, Banco de España had not made it obligatory for ICO to comply with the requirement for a countercyclical capital buffer, as laid down in Title VII, Chapter 4 of Directive 36/2013/EU.

Chapter 3 of Banco de España Circular 2/2016, of 2 February, to credit institutions, on supervision and solvency, completing the transposition of Directive 2013/36/EU and Regulation EU 575/2013 into Spanish law, regulates capital buffers from the date of its entry into force (February 2016). In this regard:

- It establishes an ordinary capital buffer of 2.5%, (“fully loaded”) with which ICO was compliant as at 31 December 2016;
- A countercyclical capital buffer has been established according to the relevant requirements. For 2016, the quarterly percentage set by Banco de España for this buffer is 0% for credit exposures in Spain;
- ICO is not subject to buffers for global or other systemically important institutions;
- Banco de España has not set any buffer for systemic risks.

### 13. INFORMATION ON UNENCUMBERED ASSETS

Shown below is information on the Group's unencumbered and encumbered assets as at 31 December 2016 (Recommendation ESRB/2012/2):

	Carrying Value of Unencumbered Assets		Fair Value of Unencumbered Assets	
		Of which: issued by other group entities	Of which: accepted by central banks	Of which: accepted by central banks
				<b>2016</b>
				<b>(€ thousands)</b>
Assets of the reporting institution	48,865,284			
Call loans	437,816			
Capital instruments	428,939		428,939	
Debt securities	13,550,986		13,550,986	
of which: Covered bonds				
of which: Asset securitisation bonds				
of which: issued by public sector bodies	12,195,123		12,195,123	
of which: issued by financial companies	1,351,796		1,351,796	
of which: issued by non-financial companies	4,067		4,067	
Loans and advances other than call loans	32,562,626			
of which: mortgage loans	327,355			
Other Assets	1,884,917			

ICO had no encumbered assets at 31 December 2016.

## 14. INFORMATION ON LEVERAGE

Shown below is information on the Group's leverage ratio as at 31 December 2016:

Exposure relating to the leverage ratio	(€ thousands)
<b>Exposure values</b>	
Exposure to securities financing transactions (SFTs) according to article 220 of the CRR	
Exposure to securities financing transactions according to article 222 of the CRR	
Derivatives: mark-to-market	1,610,350
Derivatives: add-on - Mark-to-market valuation method	237,169
Derivatives: original exposure method	0
Undrawn credit lines that are unconditionally cancellable at any time without prior notice	0
Off-balance sheet items related to medium/low-risk trade finance	0
Off-balance sheet items related to medium-risk trade finance and off-balance sheet items related to officially supported export credits	0
Other off-balance sheet items	3,581,368
Other assets	49,620,724
<b>Capital and statutory adjustments</b>	<b>0</b>
Tier 1 capital (according to the definition to be applied on completion of the phase-in process)	5,204,344
Tier 1 capital (according to the transitional definition)	5,204,344
Amount to add in application of article 429, section 4, second paragraph, of the CRR	0
Amount to add in application of article 429, section 4, second paragraph, of the CRR (according to the transitional definition)	0
Regulatory adjustments - Tier 1 capital (according to the definition to be applied on completion of the phase-in process)	-134,779
Tier 1 capital statutory adjustments (according to the transitional definition)	-134,779
<b>Leverage ratio</b>	
Leverage ratio (according to the definition of tier 1 capital to be applied on completion of the phase-in process)	9.48%
Leverage ratio (according to the transitional definition of tier 1 capital)	9.48%

Details of the exposure values taken into account are as follows:

	Exposure corresponding to the leverage ratio under the standardised approach	Risk-weighted assets: exposures under the standardised approach
<b>Covered bonds</b>		
<b>Exposures comparable to exposures to central governments</b>	<b>17,447,439</b>	<b>4,513,990</b>
Central governments and central banks	13,889,113	364,378
Regional governments and local authorities comparable to central governments		
Multilateral development banks and international organisations comparable to central governments		
Public sector bodies comparable to central governments	3,558,326	4,149,612
<b>Exposures to regional governments, multilateral development banks, international organisations and public sector bodies not comparable to central governments</b>	<b>2,361,777</b>	<b>1,696</b>
Regional governments and local authorities NOT comparable to central governments	2,353,297	0
Multilateral development banks NOT comparable to central governments	8,480	1,696
Public sector bodies NOT comparable to central governments		
<b>Institutions</b>	<b>22,190,202</b>	<b>4,349,171</b>
Secured by mortgages on immovable property, of which		
Secured by mortgages on residential immovable property		
<b>Retail exposures</b>	<b>23,890</b>	<b>16,645</b>
Retail exposures to SMEs	6,893	3,752
<b>Companies</b>	<b>5,288,193</b>	<b>4,613,686</b>
Financial		
Non-financial	5,288,193	4,613,686
Exposures to SMEs	1,622,630	1,583,671
Exposures to companies other than SMEs	3,665,563	3,030,015
<b>Exposures in default</b>	<b>1,629,203</b>	<b>129,522</b>
<b>Other exposures (for example, equities and other non-credit obligation assets), of which:</b>	<b>680,020</b>	<b>1,275,863</b>
Securitisation exposures	-	-
<b>Trade finance (memorandum item), of which:</b>	-	-
Under an official export credit insurance scheme		

As at 31 December 2016 the leverage ratio stood at 9.48%. This is significantly higher than the latest Basel and EBA recommendations, of between 4% and 5%. The leverage ratio and any changes in it are reported to senior management every month.



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