INFORMATION OF PRUDENTIAL RELEVANCE

31 December 2017

CONTENTS

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 2017 consolidated financial statements of the ICO Group, as that information is stated there and it would therefore be superfluous to repeat it here. The above-mentioned financial statements and this document "Information of prudential relevance" can be viewed on the ICO website (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 financial statements 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 2017 there were no minority interests.

- The consolidated results for the year are presented under "Profit or loss attributable to minority interests" in the consolidated statement of profit or loss. As at 31 December 2017 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 financial statements under "Investments in Subsidiaries, Joint Ventures and Holdings - 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 financial statements 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 statement of profit or loss.

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 financial statements 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 financial statements 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 2017, 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 financial statements provides relevant information on the associates included in the Group.

1.3 OTHER GENERAL INFORMATION

As at 31 December 2017 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 2017 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 2017 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 2017 consolidated financial statements, published on the ICO website. (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 2017 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 2017 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 2017, indicating each of their components and deductions and broken down into tier 1 and tier 2 capital:

				Amount (€ thousands)
Total eligible own funds				5,297,722
	Tier 1 capital			5,277,868
		Common equity tier 1 capital		5,277,868
			Capital instruments admissible as common equity tier 1 capital	4,313,068
			Retained earnings	999,593
			Other reserves	-127,567
			Adjustments to common equity tier 1 capital due to prudential filters	122,135
			Other intangible assets	-7,816
			Elements of or deductions from common equity tier 1 capital - Other	-21,545
		Additional tier 1 capital		0
	Tier 2 capital			19,854
		General credit risk adjustments under standardised approach		19,854

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 2017 is set out below:

ITEM	*(€ thousands)*
	2017
Capital	4,313,067
Reserves	1,019,706
Attributed profit	103,100
TOTAL OWN FUNDS AS PER PUBLISHED BALANCE SHEET	5,435,873
Valuation adjustments	-130,880
TOTAL EQUITY AS PER PUBLISHED BALANCE SHEET	5,304,993
Other adjustments to basic own funds	-27,125
Deductions from tier 1 capital	0
TIER 1 CAPITAL	5,277,868

4. INFORMATION ON MINIMUM OWN FUNDS REQUIREMENTS

Total minimum own fund requirements by risk type at 31 December 2017 were as follows:

TOTAL OWN FUNDS REQUIREMENTS	*(€ thousands)*
	2017
Credit, counterparty and dilution and free delivery risk	1,214,398
Settlement and delivery risk	0
Position, exchange rate and commodities risk	4,348
Operational risk	7,888
Credit valuation adjustment risk	62,891
TOTAL REQUIREMENTS	1,289,525

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

Below is the amount of the Consolidated Group's minimum own funds requirements for credit risk as at 31 December 2017, 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:

Amounts in thousands of euros

Total requirements for credit, counterparty and dilution and free delivery risk	1,214,398
Standardised approach	1,214,398
Categories of exposure under the standardised approach excluding securitisation positions	1,214,398
Central governments or central banks	108,928
Regional governments or local authorities	
Public sector bodies	271,405
Multilateral development banks	1,411
International organisations	
Institutions	330,798
Companies	366,031
Retail exposures	2,758
Exposures secured by mortgages on immovable property	
Exposures in default	11,542
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	111,408
Others	10,117
Securitisation positions under the standardised approach	
*Of which: resecuritisation	

4.2 MINIMUM OWN FUNDS REQUIREMENTS FOR SETTLEMENT AND DELIVERY RISK

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

Amounts in thousands of euros

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

Amounts in thousands of euros

Total amount of own funds requirements for position, foreign exchange and commodities risk	4,348
Amount of requirements for position, foreign exchange and commodities risk under the standardised approach	4,348
Traded debt instruments	3,113
Equity instruments	
Currencies	1,235
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 2017 tallies with the position risk on negotiable debt instruments.

4.4 MINIMUM OWN FUNDS REQUIREMENTS FOR OPERATIONAL RISK

Amounts in thousands of euros

Total amount of own funds requirements for operational risk	7,888
Operational risk - basic indicator approach	7,888
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

Amounts in thousands of euros

Total amount of own funds requirements for credit valuation adjustment risk	62,891
Advanced approach	
Standardised approach	62,891
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 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 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 credit valuation adjustment risk: the standardised approach for calculating the necessary capital for this risk has been used.

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 and ILAAP 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 IMPAIRMENT ADJUSTMENTS

The concepts of exposures in default and impairment adjustments 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 2017 consolidated financial statements 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 2017, the total value of the Consolidated Group's risk-weighted exposures to credit risk, along with its distribution by counterparty type, was as follows:

Amounts in thousands of euros

Amount of the exposures weighted for credit, counterparty and dilution and free delivery risk	15,179,975
Standardised approach	15,179,975
Categories of exposure under the standardised approach excluding securitisation positions	15,179,975
Central governments or central banks	1,361,599
Regional governments or local authorities	
Public sector bodies	3,392,565
Multilateral development banks	17,641
International organisations	
Institutions	4,134,975
Companies	4,575,385
Retail exposures	34,472
Exposures secured by mortgages on immovable property	
Exposures in default	144,275
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	1,392,605
Others	126,458
Securitisation positions under the standardised approach	
*Of which: resecuritisation	

The average value of the Consolidated Group's risk-weighted exposures to credit risk in 2017, along with its distribution by counterparty type, was as follows:

Amounts in thousands of euros

Average amount of exposures weighted for credit, counterparty, dilution and free delivery risk	15,329,285
Standardised approach	15,329,285
Categories of exposure under the standardised approach excluding securitisation positions	15,329,285
Central governments or central banks	1,383,356
Regional governments or local authorities	
Public sector bodies	3,583,351
Multilateral development banks	10,125
International organisations	
Institutions	4,221,828
Companies	4,638,073
Retail exposures	35,203
Exposures secured by mortgages on immovable property	
Exposures in default	137,760
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	1,193,213
Others	126,377
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 2017, broken down by geographical areas:

Geographical Area	Amount of exposure (€ thousands)
	2017
Spain	14,455,749
Other EU countries	449,908
Latin America	222,343
USA	24,106
Rest of Europe (non-EU)	965
Rest of the world	26,904
Exposure at 31 December 2017	15,179,975

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 2017, to which the standardised approach for calculating own funds requirements has been applied:

Risk category	Residual maturity period at 31 December 2017 (€ thousands)						
	Up to 1 year	From 1 to 2 years	From 2 to 3 years	From 3 to 4 years	From 4 to 5 years	Over 5	Total
							2017
A) Central governments and central banks	166,729	110,688	162,490	134,595	176,755	610,342	1,361,599
B) Regional governments and local authorities	-	-	-	-	-	-	
C) Public sector entities	415,422	275,791	404,860	335,358	440,404	1,520,731	3,392,565
D) Multilateral development banks	2,160	1,434	2,105	1,744	2,290	7,908	17,641
E) International organisations							
F) Institutions	506,330	336,143	493,457	408,746	536,779	1,853,519	4,134,975
G) Corporates	560,259	371,945	546,014	452,281	593,951	2,050,935	4,575,385
H) Retail exposures	4,221	2,802	4,114	3,408	4,475	15,452	34,472
I) Exposures secured by immovable property							
J) Exposures in default	17,667	11,729	17,217	14,262	18,729	64,672	144,275
K) High-risk exposures							
L) Covered bonds							
M) Short-term exposures to institutions and corporates							
N) Exposures to collective investment undertakings							
O) Equity instruments						1,392,605	1,392,605
P) Other exposures	15,485	10,280	15,091	12,500	16,416	56,685	126,458
Exposure at 31 December 2017	1,688,273	1,120,812	1,645,348	1,362,894	1,789,799	7,572,849	15,179,975

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 2017, 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 2017 financial year (standardised approach for determining own funds requirements for credit risk):

Counterparty	Total impaired exposures	Of which: Past-due exposures	Impairment losses and provisions for contingent risks and obligations	Provisions for impairment losses and contingent risks and obligations for the year (net)
			2017	***(€ thousands)***
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	1,041,392	537,520	938,117	-167,178
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 2017	1,041,392	537,520	938,117	-167,178

Exposures in default by geographical area

The table below shows the value of impaired and past-due original exposures at 31 December 2017 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			*(€ thousands)*
	Total impaired exposures	Of which: Past-due exposures	Impairment losses and provisions for contingent risks and obligations
			2017
Spain	884,166	499,943	805,853
Other EU countries	117,997	15,643	93,693
Latin America	39,229	21,934	38,571
USA			
Rest of Europe (non-EU)			
Rest of the world			
Amount at 31 December 2017	1,041,392	537,520	938,117

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

The changes during the 2017 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 2017 financial year in value adjustments due to financial asset impairment (including provisions for normal risk under special monitoring) and in provisions for contingent risks and obligations on account of credit risk, is given below:

	Impairment losses on financial assets	Provisions for contingent risks and obligations
		(€ thousands)
Balance at 01 January 2016	1,680,810	14
Provisions charged to profit and loss	19,884	9
Recoveries credited to profit and loss	-187,071	
Amounts applied during the financial year	-441,002	
Effect of foreign exchange differences	-251	
Changes caused by business combinations		
Changes in the consolidation perimeter		
Transfers		
Other movements		
Balances at 31 December 2017	1,072,370	23

Additionally, expenditure recognised in the ICO Group's 2017 consolidated statement of profit or loss in respect of items transferred directly to bad debts is nil, while credits to the consolidated statement of profit or loss for the same financial year in respect of the recovery of assets previously recorded as bad debts amounted to €7.344 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 2017, 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 guarantees received from the transaction counterparties:

	Amount (€ thousands)
	2017
Exposure value: mark-to-market valuation method	1,936,634
Less: Effect of collateral received	-7,124
Credit exposure in derivatives after collateral at 31 December 2017	1,929,510

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 2017 (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.

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 2017, 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)
	2017
A) Exposures to which a credit risk reduction technique is not applied	42,524,065
B) Exposures to which a credit risk reduction technique is applied	4,846,233
- On-balance sheet netting agreements	-
- Framework netting agreements relating to transactions with a repurchase commitment, securities lending transactions, commodities or other capital market transactions	-
- Collateral (1)	
- Other collateral (2)	1,189
- Personal guarantees	4,845,044
- 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
			€ thousands 2017
Central governments and central banks		861,128	861,128
Regional governments and local authorities		1,773,884	1,773,884
Public sector entities		2,041,148	2,041,148
Multilateral development banks			
International organisations			
Institutions			
Companies	1,189	103,566	104,755
Retail exposures			
High-risk exposures			
Covered bonds			
Short-term exposures to institutions and corporates			
Exposures in default		8,542	8,542
Exposures in the form of CIUs			
Equity instruments		56,776	56,776
Other exposures			
TOTAL EXPOSURES	1,189	4,845,044	4,846,233

7.4 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 2017, 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):

(€ thousands)

Risk category	Positions before applying risk reduction techniques	Positions after applying risk reduction techniques
		2017
Central governments and central banks	15,512,236	15,023,203
Regional governments and local authorities	2,087,959	1,931,472
Public sector entities	2,645,890	3,396,164
Multilateral development banks	88,205	88,205
International organisations		
Institutions	20,829,845	20,829,845
Companies	5,313,996	5,209,242
Retail exposures	55,551	55,551
High-risk exposures		
Covered bonds		
Short-term exposures to institutions and corporates		
Exposures in default	144,275	144,275
Exposures in the form of CIUs		
Equity instruments	565,873	565,873
Other exposures	126,468	126,468
TOTAL EXPOSURES	47,370,298	47,370,298

(€ thousands)

Risk weightings	Positions before applying risk reduction techniques	Positions after applying risk reduction techniques
Weighting 0%	14,298,647	14,514,255
Weighting 10%		
Weighting 20%	21,004,804	21,004,804
Weighting 35%		
Weighting 50%	820,114	820,114
Weighting 75%	55,551	55,551
Weighting 100%	10,537,939	10,322,331
Weighting 150%	102,089	102,089
Weighting 250%	551,154	551,154
TOTAL EXPOSURES	47,370,298	47,370,298

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

8. SECURITISATION TRANSACTIONS

8.1 GENERAL INFORMATION ON SECURITISATION

As at 31 December 2017, 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 2017, 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 financial statements for 2017 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 2017 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 2017 consolidated financial statements 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 Group's consolidated financial statements for the 2017 financial year indicates the types, nature and amounts of exposures in available-for-sale participations and capital instruments.

Unrealised gains or losses recognised in equity during the period are included in notes 8 and 21 to the Group's consolidated financial statements for the 2017 financial year.

The actual gains or losses recognised in profit or loss during the financial year as a result of the sale or settlement of equity instruments not included in the trading portfolio are included in note 29 of the Group's consolidated annual report for the 2017 financial year.

11. INTEREST RATE RISK. MARKET RISK.

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 statement of profit or loss 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 statement of profit or loss margins are 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 5.4 to the Group's report on its financial statements for the 2017 financial year includes information on the management of market risk.

12. CAPITAL BUFFERS

As at 31 December 2017, 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%, with which ICO was compliant at 31 December 2017;

- A countercyclical capital buffer has been established according to the relevant requirements. For 2017, 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 2017 (Recommendation ESRB/2012/2):

	Carrying Value of Unencumbered Assets			Fair Value of Unencumbered Assets	
		Of which: issued by other group entities	Of which: eligible for central banks		Of which: eligible for central banks
					2017 (€ thousands)
Assets of the reporting institution	42,200,747				
Call loans	2,306,401				
Equity instruments	521,429			521,429	
Debt securities	10,962,573			10,962,753	
of which: Covered bonds					
of which: Asset securitisation bonds					
of which: issued by public sector bodies	9,892,861			9,892,861	
of which: issued by financial companies	1,035,760			1,035,760	
of which: issued by non-financial companies	33,952			33,952	
Loans and advances other than call loans	27,269,052				
of which: mortgage loans	314,570				
Other Assets	1,141,292				

ICO had no encumbered assets at 31 December 2017.

14. INFORMATION ON LEVERAGE

Shown below is information on the Group's leverage ratio as at 31 December 2017:

Exposure relating to the leverage ratio	*(€ thousands)*
Exposure values	
Derivatives: current replacement cost	1,091,685
Derivatives: addition following the Mark-to-market valuation method	409,914
10% conversion factor on off-balance sheet items	41,691
20% conversion factor on off-balance sheet items	83,015
50% conversion factor on off-balance sheet items	2,768,934
100% conversion factor on off-balance sheet items	718,652
Other assets	42,978,543
Assets deducted from Tier 1 capital (according to the definition to be applied on completion of the phase-in process)	-129,951
Assets deducted from Tier 1 capital (according to the transitional definition)	-129,951
TOTAL LEVERAGE RATIO EXPOSURE (according to the definition to be applied on completion of the phase-in process)	47,962,483
TOTAL LEVERAGE RATIO EXPOSURE (according to the transitional definition)	47,962,483
Capital	
Tier 1 capital (according to the definition to be applied on completion of the phase-in process)	5,277,868
Tier 1 capital (according to the transitional definition)	5,277,868
Leverage ratio	
Leverage ratio (according to the definition to be applied on completion of the phase-in process)	11.00%
Leverage ratio (according to the transitional definition)	11.00%

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
Covered bonds		
Exposures comparable to exposures to central governments	**16,130,010**	**3,699,972**
Central governments and central banks	13,498,635	334,351
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	2,631,375	3,365,621
Exposures to regional governments, multilateral development banks, international organisations and public sector bodies not comparable to central governments	**2,124,025**	**15,802**
Regional governments and local authorities NOT comparable to central governments	2,045,013	0
Multilateral development banks NOT comparable to central governments	79,012	15,802
Public sector bodies NOT comparable to central governments		
Institutions	**18,061,921**	**3,615,781**
Secured by mortgages on immovable property, of which		
Secured by mortgages on residential immovable property		
Retail exposures	**55,855**	**34,159**
Retail exposures to SMEs	40,721	22,563
Companies	**4,754,322**	**4,178,892**
Financial		
Non-financial	4,754,322	4,178,892
Exposures to SMEs	1,461,065	1,432,306
Exposures to companies other than SMEs	3,293,257	2,746,586
Exposures in default	**1,082,391**	**144,275**
Other exposures (for example, equities and other non-credit obligation assets), of which:	**770,019**	**1,519,063**
Securitisation exposures	-	-
Trade finance (memorandum item), of which:	-	-
Under an official export credit insurance scheme		

The leverage ratio at 31 December 2017 amounted to 11.00%. The leverage ratio and its evolution are reported monthly to Management.

PASEO DEL PRADO, 4 - 28014

www.ico.es