

THE INSTITUTO DE CRÉDITO OFICIAL SOCIAL BOND

FRAMEWORK OVERVIEW AND SECOND-PARTY OPINION BY SUSTAINALYTICS



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TABLE OF CONTENTS

- 1. PREFACE**----- pg. 2

- 2. FRAMEWORK OVERVIEW** ----- pg. 2
 - 2.1 Introduction
 - 2.2 ICO Social Bond
 - 2.2.1 Use of Proceeds
 - Eligibility Criteria
 - Small, medium, and micro enterprises
 - Economically underperforming regions of Spain
 - Exclusionary Criteria
 - 2.2.2 Management of proceeds
 - Sustainalytics eligibility criteria compliance review
 - 2.2.3 Reporting

- 3. Sustainalytics' Opinion** ----- pg. 6
- Conclusion

- 4. Appendices** ----- pg. 8

1. PREFACE

The Instituto de Crédito Oficial (“ICO”) has engaged Sustainalytics to provide an opinion and support its effort to formulate a framework that can be used to issue a social bond. As part of this engagement, Sustainalytics held conversations with various members of ICO’s Capital Markets team to understand ICO’s Credit Lines program for SMEs and planned use of proceeds for its social bond; reviewed relevant public and internal documents, and provided its opinion. Subsequently, ICO fine-tuned its social bond framework to include Sustainalytics suggestions.

This document contains two sections: Framework Overview – summary of ICO’s social bond framework; and Sustainalytics’ Opinion – an opinion on the framework.

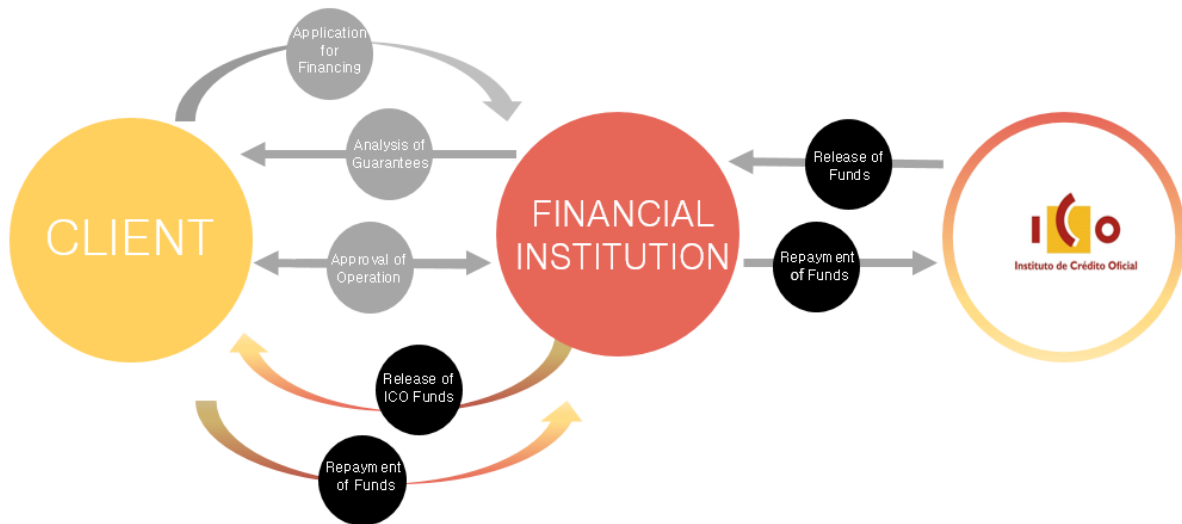
2. FRAMEWORK OVERVIEW

2.1 Introduction

ICO is a Madrid-based Spanish state-owned bank attached to the Ministry of Economic Affairs and Competitiveness via the State Secretariat for Economy and Enterprise Support. ICO’s primary mission is to promote economic activities contributing to the growth and development of Spain and to improve the distribution of national wealth, with a particular focus on activities involving social, culture, environment and innovation. As a state-owned bank, ICO provides loans to Spanish companies to fund investments and liquidity needs for their domestic and international operations through ICO’s *direct funding* and *second-floor facilities*.

Direct funding: This is corporate structured financing for large projects involving productive, public or private investment.

Second-floor facilities: ICO has collaboration agreements with Spanish financial institutions and provides line of credit to each financial institution for the disbursement of funds, through their networks, designed to finance self-employed workers, and small and medium-sized companies (SMEs). ICO provides favourable rates and terms by fixing the margins on the rate that the financial institutions can charge the SMEs, providing longer maturities, grace periods, zero-commissions and flexibility to use funds to cover any financial necessity. By accessing ICO’s second-floor facilities, financial institutions are able to provide these favourable rates and terms to qualified SMEs. These financial institutions assume the financial risk of these loans and are responsible for analysing operations, determining the loan guarantees and deciding on the approval of a loan based on the financial institutions’ internal financing criteria. Once financial institutions approve the loan, they formalize the contracts with SMEs and disburse funds by tapping into ICO’s second-floor facility. Every two weeks, the financial institutions provide ICO with the details on the loans that were funded with ICO’s second floor facility. Furthermore, ICO periodically, reviews a sample of these loans and undertakes site visits to a few SMEs to assess if they are using the loan funds for the intended purposes mentioned in their loan application.



2.2 ICO Social Bond

ICO is planning to issue a social bond aimed at small, medium and micro enterprises with an emphasis on employment creation or employment retention in specific economically underperforming regions of Spain. ICO plans to leverage its second-floor facilities aimed at SMEs, to select a subset of loans that meet the social bond criteria defined below. The following sections summarize ICO's social bond framework with regards to the use of proceeds, management of proceeds and reporting.

2.2.1 Use of proceeds

The proceeds of the social bond will be allocated towards loans funded by ICO's second-floor facilities that meet the following criteria.

Eligibility Criteria

To be eligible for the social bond proceeds, the loans funded by ICO's second floor facilities must be made to enterprises meeting each of the following criteria:

- a. Be a small, medium or microenterprise (SME) as defined below in following section
- b. Be located in an economically underperforming region of Spain listed below ; and
- c. Not be engaged in any business activity described under the Exclusionary Criteria described below.

Small, medium, and micro enterprises

ICO adheres to the European Union's definition and categorization of SMEs¹ which is described below:

1. The category of small, medium, and micro-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.
2. Within the SME category, a medium enterprise is defined as an enterprise that employs fewer than 250 persons and whose annual turnover does not exceed EUR 50 million and/or its annual balance sheet does not exceed EUR 43 million. A small enterprise is defined as an enterprise that employs fewer than 50 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million. A micro-enterprise is defined as an enterprise that employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million.

Enterprise category	Headcount	Turnover	Balance sheet total
Medium	< 250	≤ € 50 million	≤ € 43 million
Small	< 50	≤ € 10 million	≤ € 10 million
Micro	< 10	≤ € 2 million	≤ € 2 million

Economically underperforming regions of Spain

ICO defines economically underperforming regions of Spain as regions with GDP per capita in 2013 lower than the Spain's national GDP per capita, as per Spanish Regional Accounts². These economically underperforming regions are also characterized by unemployment rate of 19% or greater. The economically underperforming regions of Spain eligible for SME loans under the social bond framework, based on GDP per capita criteria are listed below, along with their corresponding GDP per capita and unemployment figures. Please refer to Appendix 2 for a map which illustrates the eligible regions listed below.

Eligible Regions	GDP per Capita (2013)	Unemployment Rate (Q3 2014)
Extremadura	€ 15,497	27.36%
Melilla	€ 16,863	30.49%
Andalucía	€ 16,843	35.21%
Castilla - La Mancha	€ 18,273	28.49%
Murcia, Región De	€ 18,392	26.25%
Ceuta	€ 18,455	31.95%
Canarias	€ 19,312	33.36%
Comunitat Valenciana	€ 19,695	25.54%
Galicia	€ 19,893	20.25%
Asturias, Principado De	€ 20,035	19.96%
Cantabria	€ 20,661	19.04%
Castilla Y León	€ 21,395	19.40%
Spanish National Average	€ 23,214	23.67%

¹ http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm

² <http://www.ine.es/dynt3/inebase/en/index.htm?padre=990&capsel=994>

Exclusionary Criteria

ICO will not allocate the proceeds from the social bond to SMEs in a number of industries that are considered to have potential negative social or environmental impact. Businesses or enterprises that meet any of the following criteria are ineligible for ICO's social bond proceeds:

1. The business falls under the NACE codes listed in Appendix 3, which cover a range of businesses such as, but not limited to, alcohol, tobacco, gambling, coal mining, energy production, etc.;
2. The business has a record of engaging in illegal business practices.

2.2.2 Management of proceeds

The proceeds from the social bond will be placed in ICO's treasury and managed by the treasury department. ICO will periodically review SME loans funded through its second-floor facilities to identify loans that meet the eligibility criteria and allocate the bond proceeds from the treasury to these loans. ICO hopes to allocate all of the social bond proceeds to SME loans within a year of issuing the bond. If there are any early loan repayments or if the loan matures before the maturity of the bond, ICO will replace such loans with new loans selected according to the eligibility criteria of the social bond.

Sustainalytics eligibility criteria compliance review

On the first anniversary of the social bond issuance, ICO will engage Sustainalytics to review loans allocated to the social bond in order to assess the compliance of allocated loans with the eligibility criteria of the bond. Sustainalytics will review a broad sample of SME applications that were approved by ICO in order to determine whether or not they meet the eligibility criteria defined in the framework. Sustainalytics will provide a report of the evaluation, which ICO commits to disclose publicly.

2.2.3 Reporting

ICO commits to provide the following reporting with regard to the social bond:

1. ICO will create a report detailing the bond proceeds allocated by region and industry, and additional details such as the numbers of SMEs, average amount lent to SMEs, average number of employees per SMEs etc. This information will be included in the Q1 2016 newsletter.
2. Sustainalytics compliance review document: On the first anniversary of the social bond issuance, ICO will make public, Sustainalytics' compliance review document that assesses if the approved SME loans met the eligibility criteria. This document is expected to be made public in Q1 2016 along with the newsletter.

3 SUSTAINALYTICS' OPINION

A socially-oriented institution: ICO, through its financing facilities, is providing affordable financing to SMEs in economically underperforming areas of Spain with a goal of creating or retaining employment. This is in line with its mission of promoting economic activities contributing to the growth and development of Spain and improving the distribution of national wealth. ICO's vision, among other things, is to be recognised, in particular by SMEs in Spain, as a supporter of growth in wealth and employment. In addition, ICO is rated in Sustainalytics' Global Platform as an outperformer in the social category and is ranked in the top 15% of peers in the banking industry in terms of its social performance. Furthermore, ICO has not been involved in any controversies or incidents relating to environmental, social or governance issues. Given its mission, vision and programmes aimed at creating socially positive outcomes in Spain, and given its outperformance among its peers in the management of social issues, Sustainalytics is of the opinion that ICO is very socially-oriented and is well positioned to issue a social bond.

Supporting SMEs: Through its second-floor facilities, ICO provides strong support to SMEs by offering favourable rates and terms by fixing the margins on the rate that the financial institutions can charge the SMEs, providing longer maturities, grace periods, zero-commissions, and providing the flexibility to use funds to cover any financial necessity. By doing this, ICO is lowering the cost of capital and reducing repayment burden, and therefore making financing more affordable to SMEs in Spain. According to Eurostat data for 2012, 99.9% of businesses in Spain had fewer than 250 workers, amounting to 75.6% of the country's workforce.³ Sustainalytics is of the opinion that, by providing affordable financing to SMEs in economically deprived regions, ICO is effectively targeting a business segment (SMEs) that has an important impact in terms of employment creation in economically underperforming areas.

Management of proceeds: Although ICO is providing loans to SMEs through financial institutions acting as intermediaries, it relies on its own expertise to select SME loans that align with the eligibility criteria for the allocation of social bond funds. This process ensures that ICO alone selects the SME loans for the social bond and not financial institutions; resulting in a high level of adherence to the eligibility criteria. ICO periodically reviews a sample of SME loans and undertakes site visits to a few SMEs to assess if they are using the loan funds for the intended purposes mentioned in their loan application. This should provide investors with further assurance that the eligibility criteria is being adhered to. In order to provide further assurance to investors, ICO plans to engage Sustainalytics on the first anniversary of the bond issuance, to carry out a review of a sample of loans and evaluate compliance with the eligibility criteria. By relying on its expertise in selecting loans for the bond, undertaking site visits -albeit a sample of SMEs, and engaging Sustainalytics for a compliance review, Sustainalytics is of the opinion that ICO will provide a high level of assurance to investors that the bond proceeds will be allocated properly.

Impact: It is highly likely that affordable financing will have a positive impact on SMEs' operations, resulting in employment creation and retention in Spain's economically underperforming areas. SME lending generally has a positive impact on disadvantaged regions and segments of society, with a few exceptions when SMEs are engaged in activities with potential negative social or environmental impact that were identified in the exclusion criteria. It may be noteworthy that, in order to provide a higher level

of assurance that the positive social impact will be achieved, SME lending could have been targeted to achieve specific impacts such as lending conditioned upon SMEs retaining a specific number of employees on its payroll, employing youth, owned by women, or engaged in healthcare, education or community-oriented services, to name a few. Nonetheless, the assumption of positive impact resulting from the social bond is sound.

Conclusion

Through its social bond, ICO aims to support employment creation and retention in economically underperforming regions of Spain, where high unemployment has persisted since the financial crisis of 2009. By focusing on such regions, ICO is targeting areas that will benefit the most from employment creation. With regard to the bond framework, ICO's social bond framework is in alignment with market best practices and norms such as the Green Bond Principles. ICO is also taking a rigorous approach to ensuring compliance with its eligibility criteria through a compliance review.

4 APPENDICIES

Appendix 1: GDP per Capita by regions in Spain

Contabilidad Regional de España - Base 2010

PIB per cápita

Unidad: Euros

Comunidad Autónoma	2010 (P)		2011 (P)			2012 (P)			2013 (A)		
	Valor	Índice España = 100	Valor	Índice España = 100	Tasa de Variación Interanual	Valor	Índice España = 100	Tasa de Variación Interanual	Valor	Índice España = 100	Tasa de Variación Interanual
EXTREMADURA	16,381	70.6%	16,030	69.7%	-2.1%	15,441	68.4%	-3.7%	15,497	68.8%	0.4%
MELILLA	18,381	79.2%	17,864	77.7%	-2.8%	16,907	74.9%	-5.4%	16,836	74.8%	-0.4%
ANDALUCÍA	17,599	75.8%	17,406	75.7%	-1.1%	16,893	74.9%	-2.9%	16,843	74.8%	-0.3%
CASTILLA - LA MANCHA	18,765	80.8%	18,575	80.7%	-1.0%	18,174	80.6%	-2.2%	18,273	81.1%	0.5%
MURCIA, REGIÓN DE	19,213	82.8%	18,765	81.6%	-2.3%	18,474	81.9%	-1.6%	18,392	81.7%	-0.4%
CEUTA	19,706	84.9%	19,155	83.3%	-2.8%	18,387	81.5%	-4.0%	18,455	82.0%	0.4%
CANARIAS	20,091	86.5%	19,914	86.6%	-0.9%	19,386	85.9%	-2.7%	19,312	85.8%	-0.4%
COMUNITAT VALENCIANA	20,511	88.4%	20,234	88.0%	-1.4%	19,623	87.0%	-3.0%	19,695	87.5%	0.4%
GALICIA	20,574	88.6%	20,249	88.0%	-1.6%	19,784	87.7%	-2.3%	19,893	88.3%	0.6%
ASTURIAS, PRINCIPADO DE	21,250	91.5%	21,047	91.5%	-1.0%	20,333	90.1%	-3.4%	20,035	89.0%	-1.5%
CANTABRIA	21,754	93.7%	21,455	93.3%	-1.4%	20,921	92.7%	-2.5%	20,661	91.7%	-1.2%
CASTILLA Y LEÓN	21,827	94.0%	21,799	94.8%	-0.1%	21,428	95.0%	-1.7%	21,395	95.0%	-0.2%
BALEARS, ILLES	24,084	103.7%	23,924	104.0%	-0.7%	23,694	105.0%	-1.0%	23,625	104.9%	-0.3%
RIOJA, LA	25,052	107.9%	24,760	107.6%	-1.2%	24,239	107.4%	-2.1%	24,426	108.5%	0.8%
ARAGÓN	25,603	110.3%	25,384	110.3%	-0.9%	24,618	109.1%	-3.0%	24,693	109.7%	0.3%
CATALUÑA	27,192	117.1%	26,777	116.4%	-1.5%	26,449	117.2%	-1.2%	26,512	117.7%	0.2%
NAVARRA, COMUNIDAD FORAL DE	28,752	123.9%	28,700	124.8%	-0.2%	27,817	123.3%	-3.1%	27,795	123.4%	-0.1%
PAÍS VASCO	30,114	129.7%	29,976	130.3%	-0.5%	29,478	130.7%	-1.7%	29,313	130.2%	-0.6%
MADRID, COMUNIDAD DE	31,005	133.6%	31,063	135.0%	0.2%	30,913	137.0%	-0.5%	30,678	136.2%	-0.8%
Total Nacional	23,214	100.0%	23,005	100.0%	-0.9%	22,562	100.0%	-1.9%	22,519	100.0%	-0.2%

(P) Estimación provisional

(A) Estimación avance

Notas:

- Para el cálculo del PIB per cápita y como consecuencia del acuerdo entre los Estados miembros de la UE y Eurostat, el valor del PIB de la Extra-Regio no se reparte entre el resto de los territorios regionales.

- Cifra de Población a 1 de Julio. Fuente: Estimaciones de la Población Actual de España. Unidades: Personas

Source: National Statistics Institute: Spanish Regional Accounts
<http://www.ine.es/jaxi/menu.do?type=pcaxis&path=%2Ft35%2Fp010&file=inebase&L=1>

Appendix 2: Economically underperforming regions of Spain (highlighted in yellow)



Appendix 3: Business with that fall under the following NACE codes are not eligible for ICO's SME facility.

NACE Code	NACE description
0115	A1.1.5 - Growing of tobacco
0510	B5.1.0 - Mining of hard coal
0520	B5.2.0 - Mining of lignite
0610	B6.1.0 - Extraction of crude petroleum
0620	B6.2.0 - Extraction of natural gas
0710	B7.1.0 - Mining of iron ores
0721	B7.2.1 - Mining of uranium and thorium ores
0729	B7.2.9 - Mining of other non-ferrous metal ores
0811	B8.1.1 - Quarrying of ornamental and building stone, limestone, gypsum, chalk and slate
0812	B8.1.2 - Operation of gravel and sand pits; mining of clays and kaolin
0891	B8.9.1 - Mining of chemical and fertiliser minerals
0893	B8.9.3 - Extraction of salt

0899	B8.9.9 - Other mining and quarrying n.e.c.
0910	B9.1.0 - Support activities for petroleum and natural gas extraction
0990	B9.9.0 - Support activities for other mining and quarrying
1101	C11.0.1 - Distilling, rectifying and blending of spirits
1102	C11.0.2 - Manufacture of wine from grape
1103	C11.0.3 - Manufacture of cider and other fruit wines
1200	C12.0.0 - Manufacture of tobacco products
2051	C20.5.1 - Manufacture of explosives
2446	C24.4.6 - Processing of nuclear fuel
2540	C25.4 - Manufacture of weapons and ammunition
2910	C29.1.0 - Manufacture of motor vehicles
2920	C29.2.0 - Manufacture of bodies (coachwork) for motor vehicles; manufacture of trailers and semi-trailers
2931	C29.3.1 - Manufacture of electrical and electronic equipment for motor vehicles
2932	C29.3.2 - Manufacture of other parts and accessories for motor vehicles
3511	D35.1.1 - Production of electricity
3512	D35.1.2 - Transmission of electricity
3513	D35.1.3 - Distribution of electricity
3514	D35.1.4 - Trade of electricity
3521	D35.2.1 - Manufacture of gas
3522	D35.2.2 - Distribution of gaseous fuels through mains
3530	D35.3.0 - Steam and air conditioning supply
4110	F41.1.0 - Development of building projects
4120	F41.2.0 - Construction of residential and non-residential buildings
4511	G45.1.1 - Sale of cars and light motor vehicles
4519	G45.1.9 - Sale of other motor vehicles
4520	G45.2.0 - Maintenance and repair of motor vehicles
4531	G45.3.1 - Wholesale trade of motor vehicle parts and accessories
4532	G45.3.2 - Retail trade of motor vehicle parts and accessories
4540	G45.4.0 - Sale, maintenance and repair of motorcycles and related parts and accessories
4617	G46.1.7 - Agents involved in the sale of food, beverages and tobacco
4635	G46.3.5 - Wholesale of tobacco products
4639	G46.3.9 - Non-specialised wholesale of food, beverages and tobacco
4726	G47.2.6 - Retail sale of tobacco products in specialised stores
6419	K64.1.9 - Other monetary intermediation
6491	K64.9.1 - Financial leasing
6492	K64.9.2 - Other credit granting
6820	L68.2.0 - Renting and operating of own or leased real estate
6831	L68.3.1 - Real estate agencies
6832	L68.3.2 - Management of real estate on a fee or contract basis
9200	R92 - Gambling and betting activities

Source of NACE codes list: http://ec.europa.eu/competition/mergers/cases/index/nace_all.html

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