axesor rating

Methodological Assumptions
BANKS RATING

1. Methodological Framework

The objective of this document is to reflect the approach followed by Axesor Rating in the ***rating of banks*** operating both nationally and internationally.

The ratings that Axesor Rating carries out are stable opinions over time on the credit profile of an issuer (capacity to meet its financial obligations in time and form), without prejudice to the reviews that may be conducted when, in the opinion of Axesor Rating, a substantial change occurs that affects the credit quality of the financial entity analyzed (or of the sector as a whole).

For this purpose, we consider historical data and future trends on a series of qualitative and quantitative factors that are combined to obtain a final rating.

The necessary information can be provided directly by the bank or, in the case of a listed company, obtained directly from public sources, given the information and transparency requirements to which these credit institutions are subject.

The rating process described here begins with the determination of the company's stand-alone credit profile by analyzing three categories of factors:

- **Operating environment**: sovereign risk, sector strength and regulation.
- **Qualitative factors**: business model, positioning and management and strategy.
- **Quantitative factors**: earnings and profitability, solvency and funding and liquidity.

The assessment of the explanatory factors of each category is carried out through scales that evaluate the quality of each metric, giving a score that ranges from 10 (the worst) to 1 (the best).

Once the company's credit profile has been determined, we analyze the effect of external support (systemic or shareholder support) that it may present.

Finally, this methodology will map the numeric rating resulting from the analytical process into the scale “Axesor Long-Term Credit Scale” (available for consultation on the website). In addition, the rating is accompanied by an outlook (over the next year) depending on the prospects of both the sector and the performance of the company (Outlook Methodological is available on the website).

The methodology described herein should be understood in a flexible manner given the dynamic nature of the sector to which it is addressed. Therefore, the importance (weights) of the factors described throughout this methodology may vary to adapt the analysis to these changes, including new factors if necessary.

2. Scope

This methodology is applicable to **financial institutions as a whole.**

Financial entities are companies whose main activity is the allocation of financial resources through the acceptance of deposits and the granting of loans (commercial banks) and with access to central bank liquidity.

Therefore, insurers, supranational entities and those financial institutions without deposit acceptance capacity, such as finance and leasing companies and other intermediaries (securities firms and investment managers) are excluded from the scope of the rating.

3. Risk profile of the Operating Environment

At Axesor Rating we believe that the operating environment in which the financial entity operates has an influence on the rating because the regulatory supervision structures establish the degree of protection for customers, investors and creditors.

In addition, we believe that sovereign risk can - but does not necessarily have to - limit a financial institution's rating given the historical relationship between bank risk and sovereign risk: banking systems with problems are a threat to the solvency of the sovereign of their country while a weak sovereign, ultimately guarantor of the system's deposits and one of its main debtors, may constitute a threat to the banking system of that country.

Specifically, the analysis that we carry out within this category focuses on the evaluation of factors related to the strength of the economy and the profile of the sovereign, as well as aspects related to the rule of law and the existing concentration in the domestic banking system.

Accordingly, we believe that a financial institution operating in regions with healthy public finances, with institutional structures that guarantee the free development of the socio-economic relations of its citizens and, consequently, of the financial sector as a whole, will be sufficiently qualified to achieve higher rating ranges within this category.

Even though as a general rule our analysis is focused on the evaluation of the domestic market, in the case of international banking entities, this extends to all those regions where the entity analyzed obtains a significant percentage of its income and/or profit.

In summary, the factors that are considered when assessing the risk profile of a bank's operating environment are classified into two groups of factors:

- **Sovereign rating:** the sovereign rating determines the government's ability to meet its payment obligations in a timely manner, especially important considering the relationship between sovereign risk and financial risk.

- **Sector & regulation:** we evaluate the regulation and the degree of protection of investors and creditors, as well as the stability, transparency and effectiveness of these, in addition to the accounting and prudential regulations and the established supervision mechanisms. We also consider the strength of the sector through its degree of concentration and its capacity to generate added value in the economy.

Each factor has an established weight in the final score of the business profile, as indicated in the following table:

Macroeconomic & sectorial environment risk profile	
	Weights
Sovereign rating	**10%**
Sovereign rating	*10%*
Sector and regulation	**5%**
Corruption perception index	*1%*
Legal system	*2%*
Concentration	*2%*

4. Qualitative factors analysis

Within this category, we assess the bank's **business model** -mainly in terms of geographic and business line diversification, its **positioning** within the sector and **management and strategy**, including its ESG (environment, social and governance) policies.

Axesor Rating evaluates the factors included in this category using a qualitative approach based on information published by the Company itself and, in the case of solicited ratings, through interviews with the teams responsible for the different aspects analyzed.

The factors that are considered when assessing the risk profile of a bank's operating environment are:

- **Business model**: we evaluate the business model implemented by the bank, paying special attention to the degree of geographical and segmental diversification. We value the different sources of income that the entity has, its relationship with the cycle and the stability in the income flow.

- **Positioning:** within this factor we analyze the market share of the bank -mainly the positioning in different sections such as turnover, credits or deposits and the pricing power-, evaluation that is complemented with sectorial analysis with which we seek to know the performance of the institution in relation to its main national and/or international peers.

- **Management and strategy:** including the shareholder structure, the professionalism of the management team, the execution of the strategy, the appetite for risk and the ESG policies. In detail, we evaluate the willingness to take risk in their current situation as well as in their future growth strategy. We conclude the analysis of this factor with the evaluation of the brand's strength.

Each factor has an established weight in the final score of the business profile, as indicated in the following table:

Business risk profile	
	Weight
Business model	**12%**
Diversification	*12%*
Positioning	**15%**
Peer analysis	*10%*
Market share	*2,5%*
Asset size	*2,5%*
Management and strategy	**18%**
Governance & ESG	*5%*
Management quality	*3%*
Execution	*3%*
Market risk	*3%*
Growth	*2%*
Brand	*2%*

5. Quantitative factors analysis

The analysis of the financial profile of the bank constitutes one of the main pillars of our rating process since it determines the economic-financial resilience of the entity in view of the expected evolution of the economic cycle.

Axesor assesses this category using a quantitative approach through selected financial ratios (many of which are required by the supervisor) and an exhaustive analysis of closed annual accounts up to three years past, as well as future projections.

Within this category we distinguish three sections:

- **Earnings and profitability**: this factor measure the capacity to generate resources shown by the bank to provide capital and, thus, have the necessary tools to absorb losses and deal with possible adverse scenarios in the future.

  For this evaluation we use the analysis of ROA, ROE, the cost-to-income ratio (calculated as the ratio of operating expenses to operating revenues), the ratio of operating income to assets, and finally the net interest margin on assets. With the first two we measure the overall capacity of the bank to generate resources according to its size (ROA) or its equity (ROE), with the third we evaluate the efficiency of the bank's current operations, and with the fourth and fifth indicators the current business and the profitability of the net interest margin on the bank's assets.

  At Axesor Rating we believe that a bank that shows predictable results throughout the cycle according to its risk profile could opt for higher ratings than a company that shows weak and unstable results, mainly due to the positive effect of profitability on the improvement of solvency.

- **Solvency**: constitutes the fundamental buffer for the absorption of losses and that is why we consider it an important part in the analysis of a bank's financial strength. Regulatory capital measures under Basel III are considered the most robust indicator of a bank's capitalization level.

  Consequently, we use the analysis of several quantitative ratios: leverage, which measures the proportion between equity and assets; the CET1 ratio, which in this case considers the highest quality capital in relation to risk-weighted assets; the volume of NPLs in the institution's credit portfolio; the capacity of the financial institution to face these non-performing loans through the coverage ratio and, at a higher level, the total equity to cover the non-performing loans, showing the level of pressure existing to absorb losses; and, finally, the proportion of off-balance sheet positions over assets since this exposure could increase the institution's risk in a less predictable way

- **Funding and liquidity:** are fundamental factors because of their important role in the current business. A strong liquidity position and adequate funding allows a high stability in the resources that an entity has, an appropriate relationship between the term structure of assets and liabilities and a diversified funding at a low cost strengthens the operating margins of the bank.

Each factor has an established weight in the final score of the economic-financial risk profile, as indicated in the following table:

Economic and financial risk profile	
	Weights
Earnings & profitability	**10%**
ROA	*3%*
ROE	*4%*
Cost to income	*1%*
Pre-Imp Operating Profit / ATA	*1%*
Interest margin / ATA	*1%*
Solvency	**15%**
Equity / Total assets	*1%*
CET1	*5%*
NPL / Gross loans	*5%*
NPL / Equity + Reserves	*1%*
Coverage ratio	*2%*
Off-balance sheet items / Total assets	*1%*
Funding and liquidity	**15%**
Loan to deposits	*5%*
Interbank ratio	*2%*
LCR	*4%*
NSFR	*4%*

This document updates the previous version while preserving its original methodological assumptions; therefore, all existing ratings remain unchanged. In this version, the format has been updated