



**Banco de Sabadell, S.A.
Risk Committee
Report on functions and activities
2016**

January 2017

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This Report on the Activities of the Risk Committee for 2016, addressed to the shareholders of Banco de Sabadell S.A. (Banco Sabadell or the Bank), was drawn up by the Risk Committee.

This Report summarises the range of activities carried out by the Risk Committee in 2016, from which it can be seen that the Committee discharged the duties assigned to it in the Regulations of the Board of Directors of Banco de Sabadell, S.A. within its main areas of responsibility.

1.- Introduction

The Risk Committee is regulated by Article 63 of the Articles of Association and Article 15 of the Regulations of the Board of Directors of Banco de Sabadell S.A.; both documents are available on the corporate website (www.grupobancosabadell.com).

Through this Regulation, the Risk Committee conforms to the legal requirements established by Act 10/2014, of 26 June, on ordering, supervision and solvency of credit institutions, and by Royal Decree 84/2015, of 13 February, implementing Act 10/2014, of 26 June on ordering, supervision and solvency of credit institutions.

It also fulfils the requirements of European law, specifically 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 and amending Regulation (EU) No 648/2012, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

2.- Regulation and functions

The core function of the Banco Sabadell Group Risk Committee is to supervise management of all material risks and their alignment with the profile defined by the Group.

The Committee's functions include those established by regulations at European and national level and it has a supervisory role; it comprises independent directors and its core function is to ensure that the risks assumed by the Group conform to its *Risk Appetite Statement*.

The Risk Committee, which oversees the appropriate acceptance, control and management of all risks in accordance with the Group's *Risk Appetite Statement*, has the following functions:

- a) to determine and propose for approval by the Board meeting the Risk Appetite Framework, including the Risk Appetite Statement, its annual review and periodic monitoring, as well as the management policies for all significant risks;
- b) to perform the overall monitoring of all the Group's significant risks and ensure they are in line with the approved Risk Appetite Framework;
- c) to monitor and detect any excess over and above the approved tolerance thresholds, overseeing the activation of the contingency (or adaptation) plans established for this purpose, and to continuously report to the Board on these actions;
- d) to examine whether the asset and liability prices offered take into account the Bank's business model and risk strategy; and
- e) to advise the Remuneration Committee as to whether the employee compensation programmes are coherent with the Bank's levels of risk, capital and liquidity.

The Risk Committee meets at least bimonthly and whenever convened by its Chair at his/her own initiative or at the request of any member of the Committee or of the Chairman of the Board of Directors.

In the exercise of its functions, the Risk Committee may directly request the information it sees fit from both the director who is Chief Risk Officer and the Head of Risk Control.

The Committee Secretary, who need not be a director, shall be designated by the Board of Directors, which shall also designate a substitute secretary for cases of illness or absence.

3.- Composition

As of 31 December 2016, the members of the Risk Committee were as follows:

Committee Chair

Mr David Vegara Figueras

Committee members

Ms María Teresa Garcia-Milà Lloveras

Mr Joan Llonch Andreu

Secretary (not a director)

Ms María José García Beato.

The Risk Committee underwent the following changes in 2016:

On 28 January 2016, the Board of Directors resolved to appoint Mr David Vegara Figueras, who was already an ordinary member of the Committee, as its Chair, in place of Mr José Manuel Martínez Martínez, who remains on the Committee as an ordinary member.

On 19 May 2016, the Board of Directors resolved to remove Mr José Manuel Martínez Martínez from the Risk Committee.

Accordingly, all directors on Risk Committee are non-proprietary, independent directors and have the knowledge and experience required to perform the duties assigned to the Committee by the Board of Directors.

4.- Activities

In accordance with the regulations set out above, the Risk Committee held nine meetings in 2016. In addition to the Committee members, meetings were regularly attended, by invitation, by the Director-General Manager, the Sub-Director-General Manager in charge of Risks, and the Head of Risk Control. Meetings were also attended by the Chief Financial Officer and by other Group executives when the nature of the business on the agenda made their attendance desirable.

These attendances ensured that the Committee was able to obtain all the information it required to perform the tasks delegated to it by the Board of Directors within its main areas of responsibility, as follows:

4.1.- Risk Appetite Framework and Risk Appetite Statement

One of the Risk Committee's core functions is proposing the Risk Appetite Statement (RAS) to the Board of Directors for approval.

In 2016, the Risk Appetite Framework and Risk Appetite Statement were reviewed to give them a more international approach aligned with the Group's global structure and with market best practices.

Banco Sabadell's Risk Appetite Framework was adapted to the group's new structure arising from internationalisation. Therefore, in order to ensure consistency and effective deployment of the Group's RAS to all geographical areas.

It should be noted or stressed that the Group's RAS has been reinforced through the incorporation of new metrics and qualitative aspects leading to it having a global view of all the risks faced by the Group.

4.2.-Risk management policies

The Group's risk governance provides for a review of the risk policy framework at regular intervals (at least once per year) or when there are significant changes.

Within this scope, the Risk Committee also analysed the Banco Sabadell Group Risk Policy document and referred it to the Board of Directors for approval; that document sets out the basic principles and procedures that must govern management and control of all the Group's material risks.

The review ensures alignment with changes in the Risk Appetite Framework and with the Group's new international structure. The main new features added are the definition of an overall framework setting out the basic principles and policies that are common to all geographies, establishment of delegations at

Group level, updating of the Risk Appetite Statement and the specific amendments made in 2015 and 2016.

4.3.- Regular monitoring of the Risk Appetite Statement

The Risk Committee regularly performed an extensive review of developments with all of the Group's material risks.

To this end, the Risk Committee analyses and debates fundamental issues and key metrics of the Risk Appetite Statement and trends in portfolio exposure, both domestic and international.

The Risk Reporting and Control Framework comprises:

- a) Drawing up and regularly updating a scorecard that reflects trends in the main metrics and variables associated with the Risk Appetite Framework, and ensuring that they conform to the established framework and limits.
- b) Systematic oversight and analysis of trends in all significant risks, with detailed second-tier metrics.
- c) Reporting and proposing the appropriate action (activating protocols, changing guidelines, etc.) as a result of analysing risk trends.

4.4.- Other regular oversight

The risk oversight function entrusted to the Risk Committee also includes regularly:

- a) Tracking risk-adjusted pricing trends in both assets and liabilities and the degree to which prices conform to the related risks.
- b) Monitoring the Large Groups that are reviewed by the Executive Committee.

4.5.- Risk models

In general terms, the Banco Sabadell Group applies internal rating models for clients and estimates risk parameters using internal data. Banco Sabadell's internal models have been approved by the supervisor for use in calculating minimal capital requirements.

In 2016, the Risk Committee reviewed improvements to the risk acceptance models (reactive rating and scoring) and the oversight models in connection with both integration into management and estimation of the parameters for capital requirements, and referred them to the Board of Directors for approval. Additionally, the Risk Committee reviewed the Remediation Plans under the Single Supervisory Mechanism (SSM) associated with Large Groups and Large Corporations and Loss Given Default (LGD).

The Risk Committee also reviewed the use of internal models for calculating coverage of impairment of credit risk, foreclosed assets and assets received in discharge of debts, in compliance with the New Annex IX of C4/2016, and referred them for approval.

Additionally, the Committee played a key role in regular supervision of the models' performance in management and capital adequacy.

4.6.- Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP), and Recovery Plan

In 2016, the Risk Committee participated actively in drafting the ICAAP and ILAAP documents, which assess the Group's capital and liquidity situation.

In this process, the Committee was assisted by the Finance and the Risk Control Departments, which provides assurance that the reports present an accurate picture of the Group's situation in both areas.

The Group's Recovery Plan continued to be enhanced by adapting it to new legislation and aligning it with the Risk Appetite Framework and the Risk Appetite Statement.

4.7.- Other matters

The Risk Committee analysed the main issues in connection with the TSB acquisition, the transaction's main risks and its impact on the Group's Risk Appetite Statement (RAS).

With regard to operational risk, the Risk Committee closely monitored progress with the TSB migration programme.

Within the area of technology risk, the Risk Committee analysed the current situation of cybercrime, i.e. criminal activities performed using technology, often by criminal organisations that bring significant economic resources to bear.

With regard to compliance risk, the Risk Committee received and debated, in its fundamental aspects, the MiFID Report drafted by the Compliance, CSR and Corporate Governance Department in compliance with Royal Decree 217/2008, of 15 February, on the rules governing investment firms and other entities that provide investment services, partly amending the Regulation under Act 35/2003, of 4 November, on collective investment institutions, approved by Royal Decree 1309/2005, of 4 November, and the Annual External Expert's Report on Preventing Money Laundering and Terrorist Finance.

The Risk Committee also reviewed the degree to which Banco Sabadell's remuneration policy and practices conform to the requirements and recommendations of the supervisory authorities in Spain and Europe.

The Risk Committee was informed of the possible impact of the macroeconomic events that arose during the year, with particular emphasis on Brexit (consequences and prospects), and tracked these issues carefully.

In 2016, the Risk Committee reviewed the proposal for a Policy on Conflicts of Interest of Directors and Senior Executives and recommended that the Board of Directors approve it.

During 2016, in accordance with article 529 nonies of the Capital Companies Act and Recommendation 36 of the Code of Good Governance for Listed Companies, and in compliance with the provisions of article 5.2 of the Regulations of the Board of Directors, the Risk Committee performed a self-assessment of its performance.