



Banco de Sabadell, S.A.
Risk Committee
Report on functions and activities
2017

January 2018

Contents

1.- Introduction	3
2.- Regulation and functions	3
3.- Composition	5
4.- Activities	6

This Report on the Activities of the Risk Committee for 2017, addressed to the shareholders of Banco de Sabadell S.A. (hereinafter, "Banco Sabadell" or "the Bank"), was drawn up by the Risk Committee (hereinafter, "the Committee").

This Report summarises the range of activities carried out by the Risk Committee in 2017, 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 at www.grupobancosabadell.com

Through this regulation, the Risk Committee conforms to the legal requirements established in article 38 of Act 10/2014, of 26 June, on ordering, supervision and solvency of credit institutions, and article 42 of 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, 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 Group'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 Chief Risk Officer and the Head of Risk Control.

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

3.- Composition

As of 31 December 2017, the members of the Risk Committee were as follows:

Committee Chair

Mr. David Vegara Figueras

Committee members

Ms. Maria Teresa Garcia-Milà Lloveras.

Mr. Manuel Valls Morató.

Mr. George Donald Johnston.

Secretary (not a director)

Ms. María José García Beato.

The composition of the Risk Committee underwent the following changes in 2017:

- On 25 May 2017, the Board of Directors resolved to appoint Mr. Manuel Valls Morató as a member of the Committee in place of Mr. Joan Llonch Andreu, whose term had concluded.
- On 26 October 2017, the Board of Directors resolved to appoint Mr. George Donald Johnston as a member of the Committee.

Accordingly, all members of the Risk Committee are 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 eleven meetings in 2017. In addition to the Committee members, meetings were regularly attended, by invitation, by the Director-General Manager, the Deputy General Manager, the Risk Control Manager and Sub-Director General, 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 required their attendance.

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 2017, a number of actions were taken in the context of the Risk Appetite Framework and the Risk Appetite Statement (RAS) to bring them into line with international approaches following the sale of Sabadell United Bank in July 2017, and the updates made in 2017 to the ICAAP, ILAAP and Recovery Plan, as well as new regulatory requirements.

The group's RAS was enhanced by adding new metrics and quantitative aspects in order to provide an overview of all the risks that the group faces, including notably the new metric for risks classified as leveraged transactions in accordance with the European Central Bank's "Guidance on leveraged transactions" published in May 2017.

4.2.-Risk management policies

The group's risk governance provides for a review of the risk policy framework at regular intervals 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.

Additionally, during 2017, in compliance with the requirements set out in the European Central Bank's "Guidance to Banks on Non-performing Loans", a new "Strategic Plan for Managing Problematic Assets" was submitted to the Board of Directors for approval, as well as the related "Operational Plan for Managing Problematic Assets", establishing (i) the principles for managing such assets, (ii)

the governance and management structure; and (iii) quantitative objectives with different time horizons for reducing both doubtful assets and foreclosed assets.

Additionally, the following were submitted to the Board of Directors for approval:

- new features deriving from the implementation of International Financial Reporting Standards 9 (IFRS 9).
- the new management and control policy for transactions classified as leveraged transactions in accordance with the ECB's "Guidance on Leveraged Transactions".

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 of powers at Group level, updating of the Risk Appetite Statement and the specific amendments made since 2015.

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.

Reporting to the Risk Committee comprises:

- a) 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 the second-tier metrics detailed in an annex to the scorecard.
- 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 was performed at all ordinary meetings of the Committee:

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

The Risk Committee also received monographic reports on specific risk classes. These monographic reports, which are presented at least once per year, make it possible to inform the Risk Committee in detail of the most salient features of the current situation, linkage with the RAS, policies, processes, models and procedures.

Specifically, the following monographic reports were presented in 2017:

- Monographic report on Operational Risk.
- Monographic report on Outsourcing.
- Monographic report on Market Risk.
- Monographic report on Counterparty Risk in Derivatives.
- Monographic report on Exposure to Financial Institutions.
- Monographic report on Country Risk.
- Monographic Debate on Sector Strategy.
- Monographic report on Shipping.
- Monographic report on Measuring Impaired Assets.
- Deep Dive into SMEs.

4.5.- Risk models

In general terms, the Banco Sabadell Group applies internal ratings-based 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 2017, 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, as well as Loss Given Default (LGD) and retail models (mortgage and consumer finance).

The Risk Committee also reviewed the use of internal models for calculating coverage of credit risk impairment, foreclosed assets and assets received in discharge of debts, in compliance with the IFRS 9.

Additionally, the Risk Committee was informed appropriately of the progress and outcome of the Targeted Review of Internal Models (TRIM) process regarding the retail and general topics models to which the Bank was subjected by the European Central Bank in 2017.

In particular, during 2017 the Risk Committee played a role in the area of internal models and the impact of implementing IFRS 9 in the Banco Sabadell Group.

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), Internal Liquidity Adequacy Assessment Process (ILAAP) and Recovery Plan

In 2017, 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 regulations and aligning it with the Risk Appetite Framework and the Risk Appetite Statement.

4.7.- Other matters

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

In the area of technology risk, the Risk Committee monitored trends in IT Risk via the specific tier-two metrics in the RAS and was informed of the adoption of a cloud-based CRM (Customer Relationship Management) solution that makes it possible to effectively manage customers' full potential while ensuring appropriate alignment between the managers in different departments and the organisation's strategic objectives.

The Risk Committee was informed of the conclusions of the ECB inspection of the retail mortgage loan book and the portfolio of foreclosed assets, and of the conclusion of the ECB's NPL qualitative assessment.

Additionally, during 2017 the Risk Committee explicitly tracked the process of re-appraising mortgage collateral and foreclosed assets.

With regard to compliance risk, the Risk Committee received and debated, in its fundamental aspects, the MiFID Report drafted by the Compliance 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 and the political situation in Catalonia, and tracked these issues closely.

In 2017, the Risk Committee reviewed the proposal for an amendment to the Policy on Conflicts of Interest of Directors and Senior Executives and recommended that the Board of Directors approve it.

During 2017, 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 Regulation of the Board of Directors, the Risk Committee performed a self-assessment of its performance with the assistance of an external consultant whose independence was verified by the Appointments Committee.