



**Banco de Sabadell, S.A.
Risk Committee
Report on functions and activities
2018**

January 2019

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This Report on the Activities of the Risk Committee for 2018, addressed to the shareholders of Banco de Sabadell S.A. (Banco Sabadell or the Bank), was drawn up by the Risk Committee (the Committee).

This Report describes the full range of activities carried out by the Risk Committee in 2018, from which it can be seen that the Committee discharged the duties assigned to it in the Regulation of the Board of Directors of Banco Sabadell 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 Regulation of the Board of Directors of Banco Sabadell; both documents are available on the corporate website (www.grupobancosabadell.com)

Through this Regulation, the Risk Committee conforms to the legal requirements established by article 38 of Act 10/2014, of 26 June, on the regulation, supervision and solvency of credit institutions, and by article 42 of Royal Decree 84/2015, of 13 February, implementing Act 10/2014, of 26 June on the regulation, 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;
- 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, must be designated by the Board of Directors, which must also designate a substitute secretary for cases of illness or absence.

3.- Composition

As of 31 December 2018, the members of the Risk Committee were as follows:

Position	Name	Category
Chairman:	David Vegara Figueras	Independent
Members:	M. Teresa Garcia-Milà Lloveras	Independent
	George Donald Johnston	Independent
	Manuel Valls Morató	Independent
Secretary:	María José García Beato	

There were no changes in the composition of the Committee in 2018.

Accordingly, all directors on 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 fourteen meetings in 2018. In addition to the Committee members, meetings were regularly attended, by invitation, by the Director-General Manager, the Assistant General Manager in charge of Risks, and the Deputy General Manager/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 both for the group and for the various geographical areas.

In this regard, in 2018 there were several updates of the Risk Appetite Framework and the Risk Appetite Statement (RAS) as well as the updates performed in 2018 in relation to the ICAAP, ILAAP, Recovery Plan and new regulatory requirements.

Noteworthy in this respect is the change in thresholds for the metrics for capital and solvency, return on assets and asset quality, TOP 50 concentration, operating risk and market risk, as well as the inclusion in the RAS of a new net Non-Performing Asset (NPA) metric and of new metrics to monitor concentration in Mexico.

Also, the Risk Committee was informed of the operating adjustment of the real estate development metric and the adjustment of the concentration metrics for private banking clients at the Miami Branch.

The group's RAS was reinforced with the inclusion of new metrics, especially second-tier metrics, with the aim of providing an overview of all the risks facing the group, including most notably specific metrics for characterising the TOP 20 and TOP 50 and large groups, NPAs, IT Risk and for various portfolios [Public Authorities, Foreign Branches (OFEX), Project Finance and Sabadell Consumer Finance (SCF) inter alia] and TSB's control climate was reinforced by incorporating reporting of breached RAS metrics and the remediation plans defined to restore them to levels commensurate with the risk appetite.

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.

In this same area, the Risk Committee also analysed and subsequently submitted to the Board of Directors, for approval, the Banco Sabadell Group's risk policies and Banco Sabadell's risk policies relating to credit and concentration risk, IRRBB, CSRBB, liquidity, market, counterparty, exchange rate and operational risk, which set out the core principles and procedures governing the management and control of all the group's material risks, incorporating the requirements established by the SSM.

Also, 2018 saw continued compliance with the requirements dictated by the European Central Bank in the document "Guidance to Banks on Non-performing Loans", submitting to the Board of Directors the updates required in the "Strategic Plan for the management of problematic assets" and the corresponding "Operational Plan for the management of problematic assets", including most notably the update of the NPA Strategic Plan in view of the broader scenario of portfolio sales.

In line with the group's policy governance, the Risk Committee also reported favourably to the Board of Directors on the approval of the following policies:

- Crisis management and control policy (Group and Banco Sabadell);
- Capital management Policies (Banco Sabadell Group);
- Strategic Planning and Finance Policy;
- Remuneration practices and policy for the Banco Sabadell Group, Material Risk Takers and Senior Management of Banco Sabadell;
- Conflict of Interest Policies for Directors and Senior Management to bring them into line with the content of the Risk Policy in relation to the policies for granting or increasing specific risks for Directors, Senior Management, related parties and Significant Shareholders.

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:

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- a) Regularly reviewing 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 in an Annex to the above-mentioned 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

At each ordinary Risk Committee meeting, 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 exposure to large groups that are reviewed by the Executive Committee.
- c) Monitoring performance of NPAs on a quarterly basis.

The Risk Committee was also informed via monographic reports on specific risk types. Those monographic reports are produced at least once per year to provide the Risk Committee with detailed information on the most salient issues relating to the current situation, connection with RAS, policies, processes, models and procedures.

In particular, the following monographs were presented in 2018:

- Operating Risk Monograph;
- Balance Sheet Risk Monograph;
- Market Risk Monograph;
- Derivative Counterparty Risk Monograph;
- Exposure to Financial Institutions Monograph;
- Country Risk Monograph;
- Sector Strategic Debate Monograph;
- No-Deal Brexit Scenario Monograph;
- Italian Government Debt Monograph;
- Concentration Metrics Monograph;
- Property Development Monograph;
- Re-appraisal Process Control Monograph;
- 2018 Stress Test Results Monograph;
- ALM Derivatives Deep Dive.

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 2018 the Risk Committee reviewed and proposed for approval by the Board of Directors the improvements made in the acceptance models (reactive Scoring and Rating) and in the monitoring models both in the area of integration in management and in the estimate of parameters for the Internal Rating Based (IRB) approach to capital requirements, especially the TSB models, monitoring in particular the performance of the initiatives required to be able to submit the IRB for approval by the SSM, the new definition of prudential default, IRB models, and it also reviewed and reported favourably to the Board of Directors on the initiative required in governance relating to internal credit risk models at group level;

It also monitored the finalization of the SSM Remediation Plans and approved their new calibration and the proposed PD estimate of capital, and monitored and assessed the progress of the Loss Given Default (LGD) Remediation Plan, Targeted Review of Internal Models (TRIM) in connection with general topics, loans to individuals, retailers/self-employed, TRIM Retail mortgage, and it was informed of the approval by the SSM of the Adjustment to the group (adjustment of the companies' individual rating to the group rating).

The Risk Committee was properly informed of the performance and outcome of the various SSM processes and communications relating to the various actions relating to IRB models.

In particular, in 2018 the Risk Committee played a role with regard to internal models and the impact of implementing IFRS 9 on the Banco Sabadell Group; in this regard, the Risk Committee reviewed and proposed for approval the update of the internal models for calculating coverage of impairment due to credit risk and real estate assets foreclosed or received in payment of debts, in order to comply with the new IFRS 9.

The Risk Committee was also informed of the conclusions of the internal audit relating to IFRS 9 and of the JST's conclusions relating to the IFRS 9 Thematic Review.

In this regard, in 2018 the Risk Committee also expressly monitored the reassessment of appraisals of mortgage collateral and foreclosed assets.

Lastly, 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 2018 the Risk Committee participated actively in:

- The preparation of the ICAAP and ILAAP documents, which assess the group's capital adequacy and liquidity adequacy in order to bring them into line with the priority areas defined by the banking supervisor for the year;
- It participated in the analysis of risks associated with the new preliminary projections for 2019-2023;
- It participated actively in drawing up the Recovery Plan, and the internal crisis management framework, and vetted the crisis management and control policies of the Group and Banco Sabadell;

In this process, the Committee was assisted by the Finance Department and the Risk Control Department, which provided 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

With regard to Operational Risk, the Risk Committee participated in monitoring the significant issues and main risks of the TSB migration and its impact on the Group's RAS, and it closely monitored the progress of the TSB Migration Programme in terms of operational risk.

The Risk Committee reviewed various issues relating to Technology Risk, including most notably: Outsourcing, Cloud Strategy and Risk Data Aggregation; and it was advised on IT Security Risk through a Deep Dive presentation on cybercrime, as well as being advised on the results of the SSM questionnaire regarding IT Risk. It also issued a favourable opinion on the strengthening of the IT Risk control framework through the creation of an IT Risk Dashboard for permanent inclusion in the annex to the Risk Committee's scorecard.

The Risk Committee was also advised on:

- Joint Supervisory Team (JST) letter containing its feedback with respect to the 2016 Pillar 3 Disclosure (Assessment of the Pillar 3 Disclosure of Banco Sabadell S.A.);
- Conclusions on ECB inspection - Deep Dive on New Lending & Business Model & Profitability;
- Preliminary results of the 2018 Supervisory Review Evaluation Process (SREP);
- ECB letter on ALM derivatives.

The Risk Committee was advised on the EBA Guidelines on Internal Governance relating to the core issues and functions of the Risk Committee.

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 was informed of the possible impact of the macroeconomic events that arose during the year, with particular emphasis on Brexit and the political situations in Italy and Catalonia, and tracked these issues closely.