

Banco de Sabadell, S.A.

Update

Key Rating Drivers

Adequate Capitalisation: The ratings of Banco de Sabadell, S.A. are driven by its adequate capitalisation, solid domestic franchise, particularly in the SME segment, and its fairly diversified business model, which together provide adequate financial flexibility to absorb asset quality and profitability pressures from the pandemic and short-term risks to the strength of the economic recovery (i.e. heightened inflationary pressures).

Risk Diversification from TSB: Sabadell's company profile also reflects some risk diversification from the UK business (through TSB Banking Group plc, TSB), which accounts for about 20% of group assets, and whose performance has improved. The strategic plan considers TSB an integral part of the group, and Sabadell expects to leverage on the UK business to achieve its group profitability targets (with a return on tangible equity of above 6% in 2022).

Moderate Rise in Impaired Loans: Sabadell's asset quality is in line with large domestic peers with a problem asset ratio (which includes impaired loans and net foreclosed assets) of 4% at end-2021, but weaker than some European peers. Asset-quality risks from the pandemic and risks of setbacks in the economic recovery are mainly related to the bank's significant exposure to SMEs. However, the economic recovery still under way, together with state-support measures, is likely to contain asset-quality deterioration.

Earnings Recovering: The group's profitability improved in 2021 from weak levels in 2020 amid the economic recovery in both Spain and the UK. We expect earnings to continue to improve in 2022 due to sound business growth prospects, cost containment and lower loan impairment charges, and reach pre-pandemic levels towards 2023. However, downside risks remain due to uncertainty about the strength of economic growth forecast following the Russia-Ukraine crisis and the risk that TSB could miss its business growth targets.

Satisfactory Capital Buffers: Sabadell's capital ratios at end-2021 benefit from recent asset disposals and are satisfactorily above minimum requirements. Our assessment of capitalisation takes into consideration the bank's target to maintain a fully loaded common equity Tier 1 (CET1) ratio above 12% throughout the 2021-2023 strategic plan, as well as its targeted dividend pay-out ratio of about 30%. We expect the bank's capital encumbrance to unreserved problem assets to remain sensitive to asset-quality risks, but to remain within tolerable levels.

Adequate Funding and Liquidity: Sabadell fully funds its loans with deposits and benefits from a reasonably diversified funding profile, with frequent access to secured and unsecured wholesale markets (while ensuring compliance with its minimum requirement for own funds and eligible liabilities). The bank's liquidity position is sound and remains supported by large investments in high-quality liquid securities.

Rating Sensitivities

Asset Quality, Profitability: An upgrade would require a decrease in the problem asset ratio to materially below 4%, partly driven by an improvement in the operating environment in Spain, in particular. This should be accompanied by enhancements in profitability towards pre-pandemic levels (with an operating profit/risk-weighted assets ratio of around 1.8%). A strengthening of capitalisation will be equally important.

Capitalisation: The ratings could be downgraded if Sabadell's CET1 ratio fell below the 12% minimum target without the prospect of recovery in the short term, capital encumbrance by unreserved problem assets rose above 50% on a sustained basis, or if the four-year average problem asset ratio increased above 5% without a clear path to reduction.

Ratings

Long-Term IDR	BBB-
Short-Term IDR	F3
Derivative Counterparty Rating	BBB(dcr)

Viability Rating bbb-

Support Rating 5
 Support Rating Floor NF

Sovereign Risk

Long-Term Foreign- and Local-Currency IDRs	A-
Country Ceiling	AAA

Outlooks

Long-Term IDR	Stable
Sovereign Long-Term Foreign- and Local-Currency IDRs	Stable

Applicable Criteria

[Bank Rating Criteria \(November 2021\)](#)

Related Research

[Fitch Affirms Sabadell at 'BBB-'; Outlook Stable \(September 2021\)](#)

[Large Spanish Banks: Back on Track \(January 2022\)](#)

[Global Economic Outlook \(December 2021\)](#)

Analysts

Cristina Torrella Fajas
 +34 93 323 8405
cristina.torrellafajas@fitchratings.com

Danel Izqueaga
 +34 91 076 1988
danel.izqueaga@fitchratings.com

Debt Rating Classes

Rating Level	Rating
Deposits	BBB/F2
Senior preferred debt	BBB/F2
Senior non-preferred debt	BBB-
Tier 2 subordinated debt	BB

Source: Fitch Ratings

Sabadell's long-term deposit and senior preferred debt ratings are rated one notch above the bank's Long-Term Issuer Default Rating (IDR) to reflect the protection offered by more junior resolution debt and equity buffers. In light of the bank's minimum requirement for own funds and eligible liabilities strategy, Fitch expects its senior non-preferred and junior debt buffers to sustainably exceed 10% of risk-weighted assets (these buffers were about 7.7% at end-2021). The short-term deposit rating of 'F2' is the higher of the two options corresponding to the long-term deposit rating of 'BBB', in line with the bank's funding and liquidity score at 'bbb+'.

Senior non-preferred notes are rated at the same level as the bank's Long-Term IDR, reflecting Fitch's view that the default risk of the notes is equivalent to that of the IDR and that senior non-preferred obligations are viewed as having average recovery prospects.

Tier 2 subordinated debt is rated two notches below the bank's Viability Rating to reflect the notes' poor recovery prospects arising from subordination if the bank becomes non-viable.

Ratings Navigator

Banco de Sabadell, S.A.

ESG Relevance:

Banks Ratings Navigator

	Peer Ratings	Operating Environment	Company Profile	Management & Strategy	Risk Appetite	Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity	Viability Rating	Support Rating Floor	Issuer Default Rating
aaa										aaa	AAA	AAA
aa+										aa+	AA+	AA+
aa										aa	AA	AA
aa-										aa-	AA-	AA-
a+										a+	A+	A+
a										a	A	A
a-										a-	A-	A-
bbb+										bbb+	BBB+	BBB+
bbb										bbb	BBB	BBB
bbb-										bbb-	BBB-	BBB- Stable
bb+										bb+	BB+	BB+
bb										bb	BB	BB
bb-										bb-	BB-	BB-
b+										b+	B+	B+
b										b	B	B
b-										b-	B-	B-
ccc+										ccc+	CCC+	CCC+
ccc										ccc	CCC	CCC
ccc-										ccc-	CCC-	CCC-
cc										cc	CC	CC
c										c	C	C
f										f	NF	D or RD

Bar Chart Legend

Vertical bars - VR range of Rating Factor

Bar Colors - Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows - Rating Factor Outlook

- ↑ Positive ↓ Negative
- ↕ Evolving □ Stable

Significant Changes

Spain's Operating Environment Stabilised

In November 2021, Fitch revised the outlook of the operating environment for Spanish banks sector to stable from negative to reflect improved macro-economic prospects, better-than-expected asset-quality performance and subsiding pandemic risks. After weaker-than-expected growth in 2021 (4.6% under Fitch estimates), we expect a solid recovery in 2022, as tourism activity recovers further, and also reflecting spending under the Next Generation EU funds, which could add around 0.7pp on average to annual growth to 2023. However, supply constraints and heightened inflationary pressures from the Russia-Ukraine crisis add risks to our economic growth projections.

Profitability Recovery in 2021; TSB Contributed Positively

Sabadell's profitability recovered in 2021, but this was still below pre-pandemic levels. The bank's operating profit/risk-weighted assets ratio improved to 0.9% from 0.1% in 2020, largely supported by lower operating expenses as cost-efficiency plans implemented in 2020 and early 2021 bear fruit, reduced loan impairment charges and the positive contribution of TSB. The latter benefited from a boost in new mortgage lending and interest rate rises in the UK, which combined with lower operating expenses helped by restructuring processes and pandemic-related provision releases contributed to a EUR118 million net profit, compared to a EUR220 million loss in 2020.

The group's core revenues (net interest income and commission income) grew 3% in 2021, principally boosted by around 9% increase in commission income, largely driven by higher service and asset-management fees.

Sabadell has financed the second phase of its restructuring plan in Spain (total costs of EUR301 million) with capital gains from sales of government bonds in 3Q21. Excluding restructuring expenses, recurring costs declined by 2% in 2021 benefiting from former efficiency plans. Sabadell's second cost-efficiency plan expects to deliver around EUR130 million of cost savings to be largely achieved by 2022.

The bank's reported return on tangible equity was 5.1% in 2021, against 0.02% in 2020, and it expects this return to be more than 6% in 2022, a year earlier than initially targeted in its strategic plan.

Contained Risks on Asset Quality

Sabadell's impaired loan ratio remained stable at 3.6% at end-2021 (problem asset ratio of 4%), in line with the bank's guidance of a problem asset ratio of below 5% by 2023. Downside asset-quality risks from those borrowers that are still not repaying principal of the state-guaranteed loans (2% of total loans at end-2021) and exposure to SME in vulnerable sectors (around 8% of total loans at end-2021) remain, particularly if the economic recovery proves to be weaker than expected.

Summary Financials and Key Ratios

	Year End USDm	31 Dec 2021 Year End EURm	31 Dec 2020 Year End EURm	31 Dec 2019 Year End EURm	31 Dec 2018 Year End EURm
	Audited - Unqualified	Audited - Unqualified	Audited - Unqualified	Audited - Unqualified	Audited - Unqualified
Summary Income Statement					
Net interest and dividend income	3,876	3,426.7	3,400.1	3,626.9	3,683.3
Net fees and commissions	1,660	1,467.5	1,350.3	1,438.7	1,335.3
Other operating income	149	131.8	551.6	-133.9	-8.4
Total operating income	5,684	5,026.0	5,302.0	4,931.7	5,010.2
Operating costs	3,741	3,307.4	3,461.4	3,213.1	3,273.5
Pre-impairment operating profit	1,944	1,718.6	1,840.6	1,718.6	1,736.7
Loan and other impairment charges	1,085	959.5	1,745.0	667.1	756.1
Operating profit	859	759.1	95.6	1,051.5	980.6
Other non-operating items (net)	-157	-139.1	-216.4	-100.5	-561.7
Tax	92	81.3	-123.8	174.1	83.6
Net income	609	538.7	3.0	776.9	335.3
Summary Balance Sheet					
Assets					
Gross loans	181,716	160,668.3	152,201.3	150,513.1	145,824.0
- of which impaired	6,445	5,698.1	5,319.9	5,922.6	6,471.6
Loan loss allowances	3,735	3,302.0	3,081.3	2,933.3	3,433.1
Net loans	177,981	157,366.3	149,120.0	147,579.8	142,390.9
Interbank	7,140	6,312.8	1,789.5	2,583.2	2,929.6
Derivatives	2,154	1,904.4	3,373.0	2,558.3	2,079.2
Other securities and earning assets	26,428	23,366.9	31,945.8	41,215.8	34,216.1
Total earning assets	213,703	188,950.4	186,228.3	193,937.1	181,615.8
Cash and due from banks	55,660	49,213.2	35,184.9	15,169.2	23,494.5
Other assets	15,589	13,783.0	14,350.1	14,647.3	17,211.7
Total assets	284,952	251,946.6	235,763.3	223,753.6	222,322.0
Liabilities					
Customer deposits	183,425	162,179.2	151,256.7	146,411.1	134,583.0
Interbank and other short-term funding	10,040	8,877.4	10,470.6	13,516.7	17,808.9
Other long-term funding	64,355	56,900.9	50,770.5	40,390.3	48,934.4
Trading liabilities and derivatives	2,162	1,911.8	3,808.1	3,677.7	2,408.4
Total funding and derivatives	259,982	229,869.3	216,305.9	203,995.8	203,734.7
Other liabilities	7,556	6,681.0	5,815.8	5,633.4	5,320.4
Preference shares and hybrid capital	2,714	2,400.0	1,150.0	1,150.0	1,150.0
Total equity	14,699	12,996.3	12,491.6	12,974.4	12,116.9
Total liabilities and equity	284,952	251,946.6	235,763.3	223,753.6	222,322.0
Exchange rate		USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057

Source: Fitch Ratings, Fitch Solutions, Banco Sabadell, S.A.

Summary Financials and Key Ratios

	31 Dec 2021	31 Dec 2020	31 Dec 2019	31 Dec 2018
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	0.9	0.1	1.3	1.2
Net interest income/average earning assets	1.8	1.8	2.0	2.1
Non-interest expense/gross revenue	67.2	65.7	65.9	66.1
Net income/average equity	4.2	0.0	6.1	2.7
Asset quality				
Impaired loans ratio	3.6	3.5	3.9	4.4
Problem assets ratio	4.0	4.1	4.4	5.1
Growth in gross loans	5.6	1.1	3.2	0.3
Loan loss allowances/impaired loans	58.0	57.9	49.5	53.1
Loan impairment charges/average gross loans	0.6	1.2	0.5	0.5
Capitalisation				
Common equity Tier 1 ratio	12.5	12.6	12.4	12.0
Fully loaded common equity Tier 1 ratio	12.2	12.0	11.7	11.1
Tangible common equity/tangible assets	4.2	4.0	4.5	4.3
Basel leverage ratio	5.9	5.2	5.0	4.9
Net impaired loans/common equity Tier 1	23.8	22.6	29.6	31.6
Funding and liquidity				
Gross loans/customer deposits	99.1	100.6	102.8	108.4
Liquidity coverage ratio	221.0	198.0	172.0	168.0
Customer deposits / total non-equity funding	70.4	70.7	72.4	66.5
Net stable funding ratio	141.0	127.0	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, Banco Sabadell, S.A.

Government Support

Support Rating Floor		Value	
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)		BBB+ or BBB	
Actual country D-SIB SRF		NF	
Support Rating Floor:		NF	
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem		✓	
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	

Sabadell's Support Rating of '5' and Support Rating Floor of 'No floor' reflect Fitch's belief that senior creditors can no longer rely on receiving full extraordinary support from the sovereign in the event that Sabadell becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors to participate in losses, instead of or ahead of a bank receiving sovereign support.

Environmental, Social and Governance Considerations

FitchRatings Banco de Sabadell, S.A.

Credit-Relevant ESG Derivation

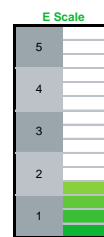
Banco de Sabadell, S.A. has 5 ESG potential rating drivers

- Banco de Sabadell, S.A. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

				Overall ESG Scale
key driver	0	issues	5	
driver	0	issues	4	
potential driver	5	issues	3	
not a rating driver	4	issues	2	
	5	issues	1	

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality



How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

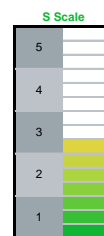
The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

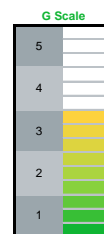
Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile



Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal/compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy



CREDIT-RELEVANT ESG SCALE	
How relevant are E, S and G issues to the overall credit rating?	
5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance, is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on Sabadell, either due to their nature or to the way in which they are being managed by Sabadell. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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