



Banco de Sabadell, S.A.
Risk Committee
Report on functions and activities
2020

25 January 2021

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Introduction

This report on the functions and activities of the Risk Committee in 2020 is addressed to the shareholders of Banco de Sabadell, S.A. (Banco Sabadell, the Bank or the Institution); it was adopted by the Risk Committee (the Committee) at a meeting on 25 January 2021 and submitted for the approval of the Board of Directors of Banco Sabadell at a meeting on 28 January 2021.

The Report sets out the activities performed by the Risk Committee in 2020 to discharge the duties assigned to it in its Regulation by the Board of Directors of Banco Sabadell within its main areas of responsibility.

Together with the publication of an Annual Report on Corporate Governance and the information available on the group's website, the distribution of this report at the General Meeting of Shareholders underlines once again Banco Sabadell's commitment to providing shareholders and investors with the information they need to keep themselves fully informed of the Bank's corporate governance performance and to ensure that it is transparent in everything that it does.

Regulation

Article 63 of the Articles of Association and article 15 of the Regulation of the Board of Directors set out the basic rules governing the Risk Committee, which is also governed by the Risk Committee Regulation, approved by the Board of Directors on 24 October 2019, which establishes its rules of procedure, competencies and functions, and the basic rules for its organisation and functioning. Those documents are available on the corporate website 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 regulation, supervision and solvency of credit institutions, and in Article 42 of Royal Decree 84/2015, of 13 February, implementing Act 10/2014, of 26 June, on 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.

The Committee also complies with the European Banking Authority's Guidelines on internal governance (EBA/GL/2017/11).

Composition and attendance at meetings in 2020

At the end of 2020, the Committee was made up exclusively of non-executive directors, all of whom are independent and have the necessary knowledge, skills and experience, all in compliance with the applicable regulations and, in particular, with Law 10/2014 of 26 June on the Regulation, supervision and solvency of credit institutions and Article 63 of Banco Sabadell's Articles of Association, which provides that the Committee *“shall comprise at most five directors, appointed by the Board of Directors, none of whom may be an executive director; they must have the appropriate knowledge, skill and experience to fully understand and oversee the Bank's risk strategy and risk appetite; at least two of them must be independent directors.”*

The following change took place in the composition of the Committee in 2020:

Ms. Aurora Catá Sala was appointed as an ordinary member of the Risk Committee in place of Ms. María Teresa García-Milà Lloveras, who stepped down as a result of her resignation as a director.

The Annual Corporate Governance Report, available on the website at www.grupobancosabadell.com, contains detailed information about the Risk Committee.

The appointment of the members of the Risk Committee by the Board of Directors at the proposal of the Appointments Committee took into account their knowledge, skills and experience in the areas of risk management and control so as to be able to fully understand and oversee the Institution's risk strategy and risk appetite, in accordance with the provisions of article 5.3 of the Risk Committee Regulation, so that, taken as a whole, the Committee members have the pertinent technical knowledge that is required for their function. When appointing members of the Committee, efforts have been made to promote diversity, in terms of gender as well as professional experience, competencies, industry knowledge, international experience and geographical origin.

Further information on the skills, knowledge and experience of each of the Committee members can be found in their professional profiles and in the matrix of competencies and diversity of the members of the Board of Directors of Banco Sabadell under "Internal Governance Framework" in the "Corporate governance" section of the Group website www.grupobancosabadell.com

At 31 December 2020, the members of the Risk Committee were as follows:

Position	Name	Category	Date of appointment to the Committee
Chairman:	George Donald Johnston	Independent	26/10/2017
Members:	Aurora Catá Sala	Independent	26/03/2020
	Manuel Valls Morató	Independent	25/05/2017
Secretary:	María José García Beato		

As provided in the Committee's Regulation, it must meet as often as necessary, and at least once every two months. The Committee met on 14 occasions in 2020, in accordance with the schedule set at the beginning of the year (six were extraordinary meetings), and the duration of the meetings was that required to discuss the matters on the agenda and to adopt the pertinent decisions.

The Committee may require the attendance at its meetings of such executives, including executive directors, as it sees fit, by notifying the General Manager(s) in question in order to schedule their attendance. The Committee may also require the presence of other directors, executives or professionals of the Institution or Banco Sabadell Group, external experts or any member of the governing bodies of associated companies, whose attendance will be confined to the items on the agenda for which their presence is required.

All meetings of the Committee were announced with at least the required advance notice, and the agenda and the available documentation were provided. The use of documentation support tools provided the directors with regular and segmented access to Committee information and enabled them to have this information sufficiently in advance to be able to debate and make decisions about the matters on the agenda of the Committee meetings.

The attendance by the Committee members at the meetings in 2020 was as follows:

Number of meetings and attendance

George Donald Johnston	14 / 14
Aurora Catá Sala*	10/11
M. Teresa Garcia-Milà Lloveras*	3 / 3
Manuel Valls Morató	14 / 14

* Number of meetings which the directors attended with respect to the number of meetings held during the period in 2020 in which they were a member of the Risk Committee.

Banco Sabadell executives responsible for the matters dealt with at the respective meetings also attended when invited in order to detail the areas relating to their respective functions.

The Secretary took detailed minutes of every meeting, which were approved at the end of the meeting itself or at the next meeting. The Board of Directors was informed promptly of the content of those meetings.

Functions

The Risk Committee is a sub-committee of the Board of Directors and its functions include those defined in article 63 of the Articles of Association of Banco Sabadell, and those defined in Article 15 of the Regulation of the Board of Directors, as well as all the functions set out in the Regulation of the Risk Committee and those attributed to it by law.

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

The Committee's functions include those established by regulations at European and national level and it has an enhanced supervisory role, being comprised of non-executive directors.

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) Supervising implementation of the Global Risk Policy.
- b) Reporting each quarter to the full Board about the levels of risk assumed, investments made and their performance, the potential repercussions on Group revenues of variations in interest rates, and the degree to which they conform to the VAR levels approved by the Board of Directors.
- c) Monitoring and detecting any excess above the approved tolerance thresholds, and overseeing the activation of the contingency plans established for this purpose.
- d) Advising the Remuneration Committee as to whether the employee compensation programmes are coherent with the Bank's levels of risk, capital and liquidity.
- e) Advising and supporting the Board of Directors in connection with tracking the institution's risk appetite and general risk strategy, taking into account all types of risks, to ensure that they are in line with the institution's business strategy, objectives, corporate culture and values.

- f) Assisting the Board of Directors in monitoring the application of the institution's risk strategy and established limits.
- g) Monitoring implementation of the capital and liquidity management strategies, as well as all the institution's other material risks, in order to assess their conformity to the approved risk strategy and appetite.
- h) Providing recommendations to the Board of Directors on such adjustments to the risk strategy as may be considered necessary as a result of, inter alia, changes in the institution's business model, market performance or recommendations made by the risk control function.
- i) Advising on the appointment of external consultants in connection with overseeing the institution's activities.
- j) Analysing a series of possible scenarios, including stress scenarios, to assess how the institution's risk profile would react to external and internal events.
- k) Monitoring the degree to which the major financial products and services offered to customers conform to the institution's business model and risk strategy. The Risk Commission will assess the risks associated with the offered financial products and services and will take into account how the prices of those products and services relate to the rewards obtained.
- l) Assessing internal or external auditors' recommendations and verifying proper implementation of any measures that are adopted.
- m) Reporting to the full Board regarding the performance of its functions under this article and other applicable legislation and the provisions of the Articles of Association and applicable regulations.

Training

The Director Training Programme continued in 2020, and it included the members of the Risk Committee; there were sessions on open banking and the digital transformation of retail banking, the sustainability action plan, data and artificial intelligence, and application to the bank of the regulations on granting and monitoring credit.

Activities in 2020

- i) **Global Risk 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 geographies, in accordance with the established governance framework.

In 2020, it reviewed the Group's Global Risk Framework Policy, which lays common foundations for risk management and control, and the Risk Appetite Framework (RAF) Policy, which establishes the structure and mechanisms associated with the governance, definition, disclosure, management, measurement, monitoring and control of the Group's Risk Appetite and its coordination with the subsidiaries.

In 2020 there were several updates of the Risk Appetite Statement (RAS) to ensure that it is comprehensive and adapted to the regulatory requirements and market best practices, and also aligned with financial planning, the ICAAP, the ILAAP and the Recovery Plan. Governance of first- and second-tier metrics of the RAS was enhanced, by stepping up the frequency of oversight and expanding the detail of RAS reporting by the Risk Committee.

In particular, the RAS was strengthened by incorporating new metrics in connection with insurance risk, conduct risk, technology risk and liquidity risk. Additionally, the thresholds for the capital, solvency, profitability, asset quality and liquidity metrics, among others, were updated. And the definition of qualitative aspects of the RAS was reviewed.

A more forward-looking approach has been incorporated in the definition and oversight of the RAS metrics in order to provide early warning of potential deterioration of the institution's risk profile. In view of the crisis created by the COVID pandemic, exercises were carried out to assess the capacity of the RAS to absorb the deterioration caused by the pandemic without affecting the institution's risk appetite.

ii) Risk Management and Control 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, as part of the development of the Global Risk Framework, the Risk Committee also analysed, and subsequently submitted to the Board of Directors for approval, an update to the risk policies relating to credit, concentration and operational risk, IRRBB, CSRBB and liquidity, market, counterparty, exchange rate, actuarial, model and compliance 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 regulations.

Also, 2020 saw continued compliance with the requirements issued 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 non-performing assets (NPAs)" and the corresponding "Operational Plan for managing NPAs".

In line with the Group's policy governance, the Risk Committee also recommended that the Board of Directors approve the following policies, among others:

- Policy on internal control over financial reporting (Group)
- Conduct risk policy (Group and Banco Sabadell)
- Policy on Coordination between the Risk Management Function at Group level and at TSB

iii) 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 reviewing a scorecard that reflects trends in the main metrics and variables associated with material risks in accordance with the existing risk taxonomy, and ensuring that they conform to the established risk appetite.
- b) A monographic analysis of risks that are detailed in the next section.
- c) Reporting and proposing the appropriate action (activating protocols, changing guidelines, etc.) as a result of analysing risk trends.

iv) Other regular oversight

At each ordinary meeting of the Risk Committee, the risk oversight function entrusted to the Committee also includes regularly:

- a) Tracking risk-adjusted pricing trends and the degree to which prices conform to the related risks.
- b) Monitoring exposure to large groups that are reviewed by the Delegated Committee.
- c) Monitoring quarterly performance of NPAs.

The Risk Committee also received information in the form of monographic analyses of specific risk types and a range of other reports. Monographs provide detailed information on the most salient aspects of the current situation, the relationship with the RAS, and policies, processes, models and procedures.

In particular, the following monographs and reports were presented in 2020:

- Operating Risk Monograph.
- Market Trading Risk Monograph.
- Country Risk Monograph.
- Structural Risk Monograph.
- Cyber Risk Monograph
- Report on outsourcing and associated risks.
- Report on foreclosed assets and assets received in payment of debt.
- Analysis of specific loan books.

Also, in 2020, the Risk Committee regularly tracked trends in the risks associated with COVID-19 from the outset of the crisis. This tracking included an analysis of the deterioration of the economic and industry situation and the potential impact on credit risk. The analysis also included monitoring other risk factors, including notably the potential financial impact and share price performance, as well as the possible reputational impact, together with the appropriate corrective measures.

The Committee specifically examined transactions with ICO guarantees and those granted in the context of moratoria, and included that information in the risk scorecard reported to the Committee. Actions and solutions implemented in credit risk management were also monitored on a regular basis, and their impact on international business operations and country risk was also monitored.

Oversight of the pandemic situation led to several extraordinary meetings of the Board Risk Commission.

v) Risk models

The Banco Sabadell Group has extensive experience with the use of internal models as support for decision-making. In recent years, the Group has stepped up work in connection with controlling and supervising the risks related to the use of such models. In this regard, during 2020 the Risk Committee reviewed the update to the risk management and control model that covers IRB (Internal Rating Based) models, provisioning models, credit risk management models and models affecting the Interest Rate Risk in the Banking Book (IRRBB), in order to recommend its approval by the Board of Directors. The Risk Committee also approved the Plan for Internal Validation Activities.

With regard to credit risk models, during 2020 the Risk Committee was informed about the adequacy of the models in use for managing credit risk and capital; in

particular, it was informed about the results of the independent backtesting of 2LoD, thus complying with the requirements of the ECB reporting Templates on IRB parameters.

It was also informed of progress with the Remedial Plans under the Single Supervisory Mechanism (SSM) regarding the TRIM (Targeted Review of Internal Models), focusing on the mortgage and corporate loan books, and of the final decision regarding the TRIM of the LDP (Low Default Portfolio) and TSB's Secured IMI (Internal Model Investigation). Work continued to advance with the new prudential definition of default required by the EBA.

With regard to provisioning models for credit risk and foreclosed real estate, the Risk Committee was informed of the conclusions of the oversight of those models and the proposal for updating them for 2020, including adjustments due to the COVID shock.

With regard to models that impact the Interest Rate Risk in the Banking Book, the Risk Committee reviewed the new model for non-performing exposures and recommended that the Board of Directors approve it.

vi) Reports on the Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP), and Recovery Plan

In 2020, the Risk Committee reviewed:

- The capital and liquidity adequacy processes (ICAAP and ILAAP reports), which assess the Group's capital and liquidity position.
- It participated in the analysis of risks associated with the new projections for 2020-2024, focusing particularly on the impact of the pandemic on the projections.
- The Recovery Plan and the internal crisis management framework. The Risk Committee monitored the potential impact of the pandemic on the resilience set out in the Group's Recovery Plan.

In this process, the Committee was assisted by the Finance and the Risk Control Divisions, 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.

vii) Other business

With regard to Operational Risk, the Risk Committee participated in regular monitoring of significant issues related to TSB's operational resilience as a result of the migration event, focusing particularly on technology.

The Risk Committee reviewed various issues relating to technology risk, including most notably: the project to implement the new Payment Services Directive (PSD2), Risk Data Aggregation & Risk Reporting and progress with the Discovery internal programme to enhance the Bank's technology capabilities, which resulted in a long-term agreement with IBM to transform the infrastructures and the way they are managed. The Risk Committee was also informed of IT security risk through the IT Cyber Risk reports. It was also informed of the outcome of the SSM questionnaire on IT risk and received regular reports dealing specifically with technology risk.

The Risk Committee was also informed about the various SSM reports produced in ordinary and specific supervisory actions, as well as the SREP 2020 operational letter.

The Risk Committee was informed about the new EBA "Guidelines on Loan Origination and Monitoring" in the process of consultation, which entails a significant impact on loan origination and credit risk monitoring, as well as changes in risk policies, procedures and analysis.

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 Division 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 Anti Money Laundering and Counter Terrorist Finance Report.

Acting as second line of defence, the Risk and Regulation Division issued a number of specific assessments on material transactions.

Additionally, the Risk Committee was informed of the possible impact of the macroeconomic events that arose during the year, with particular emphasis on the pandemic.

The Risk Committee informed the Remuneration Committee about the suitability of the composition of the Identified Staff and the alignment of their objectives with the Bank's risk profile and capital and liquidity levels.

Main progress in relation to the 2020 Action Plan

During the year, the Risk Committee fulfilled the Action Plan established for 2020 by adopting the following measures:

- The Director Training Programme continued, and it included the members of the Risk Committee; there were sessions on open banking and the digital transformation of retail banking, the sustainability action plan, data and artificial intelligence, and application to the bank of the regulations on granting and monitoring credit.
- Internal procedures for circulating meeting documentation to Committee members were enhanced to ensure that they receive the information sufficiently in advance. This objective has been fully met in connection with all documents except for some exceptional cases where there was just cause.

Evaluation of the performance of the Risk Committee

Article 529 nonies of the Capital Companies Act, establishes the obligation of the Board of Directors to assess its own performance and that of its sub-committees each year and, on the basis of the results, to propose a plan of action to correct any deficiencies detected.

In compliance with Recommendation 36 of the Good Governance Code of Listed Companies, every three years the Board of Directors engages an external facilitator to aid in the evaluation process. This facilitator's independence is verified by the Appointments Committee.

Although the aforementioned Recommendation 36 of the Good Governance Code recommends a frequency of no more than three years, and the last time Banco Sabadell was assisted by an external consultant for this assessment was in 2017, the Appointments Committee decided that the performance assessment of the Board of Directors and its Committees for 2019 should be conducted by an independent external consultant, Deloitte Legal, S.L.P.

The performance assessment of the Risk Committee for the year 2019 was performed in 2020 with the assistance of independent external consultant, Deloitte Legal, S.L.P., and the satisfactory outcome was approved by the Board of Directors on 26 March 2020.

Conclusion

During 2020, the Risk Committee properly discharged the duties assigned to it by the Articles of Association and its own Regulation.

On 25 January 2021, the members of the Risk Committee signed this report on the functioning of the Committee in 2020, which will be presented to the Board of Directors and published on the corporate website prior to the date of the General Meeting of Shareholders.

The English version is a translation of the original in Spanish and is provided for information purposes only. In case of discrepancy, the original version in Spanish shall prevail.