3 Third line of defence:

— Internal Audit develops an independent and objective verification and consulting activity, guided by a philosophy of adding value by helping to fulfil its objectives.
— Assists the group in meeting its objectives by providing a systematic, disciplined approach to evaluate the sufficiency and effectiveness of the governance processes and the risk management and internal control activities of the organisation.

Managing and monitoring the main risks

Credit risk

Description

Credit risk arises from the possibility of losses being caused by the non-fulfilment of payment conditions by customers, and a reduction in value due to the deterioration in their credit quality.

Credit risk control framework

Risk acceptance and monitoring

Credit risk exposure is subjected to rigorous monitoring and control through regular reviews of borrowers' creditworthiness and their ability to meet their obligations to the group, with exposure limits for each counterparty being adjusted to levels that are deemed to be acceptable. It is also normal practice to mitigate exposure to credit risk by requiring borrowers to provide collateral or other securities to the bank.

The Board of Directors delegates powers and discretions to the Executive Committee, which then sub-delegates authority at each level. The implementation of authority thresholds on credit approval management systems ensures that powers delegated at each level are linked to the expected loss calculated for each business loan or other transaction that is requested.

To optimise the business opportunities provided by each customer and to guarantee an appropriate degree of security, responsibility for monitoring risks is shared between the relationship manager and the risk analyst, who by maintaining effective communication are able to obtain a comprehensive view of each customer's individual circumstances.

The relationship manager monitors the business aspect through direct contact with customers and by handling their day-to-day banking, while the risk analyst takes a more system-based approach making use of his specialised knowledge.

The implementation of advanced methodologies for managing risk exposures (in line with the New Basel Capital Accord – NBCA – and industry best practice) also benefits the process in ensuring that proactive measures can be taken once a risk has been identified. Of vital importance in this process are risk management tools such as credit rating for corporate borrowers and credit scoring for individual customers, as well as indicators that serve as early warnings in monitoring risk.

The analysis of indicators and early warnings, in addition to the credit rating reviews, allows the level of the risk to be continuously measured in an integrated manner. The establishment of efficient control procedures for outstanding risks also allows benefits to be obtained from managing risks that have been overcome as it enables a proactive policy to be implemented based on an advanced identification of cases that could enter default status.

The early warnings system allows an integrated measurement to be made of the level of the risk taken and allows it to be transferred to recovery management specialists, who will determine the different types of procedures that should be applied. Therefore, based on superior risks up to a certain limit and on the predicted default rates, groups or categories are identified for their individual treatment. These warnings are additionally managed by the business manager and the risk analyst.

Irregular risk management

Debt refinancing and restructuring processes are generally the most significant risk management techniques during the weaker stages of the economic cycle. The bank's objective, when faced by debtors and borrowers that have, or are expected to have, financial difficulties when meeting their payment obligations in the agreed contractual terms, is to facilitate the repayment of the debt by reducing the likelihood of non-payment to the minimum possible level. A number of specific policies to achieve this are in place across the group, including procedures for the approval, monitoring and control of possible debt refinancing and restructuring processes. These include the following:

— Having a sufficiently detailed compliance record for the borrower and a clear intention to repay the loan, assessing the time-frame of the financial difficulties being undergone by the customer.
— Refinancing and restructuring conditions based on a realistic payment scheme which is in line with the borrower's current and predicted payment capacity, preventing issues being put off until a later date.
— If new guarantees are provided, these must be regarded as a secondary and exceptional source for recovering the debt, avoiding any prejudicial effects on existing sources. All ordinary interest must always be paid up to the refinancing date.
— Revisions of any lengthy grace periods.

The group continually monitors compliance with current terms and conditions and with the above policies.

The Banco Sabadell group has an advanced non-performing exposure management model to handle the impaired asset portfolio. The objective of non-performing exposure management is to find the best solution for customers faced by the first symptoms of impairment, helping customers with difficulties to avoid defaulting on their repayments, ensuring intensive management and preventing down-time between the different phases.

For further quantitative information, see Note 4 of the 2015 consolidated annual accounts, under the section Credit risk: refinancing and restructuring operations.

Real estate loans risk management
The group has a series of specific risk mitigation policies that form part of the general risk policy and, specifically, the risk policy for construction and real estate development sectors.

The main measures that are implemented are the continuous risk monitoring and the reassessment of the creditworthiness of the borrower taking consideration of their new economic situation. If the results of this reassessment are satisfactory, the original terms and conditions are applied, and new commitments are added where these allow for a better adaption to the new circumstances.

The policy applied varies in line with the type of asset that is being financed. For completed constructions, actions are taken that support their sale through the group's distribution channels, and a competitive price is fixed allowing transactions to be activated and enabling the final buyers to access financing options, provided that they meet the risk requirements. For works in progress, the basic objective is to complete the construction, as long as the short and medium-term market expectations allow the resulting properties to be absorbed.

In terms of financing for land and plots, the possibility of selling the future homes is also considered before financing their construction.

In the event that the analysis and monitoring performed does not show reasonable feasibility, the mechanism of non-recourse loans and/or asset purchases is applied.

When none of these solutions is possible, judicial proceedings and the subsequent award of assets shall be sought.

All assets that, through non-recourse loans, purchase, or judicial proceedings, are awarded to the group to ensure repayment or to implement other credit improvements are mainly awarded tangible assets that have been received by borrowers and other obligors of the bank, to ensure the availability of financial assets that represent collection rights, and they are actively managed with the main objective of divestment. The nature and carrying amount of these assets are given in Note 14 of the 2015 consolidated annual accounts, Non-current assets held for sale.

Based on the degree of maturity of the real estate assets, three strategic lines of action have been established:

1 **Trading:**
Various trading mechanisms are available for the sale of finished products (housing, commercial establishments, industrial buildings, parking lots, etc.) through various distribution channels and commercial agents, based on type, status, location and state of conservation. The real estate website www.solvia.es is a fundamental factor in such strategy.

2 **Mobilisation:**
In a scenario of major difficulties in the sale of development plots and works in progress, their mobilisation strategy has been adopted to make the finished plots more liquid and various mechanisms for the mobilisation of assets have been created:
- Program for collaboration with real estate developers: contribution of plots in areas with demand for housing, for developers to construct and sell their developments.
- Investors program: development of third-party real estate projects with the participation of investors.
- Protected housing program: development of official protection housing for the rent and subsequent sale of the rented developments.

3 **Urban management:**
For non-development plots, it is important to consolidate the urban rights based on the urban management, which is an important mechanism for value enhancement and is key for any subsequent development and sale.

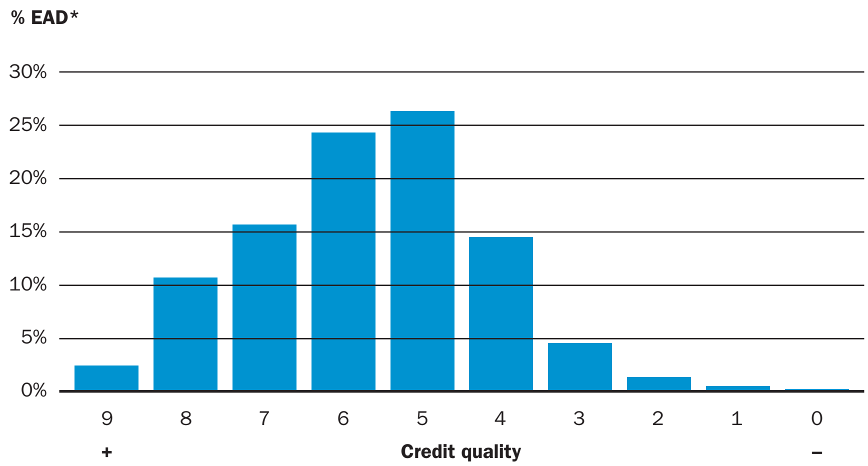
For further quantitative information see Note 4 of the 2015 consolidated annual accounts, in the section Credit Risk: Risk concentration, exposure to the real estate construction and development sector.

Risk management models

Credit rating

Credit risk exposures to corporate customers, real estate developers, specialised financing projects, financial institutions and countries are assessed according to a system of credit ratings based on predictive factors and internal estimates of the probability of default.

The rating model is reviewed each year on the basis of an analysis of actual default data. Each internal rating score is assigned to an anticipated default rate which allows consistent comparisons to be made across segments and with the ratings produced by independent rating agencies, according to a master scale (G6).



G6 Distribution by credit rating of the companies portfolio

* EAD (exposure at default)

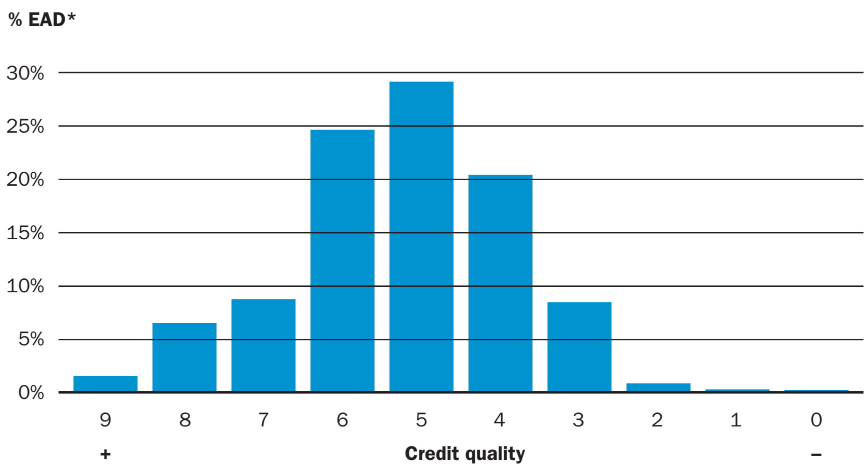
Scoring

In general, credit risk exposures to individual customers are classified by means of scoring systems which make use of quantitative modelling based on historical data to identify key predictive factors (G7). For those geographical regions for which there is a scoring, it is divided into two types:

1 Behavioural scoring: The system in which all customers are automatically classified according to their transaction histories and on each product acquired. It is used primarily for such purposes as granting loans, setting (authorised) overdraft limits, targeting sales campaigns, and for monitoring and segmenting in claim and/or recovery procedures.

2 Reactive scoring: This is used to evaluate applications for consumer loans, mortgage loans and credit cards. When full details of the application have been entered, the system generates a result based on the estimated borrowing capacity and financial position of the applicant and quality of any security or collateral.

If no scoring system exists, it is replaced with individualised analyses supplemented with policies.



G7 Distribution by scoring of individuals portfolio

* EAD (exposure at default)

Alert tools

For both companies and Individuals, in general the Banco Sabadell group has a system of alerts, either individual systems or advanced alert models which, based on available information sources (credit rating or scoring, customer file, balance sheets, the Bank of Spain's CIRBE risk information system, industry information, transaction data, etc.), models the customer's short-term risk (anticipating delinquency) and achieves a high level of predictability in detecting potential non-performing exposures. The score, which is produced automatically, is included in the monitoring process as one of the basic inputs in tracking the risk posed by individuals and companies.

This alert system allows for:

— Improvements in efficiency by focusing attention on customers with lower credit scores (different groups are assigned different thresholds).
— Early action in view of a customer's worsening situation (change of score, new serious alerts, etc.).
— Periodic oversight of customers who remain in the same situation and have been analysed by the basic management team.

Exposure to credit risk

The reduction of problem assets has exceeded the target reduction of the business plan.

Financial assets exposed to credit risk by portfolio, type of counterparty and instruments, and areas in which the risk has been generated are, at the end of 2015, those shown by their carrying value in table T1, representative of the highest level of exposure to the credit risk incurred, inasmuch as they reflect the highest level of debt of the borrower at the date to which they refer.

The group also maintains contingent risks and commitments with borrowers, materialised by the establishment of guarantees provided or commitments inherent in the credit agreements up to an availability level or limit ensuring financing for the customer when required. Such facilities also imply the acceptance of a credit risk and are subject to the same management and monitoring systems described above.

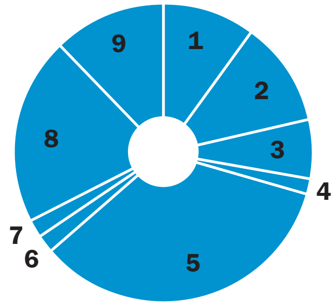
€ million

T1

	2015		
Exposure to credit risk	**Business in Spain**	**Business abroad**	**Total**
Cash and central banks	**1,835.92**	**4,303.54**	**6,139.46**
Loans and advances to credit institutions	**4,876.96**	**1,146.44**	**6,023.40**
Of which: doubtful assets	0.27	0.30	0.57
Loans and advances to customers	**106,022.81**	**45,962.85**	**151,985.66**
Public administrations	5,505.76	78.39	5,584.15
Of which: doubtful assets	11.46	—	11.46
Other private sectors	100,517.04	45,884.46	146,401.50
Of which: doubtful assets	12,173.34	285.61	12,458.95
Debt securities	**22,430.65**	**2,995.03**	**25,425.68**
Public administrations	19,111.36	1,980.10	21,091.46
Credit institutions	1,058.80	145.49	1,204.29
Other private sectors	2,249.07	869.44	3,118.51
Doubtful assets	11.42	—	11.42
Trading derivatives	**1,409.20**	**99.25**	**1,508.45**
Hedging derivatives	**642.72**	**58.09**	**700.81**
Contingent exposures	**8,086.86**	**269.31**	**8,356.17**
Contingent commitments	**11,690.01**	**9,440.60**	**21,130.61**
Total	**156,995.13**	**64,275.11**	**221,270.24**

The credit risk exposure value described above has not been subject to the deduction of the amount of the financial collateral, or other credit improvements received to ensure compliance, of common use in the type of financial instruments handled by the entity.

Figure G8 shows the distribution of credit risk across the different segments and portfolios of the group.



G8

Overall risk profile by portfolio (distribution of credit risk exposures) %EAD (Exposure at default)

1	Large corporates	10.1%
2	Midsize businesses	11.4%
3	Small businesses	6.5%
4	Retailers and sole proprietors	1.6%
5	Mortgage loans	34.2%
6	Consumer loans	1.9%
7	Banks	1.9%
8	Sovereigns	20.4%
9	Other risks	12.0%

Credit risk mitigation

Credit risk exposure is managed and rigorously monitored based on regular analyses of the solvency of borrowers and their potential to meet their payment obligations undertaken with the group, adapting the exposure limits established for each counterparty to the level deemed acceptable. It is also common to modulate the level of exposure by the obligor providing collateral and guarantees in favour of the bank.

Normally, these take the form of financial collateral, mainly mortgages on properties used as housing, whether finished or under construction. The entity also accepts, although to a lesser degree, other types of financial collateral, such as mortgages on business establishments, industrial buildings, etc., and financial assets. Another credit risk mitigation technique that is commonly used by the entity is to accept guarantees, in this case subject to the guarantor presenting a contrasted certificate of good standing.

All these mitigation techniques are established ensuring their legal certainty, i.e. under legal agreements binding all parties and allowing their legal enforceability in all relevant jurisdictions to ensure, at all times, the possibility of redeeming the guarantee. The entire process is subject to an internal control of the legal adequacy of the agreements, sometimes requesting legal opinions from international specialists when the agreements are established under foreign law.

Financial collaterals are formalised before a notary via a public document so that they are effective before third parties. These public documents, in the case of mortgage loans, are also registered at the relevant registries, to acquire effectiveness with respect to third parties. In the case of pledges, the pledged goods are regularly deposited in the entity. Unilateral cancellation by the debtor is not permitted, and the guarantee shall remain valid until repayment in full of the debt.

The personal guarantees or bonds are established in favour of the entity and, except in certain exceptional scenarios, are also formalised before a notary public via a public document, to vest the agreement with the highest possible legal security of formalisation and to allow legal claims to be submitted through executive proceedings in case of non-payment. They constitute a credit right with respect to the guarantor that is irrevocable and payable on first demand.

In addition to the mitigation of the risk derived from the guarantees formalised between the debtors and the entity as a result of the acquisition of Banco CAM, the group has an additional guarantee for a certain asset portfolio, provided by the APS, with retroactive effects from 31 July 2011, and for a period of ten years (see further details in Note 2 of the 2015 consolidated annual accounts).

The bank has not received significant guarantees which it is authorised to sell or pledge, irrespective of any non-payment by the owner of the referred guarantee, except for those intrinsic in the treasury activity, which are mostly the temporary acquisition of assets with maturities of no more than three months, therefore their fair value does not differ substantially from their carrying value (details are included in Note 6 of the 2015 consolidated annual accounts).

The fair value of the assets sold with a buyback agreement derived from the temporary acquisition is included under the heading Trading portfolio of liabilities, within the short positions of securities.

Conversely, transferred assets from the same operation amount to €768,994,000 and are included under Temporary transfers, depending on their nature.

The main concentration of risk in relation to all these types of in financial guarantees or credit improvements corresponds to the use of the mortgage bonds as a credit risk mitigation technique in exposures of loans for use in the financing or construction of housing or other types of real estate. In relative terms, the exposure secured with mortgages represents 66.6% of the overall gross investment.

In terms of risks with LTV >80%, which mainly correspond to operations from acquired institutions or business operations in which, as a supplement to the valuation of the operation, a mortgage guarantee is available for its coverage. Similarly, there are other additional reasons for approval, which mainly respond to solvent borrowers with proven payment capacity, as well as customers with a good profile who contribute additional guarantees (personal and/or pledged) to the mortgage guarantees already considered in the LTV ratio.

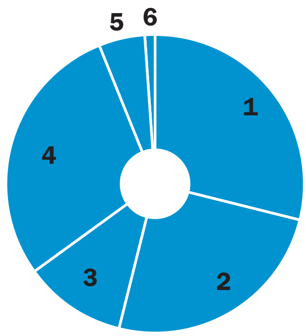
In the case of market operations, in line with general trends, the Banco Sabadell group also provides rights and contractual compensation (netting) agreements with most financial counterparties with which derivative instruments and some collateral agreements (CSA) are contracted, in order to mitigate the exposure to credit risk and avoid excessive concentrations.

The guarantees deposited at Banco Sabadell as collateral at the closing of 2015 amounted to €218 million (€426 million at the closing of 2014).

Credit quality of financial assets

As stated earlier, in general terms, the group uses internal models to rate most borrowers (or transactions) through which credit risk is incurred. Such models have been designed considering the best practices proposed by the NBCA. Nonetheless, not all portfolios where a credit risk is incurred use internal models, partly due to the fact that a minimum level of experience in cases of non-payments is required for their reasonable design. Therefore, in order to best describe the quality of the portfolio from an overall perspective, figure G9 uses the rating system of the Bank of Spain to analyse the group's credit risk exposure and to estimate the hedging requirements due to impaired values of debt instrument portfolios.

The (original) percentage exposure, calculated using internal models, in terms of solvency for the bank is 52.15%.



G9

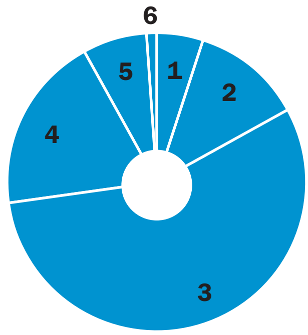
Credit quality of financial assets (%)

1	No appreciable risk	29
2	Low risk	25
3	Medium-low risk	11
4	Medium risk	29
5	Medium-high risk	5
6	High risk	1

Problem assets have been reduced by €3.2 billion in 2015.

The breakdown of the total exposure, rated based on the internal rating levels, is shown in figure G10.

During 2015 there has been an improvement in the evolution of problem assets. The reduction in doubtful balances resulted in a loan-loss ratio of 7.79% at 2015 year-end. Further information on the quantitative details of hedging and doubtful assets is included in Note 11 of the 2015 consolidated annual accounts, Loans and advances to customers.



G10

Breakdown of exposure by credit rating (%)

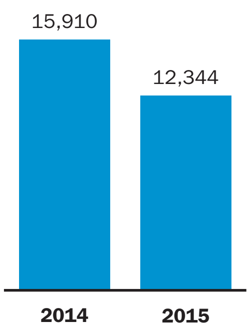
1	AAA/AA	5
2	A	12
3	BBB	56
4	BB	19
5	B	7
6	Rest	1

The balance of doubtful assets has declined at a faster pace than expected.

G11

Evolution of balance of doubtful assets*
Figures include 20% of APS.
In millions of euros.

-22.4%



* Ex TSB

A reduction of €3,566 million, of which €800 million correspond to the last quarter

Evolution of problem assets*
Figures include 20% of APS.
In millions of euros.

-12.8%

* Ex TSB

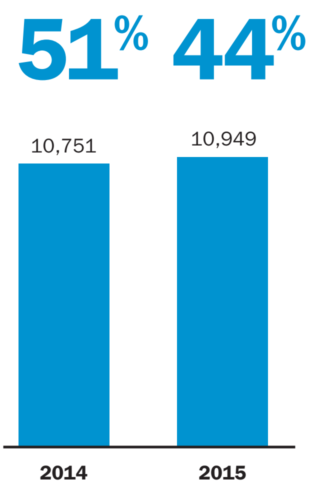
The total balance of problem assets has fallen by €3,180 million In 2015

There have been more sales of real estate assets.

The loan-loss ratio has fallen to single-digit figures.

G12 Sales of foreclosed assets in units and discounted gross value

Discounted gross value

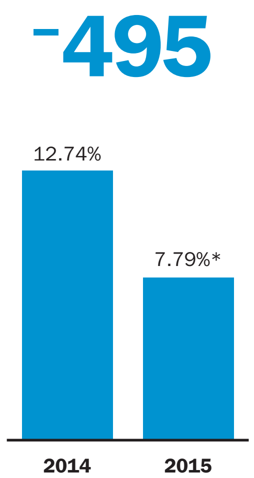


Number of units sold

Sabadell has sold 1,902 foreclosed assets in 2015, 16% more than in the previous year

G13 Loan loss ratio (%)

Basis points



* Ex TSB, loan loss ratio falls to 9.86%.

Loan loss ratio is 53.1% and, if TSB is included, this figure increases to 53.6%

T2 Loan-loss ratio by funding segment

%

	4Q14	Proforma 2Q15 (*)	2Q15	Proforma 4Q15 (*)	4Q15
Real estate development & construction	52.17	47.21	47.07	38.81	38.71
Non-real estate construction	8.08	8.74	8.74	14.36	14.35
Companies	6.46	6.14	6.14	4.62	4.62
SMEs and independent contractors	12.60	11.96	11.88	10.83	10.76
Private individuals with 1st mortgage guarantee	9.25	8.76	5.52	7.83	4.71
Banco Sabadell group loan-loss ratio	12.74	10.98	9.01	9.86	7.79

(*) Corresponds to loan-loss ratio ex TSB.

Concentration risk

Concentration risk refers to exposures than can potentially generate enough losses large enough to threaten the financial solvency of the institution or the viability of its ordinary business activity. This type of risk is divided into two basic subtypes:

— Individual concentration risk: imperfect diversification of idiosyncratic risk in the portfolio, due either to its small size or to very large exposures to specific customers.
— Sectorial concentration risk: imperfect diversification of systematic risk components in the portfolio. Such concentrations may occur in particular sectors or geographical regions, for example.

Further details and information on the risk concentration by activity and at the level of Spanish autonomous communities, as well as the concentration of the real estate construction and development can be found in the 2015 consolidated annual accounts.

In order to ensure an efficient management of concentration risk, Banco Sabadell has a series of specific tools and policies:

— Quantitative metrics in the risk appetite statement and their subsequent monitoring as top-level metrics.
— Individual limits for risks and customers considered to be significant, which are established by the Executive Committee.
— A structure of delegation which requires that relevant

customer transactions be approved by the Credit Operations Committee, or even by the Executive Committee.

Exposure to customers or significant risks
At 31 December 2015 there were no borrowers with a ceded risk that individually exceeded 10% of the group's equity.

Exposure to customers or significant risks
The country risk is that applicable to the debts of a country, globally considered to be due to reasons inherent in the sovereignty and the economic situation of a country, i.e. for circumstances other than the regular credit risk. It manifests itself in the eventual inability of a debtor to meet their foreign currency payment obligations as regards external creditors, among other reasons, for failing to allow the country access to foreign currency, the inability to transfer it, the ineffectiveness of legal actions against borrowers for reasons of sovereignty, or for reasons of war, expropriation or nationalisation.

Country risk not only affects debts contracted with a State or entities guaranteed by it, but also the entire group of private debtors forming part of that State and that for reasons outside of their own control or decision, have experienced a general inability to honour their debts.

There are no significant restrictions (such as statutory, contractual and regulatory restrictions) on the ability to access or use assets and settle liabilities of the group provided that the entity complies with regulatory requirements established in each country.

An overall exposure limit is set for each country and this applies across the whole Banco Sabadell group. These limits are approved by the Executive Committee and the corresponding decision-making bodies, depending on the level of delegation, and are constantly monitored to ensure that any deterioration in the political, economic or social situation in a country can be detected in good time.

A range of different tools and indicators are used to manage country risk: credit ratings, CDS, macroeconomic indicators, etc.

Exposure to sovereign risk
The exposure to sovereign risk, broken down by types of equity instrument, with the criteria established by the European Banking Authority (henceforth, EBA) at 31 December 2015, is shown in figure G15.

Counterparty risk

The counterparty risk management philosophy is aligned with the business strategy, which pursues value creation through the efficient use of capital allocated to the business units. Strict criteria have been established for managing counterparty risk deriving from the financial markets, to guarantee the integrity of the Banco Sabadell group's capital.

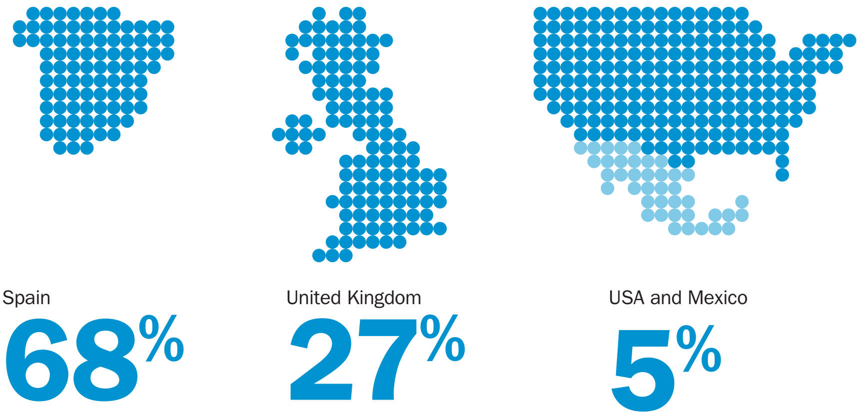
T3 Breakdown of risk concentration by activity throughout the world

€ million

	31/12/2015				
	Spain	Rest of European Union	America	Rest of the world	TOTAL
Credit institutions	**4,394.88**	**4,128.43**	**655.93**	**382.85**	**9,562.09**
Public authorities	**14,979.84**	**8,671.84**	**3,289.08**	**35.42**	**26,976.18**
Central government	10,208.89	8,653.70	3,289.08	35.42	22,187.09
Rest	4,770.95	18.14	—	—	4,789.09
Other financial institutions	**3,720.61**	**304.73**	**1,083.59**	**86.40**	**5,195.33**
Non-financial companies and individual entrepreneurs	**57,281.42**	**3,538.60**	**6,818.51**	**379.12**	**68,017.65**
Real estate development and construction	6,646.22	99.76	268.45	0.37	7,014.80
Civil engineering construction	1,876.89	16.78	19.72	3.46	1,916.85
Other purposes	48,758.31	3,422.06	6,530.34	375.29	59,086.00
Large companies	22,333.34	2,447.84	4,748.99	296.68	29,826.85
SMEs and individual entrepreneurs	26,424.97	974.22	1,781.35	78.61	29,259.15
Other households and NPISHs	**40,366.74**	**37,990.20**	**1,546.91**	**692.09**	**80,595.94**
Home loans	31,926.68	34,916.46	1,513.35	660.44	69,016.93
Consumer loans	5,607.39	1,882.20	18.32	18.58	7,526.49
Other purposes	2,832.67	1,191.54	15.24	13.07	4,052.52
Less: Adjustments due to asset impairment not allocated to specific operations	**—**	**—**	**—**	**—**	**345.11**
TOTAL	**120,743.49**	**54,633.80**	**13,394.02**	**1,575.88**	**190,002.08**

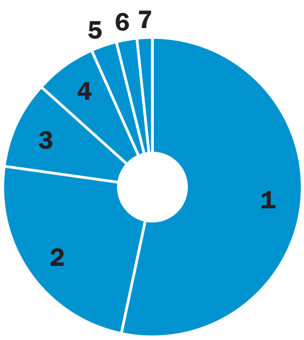
32% of performing loans and advances are located outside of Spain.

G14



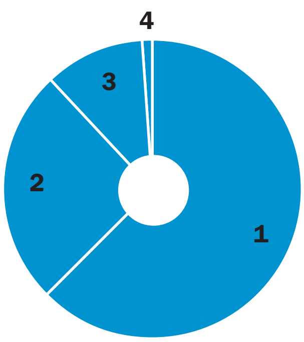
The Banco Sabadell group has a system for evaluating and managing those risks, which allows it to monitor and control compliance with approved limits on a daily basis. Figures G16 and G17 show the distribution of counterparty risk by geographical region and credit rating.

Additionally, to mitigate exposure to counterparty risk, Banco Sabadell has Credit Support Annexes (CSA) and Global Master Repurchase Agreements (GMRA) with most counterparties, which notably reduce the risks incurred through the provision of collateral, as explained previously.



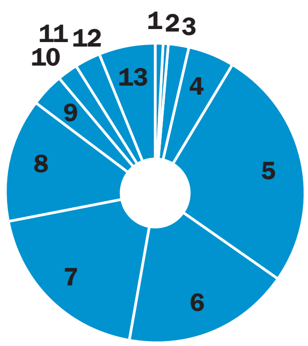
G15 Breakdown of exposure to sovereign risk

1	Spain	53.5%
2	Italy	23.9%
3	USA	9.5%
4	UK	6.7%
5	Portugal	2.7%
6	Mexico	2.3%
7	Rest of the world	1.4%



G16 Distribution of counterparty risk (by geographical region)

1	Eurozone	62.6%
2	Rest of Europe	25.6%
3	USA and Canada	10.9%
4	Rest of the world	0.9%



G17 Distribution of counterparty risk by credit rating (%)

1	AAA / Aaa	1.0%
2	AA+ / Aa1	0.6%
3	AA / Aa2	2.1%
4	AA- / Aa3	5.0%
5	A+ / A1	26.2%
6	A / A2	18.1%
7	A- / A3	19.0%
8	BBB+ / Baa1	13.3%
9	BBB / Baa2	3.8%
10	BBB- / Baa3	2.2%
11	BB+ / Ba1	0.0%
12	BB / Ba2	2.7%
13	Other	6.0%

Assets pledged in financing activities

At the end of 2015, there are certain financial assets pledged in financing operations, i.e. offered as collateral or guarantee for certain liabilities. Such assets correspond mainly to loans linked to the issue of mortgage covered bonds, territorial bonds or long-term securitisation bonds (see Note 21 and Schedules III and IV of the 2015 consolidated annual accounts). The remaining pledged assets are debt securities that are submitted in operations of assets ceded under repurchase agreements, pledged collateral (loans or debt instruments) to access certain financing operations with central banks and all types of collateral provided to guarantee derivatives.

On the other hand, the bank has used part of its loan portfolio and harmonised loans in fixed income securities by transferring assets to various securitisation funds created for this purpose. Under current regulations, securitisations where there is no substantial risk transfer cannot be derecognised from the balance sheet (further details on securitisation funds are included in Schedule II of the 2015 consolidated annual accounts).

For further information on funding programs in the capital market, refer to the section below on liquidity risk.

Liquidity risk

Description

Liquidity risk arises from the possibility of losses being incurred as a result of the bank's being unable, albeit temporarily, to honour payment commitments due to a lack of liquid assets, or of its being unable to access the markets to refinance debts at a reasonable cost. This may be associated with factors of a systemic nature or specific to the bank itself.

The group is exposed to daily demands on its available cash resources to meet contractual obligations related to financial instruments with which it trades, such as maturing deposits, drawdowns of credit facilities, settlements of derivatives, and so on. Experience shows, however, that only a minimum amount is ever actually required and this can be predicted with a high degree of confidence.

In this regard, the objective of the Banco Sabadell group is to maintain liquid assets and a financing structure that, in line with its strategic objectives and based on its risk appetite statement, allows it to fulfil its payment commitments normally and at a reasonable cost, under business as usual conditions or under a stress situation caused by both systemic and idiosyncratic factors.

In order to fulfil these objectives, the group's current liquidity risk management plan is based on the following principles and pillars, serving the group's retail business model and defined strategic objectives:

- Involvement of the Board of Directors and Senior Management in the management and control of liquidity risk and funding.
- Clear segregation of functions between the different areas of the organisation, with a clear delineation of the three lines of defence, providing independence in the valuation of positions and in risk control and analysis.
- Decentralised liquidity risk management system for the most significant units, but with a centralised risk monitoring and management system.
- Sound processes of identification, measurement, management, control and information of the different liquidity and financing risks facing the group.
- Existence of a price transfer system to transfer financing costs.
- Balanced financing structure, based primarily on customer deposits.
- Wide range of unencumbered and immediately available liquid assets to generate liquidity, which make up the group's first line of defence.
- Diversification of funding sources, with controlled use of short-term wholesale funding and which is not dependent on providers of individual funds.
- Self-funding of significant foreign banking subsidiaries.
- Oversight of the level of encumbrance of the group's balance sheet.
- Maintenance of a second line of liquidity that makes up the capacity of issuing mortgage covered bonds and territorial bonds.
- Availability of a liquidity contingency plan.

Liquidity management

The purpose of managing liquidity in Banco Sabadell is to guarantee the financing of commercial activities at an adequate cost and within a reasonable time frame, thus minimising the liquidity risk. In recent years, the bank's financing policy has focused on generating a liquidity gap in commercial business, reducing total financing in wholesale markets (which stood at €27,436 million at the end of 2015) and increasing the bank's liquidity position.

Basic policies state that all management units must comply with local regulatory requirements and with internal limits. These limits are established in the first instance for the consolidated companies in the Banco Sabadell group, and as management limits for each of the management units. Standardised individual limits are also established for each management unit which are adapted to the specific aspects of each business and to the risk of each jurisdiction. These limits, at group-level and at management unit-level are established for the following variables:

- Collateral guarantees under agreement with the Bank of Spain: a minimum figure is set which may be achieved through discountable assets within the National Central Banks of the European Central Bank System as a whole.