Capital strength: The Group had a CET1 capital ratio of 12% at 31 December 2016.

The stress test performed by the European Banking Authority confirmed the group's strong capital position and its ability to withstand very adverse economic scenarios.

Capital management

Capital management is the result of an ongoing capital planning process. This process considers expected economic, regulatory and industry performance, as well as adverse scenarios. It factors in projected capital consumption in the various businesses under a number of scenarios as well as market conditions that may determine the efficacy of measures that may be taken. The process is conducted in line with the bank's strategic goals and the pursuit of attractive returns for shareholders, while always ensuring that own funds are sufficient to attend to the risks inherent in the business.

In terms of capital management, as a general policy, the bank aims to ensure the adequacy of the available capital to the organisation-wide level of risks incurred.

The group follows the guidelines established by the Basel Capital Accord as a basic principle which closely ties the requirements of banks' own funds to the risks that are actually incurred, based on internal risk measurement models which must first be independently assessed.

The group has been authorised by the Supervisor to use the majority of its internal models to calculate regulatory capital requirements. Based on the risk measures that provide these new methodologies, the group has a comprehensive risk measurement model under an internal measurement unit in terms of assigned capital.

The capital mapping by risk type at 2016 year-end is shown in Table T15. The risk assessment in terms of the necessary contributed capital allows it to be compared with the profitability obtained from operational and customer levels to the business unit level. The group has implemented a system to analyse return adjusted to risk (RaRoC) provided by this assessment, allowing

%

T15

	2016
Credit risk	82
Structural risk	4
Operational risk	8
Market risk	1
Other	5
Total	**100**

homogeneous comparisons to be made and enabling their inclusion within the price fixing process of operations.

The group has a complex measurement system in place for each type of risk faced by the bank and some integration methodologies for each of these risks, from an overall point of view and taking into account all possible stress scenarios and corresponding financial planning. These risk assessment systems have been adapted to the corresponding best practices.

The group carries out an annual internal capital assessment process, envisioned in the new framework set out by the NBCA (New Basel Capital Accord), and more specifically in the regulations on the adequacy of regulatory own funds, which is reported to the Supervisor.

This process is based on a wide inventory of previously identified risks and on the qualitative internal assessment of policies, procedures, risk acceptance, measurement and control systems and their corresponding mitigation techniques.

A global quantitative assessment is subsequently carried out on the necessary capital based on internal parameters using models used by the bank (for example, borrowers' credit rating systems in the form of ratings and scorings), as well as other internal estimates suited to each type of risk. The assessments of each risk type are subsequently included and a figure is set using an indicator in terms of allocated capital. Furthermore, the business and financial plans of the bank and its stress tests are taken into account in order to verify whether the business trends and possible adverse scenarios may endanger the bank's level of solvency by comparing it with available own funds.

Capital level and quality are metrics used in the Risk Appetite Statement within the Group's Risk Appetite Framework, as set out in the chapter on "Risk management".

For further information on capital management, refer to the annual Basel 2 - Pillar 3 Disclosures, available on the bank's website under the section Shareholder and Investor Information/Financial Information.

Qualifying capital and capital ratios

Regulations

The new regulatory framework under which the European Union implemented the Basel III capital accords of the Basel Committee on Banking Supervision (BCBS) known as Basel III came into force on 1 January 2014 and will be phased in until 1 January 2019.

This new framework, which is made up of Directive 2013/36/EU, generally known as CRD-IV, and Regulation (EU) 575/2013, generally known as the CRR, structured in three pillars, which regulates minimum own funds that credit institutions need to maintain, both at an individual and a consolidated level, and the way in which these own funds are to be calculated (Pillar I), as well as capital self-assessment process (Pillar II), and the public information to be disclosed to the market (Pillar III).

As a Spanish credit institution, the Group is subject to Directive CRD-IV, which has been implemented in Spain through various standards and regulations (for further details of these regulations, see Note 5 of the consolidated annual accounts for 2016).

In accordance with the requirements established in the CRR Regulation, credit institutions should have a total capital ratio of 8% at all times. However, it should be noted that regulators may exercise their powers under the new regulatory framework and require banks to have additional levels of capital.

The stress test performed in July 2016 by the European Banking Authority in cooperation with the European Central Bank concluded that, in the most adverse scenario considered, the Banco Sabadell Group would have a Common

Equity Tier 1 (CET1) capital ratio of 8.19% on a phased-in basis and 8.04% fully loaded in 2018, evidencing the Group's capital strength and its resilience in the face of very adverse economic circumstances.

Additionally, in November 2016, the bank also received notice from the European Central Bank with regard to its decision on prudential minimum capital requirements for the bank in 2017, following the Supervisory Review and Evaluation Process (SREP): the Banco Sabadell Group is required to maintain a CET1 ratio of 7.375% on a consolidated basis, measured with respect to the phased-in regulatory capital. This includes the minimum required under Pillar 1 (4.50%) and Pillar 2 (1.50%), the capital conservation buffer (1.25%) and the requirement deriving from the bank being classified as systemic (0.125%). This is the level of consolidated CET1 below which the Group would be required to calculate the Maximum Distributable Amount (MDA), which would constitute a limit on the payment of dividends, variable remuneration and coupons to holders of additional Tier 1 capital instruments.

Additionally, on the basis of the note published by the Bank of Spain on 14 December 2016 in which it identified the systemic institutions for 2017 and established their capital buffers in line with the European Banking Authority Guidelines on the criteria to identify other systemically important institutions (O-SIIs) (EBA/GL/2014/10), as set out in Standard 14 and Annex 1 of Bank of Spain Circular 2/2016, Banco Sabadell was designated as an O-SII; as a result, its countercyclical capital buffer was set at 0% and its prudential capital buffer a 0.125% for 2017.

At 31 December 2016, the Group had a CET1 capital ratio of 12%. Therefore, those capital requirements do not trigger any of the aforementioned limitations.

Ratios

At 31 December 2016, the group's qualifying capital amounted to €11,852 million, entailing a surplus of €4,966 million, as shown in table T16.

Common Equity Tier 1 (CET1) accounts for 87.2% of qualifying capital.

Under Basel III, Tier 1 comprises CET1, convertible bonds and deductions of intangible assets of the same value.

Tier 2 funds, which contribute 12.8% of the BIS ratio, are comprised mainly of subordinated debt and general provisions (with regulatory qualifying capital limits), as well as the remaining required deductions.
Risk-weighted assets (RWA) are broken down by risk type, as shown in graphic G11; the largest single component is credit risk.

The distribution of own funds requirements for this risk class (credit risk), by segment, location and economic segment, is shown in figures G12 y G13.
To calculate risk-weighted assets, the Bank has authorisation from the supervisor to use an internal-ratings based (IRB) method for certain portfolios that represent 52.12% of the total.

Graphics G14, G15, G16, G17, G18 and G19 show the distribution of EAD (exposure at default) and RWA (risk-weighted assets) by segment, and the same information detailed by calculation method.

In addition to the capital ratio, the leverage ratio seeks to enhance capital requirements with a supplementary metric unrelated to the level of risk. It is defined as the quotient between qualifying Tier 1 capital and the exposure calculated from the adjusted balance sheet.

The CRR defines a leverage ratio which will be binding from 1 January 2018. Before that, there is a definition and calibration period from 2014 to 2017 in which institutions are obliged to publish information about the ratio and file it with the supervisor; as a function of the outcome, the latter will make the necessary changes to bring it into force. The ratio is currently reported to the regulator on a quarterly basis, based on a benchmark value of 3%.

The exposure metric is calculated in accordance with the definition in

BIS Ratio

12.8%

Qualifying capital

87.2%

Commission Delegated Regulation 62/2015. Table T17 shows the leverage ratio at 31 December 2016 and 2015; it is evident that the institution amply exceeds the minimum required by the supervisor.

Capital-raising issues

Over the last five years, the bank has increased its capital base through issuances which qualify as Tier 1 capital, which have allowed the capital to increase by over €6,600 million. These include a rights issue amounting to €1,607 million carried out in April 2015, as a result of the acquisition of TSB (T18).

In 2016, the total amount of the Serie III/2013 issue of mandatory convertible bonds and 25% of the nominal amount of the Serie IV/2013 issue of mandatory convertible bonds were converted mandatorily upon maturity, with no impact on the capital ratios. Additionally, a €500 million subordinated debt issue was placed in 2016, which raised qualifying Tier 2 assets to €1,519 million.

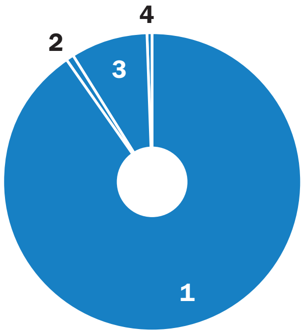
The change in phased-in common equity tier 1 (CET1) for 2015 (€10,209 million) and 2016 (€10,332 million) is mainly due to retained earnings, higher deductions and full inclusion of impairments (including impairment of sovereign debt instruments).

Risk weighted assets (RWA) for the year amount to €86,070 million, a 3.04% decrease compared with the previous year that was attributable principally to sterling's depreciation against the euro in the year.
All of these capital-raising issues and events enabled Banco Sabadell to reach a phased-in common equity tier 1 (CET1) of 12.0% in December 2016, and a total capital ratio of 13.8%, amply exceeding the standards required by the regulatory framework.

€ million

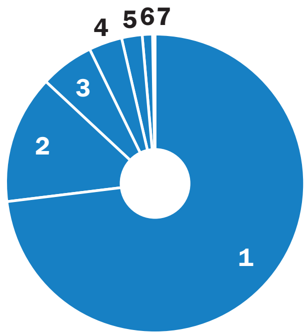
T16

	2015	2016	% 16/15
Capital	679.9	702.0	3.3
Reserves	11,428.7	11,874.2	3.9
Convertible bonds	—	—	—
Minority interest	24.3	21.5	(11.6)
Deductions	(1,923.5)	(2,265.4)	17.8
Common equity Tier 1	**10,209.5**	**10,332.4**	**1.2**
Core capital (Common equity Tier 1) (%)	11.5	12.0	—
Preference shares, convertible bonds and deductions	—	—	—
Primary capital	**10,209.5**	**10,332.4**	**1.2**
Tier I (%)	11.5	12.0	—
Secondary capital	**1,207.9**	**1,519.2**	**25.8**
Tier II (%)	1.4	1.8	—
Total capital	**11,417.4**	**11,851.6**	**3.8**
Minimum capital requirement	7,101.5	6,885.6	(3.0)
Capital surplus	**4,315.9**	**4,966.0**	**15.1**
Total capital ratio (BIS ratio) (%)	**12.9**	**13.8**	**7.06**
Risk weighted assets (RWA)	**88,768.7**	**86,070.0**	**(3.0)**



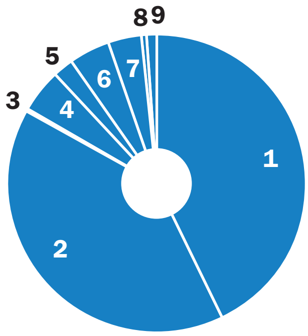
G11
Breakdown of capital requirements by exposure type
31.12.2016 (%)

1	Credit risk	90.54
2	Market risk	0.82
3	Operational risk	8.35
4	Credit impairment risk	0.3



G12
Own resources requirements per geography
31.12.2016 (%)

1	Spain	73.29
2	UK	13.81
3	North America	5.87
4	Rest of EU	3.49
5	Latin America	2.32
6	Rest of the world	1.05
7	Rest of OECD	0.16



G13
Finance, commerce and other services
31.12.2016 (%)

1	Finance, commerce and other services	42.83
2	Individuals	40.33
3	Extractive industries	0.35
4	Manufacturing industries	4.68
5	Energy production and distribution	2.14
6	Real estate development	4.46
7	Transport, distribution and hospitality	3.77
8	Agriculture, livestock, hunting and fishing	0.53
9	Construction	0.89

T17

€ million

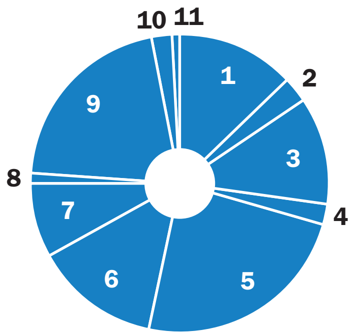
	2016	2015
Tier 1 capital	10,332.0	10,209.0
Exposition	217,919.0	210,370.0
Leverage ratio	**4.74%**	**4.85%**

T18

€ million

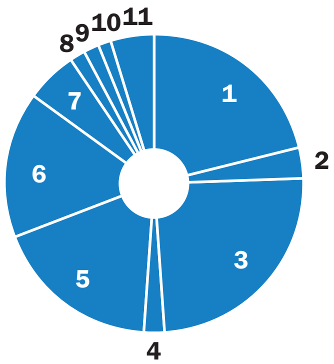
		Amount	Impact on capital
February 2011	Debt-for-equity swap (equity through accelerated book building and repurchase of preferential and subordinated shares)	411	+68 bp of Core Tier 1
February 2012	Preferential shares swapped for ordinary shares	785	+131 bp of Core Tier 1
March 2012	Capital increase	903	+161 bp of Core Tier 1
July 2012	Preferential debt instruments and Banco CAM subordinated shares swapped for ordinary shares	1,404	+186 bp of Core Tier 1
September 2013	Accelerated bookbuilding and rights issue	1,383	+178 bp of Core Tier 1
October 2013	Mandatorily convertible bonds issued and exchanged for B. Gallego hybrids	122	+17 bp of Core Tier 1
April 2015	Rights issue - TSB	1,607	+181 bp of Core Tier 1

Note: The impact on capital (in basis points) is calculated using the year-end data for each year; these figures have varied significantly due to the increase in the Group's consolidation scope in the last few years.



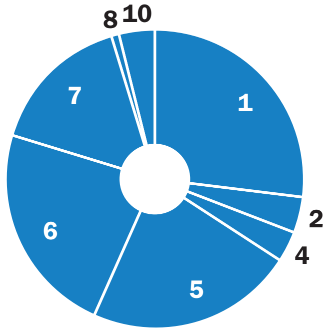
G14
EAD by segment
31.12.2016 (%)

1	Companies	13.03
2	Financial institutions	2.74
3	Other	11.49
4	Loans	2.27
5	Mortgage loans	23.93
6	Retail SME	13.51
7	Corporate SME	8.23
8	Other retail	1.15
9	Public sector	20.77
10	Retailers and sole proprietors	2.03
11	Equities	0.83



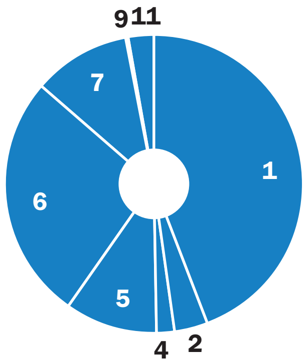
G15
RWA by segment
31.12.2016 (%)

1	Companies	21.36
2	Financial institutions	3.12
3	Other	24.64
4	Loans	2.20
5	Mortgage loans	18.03
6	Retail SME	15.85
7	Corporate SME	5.50
8	Other retail	1.66
9	Public sector	1.69
10	Retailers and sole proprietors	1.45
11	Equities	4.51



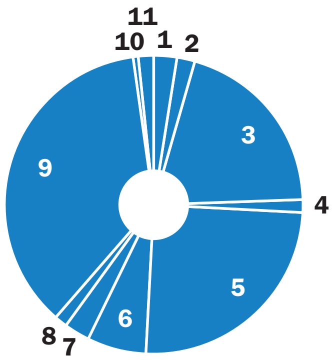
G16
EAD by segment, using IRB method
31.12.2016 (%)

1	Companies	27.18
2	Financial institutions	3.70
3	Other	—
4	Loans	3.41
5	Mortgage loans	22.61
6	Retail SME	22.95
7	Corporate SME	15.65
8	Other retail	0.77
9	Public sector	—
10	Retailers and sole proprietors	3.73
11	Equities	—



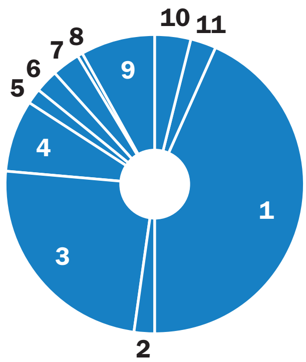
G17
RWA by segment, using IRB method
31.12.2016 (%)

1	Companies	44.18
2	Financial institutions	3.71
3	Other	—
4	Loans	1.97
5	Mortgage loans	10.02
6	Retail SME	26.58
7	Corporate SME	10.50
8	Other retail	—
9	Public sector	0.51
10	Retailers and sole proprietors	—
11	Equities	2.52



G18
EAD by segment, using standard method
31.12.2016 (%)

1	Companies	2.52
2	Financial institutions	2.03
3	Other	20.04
4	Loans	1.42
5	Mortgage loans	24.92
6	Retail SME	6.50
7	Corporate SME	2.71
8	Other retail	1.43
9	Public sector	36.21
10	Retailers and sole proprietors	0.77
11	Equities	1.45



G19
RWA by segment, using standard method
31.12.2016 (%)

1	Companies	4.05
2	Financial institutions	2.67
3	Other	43.33
4	Loans	2.38
5	Mortgage loans	24.10
6	Retail SME	7.70
7	Corporate SME	1.71
8	Other retail	2.53
9	Public sector	2.97
10	Retailers and sole proprietors	0.64
11	Equities	7.93