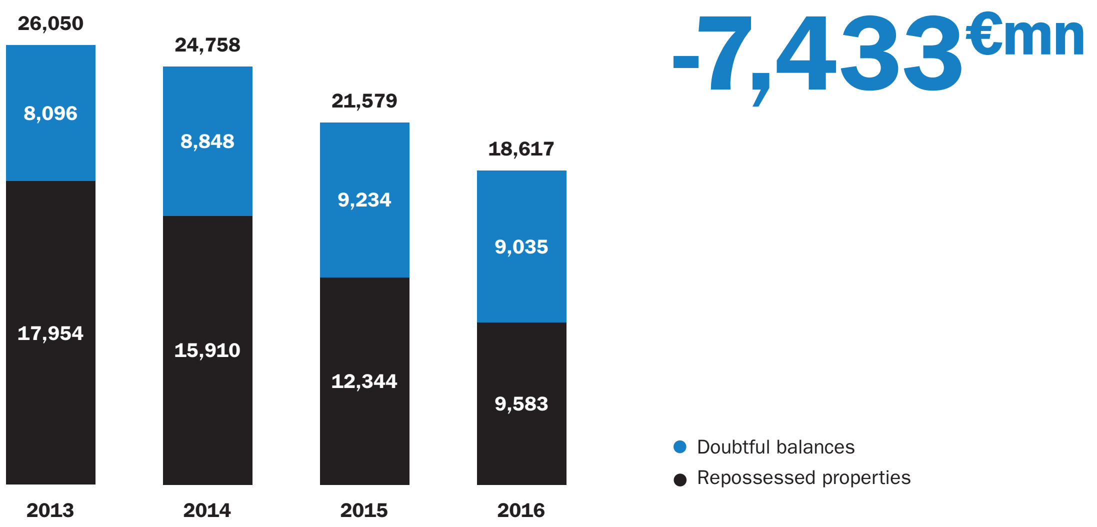
Asset Transformation

The pace of shedding problem assets was maintained, supported by the first year-on-year decline in the volume of foreclosed assets.

G4



Business overview

The Asset Transformation unit manages the Group's non-performing and real estate exposure across all its businesses, and it sets and implements the strategy with regard to real estate investees, including notably Solvia.

The approach to non-performing and real estate exposure is to develop an asset transformation strategy based on a comprehensive vision of the Group's real estate portfolio with the goal of maximising its value.

Key developments in 2016

During the year the Asset Transformation and Industrial and Real Estate Holdings department continued to plan and implement improvements to the asset transformation strategy developed over the preceding years with the primary aim of making troubled asset recovery and transformation processes more effective and maximising any possible recovery in value, either by efficient management or, if likely to be a better option, by divesting the assets. A policy to deal with loan defaults was drawn and is reflected in the following action guidelines:

Default prevention by developing advance warning indicators so that pre-default action, so far as possible, can be taken at an earlier stage and suitable alternative measures put in place to reduce new cases of default.

Specialisation, that is, specialised account managers working on specific segments of the loan portfolio, so that solutions are arrived at on a case-by-case basis and value preservation is optimised.

Productivity, for example by developing ad hoc default management tools, forming dedicated teams and improving the procedures for increasing productivity and efficiency in the management and transformation of troubled assets.

Streamlining the recovery process through a segment-based approach to problem loan portfolios so as to minimise potential losses.

To perform its function of implementing the above strategy, the Asset Transformation business unit is split among the Bank's various departments and divisions, where it scrutinises each stage of the recovery process and of the administration, management and transformation of any troubled assets, making use of its experience and specialist knowledge of the different parts of the process. This organisational structure has evolved and been adapted over the years to respond more effectively to the needs and priorities inherent in the asset transformation process. It has proved to be effective, as reflected in a continuous and gradual reduction in the Group's doubtful or problematic accounts over the last few years. It is structured into the following departments, each focusing on a different part of the process.

The loan loss recovery and default management process covers the following areas:

The Default Prevention and Management Department is primarily responsible for practical implementation of policies and decisions on managing abnormal credit risk and seeking an amicable arrangement with the customers involved, where this is the best way of resolving the case. Special care is always taken in handling any risk of social exclusion that could arise in these situations. The Recovery Department covers the areas of external debt collection, insolvency and legal proceedings. Its mission is to optimise the credit risk management/recovery process by means of external or dispute procedures, where an amicable settlement is not sufficient or is considered inappropriate.

The Corporate Loan Restructuring Department specialises in dealing with issues surrounding the recovery of corporate, property and developer loans and focuses on loan restructuring, recovery and loss minimisation within that borrower category.

The Business Intelligence, Management Control and Asset Protection Scheme Department is a Group-wide servicing unit tasked with optimising and continually improving the Group's recovery processes and overseeing the management of those processes. Its responsibilities include the handling and use of existing information on the Group's troubled assets in order to assist decision-taking by the Group on different balance sheet transformation options.

The Sabadell Real Estate and Institutional Markets Department is charged with handling the Group's real estate exposures and the transformation of those exposures on a Group-wide basis with the aim of reducing them and maximising their value. A special section within the department has responsibility for structuring loans and planning sales processes addressing institutional and wholesale investors.

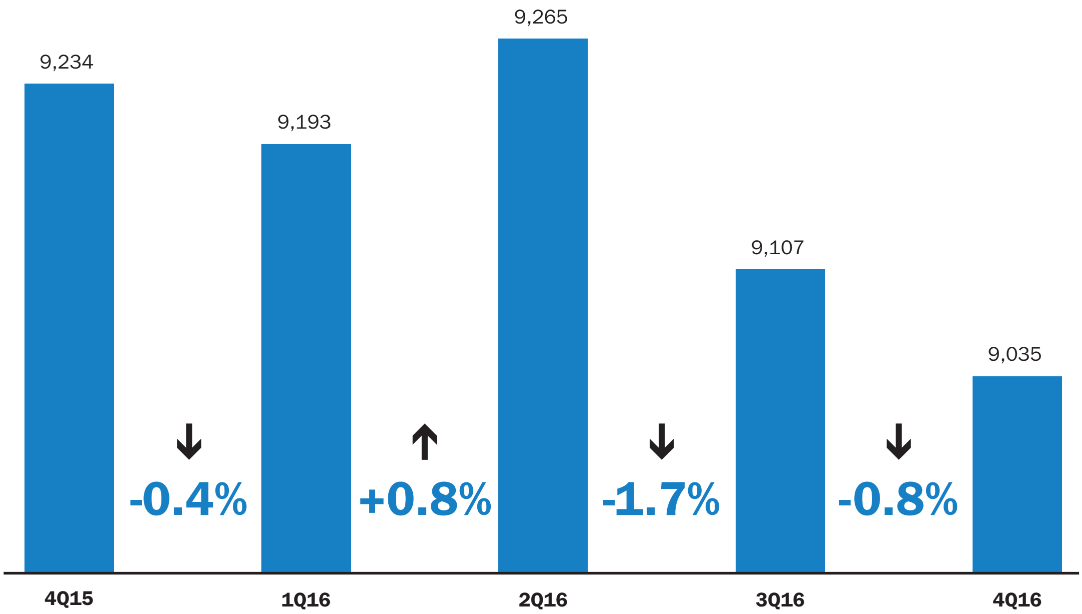
Throughout 2016, in all actions taken by the Bank to recover payment arrears, the Bank adopted a proactive approach in handling mortgage default situations where the mortgaged property was the borrower's normal residence, and looked for solutions that did not involve court proceedings or, in any circumstances, eviction. For example, a total of 3,042 cases resulted in "dation in payment" settlements with an aggregate value of €479 million. As a consequence of its policy of offering alternative accommodation to customers at risk of social exclusion and involved in mortgage foreclosure or "dation in payment" proceedings, the Bank has a stock of nearly 6,600 homes to be let out at reduced rents, including the homes contributed to the Social Housing Fund.

In 2016, properties worth €3,107 million were sold or otherwise disposed of, with the result that for the first time the objective of having a lower number of properties than at the beginning of the year was achieved, showing that the real estate market is now on an upward trend which is likely to continue in 2017. It is especially significant that property sales within the real estate sector (building sites, vacant land and completed non-residential buildings) were higher than in previous years, standing at 112% of the figure at the close of the previous year. This suggests that the revival of the sector is being experienced not only by the end-user or the small investor, but that we are seeing an upturn in business investment fuelled by shortages of properties in certain areas. To take advantage of this revival, enhancements were made to the sales channel for properties of this type.

Sales to real estate investors and of big-ticket assets continued to be made throughout the year and are expected to continue in the coming year (G5).

Of the components of gross income in 2016, net interest income showed an improvement over the previous year, while income from financial assets and liabilities detracted from the result. These revenue figures were reflected in a very positive trend in the results for Asset Transformation, the result of a substantial improvement over the year in provisions for bad debts and other impairments.

G5 Property repossessions (€ million)



Key business data

T10 Asset Transformation

€ million

	2015	2016	% 16/15
Net interest income	**(44.77)**	**(30.99)**	**(30.8)**
Fees and commissions (net)	(1.58)	(1.39)	(12.2)
Other revenues	107.85	92.29	(14.4)
Gross income	**61.50**	**59.91**	**(2.6)**
Operating expenses	(143.18)	(167.84)	17.2
Operating profit/(loss)	**(81.68)**	**(107.93)**	**32.1**
Provisioning expense (net)	(0.07)	1.39	(2,046.0)
Profit/loss on problematic assets	(762.45)	(801.94)	5.2
Other profits/(losses)	—	—	—
Profit/loss before tax	**(844.21)**	**(908.49)**	**7.6**
Ratios (%)			
ROE (profit / average shareholders' equity)	(13.60)	(26.10)	—
Cost:income (general administrative expenses / gross income)	—	—	—
NPL ratio	64.9	70.2	—
NPL coverage ratio	52.5	54.9	—
Business volumes			
Loans and advances	8,413	6,041	(28.2)
Customer funds	301	213	(29.4)
Real estate assets (gross)	9,234	9,035	(2.2)
Other information			
Employees	712	915	28.5
Spanish branches	—	—	—

The recovery in the Spanish real estate market resulted in a strong improvement in Solvia's property sales.

Solvia

In property market services, business at Solvia, Banco Sabadell's real estate services subsidiary, continued at a high level this year. Solvia's real estate servicing platform is one of the biggest in the sector and covers a full range of property market services, from property preparation and development to administration and sales mainly in the retail market.

Solvia continued to develop its business by diversifying its client portfolio. During the year Solvia added Neinor, a real estate developer, as a client for its sales services. It broadened the range of its services to Sareb by adding real estate development. Solvia makes use of its market expertise to provide real estate consultancy for international funds wishing to build property portfolios in Spain.

In a major new business development initiative, in 2016 Solvia took a decision to offer property broking services to individuals and businesses in both sales and lettings. To this end it is enhancing the capabilities of its people, particularly by extending its network of sales representatives and consultants. With these objectives in view, in 2016 Solvia opened 11 high street offices and began to franchise new sales outlets and thus acquire additional points of sale from its network of franchisees. The properties of individual and business clients using Solvia's brokerage services are already on its website, solvia.es. The company continued to invest in its marketing capability and in 2016 was ahead of the market in brand recognition.

In 2016 Solvia saw its property sales grow by 17% and completed the process of integrating Sareb assets that began in 2015. Solvia's debt recovery work for Sareb continued at a high level, with recoveries surpassing 2015 totals. Its real estate development operations were extended with the addition of new projects to its management portfolio: Solvia currently has 79 properties under construction or for sale in developments using sites owned by customers, sales of which totalled more than €110 million. In 2016 the overall value of Solvia-brokered properties, across its various managed portfolios, was over €2,000 million, a record number for a business that goes back to 2008.

BS Capital

BS Capital is the department that manages the Bank's industrial holdings. Its business consists of taking temporary holdings in non-financial companies or business ventures with the primary aim of maximising returns on its investments in the companies in which holds interests.

In 2016 BS Capital actively managed its portfolio to continue a divestment programme going back several years. It also launched and promoted new projects; these included its investment in Aurica III, valued at €100 million at the end of its first year of operation by the Group's venture capital vehicle, Aurica Capital Desarrollo; approving a new 2016-2019 action framework for Sinia Renovables to bring its mezzanine debt and equity investments up to €150 million for renewable energy projects in Spain, Latin America (mainly Mexico) and Europe (mainly the UK); investments in more than five new digital and technology start-ups held by its new vehicle, Sabadell Venture Capital; and organising and managing equity interests resulting from restructurings and debt capitalisations.

BancSabadell d’Andorra

BancSabadell d’Andorra is ideally suited to the needs of individuals and businesses, whether they are already well established or resident in Andorra or have recently moved to the Principality as a result of its open economy policy, and is ready to help them develop their businesses thanks to its offering of value-added services and the high quality service to customers provided by its qualified, expert team.

BancSabadell d'Andorra posted a profit for the year of €8.5 million and an ROE of 11.12%.