

The improvement in the Group's fundamentals is reflected in the general improvement in its credit ratings.

Milestones in 2016

In 2016, the Banco Sabadell group continued to strengthen its risk management framework by making improvements in line with best practices in the financial sector.

Strengthening of the Strategic Risks Framework, giving it a greater deployment in terms of sectors and geographies

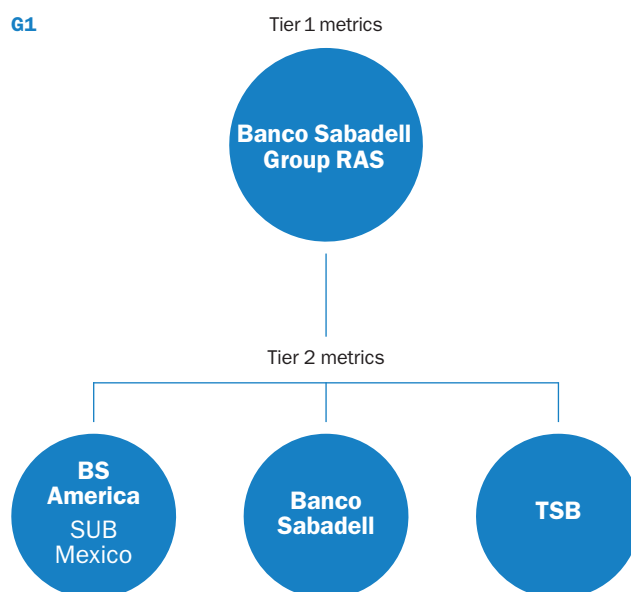
The Banco Sabadell Group's risk appetite framework has been adapted to the new Group structure resulting from internationalisation in order to ensure consistency and effective implementation of the Group's risk appetite statement in all geographies (G1).

Thus, a first tier is established comprising the Group's RAS, setting overall objectives and limits, and a second tier provides details of the first-tier objectives and limits in the various geographies.

During 2016, the Group continued to strengthen its control environment by deploying the risk appetite framework, through the establishment of specific management and control frameworks to manage and control risks associated with lending to certain segments, sectors

and geographies. These frameworks aim to establish policies, tools and asset allocations in line with the type of risk and geography, aligned with the Group's risk appetite framework.

Additionally, during 2016, the Group deployed the risk appetite framework through RAS tier two metrics specific to each portfolio, in order to set objectives/limits for monitoring the loan stock, both existing and, in particular, new stock.



Improvement of the Group's risk profile during the year

The Group's risk profile improved in five fundamental aspects during 2016:

- 1 Internationalisation: following the acquisition of UK bank TSB in 2015, Banco Sabadell Group strengthened its international diversification process in 2016, with international exposure increasing by €641 million. This increase was located in such regions as the UK, the US and Mexico. This increased the Group's international exposure to 32% of its loan book.
- 2 Concentration: reduction of both individual and sectoral concentration risk. This was coupled with an improvement in the composition of the loan book, with a reduction of over €1,733 million in exposure to real estate developers and an increase in exposure to sectors with higher credit quality.
- 3 Risk-adjusted pricing system, with a process for allocating costs, risk and capital at the transaction level, ensuring that pricing matches the risks and costs incurred.
- 4 Reduction of problematic risk: sharp reduction of problematic assets, by over €2,960 million, i.e. by more than the target in the Triple Plan and that achieved by the Group's peers in the same period.
- 5 Establishment of specific management frameworks for each portfolio and constant improvements in credit risk management, by incorporating lessons learned during the economic crisis with a particular focus on defaults.

The improvement in the Group's fundamentals, particularly in terms of risk, is reflected in the overall improvement of the Bank's senior debt rating by credit rating agencies in 2016.

Strengthening of risk governance and internal credit risk models

The risk appetite framework is part of a risk governance framework in line with both European and Spanish regulations and regulations, specifically, the CRR and CRD-IV, transposed into Spanish law through Law 10/2014 on Organisation, Supervision and Solvency of Credit Institutions.

During 2016, the Group continued to strengthen its risk control function, reorganising the structure to give it more independence.

The Banco Sabadell Group also strengthened the management framework of its internal credit risk models during the year. The Group has risk control systems that are appropriate to the activities of the business units in

which it operates and to the risk profile it pursues. These control systems form part of the procedures for acceptance, monitoring, mitigation and recovery of the aforementioned risks and are monitored in turn.

The risk assessment also forms part of the control framework and is implemented through advanced measurement methodologies. In this regard, CRR and CRD IV establish requirements in connection with internal models to calculate minimum capital requirements, and Bank of Spain Circular 4/2016 establishes requirements for the calculation of provisions using internal models. The basic principle of these regulations and their implementation in the Bank consists of closer linkage between own funds and provision requirements, on the one hand, and risks actually incurred and the prospects of their materialising in the future, on the other. The Bank has a system made up of three lines of defence to ensure the quality and oversight of internal models, and a governance process specifically designed to manage and monitor these models and their compliance with regulations and the supervisory requirements.

The Bank is aware that having an advanced methodology allows it to reliably assess and actively manage the risks assumed; consequently, it has been authorised to use internal rating based (IRB) models since 2008 and implements the various components required to complete the risk measurement systems and the applications arising from them.

Some of the main bodies within the governance framework of internal risk models include the new Models Committee, which convenes on a monthly basis and strengthens the governance of internal credit risk models (risk management, regulatory capital and provisions), which is based on the following pillars:

- Effective management of changes to internal models.
- Recurring monitoring of the internal model environment.
- Regular reporting, both internal and external.
- Tools for managing internal models.