monthly basis to the Risk Committee and to the Audit and Control Committee, respectively.

The Financial Department, through the ALCO, designs and implements the strategies for hedging the structural position in foreign currency with the priority objective of minimising the negative impact on capital ratios (CET1) of exchange rate fluctuations.

In 2016, in a context of persisting uncertainty about the negotiations in the wake of the Brexit referendum, Banco Sabadell continued to monitor the EUR/GBP exchange rate. During this period, the Group has adopted a hedging policy which aims to mitigate the negative effects on capital ratios, as well as on the earnings generated by its business in GBP, as a result of the evolution of the EUR/GBP exchange rate.

During 2016, capital hedging increased, from 768 million pounds sterling in 2015 to the current 1,368 million pounds sterling, which represents 73% of the total investment.

This currency hedge is monitored continuously based on market movements.

The value in euro of the assets and liabilities denominated in foreign currencies held by the group at 31 December 2015, classified on the basis of their nature, is shown in figure G18.

The net position of foreign currency assets and liabilities includes the bank's structural position measured at a historical exchange rate, amounting to €1,685 million, of which €597 million correspond to permanent shareholdings in GBP, €769 million to permanent shareholdings in USD and €279 million to stakes in MXN. Net assets and liabilities valued at the exchange rate are hedged through foreign exchange forward transactions and options, in accordance with the Group's risk management policy.

At the end of 2016, the sensitivity of equity exposure to a 1% devaluation in the exchange rates against the euro of the main currencies to which the bank is exposed amounted to €17 million, of which 35% related to the pound sterling, 46% to the US dollar, 17% to the Mexican peso and the rest to other currencies.

Operational risk

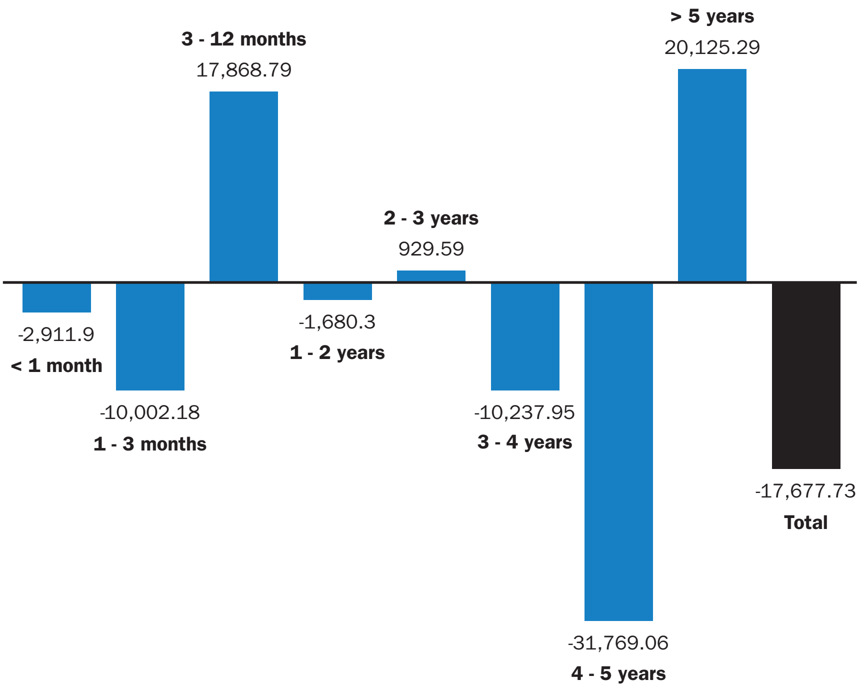
Operational risk is defined as the risk of incurring losses due to inadequate or failed internal processes, people or systems or due to unexpected external events. This definition includes reputation risk (which, in turn, includes behavioural risk), technology, model and outsourcing risks.

T7

%

Instantaneous parallel increase of 100bp		
Interest rate sensitivity	Impact on net interest income	Impact on economic value
EUR	0.1	1.3
GBP	1.9	(2.2)
USD	0.2	(0.3)

G17 Interest rate gap



Management of operational risk is decentralised and devolved to process managers throughout the organisation. The processes they manage are indicated in the corporate process flowchart, which facilitates the distribution of information throughout the organisation. The Group has a specialized central unit to manage operational risk whose main functions are to coordinate, supervise and promote the identification, assessment and management of risks by process managers in line with the Banco Sabadell Group's risk management approach.

Senior Management and the Board of Directors are directly and effectively involved in managing this risk by approving the Risk Appetite Framework and its implementation as proposed by the Operational Risk Committee. The latter is formed of Senior Management members from different functional areas. The management of this risk also requires regular audits to be carried out on the application of the risk management framework and the reliability of the information provided, as well as internal validation tests of the operational risk model. Operational risk management is based on two lines of action:

The first is based on the analysis of processes, identification of risks associated with such processes that may result in losses, and a qualitative assessment of the risks and the associated controls, all carried out jointly by process managers and the central operational risk unit. This provides an assessment which lets the entity know its future exposure to the risk in terms of expected and unexpected loss, and also allows trends to be projected and mitigating actions to be targeted appropriately.

This is complemented by the identification, monitoring and active management of the risk through the use of key risk indicators, resulting in alerts that are triggered by any increase in this exposure, the identification of the causes of such an increase, and measurement of the efficacy of the controls and of any improvements.

At the same time, business continuity plans are designed and implemented for any processes identified as being of high criticality in the event of outage. A qualitative estimate is made of the reputational impact of the identified risks if they were to materialise.

The second line of action is based on experience. It consists of compiling all losses suffered by the entity in a database, which provides information about the operational risks encountered by each line of business, as well as their causes, so that action may be taken to minimise them.

Additionally, this information makes it possible to cross-check the estimates of potential losses with actual losses, in terms of both frequency and severity, iteratively improving the estimates of exposure levels.

A database is available containing historical records of actual losses resulting from operational risk dating back to 2002. It is constantly being updated as information is received on losses and recoveries, whether resulting from the bank's own efforts or from insurance (G19 and G20).

Operational risk includes management and oversight of the following main risks:

— Reputational risk: the possibility of losses arising from negative publicity related to the Bank's practices and activities, potentially leading to a loss of trust in the institution with an impact on its solvency.
— Technology risk: possibility of losses due to inability of the systems infrastructure to fully support the continuation of ordinary business activity.
— Outsourcing risk: the possibility of losses deriving from failure by suppliers to provide subcontracted services or their discontinuation, weaknesses in their systems' security, disloyal conduct on the part of their employees or a breach of applicable regulations.
— Model Risk: the possibility of losses arising from decision-making based on the use of inadequate models.

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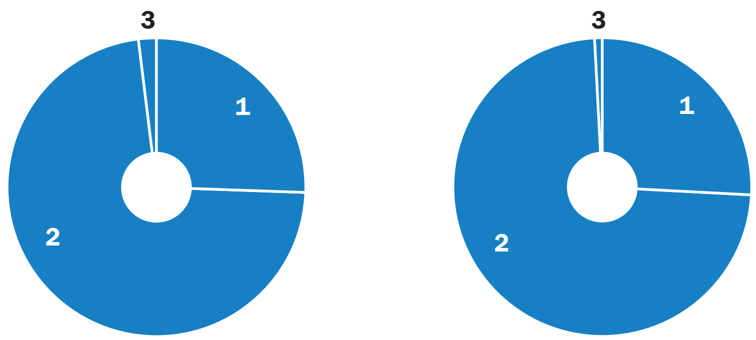

G18 Value in euro of foreign currency assets and liabilities (%)

Assets in foreign currency

1	US dollar	25.8
2	Pound sterling	72.3
3	Other currencies	1.8

Liabilities in foreign currency

1	US dollar	26.1
2	Pound sterling	73.2
3	Other currencies	0.7

— Outsourcing risk: the possibility of incurring losses deriving from: failure by suppliers to provide sub-contracted services or their discontinuation, weaknesses in their systems' security, disloyal conduct on the part of their employees or a breach of applicable regulations.
— Model Risk: the possibility of losses arising from decision-making based on the use of inadequate models.

Tax risk

Tax risk is defined as the probability of failing to comply with the objectives set out in Banco Sabadell's tax strategy Sabadell from a dual perspective due to either internal or external factors:
— On one hand, the probability of failing to comply with the tax obligations that may result in a failure to pay taxes that are due or the occurrence of any other event that impairs attainment of the Bank's goals.
— On the other hand, the probability paying taxes not actually due under tax obligations, thus impairing the position of shareholders or other stakeholders.

Banco Sabadell's tax risk policies aim to set out principles and guidelines in order to ensure that any tax risks that may affect the Group's tax strategy and objectives are systematically identified, measured and managed so as to comply with the new requirements of the Spanish Capital Companies Act and meet the demands of the Banco Sabadell Group's stakeholders.

Banco Sabadell aims to meet its tax obligations at all times while conforming to the current legal framework in matters relating to taxation.

Banco Sabadell's tax strategy also reflects its commitment to promoting responsible taxation, promoting safety and developing transparency schemes in order to strengthen trust among stakeholders.

The Group's tax strategy is aligned with its business strategy, and tax issues are managed efficiently in line with the principles of prudence and minimisation of tax risk.

The Board of Directors of Banco Sabadell, under the mandate set out in the Spanish Capital Companies Act for the improvement of corporate governance, is responsible for the following, which responsibility is non-delegable:
— Setting the company's tax strategy.
— Approving investments and operations of all types which are considered strategic or to have a particular tax risk due to their amounts or specific characteristics, except when such approval corresponds to the Annual General Meeting.
— Approving the creation and acquisition of holdings in special purpose entities or entities domiciled in countries or territories classified as tax havens.
— Approving any similar transaction which, due to its complexity, might undermine the transparency of the company and its Group.

Thus, the functions of the Board of Directors of Banco Sabadell include the obligation to approve the corporate tax policy and ensure compliance therewith by implementing an appropriate control and oversight system as part of the Group's general risk management and control framework.

Compliance risk

Compliance risk is defined as the risk of incurring legal or administrative penalties, significant financial losses or an impairment of reputation due to a breach of laws, regulations, internal rules or codes of conduct applicable to the banking industry.

An essential aspect of the Banco Sabadell Group's policy, and one of the foundations of its organisational culture, is meticulous compliance with all legal provisions. The achievement of the business objectives must be compatible, at all times, with compliance with the law and the application of best practices.

To this end, the Group has a Compliance Department whose purpose is to promote and endeavour to reach the highest levels of compliance with the legislation in force and principles of professional ethics within the Group so as to minimise the possibility of non-compliance and ensure that any instances of non-compliance are identified, reported and diligently resolved, and that the appropriate preventive measures are adopted if not already in place.

The compliance model centralises responsibility for establishing policies, procedures and controls and execution of oversight programmes in the parent undertaking. Execution of specific programmes is decentralised to the overseas subsidiaries and branches, while retaining functional responsibility.

It is a flexible risk-focused model which can be adapted to the Group's strategy at all times and leverages synergies, maintaining an overall approach to those aspects that are general in scope and/or which require major technological developments, but also adapting to the specific features and legislation affecting each business or country.

The main challenge is to standardise the levels of compliance oversight across the Group and establish minimum standards for mandatory compliance, regardless of the activity or country.

This model is comprised of two main pillars:

1 A central unit providing services to the entire Group in pursuit of comprehensive management of compliance risk. Its main activity is the analysis, distribution and oversight of the implementation of any new regulations with an impact on the Group, as well as risk-focused oversight of compliance with pre-existing regulations.

It is also directly responsible for the implementation of a number of processes that are classified as of high risk as they require direct and comprehensive control: prevention of money laundering and terrorist financing; oversight of market abuse; oversight of compliance with the