The Bank maintains a sound capital profile after implementing IFRS 9.

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 ensuring that own funds are sufficient to attend to the risks inherent in the banking business.

As a general policy, the institution aims to ensure that available capital is adequate to the overall level of risks incurred.

The Group follows the guidelines established by CRD-IV and secondary legislation to determine the capital requirements inherent in the risks that are actually incurred by the institution, based on internal risk measurement models that have been validated independently. The supervsor has authorised the Group to use most of its internal models to calculate regulatory capital requirements.

The capital map by risk type at 2017 year-end is shown in figure G11.

The Group has a complex measurement system in place for each type of risk that it incurs as well as integration methodologies for each of these risks, all of which apply on an end-to-end basis and take into account possible stress scenarios and the pertinent financial planning. These risk assessment systems conform to best practices.

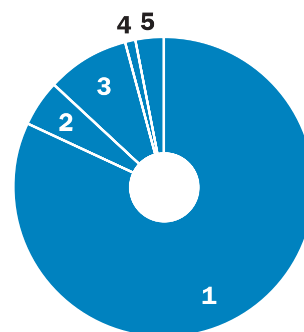
The Group performs a capital self-assessment each year. This process is based on a broad inventory of previously identified risks and on a qualitative internal assessment of policies, procedures, risk acceptance, measurement and control systems and their corresponding mitigation techniques.

An overall quantitative assessment then determines capital needs based on internal parameters using models employed by the bank (e.g. borrower credit rating or scoring systems), as well as other internal estimates suited to each type of risk. The assessments of each risk type are subsequently combined and an amount of allocated capital is determined.

Furthermore, the institution's business and financial plans and its stress tests are taken into account in order to ascertain whether business trends and possible adverse scenarios may endanger the bank's capital when compared with available equity.

The risk assessment in terms of the necessary allocated capital enables it to be compared with the returns, from transaction and customer level up to the business unit level. The Group has implemented a system to analyse the risk-adjusted return on capital (RaRoC) provided by this assessment, allowing homogeneous comparisons to be made and enabling them to be factored into transaction pricing.

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



G11 Capital map by risk type 31.12.2017 (%)

1	Credit risk	82
2	Structural risk	5
3	Operational risk	9
4	Market risk	1
5	Other	3

For further information on capital management, refer to the annual "Basel 2 - Pillar 3 Disclosures", available on the bank's website in 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) came into force on 1 January 2015 and will be phased in until 1 January 2019.

This framework, structured in three pillars, 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 1), a capital self-assessment and supervisory review process (Pillar 2), and the public information to be disclosed to the market (Pillar 3).

As a Spanish credit institution, the Group is subject to CRD-IV, which has been implemented in Spain through various standards and regulations (for further details of these regulations, see Note 5 to the consolidated annual accounts for 2017).

In accordance with the requirements established in the CRR, credit institutions must have a total capital ratio of 8% at all times. However, under the new regulatory framework, regulators are empowered to require banks to have additional levels of capital.

On 14 December 2017, the institution received notice from the European Central Bank with regard to its decision on the prudential minimum capital requirements applicable to the bank in 2018, following the Supervisory Review and Evaluation Process (SREP): the Banco Sabadell Group is required to maintain a CET1 ratio of 8.3125% 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 (1.75%), the capital conservation buffer (1.875%) and the requirement deriving from the bank being classified as systemic (0.1875%). In aggregate, 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 24 November 2017 in which it identified systemically important Institutions and established their capital buffers in line with the European Banking Authority Guidelines on the criteria for the assessment of 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 and its capital buffer was set at 0.1875% for 2018. Banco Sabadell's specific countercyclical capital buffer, calculated in accordance with Bank of Spain Circular 2/2016, of 2 February, was 0% throughout 2017.

At 31 December 2017, the Group had a CET1 phased-in capital ratio of 13.4% and, accordingly, did not incur any of the limitations referred to above.

The fully-loaded CET1 ratio amounts to 12.8%, as of December 2017, or 12.0% pro-forma the implementation of IFRS 9.

As of 31 December 2017, the group's qualifying capital amounted to €12,524 million, i.e. a surplus of €6,313 million, as shown in table T15.

Common Equity Tier 1 (CET1) accounts for 83.2% of qualifying capital. The deductions consist mainly of goodwill and intangibles.

Under Basel III, Tier 1 capital is made up of CET1 plus Additional Tier 1 capital, which comprises capital instruments in the form of preferred securities and deductions — mainly deductions due to goodwill and intangible assets in percentage corresponding to the transition period (20%) and deductions due to underprovisions for expected losses under IRB models, also in the percentage corresponding to the transition period (10%).

Tier 2 funds, which contribute 11% of the BIS ratio, are comprised mainly of subordinated debt and general-purpose provisions (subject to regulatory caps), as well as the other required deductions.

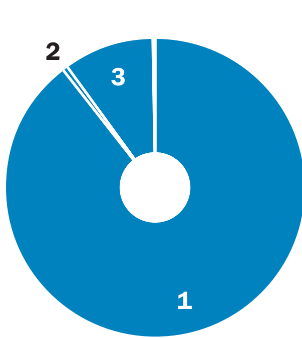
Risk-weighted assets (RWA) are broken down by risk type, as shown in figure G12; the largest single component is credit risk.

The distribution of own funds requirements for this risk class (credit risk), by segment, location and economic sector, is shown in figures G13 y G14.

Figures G15, G16, G17, G18, G19 and G20 show the distribution of EAD (exposure at default) and RWA (risk-weighted assets) by segment, and the same information detailed by calculation method.

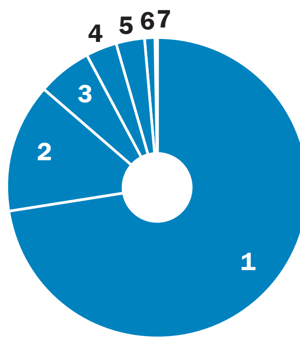
In addition to the capital ratios, the leverage ratio seeks to enhance capital requirements with a supplementary metric unrelated to the level of risk. It is defined as the quotient between qualifying Tier 1 capital and the exposure calculated in accordance with Commission Regulation (EU) 2015/62, of 10 October 2014. Table T16 shows the leverage ratio as of 31 December 2017 and 2016; it is evident that the institution amply exceeds the minimum required by the supervisor.

The CRR defines a leverage ratio which is binding from 1 January 2018. Before that, there was a definition and calibration period from 2014 to 2017 in which institutions were obliged to publish information about the ratio and file it with the supervisor; as a function of the outcome, the latter made 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%.



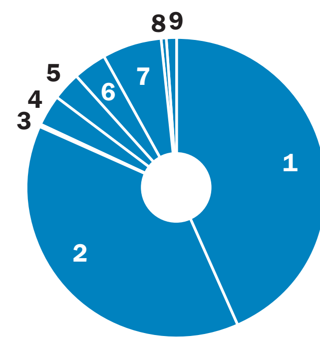
G12
Capital requirements, by exposure type
31.12.2017 (%)

1	Credit risk	89.5
2	Market risk	0.7
3	Operational risk	9.8



G13
Capital requirements, by region
31.12.2017 (%)

1	Spain	72.6
2	UK	13.8
3	Latin America	5.9
4	Rest of EU	3.4
5	North America	3.1
6	Rest of the world	1.2
7	Rest of OECD	0.0



G14
Exposure, by segment
31.12.2017 (%)

1	Finance, commerce and other services	43.6
2	Individuals	38.3
3	Extractive industries	0.2
4	Manufacturing industries	3.3
5	Energy production and distribution	3.1
6	Real estate	3.5
7	Transport, distribution and hospitality	6.6
8	Agriculture, livestock and fishing	0.4
9	Construction	1.0

T15 Composition of the capital ratios

€M

	2016	2017	% 17/16
Capital	702.0	703.4	0.2
Reserves	11,874.2	12,106.6	2.0
Convertible bonds	—	—	—
Minority interest	21.5	16.9	(21.3)
Deductions	(2,265.4)	(2,403.8)	6.1
CET1 capital	**10,332.4**	**10,423.1**	**0.9**
CET1 (%)	12.0	13.4	—
Preference shares, convertible bonds and deductions	—	697.9	—
AT1 capital	**—**	**697.9**	**—**
AT1 (%)	—	0.9	—
Primary capital	**10,332.4**	**11,121.0**	**7.6**
Tier I (%)	12.0	14.3	—
Secondary capital	**1,519.2**	**1,403.3**	**(7.6)**
Tier II (%)	1.8	1.8	—
Total capital	**11,851.6**	**12,524.3**	**5.7**
Minimum capital requirement	6,885.6	6,211.1	(9.8)
Capital surplus	**4,966.0**	**6,313.2**	**27.1**
BIS ratio (%)	**13.8**	**16.1**	**—**
Risk weighted assets (RWA)	**86,070.0**	**77,638.2**	**(9.8)**

T16 Leverage ratio

€M

	2016	2017
Tier 1 capital	10,332.4	11,121.0
Exposure	217,918.6	223,785.8
Leverage ratio	**4.74%**	**4.97%**

Capital-raising

In the last five years, the bank has increased the capital base by more than €5,000 million through organic generation of profits and through issues that qualify as Tier 1 capital, including the €1,607 million rights issue in 2015 as a result of the TSB acquisition (T17).

The change in phased-in common equity tier 1 (CET1) between 2016 and 2017 is mainly due to retained earnings, higher deductions and two issues of contingently convertible preferred securities in 2017, amounting to €750 million and €400 million. Those two issues not only increased the phased-in CET1 ratio but also optimised Banco Sabadell's capital structure.

Risk weighted assets (RWA) for the year amount to €77,638 million, a 9.80% decrease compared with the previous year. This change is due mainly to the sale of subsidiary Sabadell United Bank, the application of the Group's new models to calculate the capital requirements for private individuals and adjustments, and the improvement in customers' credit profiles.

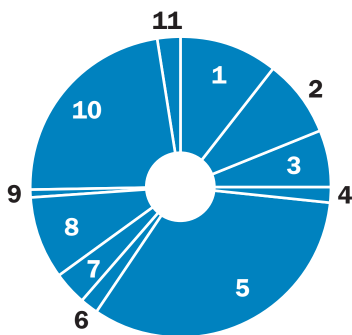
All of these capital-raising issues and events, which impacted both available capital and risk-weighted assets, enabled Banco Sabadell to reach a phased-in common equity tier 1 (CET1) ratio of 13.4% in December 2017, and a total capital ratio of 16.1%, amply exceeding the standards required by the regulatory framework.

€M

T17

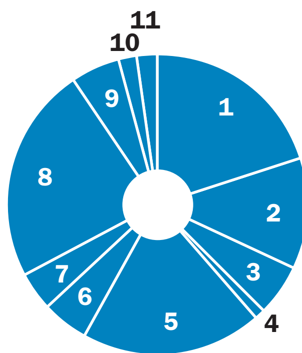
		Amount	Impact on capital
February 2011	Debt-for-equity swap (equity raised through accelerated book building, and repurchase of preferred securities and subordinated debt)	411	+68 bp of Core Tier I
February 2012	Preference shares swapped for ordinary shares	785	+131 bp of Core Tier 1
March 2012	Capital increase	903	+161 bp of Core Tier I
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 I
October 2013	Mandatorily convertible bonds issued and exchanged for B. Gallego hybrids	122	+17 bp of Core Tier I
April 2015	Rights issue - TSB	1,607	+181 bp of Core Tier I

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.



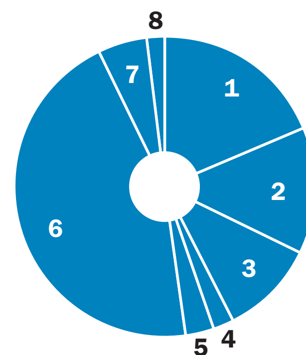
G15
EAD by segment
31.12.2017 (%)

1	Companies	10.7
2	Corporate SME	8.3
3	Retail SME	6.3
4	Retailers and sole proprietors	1.5
5	Mortgage loans	32.7
6	Loans	2.1
7	Other retail	3.6
8	Other	8.7
9	Equities	0.8
10	Public sector	23.0
11	Financial institutions	2.3



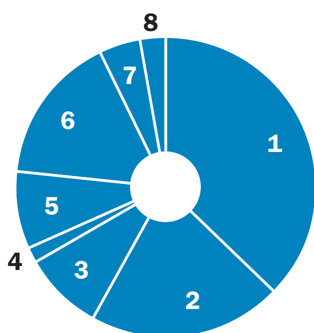
G16
RWA by segment
31.12.2017 (%)

1	Companies	20.1
2	Corporate SME	12.0
3	Retail SME	5.4
4	Retailers and sole proprietors	1.1
5	Mortgage loans	19.5
6	Loans	5.1
7	Other retail	4.1
8	Other	23.3
9	Equities	5.5
10	Public sector	1.7
11	Financial institutions	2.2



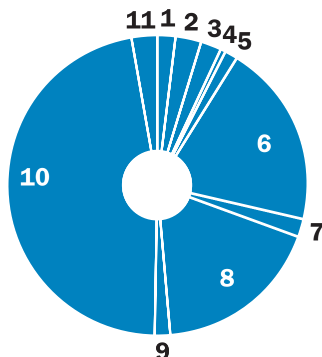
G17
EAD by segment, using IRB method
31.12.2017 (%)

1	Companies	18.8
2	Corporate SME	13.5
3	Retail SME	10.3
4	Retailers and sole proprietors	2.4
5	Loans	3.0
6	Mortgage loans	44.9
7	Other retail	5.2
8	Financial institutions	1.9



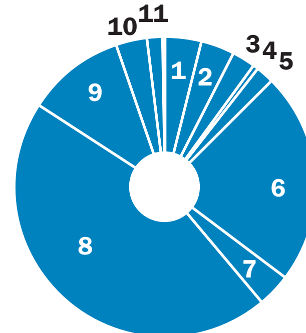
G18
RWA by segment, using IRB method
31.12.2017 (%)

1	Companies	37.4
2	Corporate SME	20.9
3	Retail SME	8.6
4	Retailers and sole proprietors	1.7
5	Loans	8.4
6	Mortgage loans	16.0
7	Other retail	4.5
8	Financial institutions	2.5



G19
EAD by segment, using standard method
31.12.2017 (%)

1	Companies	2.1
2	Corporate SME	2.9
3	Retail SME	2.1
4	Retailers and sole proprietors	0.6
5	Loans	1.3
6	Mortgage loans	20.0
7	Other retail	1.9
8	Other	17.9
9	Equities	1.6
10	Public sector	47.0
11	Financial institutions	2.6



G20
RWA by segment, using standard method
31.12.2017 (%)

1	Companies	3.9
2	Corporate SME	3.8
3	Retail SME	2.4
4	Retailers and sole proprietors	0.6
5	Loans	2.0
6	Mortgage loans	22.7
7	Other retail	3.7
8	Other	45.1
9	Equities	10.6
10	Public sector	3.3
11	Financial institutions	1.9