



This version of our report is a free translation of the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation.

Independent auditor's report on the consolidated annual accounts

To the shareholders of Banco de Sabadell, S.A.:

Report on the consolidated annual accounts

Opinion

We have audited the consolidated annual accounts of Banco de Sabadell, S.A. (the Parent company) and its subsidiaries (the Group), which comprise the balance sheet as at December 31, 2018, and the income statement, statement of recognized income and expenses, statement of total changes in equity, cash flow statement and related notes, all consolidated, for the year then ended.

In our opinion, the accompanying consolidated annual accounts present fairly, in all material respects, the equity and financial position of the Group as at December 31, 2018, as well as its financial performance and cash flows, all consolidated, for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union (IFRS-EU) and other provisions of the financial reporting framework applicable in Spain.

Basis for opinion

We conducted our audit in accordance with legislation governing the audit practice in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the consolidated annual accounts* section of our report.

We are independent of the Group in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the consolidated annual accounts in Spain, in accordance with legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, and situations or circumstances have not arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated annual accounts of the current period. These matters were addressed in the context of our audit of the consolidated annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

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Key audit matters

How our audit addressed the key audit matter

Impairment due to credit risk and real estate assets arising from foreclosures

Determining impairment due to credit risk is one of the most significant and complex estimation exercises performed when preparing the accompanying consolidated annual accounts. The evaluation of impairment due to credit risk is based on both individualized and collective estimates of coverage, in this case through the application of the Group's internal models.

In the determination of hedges for credit risk, guarantees, real or personal, considered effective are considered. The Group has developed internal methodologies for evaluating the recoverable amount of real estate collateral.

In this financial year 2018, these internal models have been updated in accordance with the new requirements arising from the entry into force of IFRS 9 "Financial Instruments". Note 1 of the accompanying consolidated annual accounts includes changes in policies, procedures and the Group's tools as a result of the entry into force of said standard, as well as the most significant impacts recorded as of January 1, 2018.

Periodically the Group performs recalibrations of its internal models in order to optimize its predictive capacity by updating, where appropriate, the variables considered or the algorithms used.

It should be noted that the estimation of the impairment of real estate assets originated from loan activities and which, through deed in lieu, purchase or judicial proceedings, are awarded to the Group, are subject to the same policies indicated above for real estate collateral.

Models and valuation methods used suppose a high component of judgment and estimation for the determination of losses due to deterioration.

In addition to the guarantees established on the different operations, as a result of the acquisition of Banco CAM, the Asset Protection Scheme (hereinafter, APS) entered into force for a predetermined portfolio of assets. Through said APS, the Deposit Guarantee Fund (hereinafter, DGF) assumes 80% of the losses derived from said portfolio during a period of 10 years, once the provisions constituted on said date of acquisition have been absorbed.

Our work has focused on the analysis, evaluation and verification of the internal control system, as well as the performance of detailed tests on provisions, both for those estimated collectively and individually.

The procedures we performed on the internal control system included the following, among others:

- Verifying that the various policies and procedures and the approved internal models comply with applicable regulations and Group's internal governance model.
- Review of the periodic risk assessment and follow-up alerts carried out by the Group, as well as the effective performance of the process of periodic review of files of accredited persons for the follow-up of their classification and, in the cases in which it applies, registration of the deterioration.

In addition, we carried out the following tests of details:

- Review of the methodology for classifying credit assets in the three states defined in the standard, analyzing the adequacy of: i) the definition of impairment applied; and ii) the methodology for estimating the significant increase in credit risk for assets classified as Stage 2, based on the definition of qualitative indicators and thresholds for the increase of quantitative indicators.
- Review of the different calculation methodologies and the criteria adopted for the estimation of the risk parameters used in the calculation of the expected credit loss, including: i) the estimation of the risk parameters throughout lifetime or 12 months, depending on the corresponding stage; ii) the use of alternative scenarios in the projections carried out in the future, considering specially the reasonableness of assumptions and likelihood assigned to the no-deal Brexit scenario (Cliff Edge Brexit scenario); and iii) the use of retrospective contrast methodologies for the most relevant parameters in the impairment's estimation.
- Checks referred to: i) the reliability and consistency of the data sources used; ii) historical loss rates for impairment in credit risk in the estimation of future cash flows and historic discount rates on sale of real estate assets against the appraised value; and iii) recalibrations and retrospective contrasts performed in internal models.

Key audit matters

How our audit addressed the key audit matter

In this way, for the accounting impairment losses corresponding to these assets, Group Banco Sabadell estimates a collection right against the DGF for the guarantee granted under the heading "Loans and advances". This collection right is subject to periodic settlements by the DGF.

On July 19, 2018, the Group agreed to transfer almost all of its real estate exposure to a subsidiary of Cerberus Capital Management L.P. The real estate assets of the operation have a total gross carrying amount of approximately €9,100 million and a total net carrying amount of approximately €3,900 million. Additionally, on July 24, 2018, the transfer of a credits portfolio, mainly mortgage loans, composed, in turn, of three sub-portfolios, with an outstanding balance of approximately €2,295 million, to Deutsche Bank and Carval Investors, has been agreed. These assets are recognized at December 31, 2018 under *"Non-current assets and disposal groups classified as held for sale"*.

These operations are expected to be concluded in the financial year 2019, once the corresponding permits have been obtained and the conditions for each of the portfolios have been met, implying the transfer of control of these real estate assets and credits and, consequently, their deconsolidation from the consolidated balance sheet.

See Notes 1, 2, 4.4.1 and 11 and Appendix 6 to the accompanying consolidated annual accounts with respect to impairment due to credit risk and Notes 1, 2, 4.4.1, 13, 15 and 17 and Appendix 6 to the accompanying consolidated annual accounts with respect to the impairment of real estate assets deriving from foreclosures.

- Review of the working of the "calculation engine" and re-execution of the calculation of collective provisions, for portfolios with structural models, and of the calculation of impairment of real estate assets deriving from foreclosures based on the different asset categories.
- Review of a sample of individualized credit files, as well as real estate assets deriving from foreclosures, to evaluate their proper classification and registration, as the case may be, of the corresponding impairment.
- Review of the Group's consolidated equity impacts as at January 1, 2018 related to the estimation of credit risk impairment, deriving of entry into force of IFRS9.

We performed the following tests of details specifically on the estimate of the receivable entitlement from the DGF deriving from the Asset Protection Scheme:

- Review of the reliability and the coherence of sources of the data concerning assets covered by the APS used in the calculation of the estimated receivable entitlement from the DGF.
- Verification of the calculation of the estimated receivable entitlement from the DGF based on the various categories of assets and transactions carried out, as well as its alignment with the accounting records.
- Analysis of changes to accounting estimates as a result of the periodic evaluation of the assets and projected profits related to the APS cover, as a result of additional information or new events regarding the situation of the assets.

Regarding sales operations for real estate assets and credits portfolios, we have performed the following tests:

- Review and analysis of contractual support documentation of the agreements reached and the related accounting impact.
- Execution of tests of details to verify the correct evaluation of the real estate assets and credits of these operations, in accordance with the sales price agreed between the parties and based, where appropriate, on the guarantees deriving from the APS.
- Review, from the date of the agreement, of the procedures for assigning risks and profits to the economic transactions performed on the real estate assets of the transaction in accordance with the percentages of shareholding in the corporate structure that will own these assets when the operation is concluded.

Key audit matters

How our audit addressed the key audit matter

As a result of our tests on the calculations and estimates of the amount of credit risk impairment and real estate assets deriving from foreclosures, we have not identified any differences outside a reasonable range in the amounts recorded in the accompanying consolidated annual accounts.

Verification of the recoverability of goodwill

On an annual basis, or when there are indications of impairment, Banco Sabadell Group performs an assessment to determine whether the goodwill recognized in its consolidated annual accounts is impaired.

Each goodwill item is associated with one or more cash generating units (CGU), using the discount method for profits distributed through the various operating plans within each CGU to estimate their recoverable value.

The estimation of the recoverable value of each CGU is inherently uncertain and includes a high level of judgments and estimates given that it is based on assumptions concerning macroeconomics evolution and other matters such as key business assumptions (the evolution of credit, non-performing loans ratio, interest rates, etc...) that determine the cash flows, discount rates and long-term growth rates that are applied. The models are sensitive to the variables and assumptions used, and there is a risk of the inaccurate assessment of those items due to their nature.

See Notes 1 and 16 to the accompanying consolidated annual accounts.

With the assistance of our appraisal experts, we gained an understanding and performed a review of the estimation process carried out by the Group, focusing our procedures on aspects such as:

- Review of the criteria for defining the Group's CGUs associated with the various goodwill items.
- Evaluation of the method used by to estimate the impairment of goodwill.
- Review of the annual measurement reports on the impairment of goodwill prepared by the Group.

We have performed tests to examine the cash flow projection models for the various CGUs utilized by the Group, taking into consideration the content of current legislation, market practices and the specific expectations for the banking sector. This assessment included the verification of assumptions such as growth rates and discount rates used, as well as an analysis of the budgetary monitoring of the primary CGUs and the impact of variations identified in the budgets and growth rates.

Finally, we have also reviewed the adequacy of the information presented in the accompanying consolidated annual accounts.

As a result of the aforementioned procedures, we consider that the estimates made by the Group with respect to the recoverability of goodwill fall within a reasonable range within the context of the circumstances under which these consolidated annual accounts are prepared.

Key audit matters

How our audit addressed the key audit matter

Provisions for tax, legal and regulatory litigations

During the ordinary course of its business operations the Group may become involved in administrative, judicial or arbitration proceedings of a tax, legal and/or regulatory nature.

There are therefore situations that are not subject to judicial proceedings but which, based on the Group's evaluation, require the recognition of provisions like those associated with possible impacts regarding the amounts payable as a result of the cancellation by the Courts of floor clauses or the application of Royal Decree-Law 1/2017 on consumer protection with regard to floor clauses, as well as the client's claims associated to the incidents occurred as a consequence of the TSB Bank PLC technological branch migration's.

These proceedings generally take a long period of time to run their course, giving rise to complex processes dictated by the legislation prevailing in the various jurisdictions in which the Group operates.

The Group records a provision in this respect, therefore estimating the associated payment deemed probable based on the estimates made, applying calculation procedures that are prudent and consistent with the uncertainty conditions inherent to the obligations they cover. Additionally it also considers all disbursements to be made in the process of incident analysis and its remediation, considered unavoidable.

The recognition of provisions for litigation is one of the areas requiring the highest degree of judgments and estimates.

See Notes 1 and 11 where the provisions made by the Group to cover the contingency outcomes related to floor clauses are detailed in the accompanying consolidated annual accounts.

Our review of the process for estimating the provisions for tax, legal and regulatory litigations carried out by the Group, and the analysis and evaluation of the internal controls over that process, consisted of the following procedures:

- We familiarized ourselves with the policy for classifying litigation and provisions needed, in accordance with applicable accountant legislation.
- We analysed the main individual and class-action lawsuits.
- We obtained confirmation letters from internal attorneys who work with the Group to cross-check its assessment of the outcome of the litigation, the correct recognition of the provisions and the identification of potentially omitted liabilities.
- With the support of our internal experts, we monitored ongoing tax inspections, we analysed the estimate of the expected outcomes of the most significant tax proceedings in progress and possible contingencies relating to compliance with the Group's tax obligations for all the years open to inspection.
- We analysed the recognition, estimation of, and movements in, the provisions recorded for accounting purposes.

Specifically in connection with the provisions recorded to cover client claims relating to floor clauses and the ones caused by client's claims associated to the incidents occurred as a consequence of the TSB Bank Plc. Technological branch migration's, our procedures focused on:

- Understanding the control environment, assessing and checking the controls associated with the calculation and review of the provision recognized for customer compensation, including the process of generating and approving the model assumptions and results.
- Evaluating the methodology and hypothesis used by the Group, verifying that it is in line with market practice.
- Performing a sensitivity analysis on the model's results to determine possible changes in key assumptions.

The result of our work shows that, in general, the judgments and estimates applied by the Group when evaluating these types of provisions are supported and reasonable based on available information.

Key audit matters

How our audit addressed the key audit matter

Automation of financial reporting systems

Due to its nature, Banco Sabadell Group's business, particularly the preparation of financial and accounting information, is highly dependent on information technology systems, such that adequate control of these systems is crucial to ensuring correct data processing.

Moreover, as the systems become more complex, the risks relating to the organization's information technology systems and, by extension, the data they process, increase.

The effectiveness of the general internal control framework for information systems relating to the accounting recognition and closing process is essential for the performance of certain audit procedures relating to internal controls.

Considering this context, it is vital to evaluate aspects such as the organization and governance of the Information Technology Area, software maintenance and development controls, physical and logical security and system operation.

With the help of our information technology system experts, our work consisted of reviewing the general internal control environment associated with the information systems and applications that support the Group's accounting recognition and closings. We have also gained an understanding of the functionalities and involvement of the various information systems at the Group within the accounting recognition and closing process.

We essentially performed the following procedures on the information systems considered relevant to the financial reporting process:

- Review of the general computer controls relating to aspects deriving from operations, the development and maintenance of applications, their security and the governance and organization of the Group's Information Systems Area.
- Review of the general controls to manage authorization to access financial reporting systems and controls relating to the authorization of personnel to make changes to computer processes.
- Understanding of key business processes, identifying automatic controls that exist in those processes and their validation.
- Understanding and review of the process for generating manual accounting entries considered to give rise to a risk. Extraction, completeness validation and filtering of the accounting entries.
- Understanding and re-execution of some of the calculations performed by the Group considered to have the highest impact, particularly those relating to the apportionment of financial product interest (loans, credit facilities and deposits) and the fees received.

Regarding TSB Bank Plc., as a result of the incidents identified in the computer systems environment, following TSB's Technological Migration Project, our audit approach for this component has mainly been substantive, based on tests of details, and supposing a significant increase of our audit procedures. At the moment of the technological migration, various procedures were performed to test the completeness and accuracy of relevant data in the financial reporting process, which concluded satisfactorily.

In general terms, the results of our procedures were satisfactory and we did not detect any material aspect affecting the financial information included in the accompanying consolidated annual accounts.

Other information: Consolidated management report

Other information comprises only the consolidated management report for the 2018 financial year, the formulation of which is the responsibility of the Parent company's directors, and does not form an integral part of the consolidated annual accounts.

Our audit opinion on the consolidated annual accounts does not cover the consolidated management report. Our responsibility regarding the information contained in the consolidated management report is defined in the legislation governing the audit practice, which establishes two distinct levels in this regard:

- a) A specific level applicable to the consolidated statement of non-financial information and certain information included in the Annual Corporate Governance Report (ACGR), as defined in article 35.2 b) of Audit Act 22/2015, that consists of verifying solely that the aforementioned information has been provided in the management report or, if appropriate, that the consolidated management report includes the pertinent reference in the manner provided by the legislation and if not, we are required to report that fact.
- b) A general level applicable to the rest of the information included in the consolidated management report that consists of evaluating and reporting on the consistency between that information and the consolidated annual accounts as a result of our knowledge of the Group obtained during the audit of the aforementioned financial statements and does not include information different to that obtained as evidence during our audit, as well as evaluating and reporting on whether the content and presentation of that part of the consolidated management report is in accordance with applicable regulations. If, based on the work we have performed, we conclude that material misstatements exist, we are required to report that fact.

On the basis of the work performed, as described above, we have ascertained that the information mentioned in paragraph a) above has been provided in the consolidated management report and that the rest of the information contained in the consolidated management report is consistent with that contained in the consolidated annual accounts for the 2018 financial year and its content and presentation are in accordance with the applicable regulations.

Responsibility of the directors and the Audit and Control Committee for the consolidated annual accounts

The Parent company's directors are responsible for the preparation of the accompanying consolidated annual accounts, such that they fairly present the consolidated equity, financial position and financial performance of the Group, in accordance with International Financial Reporting Standards as adopted by the European Union and other provisions of the financial reporting framework applicable to the Group in Spain, and for such internal control as the directors determine is necessary to enable the preparation of consolidated annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated annual accounts, the Parent company's directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

The Parent company's Audit and Control Committee is responsible for overseeing the process of preparation and presentation of the consolidated annual accounts.

Auditor's responsibilities for the audit of the consolidated annual accounts

Our objectives are to obtain reasonable assurance about whether the consolidated annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with legislation governing the audit practice in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated annual accounts.

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Parent company's directors.
- Conclude on the appropriateness of the Parent company's directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated annual accounts, including the disclosures, and whether the consolidated annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated annual accounts. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with the Parent company's audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Parent company's audit committee with a statement that we have complied with relevant ethical requirements, including those relating to independence, and we communicate with the audit committee those matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the Parent company's audit committee, we determine those matters that were of most significance in the audit of the consolidated annual accounts of the current period and are therefore the key audit matters.

We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.



Banco de Sabadell, S.A. and Subsidiaries Companies

Report on other legal and regulatory requirements

Report to the Parent company's Audit and Control Committee

The opinion expressed in this report is consistent with the content of our additional report to the Parent company's Audit and Control Committee dated January 28, 2019.

Appointment period

The General Ordinary Shareholders' Meeting held on April 19, 2018 appointed us as auditors of the Group for the year ended December 31, 2018.

Previously, we were appointed by resolution of the General Shareholders' Meeting and we have been auditing the accounts continuously since the year ended December 31, 1983.

Services provided

PricewaterhouseCoopers Auditores, S.L. has provided to Group Banco Sabadell during the period between January 1, and December 31, 2018, after obtaining the relevant approval from the Audit and Control Committee, services other than audit, including the issuance of comfort letters, other regulatory reviews required from the auditor, as well as advisory and regulatory compliance services.

PricewaterhouseCoopers Auditores, S.L. (S0242)

PRICEWATERHOUSECOOPERS AUDITORES, S.L.

Original in Spanish signed by
Raúl Ara Navarro (20210)

February 1, 2019