Creditreform Bank Rating
Banco de Sabadell S.A. (Group)

Creditreform Rating

Rating Object	Rating Information
Banco de Sabadell S.A. (Group) Creditreform ID: 18644 Management: César González-Bueno (CEO)	Long Term Issuer Rating / Outlook: **BBB- / positive** Short Term: **L3** Type: Update / Unsolicited
Rating Date: **13 October 2021** Monitoring until: withdrawal of the rating Rating Methodology: CRA "Bank Ratings v.3.0" CRA "Rating of Bank Capital and Unsecured Debt Instruments v.2.0" CRA "Environmental, Social and Governance Score for Banks v.1.0" CRA "Rating Criteria and Definitions v.1.3" Rating History: www.creditreform-rating.de	Rating of Bank Capital and Unsecured Debt Instruments: Preferred Senior Unsecured: **BB+** Non-Preferred Senior Unsecured: **BB** Tier 2: **B+** Additional Tier 1: **B**

Contents

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Key Rating Drivers

+ Valuable brand with focus on individuals and SME
+ Diversification through activities of TSB
+ Improving asset quality through ongoing reduction of NPLs in recent years
+ New strategic business plan for 2021-2023 fosters digitization and cost cuttings

+/- Digital transformation of the banking business

- Low-interest policy of the ECB puts significant pressure on the bank's major source of income – interest income
- Low capitalization in comparison to other large European banks
- Moderate growth opportunities and relatively high dependency on its home market Spain, which is subject to hard competition
- Historically high level of cost of risk

Executive Summary

Creditreform Rating AG has affirmed the long-term issuer rating of Banco de Sabadell SA (Group) at BBB- but increased the outlook to positive. In particular, the ongoing cost cutting and digitization measures will likely improve the banks intrinsic profitability in the next years, which are the main reason for the positive outlook. By contrast, the Corona pandemic had only a minor impact on Banco Sabadell's business activities in comparison to our previous expectation. The bank's capitalization remains moderate.

Company Overview

Banco de Sabadell S.A. (hereafter: Sabadell or SB) is a banking group whose roots go back to 1881. Sabadell decided in October 2017 to relocate its registered headquarters from Barcelona to Alicante as a result of the independence ambitions of Catalonia; the operational headquarters, however, remained in Catalonia. The bank is recognized as an "other systemically important institution" (O-SII) and must therefore comply with additional regulatory requirements. With 21,846 employees (average as of half-year 2021) and 1,918 branches (thereof 1,588 in Spain), SB serves approximately 12 million customers and had total assets of €250 billion as of half-year 2021.

Sabadell acts as a universal bank (focus on individuals and SME) with activities in the insurance business, and operates primarily in Spain and the United Kingdom. In addition, SB has 12 representative offices worldwide and a noteworthy business in Mexico. SB is divided into the following segments. *Banking Business Spain* includes SB's commercial banking and corporate banking activities as well as the Corporate & Investment Banking. TSB, as part of SB's *International Presence*, covers retail business activities of SB's franchise Trustee Savings Bank plc (TSB) in the United Kingdom. TSB was acquired by Sabadell in 2015 and is the most relevant acquisition in the past years. The acquisition of TSB enabled Sabadell to access the banking market in the United Kingdom as well as to increase its international operations significantly. By contrast, Other International, as other part of *International Presence*, comprises mainly SB's activities in Mexico where SB offers all types of banking and financial services related to corporate banking and commercial banking.

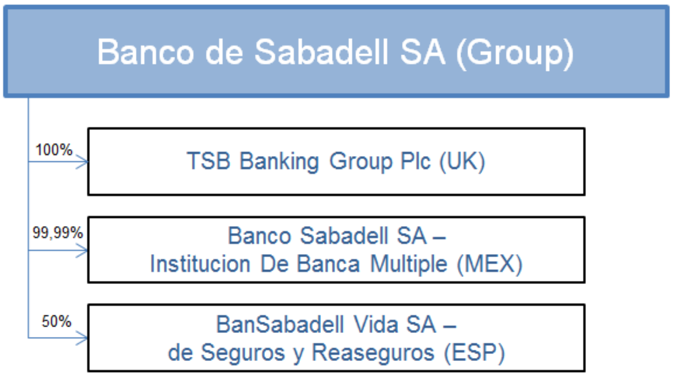
Sabadell introduced its new strategic business plan for 2021-2023, which is based on three main pillars. According to the plan, SB intends to consolidate its position and increase its business volume at Spanish companies. In addition, SB intends to complete the digital transformation of the retail banking service with 100% digital access to its products. Moreover, TSB is determinate to accelerate its mortgage growth, to the detriment of consumer and SME loans. At the end of the plan, the bank expects to maintain a fully loaded CET1 ratio of above 12% and a return on equity of >6%.

Most significant recent changes in the scope of consolidation of the Group are as follows. In June 2020, SB obtained all necessary authorizations to sell 100% of the share capital of Sabadell Asset Management to Amundi Asset Management. This transaction generated a capital gain amounting to €349 million net of taxes.

SB's shareholder structure is ordinary. Most significant shareholders (at year-end 2020) are BlackRock Inc., Fintech Europe S.A.R.L., Lewis A. Sanders and the Norges Bank with about 3% each, while the remaining shares are in free float.

The main subsidiaries and investments of Sabadell can be found in the following chart:

Chart 1: Main subsidiaries and investments of Sabadell | Source: Own presentation based on Annual Report 2020 of Banco de Sabadell

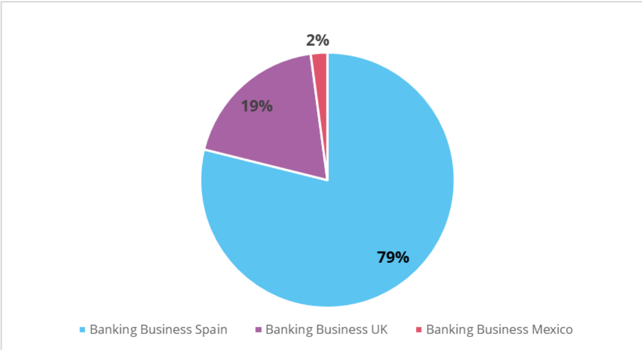


Business Development

Profitability

Sabadell was able to increase its operating income to €5.8 billion in 2020. See Chart 2 for the contribution of each business segment to the Group's operating income.

Chart 2: Operating income by business segment | Source: Own presentation based on Annual Report 2020 by Banco de Sabadell SA (Group)



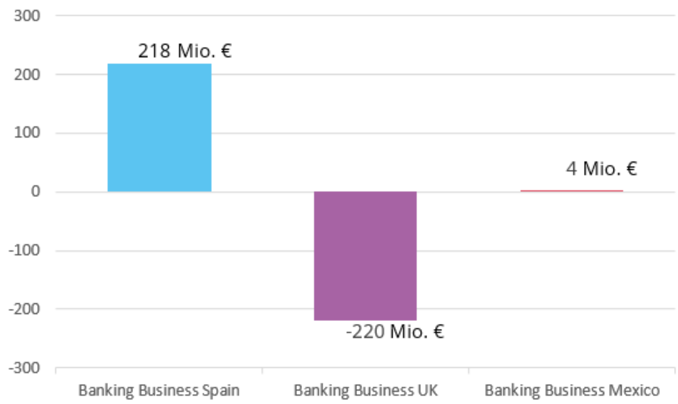
Net interest income represents SB's major source of income, accounting for about 58% of SB's operating income. The decline year-over-year is mainly a result of lower interest rates, a lower contribution from the ALCO portfolio following the divestments made during the year, lower overdraft fees following the measures related to COVID-19, and the reduction in revenues following the securitization of consumer loans in the third quarter of the previous year. In general, SB suffers from the low interest environment, which puts a significant burden on the bank's major source of income. In addition, SB's half-year 2021 report confirms the negative development. SB's net fee and commission income as the second major source of income lowered YOY as well, but are expected to rebound in 2021 already. The drawdown in 2020 is mainly related to lower customer activities due to the Corona pandemic (such as lower payment fees), which are likely to accelerate in 2021 already as indicated by the bank's semi-annual report 2021. Net trading income increased significantly YOY, which is however related to one-off effects. SB boosted its result by the sale of certain debt securities in order to manage the increase in credit risk and to preserve the Group's solvency as part of a series of actions taken to improve the future profitability and quality of its balance sheet in response to the Corona pandemic impact. Thus, a rebound to the previous lower net trading income level is expected in 2021. In addition, SB recorded foreign exchange losses, which were counteracted by fair value gains of its derivatives used to hedge against the foreign exchange risk.

Operating expenses amounted to €3.9 billion in 2020, increasing only slightly YOY. The banks expense in relation to the voluntary redundancy, early retirement and incentive packages of €345m to reduce the bank's workforce were regrouped to the non-recurring item in contrast to the banks income statement to point out the banks intrinsic profitability. Over the last years, SB reduced its workforce significantly from 26,181 (year-end 2018) to 21,095 (half-year end 2021) and the number of branches from 2,457 (year-end 2018) to 1,918 (half-year 2021). SB will benefit from these cost reduction measures in the long-run by an improved intrinsic profitability, which is already indicated by the bank's half-year 2021 report. SB's other provisions increased YOY following pending legal issues and tax litigations, commitments and guarantees given in addition to provisions to cover the anticipated costs relating to reduction of the banks workforce. Other expense items remained widely ordinary and stable.

In 2020, SB recorded relatively high impairments on its customer loans (€1,745mn). With cost of risk of about 117bp, SB is clearly at the higher end in comparison to other large banks in Europe. In addition, SB recorded already relatively high cost of risk before the Corona pandemic impact, which clearly burdens the bank's profitability. Moreover, in the first half-year 2021, SB recorded impairments on customer loans of about €503.9 million, which is considerably lower YOY due to the extraordinary provisions associated with the Corona pandemic in 2020. However, SB is still at a high level with its customer loans impairments while other large European banks record even reversal of impairments. In addition, SB was only able to report a positive net result in 2020 due to non-recurring income (sale of Sabadell Asset Management) and tax refunds.

Chart 3 shows the net profit of each business segment of SB, which indicates the burden of TSB on the Group.

Chart 3: Profit before tax by business segment | Source: Own presentation basen on Annual Report 2020 by Banco de Sabadell SA (Group)



A detailed group income statement for the years of 2017 through 2020 can be found in Figure 1 below:

Figure 1: Group income statement | Source: eValueRate / CRA

Income Statement (EUR k)	2020	%	2019	2018	2017
Income					
Net Interest Income	3.399.116	-6,2	3.622.396	3.675.184	3.802.370
Net Fee & Commission Income	1.350.328	-6,1	1.438.741	1.335.301	1.223.436
Net Insurance Income	-	-	-	-	-19.047
Net Trading Income	799.640	> +100	126.256	225.391	622.533
Equity Accounted Results	35.926	-36,3	56.427	56.554	308.686
Dividends from Equity Instruments	1.018	-77,5	4.516	8.180	7.252
Other Income	234.711	-16,8	281.993	293.653	338.365
Operating Income	**5.820.739**	**+5,3**	**5.530.329**	**5.594.263**	**6.283.595**
Expense					
Depreciation and Amortisation	563.648	+1,4	555.892	753.743	1.013.954
Personnel Expense	1.539.426	-6,6	1.648.836	1.590.590	1.573.560
Tech & Communications Expense	443.897	+2,8	431.645	518.201	438.059
Marketing and Promotion Expense	87.783	-11,6	99.333	114.162	106.706
Other Provisions	275.408	> +100	26.595	160.706	13.864
Other Expense	1.043.329	-6,9	1.120.863	1.246.860	1.150.970
Operating Expense	**3.953.491**	**+1,8**	**3.883.164**	**4.384.262**	**4.297.113**
Operating Profit & Impairment					
Pre-impairment Operating Profit	**1.867.248**	**+13,4**	**1.647.165**	**1.210.001**	**1.986.482**
Asset Writedowns	1.973.684	> +100	829.633	828.234	1.211.373
Net Income					
Non-Recurring Income	354.372	> +100	133.586	49.645	0
Non-Recurring Expense	368.765	> +100	41	12.547	-73.144
Pre-tax Profit	**-120.829**	**< -100**	**951.077**	**418.865**	**848.253**
Income Tax Expense	-123.839	< -100	174.199	83.635	43.075
Discontinued Operations	-	-	-	-	-
Net Profit	**3.010**	**-99,6**	**776.878**	**335.230**	**805.178**
Attributable to minority interest (non-controlling interest)	1.008	-88,9	9.056	7.128	3.712
Attributable to owners of the parent	2.002	-99,7	767.822	328.102	801.466

Due to Sabadell's strong diminished net profit in 2020, its earnings figures worsened significantly in comparison to the previous year. As a result, SB's values of ROA, ROE and RORWA before and after taxes are now close to zero respectively negative and thus clearly at a low level. However, the bank's intrinsic profitability, represented by the banks cost to income ratios, improved following the lower personnel expense (leaving out the one-off expense in relation to the leaving incentive programs). SB will likely benefit from its cost cutting measures with a further improvement of its intrinsic profitability in the long-run, which, however, will reach only an average level. By contrast, SB's net interest margin decreased slightly over the previous year and is now just on an average level.

Moreover, SB's profitability is burdened by the bank's relatively high cost of risk, which even increased following the Corona pandemic impact in 2020. However, since the Corona pandemic impact did not materialize as expected an improvement already in 2021 is likely. Overall, SB's profitability figures are the least favorable performers of all areas analyzed. Having said this, we expect an improvement following the bank's cost cutting measures already in 2021.

A detailed overview of the income ratios for the years of 2017 through 2020 can be found in Figure 2 below:

Figure 2: Group key earnings figures| Source: eValueRate / CRA

Income Ratios (%)	2020	%	2019	2018	2017
Cost Income Ratio (CIR)	67,92	-2,30	70,22	78,37	68,39
Cost Income Ratio ex. Trading (CIRex)	78,74	+6,88	71,86	81,66	75,91
Return on Assets (ROA)	0,00	-0,35	0,35	0,15	0,36
Return on Equity (ROE)	0,02	-5,96	5,99	2,77	6,09
Return on Assets before Taxes (ROAbT)	-0,05	-0,48	0,43	0,19	0,38
Return on Equity before Taxes (ROEbT)	-0,97	-8,30	7,33	3,46	6,42
Return on Risk-Weighted Assets (RORWA)	0,00	-0,95	0,96	0,42	1,04
Return on Risk-Weighted Assets before Taxes (RORWAbT)	-0,15	-1,32	1,17	0,52	1,09
Net Interest Margin (NIM)	1,49	-0,13	1,62	1,69	1,77
Pre-Impairment Operating Profit / Assets	0,79	+0,06	0,74	0,54	0,90
Cost of Funds (COF)	0,42	-0,23	0,65	0,57	0,50
Change in %- Points					

Asset Situation and Asset Quality

Net loans to customers represent Sabadell most significant asset with about 63% of the bank's total assets. The increase is mainly attributable to the growth of the banks item of other term loans (€6.4 billion) while SB recorded a decline in overdrafts and commercial loans. Overall, 58% of SB's customer loans are secured loans with a lower risk profile. Moreover, 32% of SB's loans are denominated in foreign currencies (primarily British pound sterling), and only 7% are loans to the general government sector. As of June 2021, SB was able to increase its lending business (€154.8bn), primarily by increased secured lending. Moreover, SB's stage 3 exposure increased to €5.5bn in June 2021 from €5.3bn at year-end 2020. Total securities, as the banks other significant working asset, decreased YOY by about €2.5bn. The decrease is a result of SB's intention to decrease its credit risk as well as to preserve the Group's solvency and improve future profitability and the quality of its balance sheet, which resulted in a sale of Italian, Spanish and Portuguese debt instruments. SB holds primarily general government's debt securities (88% of total securities) with little risk. Moreover, SB's holdings of debt securities are mostly denominated in Euro with 83%, which reduces foreign exchange risk. Most of SB's debt securities are related to Spain as sovereign issuer, which shows a close connection to the home market. The most significant non-Spanish government debt securities are related to the Italian government with about €2.8 billion. Moreover, in 2020, Sabadell increased its cash balances at central banks significantly; following the participation at the ECB TLTRO III funding program with about €27 billion. In addition, until June 2021 SB increased its TLTRO III funding to about €32bn. As a result, we expect SB to increase its lending activities in the short run and benefit from the very favorable conditions if conditions are met. However, the relatively high cash positions indicate a lack of investment opportunities.

As of June 2021, SB has granted over €8.9 billion of government guaranteed loans under the guarantee facility of Instituto Credito Oficial (ICO) in Spain, whereby guarantees are provided for 60%-80% of the loans. Thus, SB bears despite the ICO guarantee a part of the risk. SB's loans under moratorium/ payment holidays decreased to an insignificant amount.

A detailed look at the development of the asset side of the balance sheet for the years of 2017 through 2020 can be taken in Figure 3 below:

Figure 3: Development of assets | Source: eValueRate / CRA

Assets (EUR k)	2020	%	2019	2018	2017
Cash and Balances with Central Banks	35.319.407	> +100	15.282.125	23.592.633	26.425.958
Net Loans to Banks	1.654.961	-33,0	2.470.321	2.831.414	2.350.044
Net Loans to Customers	149.119.982	+1,0	147.579.752	142.390.905	141.596.529
Total Securities	25.196.429	-9,3	27.792.423	26.844.884	25.098.648
Total Derivative Assets	3.372.994	+31,8	2.558.313	2.079.221	1.863.053
Other Financial Assets	5.487.621	-54,4	12.040.929	5.963.266	4.967.397
Financial Assets	**220.151.394**	**+6,0**	**207.723.863**	**203.702.323**	**202.301.629**
Equity Accounted Investments	779.859	+6,3	733.930	574.940	575.644
Other Investments	348.092	-32,4	514.629	701.021	1.964.793
Insurance Assets	133.757	-0,2	133.960	132.299	139.114
Non-current Assets & Discontinued Ops	975.540	+27,7	764.203	4.586.923	2.561.744
Tangible and Intangible Assets	5.448.370	-1,2	5.512.753	5.192.681	6.183.882
Tax Assets	7.151.681	+2,0	7.008.327	6.859.405	6.861.406
Total Other Assets	774.599	-43,1	1.361.976	572.829	760.103
Total Assets	**235.763.292**	**+5,4**	**223.753.641**	**222.322.421**	**221.348.315**

SB was able to improve its NPL ratio (stage 3 loans) over the last years significantly to a half-year 2021 ratio of about 3.6%. Thus, SB was able to catch up to its competitors and reached a satisfying level. The business segment Banking Business Spain reports the worst NPL ratio with 4.3% of the bank's three segments (as of June 2021). SB's NPL / RWA ratio of 6.75% - despite the improvements YOY - remains significantly less favorable in comparison to other large European banks. While Sabadell almost overcome the legacy issues from their non-performing loan portfolio since the dramatic increase in 2012, the Corona pandemic might lead to a relapse. Nevertheless, we acknowledge SB's continuous reductions of its NPL stock since 2013. As of June 2021, the Corona pandemic lead to an increase of the banks potential problem loans (stage 2 loans), which are now at a below average level with about €12.1bn stage 2 exposure. Considering the reserves / NPL ratio, SB records an increasing ratio, which reached a satisfying level and indicates a more prudent approach. In addition, the Group's RWA ratio reached and satisfying level as well with about 32% as of half-year 2021. SB's net write-offs / risk-adjusted assets ratio as well as the banks net write-offs to net loans ratio remain at an unsatisfactory high level throughout the last years and even worsened due to the Corona pandemic in 2020.

In general, we expect decreasing asset quality figures in the upcoming period due to the run out of public guarantees as well as the end of moratorium measures.

A detailed overview of the asset quality for the years of 2017 through 2020 can be found in Figure 4 below:

Figure 4: Development of asset quality | Source: eValueRate / CRA

Asset Ratios (%)	2020	%	2019	2018	2017
Net Loans/ Assets	63,25	-2,71	65,96	64,05	63,97
Risk-weighted Assets/ Assets	33,42	-2,90	36,32	36,07	35,01
NPLs*/ Net Loans to Customers	3,60	-0,23	3,83	4,22	5,14
NPLs*/ Risk-weighted Assets	6,75	-0,54	7,29	8,07	10,15
Potential Problem Loans**/ Net Loans to Customers	7,56	+2,20	5,37	6,22	0,00
Reserves/ NPLs*	57,92	+8,39	49,53	53,05	47,37
Reserves/ Net Loans	2,07	+0,08	1,99	2,41	2,63
Net Write-offs/ Net Loans	1,32	+0,76	0,56	0,58	0,86
Net Write-offs/ Risk-weighted Assets	2,51	+1,48	1,02	1,03	1,56
Net Write-offs/ Total Assets	0,84	+0,47	0,37	0,37	0,55
Level 3 Assets/ Total Assets	0,07	-0,03	0,10	0,06	0,08
Change in %Points					

* NPLs are represented from 2017 onwards by Stage 3 Loans.
** Potential Problem Loans are Stage 2 Loans where available.

Refinancing, Capital Quality and Liquidity

Total deposits from customers represent the major funding source of SB with 68% of total liabilities, increasing by 3.3% YOY due to an inflow of demand deposits, which represent about 88% of the Group's total customer deposits. The customer deposits inflow accelerated as of June 2021 to about €158bn, however; this development is in line with other large European banks. In addition, €45.1 billion of SB's deposits are in foreign currency, primarily the British pound sterling and attributable to TSB. In general, customer deposits as major funding source face a risk of quick withdrawals in times of financial distress at the bank. Total debt, accounting for only 9% of SB's liabilities, show a stable development over the last years. The bank's debts securities are well diversified and consist primarily of covered bonds (€8 billion) and plain-vanilla bonds (€6.7 billion). Total deposits from banks represents primarily the bank's deposits at central banks, which increased significantly following the aforementioned participation at the ECB TLTRO III program. However, as of June 2021, these participation lead only to significantly increased cash holdings.

The Group's total equity decreased significantly due to foreign exchange losses of equity instruments (other comprehensive income) mostly related to Sabadell's TSB subsidiary.

A detailed overview of the development of liabilities for the years of 2017 through 2020 can be found in Figure 5 below:

Figure 5: Development of refinancing and capital adequacy| Source: eValueRate / CRA

Liabilities (EUR k)	2020	%	2019	2018	2017
Total Deposits from Banks	35.174.739	+47,0	23.928.591	33.198.223	32.427.348
Total Deposits from Customers	151.256.688	+3,3	146.411.095	136.545.974	130.557.802
Total Debt	20.413.398	-9,6	22.569.896	22.598.653	23.787.844
Derivative Liabilities	3.592.218	+28,0	2.805.859	2.360.374	2.360.622
Securities Sold, not yet Purchased	-	-	-	-	-
Other Financial Liabilities	9.716.709	-22,2	12.494.414	13.782.131	17.381.882
Total Financial Liabilities	**220.153.752**	**+5,7**	**208.209.855**	**208.485.355**	**206.515.498**
Insurance Liabilities	-	-	-	-	-
Non-current Liabilities & Discontinued Ops	-	-	10.155	82.605	20.645
Tax Liabilities	206.206	-14,4	240.803	176.013	531.938
Provisions	983.512	> +100	430.434	466.379	317.538
Total Other Liabilities	1.928.184	+2,1	1.887.988	995.069	740.915
Total Liabilities	**223.271.654**	**+5,9**	**210.779.235**	**210.205.421**	**208.126.534**
Total Equity	**12.491.638**	**-3,7**	**12.974.406**	**12.117.000**	**13.221.781**
Total Liabilities and Equity	**235.763.292**	**+5,4**	**223.753.641**	**222.322.421**	**221.348.315**

Sabadell slightly increased its CET1 ratio (only fully loaded figures are considered in this unless other mentioned) primarily through the reduction of its risk-weighted assets YOY. The CET1 ratio of about 12% is substandard and clearly at the lower end in comparison to other large European banks. Nonetheless, SB shows sufficient buffer to and meets the regulatory SREP requirement of about 8.52% for the year 2021 with regard to its CET ratio clearly. Following the growth of its CET1 ratio SB reported an appropriate growth of its AT1 ratio as well. The Tier 2 Capital ratio improved YOY due to an additional issue of Tier 2 capital with a volume of about €300mn. Nevertheless, all of SB's regulatory capital ratios are at relatively low level. With regard to the bank's Tier 2 capital, SB issued two additional instruments (thereof one at TSB) at the beginning of the year 2021 and improved thereby its Total Capital ratio to 16.9% (phased-in), which is nevertheless at a below average level.

The leverage ratio of SB increased due to lower leverage exposure and reached an comparable level with other large banks. In addition, SB reports additional increase in this regard as of June 2021 to about 5.4%, mainly due to exchange rate effects. The total equity / total assets ratio dropped due to the aforementioned foreign exchange effects mainly at TSB. In addition, Sabadell's TLTRO III participation extended its total assets, which has a negative impact on the total equity / total assets ratio. However, this is rather a technical issue than a potential risk and does not indicate a material deterioration of the capitalization.

Overall, SB's credit rating would benefit from a stronger capitalization, which would increase the bank's absorption capacity in times of financial distress.

Sabadell has not published any exact figures for its Net Stable Funding Ratio, however, this ratio is only binding starting 2021. The Group's LCR of 198% exceeds the regulatory requirement comfortably and shows the banks excess liquidity.

The customer deposits to total funding ratio shows the Group's stable and favorable source of funding - the deposits of its customers. However, considering the negative interest rate for deposits at the ECB, Sabadell has to be aware of excess liquidity (in particular after the recent TLTRO III participation). In addition, the decline of the Group's LTD ratio in recent years shows a declining demand for the Group's loans.

Overall, Sabadell's liquidity situation is satisfactory. Up to now, we do not perceive any liquidity issues at Sabadell and the whole banking sector.

A detailed overview of the development of capital and liquidity ratios for the years of 2017 through 2020 can be found in Figure 6 below:

Figure 6: Development of capital and liquidity ratios | Source: eValueRate / CRA

Capital Ratios and Liquidity (%)	2020	%	2019	2018	2017
Total Equity/ Total Assets	5,30	-0,50	5,80	5,45	5,97
Leverage Ratio	5,23	+0,22	5,01	4,86	4,97
Common Equity Tier 1 Ratio (CET1)*	12,02	+0,29	11,73	11,11	12,79
Tier 1 Ratio (CET1 + AT1)*	13,49	+0,34	13,15	12,55	14,27
Total Capital Ratio (CET1 + AT1 + T2)*	15,90	+0,90	15,00	14,13	16,02
SREP Capital Requirements	9,50	-0,14	9,64	8,31	8,31
Net Loans/ Deposits (LTD)	98,59	-2,21	100,80	104,28	108,46
Interbank Ratio	4,70	-5,62	10,32	8,53	7,25
Liquidity Coverage Ratio	198,00	+26,00	172,00	168,00	168,00
Customer Deposits / Total Funding (excl. Derivates)	68,85	-1,55	70,40	65,70	63,45
Change in %Points					

*Fully loaded figures wherever available.

Due to Sabadell's bank capital and debt structure and in particular the low CET1 capital the Group's Preferred Senior Unsecured Debt instruments have been notched down by one notch in comparison to the long-term issuer rating. Due to the seniority structure, Sabadell's non-preferred senior unsecured debt has been notched down by two notches. However, SB's Tier 2 capital rating is rated four notches below the long-term issuer rating based on the bank's capital structure and seniority in accordance with our rating methodology. Additional Tier 1 capital is rated five notches below the long-term issuer rating, reflecting a high bail-in risk in the event of resolution.

Environmental, Social and Governance (ESG) Score Card

Banco de Sabadell (Group) has one significant and two moderate ESG rating driver

• Corporate Governance is identified as a highly significant rating driver. The relevance for the credit rating results from the impact of the Corporate Governance factor on all other ESG factors and the overall well-being of the bank. This sub-factor is upnotched to neutral due to the bank's implementation of its Sustainable Bond Framework, the overcome of the issues in relation with the IT migration of TSB as well due to the bank's increased ambitions with regard to the ESG development.

• Corporate Behaviour and Green Financing / Promoting are identified as moderate rating driver. While Green Financing / Promoting was upnotched to neutral due to relatively low but increasing amount of green bonds since the start of issuance in 2020, Corporate Behaviour is rated positive due its business activities in accordance with the ideas and beliefs of the society.

ESG Score
3,6 / 5

ESG Score Guidance	
> 4,25	Outstanding
>3,5 - 4,25	Above-average
>2,5 - 3,5	Average
>1,75 - 2,5	Substandard
< = 1,75	Poor

Factor	Sub-Factor	Consideration	Relevance Scale 2021	Eval.
Environmental	1.1 Green Financing / Promoting	The sub-factor "Green Financing/Promoting" has a moderate relevance for the credit rating, and is rated neutral in terms of the CRA ESG criteria.	3	( )
	1.2 Exposure to Environ-mental Factors	The sub-factor "Exposure to Environmental Factors" has a low relevance for the credit rating, and is rated positive in terms of the CRA ESG criteria.	2	(+)
	1.3 Resource Efficiency	The sub-factor "Resource Efficiency" has no significant relevance for the credit rating, and is rated positive in terms of the CRA ESG criteria.	1	(+)
Social	2.1 Human Capital	The sub-factor "Human Capital" has low relevance for the credit rating, and is rated positive in terms of the CRA ESG criteria.	2	(+)
	2.2 Social Responsibility	The sub-factor "Social Responsibility" has no significant relevance for the credit rating, and is rated neutral in terms of the CRA ESG criteria.	1	( )
Governance	3.1 Corporate Governance	The sub-factor "Corporate Governance" is highly relevant for the credit rating, and is rated neutral in terms of the CRA ESG criteria.	4	( )
	3.2 Corporate Behaviour	The sub-factor "Corporate Behaviour" has a moderate relevance for the credit rating, and is rated positive in terms of the CRA ESG criteria.	3	(+)
	3.3 Corporate Transparency	The sub-factor "Corporate Transparency" has no significant relevance for the credit rating, and is rated very positive in terms of the CRA ESG criteria.	1	(+ +)

ESG Relevance Scale	
5	Highest Relevance
4	High Relevance
3	Moderate Relevance
2	Low Relevance
1	No significant Relevance

ESG Evaluation Guidance	
(+ +)	Strong positive
(+)	Positive
( )	Neutral
(-)	Negative
(- -)	Strong negativ

The ESG Score is based on the Methodology "Environmental, Social and Governance Score of Banken (Version 1.0)" of Creditreform Rating AG, which is available on our homepage https://creditreform-rating.de/en/about-us/regulatory-requirements.html. In addition, we refer to CRA's position paper "Consodering the Impact of ESG Factors".

Conclusion

Overall, Banco de Sabadell S.A. (Group) reported a substandard year of performance in 2020, but initiated various cost cutting and digitization measures, which will likely improve the banks performance in the upcoming years. Due to this fact, we affirmed the long-term issuer rating at BBB- but increased the outlook to positive. In addition, SB benefits from its strong franchise in Spain.

In 2020, SB was just able to reach a positive net result because the one-off gain due to the sale of Sabadell Asset Management. The low interest rate environment puts significant pressure on the banks main source of income – interest income. The Corona pandemic did not materialize as expected but still had a significant impact on SB's business activities and has led to a rise of the bank's cost of risk from an already above average level of 45bp to about 117bp in 2020. However, in contrast to other large European banks, SB does not record significant reversal of its impairments already as of June 2021. In addition, following the bank's cost cutting measures, the bank recorded additional expense (incentive leaving packages) for its restructuring undertaking. Additionally to its digitization efforts, SB will therefor likely improve its level of profitability from the year 2021 already on. However, significant risk might arise once all fiscal stimulus measures and guarantees run out.

The asset quality of SB improved over the last years to a moderate level. As of now, the Corona pandemic has led to increased stage 2 exposure (potential problem loans) and higher loan impairments. However, with the run out of public guarantees and support measures, the Corona pandemic might have a negative impact on the banks asset quality over the next years.

On the liabilities side, SB reported increasing customer deposits and increasing cash and balances with central banks, which is in line with the development of other large European banks. The participation in ECB's TLTRO III funding program, enables SB to reduce its costs of funding if conditions are met. SB's capital ratios are constantly below the average of its competitors and SB does not intends an improvement in this regard according to its targets. However, a stronger capitalization would suit the bank well to improve its absorption capacity in times of financial distress.

Outlook

We raised the outlook of Banco Sabadell (Group) long-term issuer rating from stable to positive. This reflects our view that the bank is likely to overcome the current adverse impact by the Corona pandemic and achieve a higher level of profitability. In particular, the ongoing digitalization efforts in addition to already started restructuring measures (reduction of workforce and branches) will likely lead to a higher intrinsic profitability. However, we will observe how the bank will deal with the Corona pandemic effects on the economy, as the final impact is still uncertain. In addition, we assume no significant economic worsening due to the Corona pandemic and stable political environment in the banks markets of operations.

Scenario Analysis

Best-case scenario: BBB+

Worst-case scenario: BB

Please note:

The scenarios are based on information available at the time of the rating. Within the forecast horizon, circumstances may occur that could lead to a change of the rating out of the indicated range.

In a scenario analysis, the bank is able to reach an “BBB+“ rating in the “best case” scenario and an “BB” rating in the "worst case" scenario. The ratings of bank capital and senior unsecured debt would behave similarly based on our rating mechanism. These ratings are especially sensitive to changes in total equity and to the bank capital and debt structure in general.

We might upgrade Sabadell’s long-term issuer credit rating and its bank capital and debt instruments if we see that Sabadell is able to increase its level of profitability. In addition, improvements in SB’s asset capitalization might lead to an upgrade as well.

By contrast, a downgrade of the Group`s long-term issuer credit rating and its bank capital and debt instruments is likely if we see a lasting decline of SB’s profitability and / or a reduction of the banks’ capital ratios. In particular, we will observe the Corona pandemic impact on SB’s asset quality and its business activities in general.

Appendix

Bank ratings

The bank ratings are dependent on a host of quantitative and qualitative factors. An improvement in either sub-category may result in a higher rating score.

LT Issuer / Outlook / Short-Term **BBB- / positive / L3**

Bank Capital and Debt Instruments Ratings

The ratings for bank capital and debt instruments are inter alia dependent on subordination and relative size of the instrument class, based on the long-term issuer rating of the bank.

Preferred Senior Unsecured Debt (PSU): **BB+**
Non-Preferred Senior Unsecured Debt (NPS): **BB**
Tier 2 (T2): **B+**
Additional Tier 1 (AT1): **B**

Rating History

Please consult our website www.creditreform-rating.de for additional information regarding the dates of publication.

Figure 7: Rating History

Bank Issuer Rating	Rating Date	Result
Initialrating	23.05.2018	BBB / stable / L3
Rating Update	08.07.2019	BBB / stable / L3
Monitoring	24.03.2020	BBB / NEW / L3
Rating Update	01.10.2020	BBB- / stable / L3
Rating Update	13.10.2021	BBB- / positive / L3
Bank Capital and Debt Instruments	**Rating Date**	**Result**
Senior Unsecured / T2 / AT1 (Initial)	23.05.2018	BBB- / BB- / B+
PSU / NPS / T2 / AT1	08.07.2019	BBB- / BB+ / BB- / B+
PSU / NPS / T2 / AT1 (NEW)	24.03.2020	BBB- / BB+ / BB- / B+
PSU / NPS / T2 / AT1	01.10.2020	BB+ / BB / B+ / B
PSU / NPS / T2 / AT1	13.10.2021	BB+ / BB / B+ / B

Regulatory

Creditreform Rating AG was neither commissioned by the rating object nor by any other third party for the rating. The analysis took place on a voluntary basis by Creditreform Rating AG and is to be described in the regulatory sense as an unsolicited rating. The following scheme clarifies the level of participation of the rated entity (rating object):

Unsolicited Credit Rating	
With Rated Entity or Related Third Party Participation	Yes
With Access to Internal Documents	No
With Access to Management	No

The rating is based on publicly available information and internal evaluation methods for the rated bank. The quantitative analysis is based mainly on the latest annual accounts, interim reports, other investor relations information of the bank, and calculated key figures by eValueRate / CRA.

The information and documents processed met the requirements of the rating system of Creditreform Rating AG as published on the website www.creditreform-rating.de. The rating was carried out on the basis of the rating methodology for bank ratings as (v3.0), the methodology for the rating of bank capital and unsecured debt instruments (v2.0) as well as the rating methodology for Environmental, Social and Governance Score for Banks (v1.0) in conjunction with Creditreform's basic document Rating Criteria and Definitions (v1.3).

The complete presentation of the rating methodologies used by Creditreform Rating AG and the basic document Rating Criteria and Definitions (v1.3) are published on our homepage:

https://www.creditreform-rating.de/en/about-us/regulatory-requirements.html

On 13 October 2021, the rating was presented by the analysts to the rating committee and adopted in a resolution.

The rating result was communicated to Banco de Sabadell S.A. (Group), and the preliminary rating report was made available to the bank. There was no change in the rating score.

The rating is valid until withdrawal and is subject to monitoring from the rating date (see cover page). The rating will be comprehensively reviewed at least once every year. Within this period, the rating can be updated.

In 2011 Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG (CRA) is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

Rating Endorsement Status: The rating of Banco de Sabadell S.A. (Group) was not endorsed by Creditreform Rating AG from a third country as defined in Article 4 (3) of the CRA-Regulation.

Conflict of Interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks.

In case of providing ancillary services to the rated entity, CRA will disclose all ancillary services in the credit rating report.

Rules on the Presentation of Credit Ratings and Rating Outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our policy "Rating Committee," all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, CRA has used following substantially material sources:

1. Aggregated data base by eValueRate

2. Annual Report and interim reports

3. Investors relations information and other publications

4. Website of the rated bank

5. Public and internal market analyses

6. Internet research

There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRA website. Furthermore CRA considers satisfactory the quality and extent of information available on the rated entity. In regard to the rated entity Creditreform Rating AG regarded available historical data as sufficient.

Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

The "Basic data" information card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In case where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating and indicates how the different methodologies or these other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions, such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings as well as best-case scenario credit ratings are explained in mentioned methodologies and / or in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the "Basic data" card as a "Rating action"; first release is indicated as "initial rating", other updates are indicated as an "update", "upgrade or downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within „Basic data" information card.

In accordance to Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of Creditreform's default rates are available in the credit rating methodologies disclosed on the website.

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