

Rating Object	Rating Information			
Banco de Sabadell S.A. (Group) Creditreform ID: 18644 Incorporation: 1881 (Main-) Industry: Banks Management: Jaime Guardiola Romojaro (CEO) Josep Oliu Creus (Chairman) José Luis Negro Rodríguez (Director-General Manager)	Long Term Issuer Rating / Outlook:	Short Term:	Type:	
	BBB- / stable	L3	Update unsolicited	
	Rating of Bank Capital and Unsecured Debt Instruments:			
	Preferred Senior Unsecured:	Non-Preferred Senior Unsecured:	Tier 2:	Additional Tier 1:
	BB+	BB	B+	B
	Rating Date:	01 October 2020		
	Monitoring until:	withdrawal of the rating		
	Rating Methodology:	CRA "Bank Ratings v.2.0" 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" www.creditreform-rating.de		
	Rating History:			

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Key Rating Driver

Strengths

- + Valuable brand with focus on individuals and SME
- + Sound cost to income ratios

Weaknesses

- Low capitalization in comparison to the peer group
- Relatively high stock of NPLs
- Moderate growth opportunities and relatively high dependency on in its core market Spain

Opportunities / Threats

- + Improving asset quality through ongoing reduction of NPLs in recent years
- + Diversification through activities of TSB
- +/- Digital transformation of the banking business
- Impact of the Corona pandemic with Spain being heavy affected and suffering a strong economic downturn
- High exposure affected to moratorium measures
- High dependency on the home market
- Low-interest policy of the ECB puts pressure on profitability

Company Overview

Banco de Sabadell S.A. (hereafter: Sabadell or BS) 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 24,334 employees (average as of half-year 2020) and 2,271 branches (thereof 1,728 in Spain) SB serves approximately 12 million customers and had total assets of €234 billion as of half-year 2020.

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 13 representative offices worldwide and a noteworthy business in America, in particular in Mexico. SB is divided into three business segments. *Banking Business Spain* includes SB’s commercial banking and corporate banking activities as well as its activities related to the asset transformation of its non-performing and real estate exposure. By contrast, *Banking Business Mexico*, comprises SB’s activities in Mexico which offers all types of banking and financial services related to corporate banking and commercial banking. *Banking Business UK* 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.

Sabadell is currently pursuing its business plan 2018-2020. According to the plan SB will focus on growing business in its priority markets Spain, United Kingdom and Mexico, and will further strengthen its commercial and digital capabilities, allowing the bank to continue working towards its main priorities: the improvement of profitability and the reduction of non-performing assets. In the United Kingdom, a new strategic plan for 2022 was launched, which aims to improve business efficiency while increasing volumes and revenues organically, in mortgages and consumer loans to individuals, in order to enhance profitability. The strategy for SB’s Mexican business is focused on continuing to strengthen the Business and Corporate Banking segment, focusing on customers and on products that enable SB to maximize profitability while developing a model of banking for individuals based on an innovative all-digital approach.

SB’s shareholder structure is ordinary. The majority of Sabadell’s shares are free floating and the most significant shareholders are BlackRock Inc. with 5.1% and Fintech Europe S.A.R.L. with 3.5% at year-end 2019.

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 2019 of Sabadell

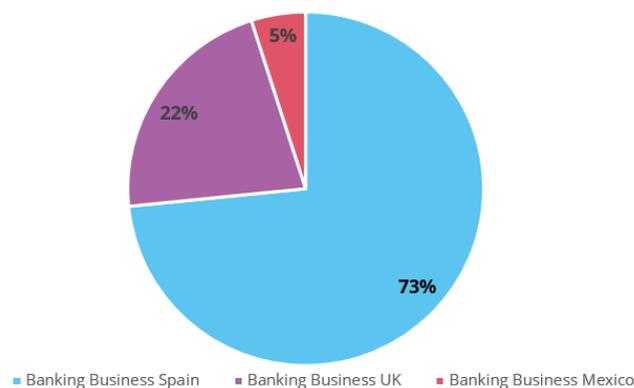


Business Development

Profitability

Sabadell's operating income amounted to €5.5 billion in 2019, remaining almost unchanged in a year-over-year comparison (€-64 million). 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 2019 by Banco de Sabadell SA (Group)



Net interest income contributed 65.5% to SB's operating income, remaining also roughly constant compared to the previous year (-€52 million). This development is primarily due to increased interest expense of the banks customer deposits, which could not be offset by increased interest income. In general, we perceive that SB struggles to increase its interest income over the previous years. Net fee and commission income as the second major source of income accounted for 26% of operating income, increasing by 7.7% (€103 million) YOY due to the positive performance of service fees for the use of payment cards. Net trading income contributed only €126 million to SB's operating income and dropped by about €100 million YOY on one hand due to lower gains from the sale of debt securities (€-110 million YOY) and on the other hand due to fair value losses of banks derivatives in relation with foreign exchange risk hedges (€-147million YOY). Both adverse effects could not be offset by a positive development of the banks other trading items.

Operating expenses amounted to €3.9 billion in 2019, decreasing significantly by 11% in a year-over-year comparison (€501 million). While SB's Personnel expenses, accounting for 42.5% of total expenses in 2019, remained almost unchanged in a year-over-year comparison (€58 million), SB achieved a strong reduction of its depreciation and amortization expense by about €198 million due to lower impairments on its inventories next to lower IT expense (€-104 million) and lower provisions (€-134 million).

The general increase in the previous years of the banks operating expense is due to the integration of the TSB Bank and the reduction of its work force. However, after the

completion of the integration and reduction of its staff, we expect a further decline of the operating expense.

SB's pre-impairment operating profit amounted to €1.65 billion in the fiscal year 2019, which shows a strong increase year-over-year and a sound profitability in general. However, relatively high impairments (€829 million), mostly on customer loans, decrease the profitability of SB significantly. Nevertheless, the net profit of about €776.8 million in 2019 shows a strong improvement.

Chart 3 shows the profit before taxes of each business segment of SB.

Chart 3: Profit before tax by business segment | Source: Own presentation based on Annual Report 2019 by Banco de Sabadell SA (Group)



Considering the current Corona pandemic impact and Sabadell's half-year 2020 results, SB reports a net profit of about €145 million (H1-2019: €538 million). However, the Group benefits from a net capital gain of €293 million following the disposal of Sabadell Asset Management in June 2020 in addition to an income tax income of about €59 million. Without these one-off effects, Sabadell would report a negative result in the first half-year 2020.

The strong decrease of Sabadell's net profit is related to increased loan loss provisions following the Corona pandemic, which almost tripled the Group's loan loss provision in comparison to the first half-year 2019. The cost of risk (calculated in relation to the bank's net loans) amounted to 119 bp annualized for 2020 (2019: 41 bp). Moreover, SB realized declining net interest income (€-100 million) in comparison to the first half-year 2019 due to lower overdraft fees following the Covid-19 measures and due to lower interest rates. In addition, the bank recorded a reduction of its fee and commission income (€-33 million in comparison to H1-2019) due to lower customer activities following the lockdown. By contrast, SB was able to reduce its operating costs (€-33 million) mainly through reduced personnel expense. Overall, the final impact of Corona is still uncertain and it remains doubtful if SB is able to generate a positive result for fiscal year 2020.

A detailed group income statement for the years of 2016 through 2019 can be found in Figure 1 below:

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

Income Statement	2016	2017	2018	%	2019
Income (€000)					
Net Interest Income	3.837.752	3.802.370	3.675.184	-1,4	3.622.396
Net Fee & Commission Income	1.148.582	1.223.436	1.335.301	+7,7	1.438.741
Net Insurance Income	-46.722	-19.047	-	-	-
Net Trading Income	626.624	622.533	225.391	-44,0	126.256
Equity Accounted Results	74.573	308.686	56.554	-0,2	56.427
Dividends from Equity Instruments	10.037	7.252	8.180	-44,8	4.516
Other Income	286.725	338.365	293.653	-4,0	281.993
Operating Income	5.937.571	6.283.595	5.594.263	-1,1	5.530.329
Expenses (€000)					
Depreciation and Amortisation	1.205.946	1.013.954	753.743	-26,2	555.892
Personnel Expense	1.663.053	1.573.560	1.590.590	+3,7	1.648.836
Tech & Communications Expense	293.552	438.059	518.201	-16,7	431.645
Marketing and Promotion Expense	111.148	106.706	114.162	-13,0	99.333
Other Provisions	-3.044	13.864	160.706	-83,5	26.595
Other Expense	1.062.467	1.150.970	1.246.860	-10,1	1.120.863
Operating Expense	4.333.122	4.297.113	4.384.262	-11,4	3.883.164
Operating Profit & Impairment (€000)					
Pre-impairment Operating Profit	1.604.449	1.986.482	1.210.001	+36,1	1.647.165
Asset Writedowns	553.698	1.211.373	828.234	+0,2	829.633
Net Income (€000)					
Non-Recurring Income	0	0	49.645	>+100	133.586
Non-Recurring Expense	31.329	-73.144	12.547	-99,7	41
Pre-tax Profit	1.019.422	848.253	418.865	>+100	951.077
Income Tax Expense	303.569	43.075	83.635	>+100	174.199
Discontinued Operations	-	-	-	-	-
Net Profit (€000)	715.853	805.178	335.230	>+100	776.878
Attributable to minority interest (non-controlling interest)	5.421	3.712	7.128	+27,0	9.056
Attributable to owners of the parent	710.432	801.466	328.102	>+100	767.822

Due to Sabadell's strong increased net profit in 2019, its earnings figures improved in comparison to the previous year significantly. As a result, SB's values of ROAA, ROAE and RORWA before and after taxes are now in line with the peer group average. In particular, we acknowledge the sound development of SB's cost to income ratio. Only the relatively high impairments on loans prevent SB to outperform the peer group.

By contrast, SB's net interest margin decreased slightly over the previous year and is now just in line with the peer group. SB's credit rating would benefit clearly, if SB is able to keep its level of profitability as of 2019. However, the impact of the Corona pandemic represents currently a significant burden for SB. We expect a strong decline of SB's profitability due to increasing loan loss provisions following the Corona pandemic and it remains uncertain if SB is able to generate a positive net profit in 2020.

A detailed overview of the income ratios for the years of 2016 through 2019 can be found in Figure 2 below:

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

Income Ratios (%)	2016	2017	2018	%	2019
Cost Income Ratio (CIR)	72,98	68,39	78,37	-8,15	70,22
Cost Income Ratio ex. Trading (CIRex)	81,59	75,91	81,66	-9,80	71,86
Return on Assets (ROA)	0,34	0,36	0,15	+0,20	0,35
Return on Equity (ROE)	5,47	6,09	2,77	+3,22	5,99
Return on Assets before Taxes (ROAbT)	0,48	0,38	0,19	+0,24	0,43
Return on Equity before Taxes (ROEbT)	7,79	6,42	3,46	+3,87	7,33
Return on Risk-Weighted Assets (RORWA)	0,83	1,04	0,42	+0,54	0,96
Return on Risk-Weighted Assets before Taxes (RORWAbT)	1,18	1,09	0,52	+0,65	1,17
Net Interest Margin (NIM)	1,86	1,77	1,69	-0,07	1,62
Pre-Impairment Operating Profit / Assets	0,76	0,90	0,54	+0,19	0,74
Cost of Funds (COF)	0,68	0,50	0,57	+0,08	0,65
Change in %- Points					

Asset Situation and Asset Quality

Sabadell's financial assets accounted for 93% of total assets in 2019, increasing by 2% (€2 billion) year-over-year. Net loans to customers represent the largest share of financial assets, accounting for 71% and decreasing by 3.6% YOY (€5.2 billion). The increase is mainly attributable to the growth of secured loans (€3.4 billion). Overall, 59% of SB's customer loans are secured loans. Moreover, 32.8% of SB's loans are denominated in foreign currencies (primarily British pound sterling), and only 7% are loans to the general government sector. Total securities, as the second largest asset, representing 13.4% of SB's financial assets and remained as in the previous year constant. SB holds primarily general government's debt securities (88% of total securities). Moreover, SB's holdings of debt securities are mostly denominated in Euro with 85.5%. About €24 billion of SB's debt securities are related to Spain as sovereign issuer, which shows a close connection. In addition, about €5 billion of the banks securities obligations of the Italian government.

Moreover, in 2019, Sabadell decreased its cash balances at central banks significantly over the previous year; following the repayment of TLTRO II funding's in the amount of €7 billion. However, SB participated in in June 2020 at ECB's TLTRO III funding program with about €27 billion. As a result, we expect SB to increase its lending activities in the short run and benefit from the very favorable conditions.

Following the Corona pandemic impact as of the first half-year 2020, SB reports a moderate increase in its net loan to customers (+€200 million). In fact, SB reported a sound increase in loans in Spain, driven by government guaranteed loans granted to corporates, SMEs and self-employed, which was offset by the negative effect of the British Pound sterling exchange rate at TSB. As of June 2020, SB has granted over €9.45 billion of government guaranteed loans; thereof €9.3 billion under the Instituto Credito Oficial (ICO) guarantee facility in Spain, whereby guarantees are provided for 60%-80% of the loans. Thus, SB bears despite the ICO guarantee a part of the risk. In addition, about €7.45 billion of SB's loans are under moratorium/payment holidays, thereof €2.5 billion in Spain.

The group's total assets amounted to €234 billion as of June 2020, which shows a strong increase stemming from the TLTRO III participation.

A detailed look at the development of the asset side of the balance sheet for the years of 2016 through 2019 can be taken in Figure 3 below:

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

Assets (€000)	2016	2017	2018	%	2019
Cash and Balances with Central Banks	11.754.479	26.425.958	23.592.633	-35,2	15.282.125
Net Loans to Banks	2.521.363	2.350.044	2.831.414	-12,8	2.470.321
Net Loans to Customers	143.469.461	141.596.529	142.390.905	+3,6	147.579.752
Total Securities	25.919.666	25.098.648	26.844.884	+3,5	27.792.423
Total Derivative Assets	2.370.620	1.863.053	2.079.221	+23,0	2.558.313
Other Financial Assets	3.408.808	4.967.397	5.963.266	> +100	12.040.929
Financial Assets	189.444.397	202.301.629	203.702.323	+2,0	207.723.863
Equity Accounted Investments	380.672	575.644	574.940	+27,7	733.930
Other Investments	2.404.247	1.964.793	701.021	-26,6	514.629
Insurance Assets	153.989	139.114	132.299	+1,3	133.960
Non-current Assets & Discontinued Ops	4.578.694	2.561.744	4.586.923	-83,3	764.203
Tangible and Intangible Assets	7.131.027	6.183.882	5.192.681	+22,9	6.381.330
Tax Assets	7.055.876	6.861.406	6.859.405	+2,2	7.008.327
Total Other Assets	1.358.817	760.103	572.829	-13,9	493.399
Total Assets	212.507.719	221.348.315	222.322.421	+0,6	223.753.641

Despite Sabadell's reduction of its relatively high stock of NPLs, SB's asset quality remained at a below peer group average level.

SB was able to improve its NPL ratio over the last years significantly to a year-end 2019 ratio of about 3.8%. Thus, SB was able to catch up to its competitors; however, this NPL ratio is still below the average of the peer group. The business segment Banking Business Spain reports thereby the worst NPL ratio with 4.7%. Following the Corona pandemic impact as of SB' half-year report, the bank reports a slight increase of its NPL ratio at 4%. SB's NPL / RWA ratio of 7.3% - despite the improvements YOY - remains significantly less favorable in comparison to the peer group. Sabadell is still struggling with legacy issues from their non-performing loan portfolio since the dramatic increase in 2012. Nevertheless, we acknowledge SB's continuous reductions of its NPL stock since 2013. Considering the reserves / NPL ratio, SB records a declining ratio while the peer group increased its reserves in comparison to the previous year. Moreover, the peer group clearly shows a more prudent approach in this respect. This development is confirmed by the Group's RWA ratio. While SB's RWA ratio remained stable YOY, the peer group reduced its risk-weighted assets, which leads to SB's RWA ratio being less favorable than the ones of its competitors. In addition, 89% of the Group's risk weighted assets are related to credit risk. 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.

In general, SB should continue with its ambitions to reduce its stock of NPL's to improve its asset quality. This would enable SB to catch up to its competitors in the near future.

According to SB's half-year 2020 report, the Group reports stable asset quality with regard to its NPL ratio. However, we expect a strong decrease in the asset quality in the upcoming period due to the run out of public guarantees as well as the end of moratorium measures. According to the ECB, moratorium measures are not automatically a trigger of unlikeliness to pay. Thus, we perceive a high credit risk with regard to SB's asset quality, which requires a close monitoring of the upcoming development. As of 30 June 2020, SB's total volume of stage 3 loans stood at €6.4 billion, which shows an increase by about €300 million in comparison to the year-end 2019 volume. By contrast, we appreciate that SB was able to increase its coverage ratio to 55.6% as of June 2020.

A detailed overview of the asset quality for the years of 2016 through 2019 can be found in Figure 4 below:

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

Asset Ratios (%)	2016	2017	2018	%	2019
Net Loans/ Assets	67,51	63,97	64,05	+1,91	65,96
Risk-weighted Assets/ Assets	40,50	35,01	36,13	+0,15	36,28
NPLs*/ Net Loans to Customers	6,14	5,14	4,22	-0,39	3,83
NPLs*/ Risk-weighted Assets	11,20	10,15	8,06	-0,76	7,30
Potential Problem Loans**/ Net Loans to Customers	NA	NA	6,22	-0,85	5,37
Reserves/ NPLs*	51,04	47,37	53,05	-3,52	49,53
Reserves/ Net Loans	3,43	2,63	2,41	-0,42	1,99
Net Write-offs/ Net Loans	0,39	0,86	0,58	-0,02	0,56
Net Write-offs/ Risk-weighted Assets	0,64	1,56	1,03	-0,01	1,02
Net Write-offs/ Total Assets	0,26	0,55	0,37	-0,00	0,37

Change in %-Points

* NPLs are represented from 2017 onwards by Stage 3 Loans.

** Potential Problem Loans are Stage 2 Loans where available.

Refinancing and Capital Quality

Sabadell's financial liabilities accounted for almost 100% of total liabilities in 2019, remaining almost unchanged YOY. Total deposits from customers represent the major funding source of SB with 69.5% of total liabilities, increasing strongly by 7.2% YOY (€9.8 billion) due to a strong inflow at current and saving accounts, which represent about 80% of the Group's total customer deposits. However, €45.2 billion of SB's deposits are in foreign currency, primarily the British pound sterling and attributable to TSB. Total debt, accounting for only 10.7% of SB's liabilities and remaining constant over the last years and consists primarily of covered bonds (€10.4 billion) and plain-vanilla bonds (€6.3 billion). Total deposits from banks represents primarily the bank's deposits at central banks with about €20 billion.

As of June 2020, SB participated at ECB's TLTRO III funding program with about €27 billion at very favorable conditions (at a currently rate of -50bp). As a result, the bank increased its cash amount at central banks again. However, €13.5 billion of the TLTRO III funding used SB to repay the TLTRO II borrowings.

The Group's total equity increased significantly due to the waived dividend distribution in relation with the Corona pandemic and the recommendation of the ECB, which we explicitly appreciate.

The movement of SB's insurance liabilities respectively non-current liabilities held for sale in 2016 are a result of the sale of the Mediterráneo Vida SA.

Considering the Group's half-year 2020 report, SB does not report any other significant changes on its liabilities side despite of the aforementioned TLTRO III funding.

A detailed overview of the development of liabilities for the years of 2016 through 2019 can be found in Figure 5 below:

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

Liabilities (€000)	2016	2017	2018	%	2019
Total Deposits from Banks	18.636.028	32.427.348	33.198.223	-27,9	23.928.591
Total Deposits from Customers	132.342.381	130.557.802	136.545.974	+7,2	146.411.095
Total Debt	26.533.538	23.787.844	22.598.653	-0,1	22.569.896
Derivative Liabilities	3.086.068	2.360.622	2.360.374	+18,9	2.805.859
Securities Sold, not yet Purchased	-	-	-	-	-
Other Financial Liabilities	14.593.805	17.381.882	13.782.131	-1,3	13.598.248
Total Financial Liabilities	195.191.820	206.515.498	208.485.355	+0,4	209.313.689
Insurance Liabilities	-	-	-	-	-
Non-current Liabilities & Discontinued Ops	2.213.368	20.645	82.605	-87,7	10.155
Tax Liabilities	778.540	531.938	176.013	+36,8	240.803
Provisions	306.214	317.538	466.379	-7,7	430.434
Total Other Liabilities	934.801	740.915	995.069	-21,2	784.154
Total Liabilities	199.424.743	208.126.534	210.205.421	+0,3	210.779.235
Total Equity	13.082.976	13.221.781	12.117.000	+7,1	12.974.406
Total Liabilities and Equity	212.507.719	221.348.315	222.322.421	+0,6	223.753.641

Sabadell's regulatory capital ratios improved significantly in comparison to the previous year as a result of the aforementioned retained earnings; however, SB is still clearly behind its competitors with its capital ratios.

Sabadell's increase in the CET1 ratio by 0.62 percentage points is a result of retained earnings. In addition, following the growth of its CET1 ratio SB achieved an appropriate growth of its AT1 ratio as well as of its Total Capital ratio. However, all of the three aforementioned regulatory capital ratios are still less favorable than the average of SB's competitors. Here, SB should continue with its ambitions to improve its capitalization. Nonetheless, SB clearly meets the regulatory SREP requirement (9.5% as of year-end 2019) with regard to its CET ratio.

The leverage ratio of SB is, as is the case with its regulatory capital ratios, behind that of its competitors. Both, SB and the peer group were able to improve in this ratio in almost the same proportion YOY. However, SB was able to counteract its negative development of its total equity / total assets ratio and achieved to catch up to the average of the peer group in this regard.

Considering SB's half-year 2020 report, the Group reports almost unchanged regulatory capital ratio (fully-loaded) and a drop of its leverage ratio back to 4.69%.

Sabadell's capital ratios are the least favorable performers of all of the areas analyzed.

A detailed overview of the development of capital ratios for the years of 2016 through 2019 can be found in Figure 6 below:

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

Capital Ratios (%)	2016	2017	2018	%	2019
Total Equity/ Total Assets	6,16	5,97	5,45	+0,35	5,80
Leverage Ratio	4,74	4,97	4,86	+0,15	5,01
Fully Loaded: Common Equity Tier 1 Ratio (CET1)	11,95	12,79	11,11	+0,62	11,73
Fully Loaded: Tier 1 Ratio (CET1 + AT1)	11,97	14,27	12,55	+0,60	13,15
Fully Loaded: Total Capital Ratio (CET1 + AT1 + T2)	13,80	16,02	14,13	+0,87	15,00
SREP Capital Requirements	-	8,31	8,31	+1,33	9,64
Change in %-Points					

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 of, Sabadell's non-preferred senior unsecured debt has been notched down by two notches. However, SB's Tier 2 capital rating is 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. All ratings were notched down by one notch in comparison to the previous rating due to the downgrade of the long-term issuer rating.

Liquidity

Sabadell has not published any exact figures for its Net Stable Funding Ratio, however, this ratio is binding starting 2021. The Group's LCR of 172% outperforms the average of the peer group.

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 in case of excess liquidity (in particular after the recent TLTRO III participation). In addition, the almost equal LTD ratio with about 100.8% shows an adequate demand for the Group's loans. However, the banks competitors report a higher LTD ratio on average, showing a higher demand for loans in comparison to its customer deposits.

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 liquidity for the years of 2016 through 2019 can be found in Figure 7 below.

Figure 7: Development of liquidity | Source: eValueRate / CRA

Liquidity (%)	2016	2017	2018	%	2019
Net Loans/ Deposits (LTD)	108,41	108,46	104,28	-3,48	100,80
Interbank Ratio	13,53	7,25	8,53	+1,79	10,32
Liquidity Coverage Ratio	100,00	168,00	168,00	+4,00	172,00
Customer Deposits / Total Funding (excl. Derivates)	67,41	63,45	65,70	+4,70	70,40
Net Stable Funding Ratio (NSFR)	-	-	-	-	-
Change in %- Points					

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 rated negative due to the bank's low amount of green bonds, its issues in relation with the IT migration of TSB as well as its few ambitions with regard to the ESG development.

- Corporate Behaviour and Green Financing / Promoting are identified as moderate rating driver. While Green Financing / Promoting is rated negative due to relatively low amount of green bonds, Coporate Behaviour is rated positive due its business activities in accordance with the ideas and beliefs of the society.

ESG Score

3,2 / 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 2020	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 Environmental Factors	The sub-factor "Exposure to Environmental Factors" has a low relevance for the credit rating and is rated neutral 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, but 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, but 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 positive 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 neutral 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 potive 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 "Considering the Impact of ESG Factors".

Conclusion

Overall, Banco de Sabadell S.A. (Group) had a sound year of performance in 2019, but faces a challenging fiscal year 2020. The Corona pandemic has a massive impact on the economy in Spain, which is the major market of SB. Moreover, the current adverse economic development is characterized by a high degree of uncertainty for SB despite the valuable franchise.

The Group reported an adequate level of profitability with its earnings figures in 2019. However, following the Corona pandemic, we expect a strong negative impact on the profitability of the bank in 2020. The massive increase in loan loss provisions has a significantly negative impact on SB's profitability. However, the strong decrease is mitigated by the sale of Sabadell Asset Management, which leads to a one-off gain of about €293 million. Sabadell did not provide any estimate regarding its net profit 2020. Nevertheless, a positive result in 2020 is uncertain and a second wave of the pandemic would likely lead to negative net profit. The strong economic downturn in Spain bears a significant risk for SB. However, we assume that SB will overcome this difficult period whereby the bank will benefit from its already initiated cost cutting measures. In addition, fiscal stimulus measures and guarantees will help the bank as well.

The asset quality of SB remains below average despite the improvements in recent years. However, the sudden impact of the Corona pandemic and the following economic downturn, leads likely to a significant regression with regard to SB's reduction of its NPL portfolio. In addition, SB reports a significant amount of exposure related to memorandum, payment holidays and guarantee measures. Thus, SB might bear huge credit risk in its loan portfolio, which currently do not lead automatically to an unwillingness to pay.

On the liabilities side, SB reports stable customer deposits and increasing cash and balances with central banks following the participation in ECB's TLTRO III funding program, which enables SB to reduce its costs of funding. SB's capital ratios are constantly below the average of its competitors. The waived dividend payment for 2019 will at least mitigate this issue. The liquidity situation of SB remains sufficient.

The impact of the Corona pandemic bears a high risk for the Group next to the still challenging low interest rate environment. Nevertheless, we assume SB to overcome this challenging environment with its strong franchise. However, the upcoming development is characterized by a high level of uncertainty.

Outlook

We consider the outlook of Banco Sabadell (Group) long-term issuer rating and its bank capital and debt instruments as stable. This reflects our view that the bank is able to overcome the current adverse impact by the Corona pandemic. 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

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 release its current loan loss provisions and regain solid earnings figures. In addition, improvements in SB's asset quality net to increased capital ratios 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 ongoing Corona pandemic impact on SB's asset quality and its business activities in general.

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.

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- / stable / 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 8: 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
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

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	No
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. Subject to a peer group analysis were 24 competing institutes.

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 \(Version 2.0\)](#), the methodology for the [rating of bank capital and unsecured debt instruments \(Version 2.0\)](#) as well as the rating methodology for [Environmental, Social and Governance Score for Banks \(Version 1.0\)](#) in conjunction with Creditreform's basic document [Rating Criteria and Definitions \(Version 1.3\)](#).

The complete presentation of the rating methodologies used by Creditreform Rating AG and the basic document Rating Criteria and Definitions (Version 1.3) are published on our homepage:

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

On 01 October 2020, 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.

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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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