Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries

Consolidated Financial Statements for the Years Ended December 31, 2017 and 2016, and Independent Auditors' Report Dated February 21, 2018

Banco Mercantil del Norte, S. A.,
Institución de Banca Múltiple,
Grupo Financiero Banorte and Subsidiaries

Independent Auditors' Report and Consolidated Financial Statements as of December 31, 2017 and 2016

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Independent Auditors’ Report to the Board of Directors and Shareholders of Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries

Opinion

We have audited the accompanying consolidated balance sheets of Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries (the Institution) as of December 31, 2017 and 2016, and the related consolidated income statements, changes in stockholders’ equity and cash flows for the years then ended, as well as a summary of the significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Parent Company as of December 31, 2017 and 2016, as well as its consolidated results of operations and cash flows for the years ended These dates, in accordance with the accounting criteria established by the National Banking and Securities Commission (the Commission) through the "General Provisions applicable to Credit Institutions" (the Accounting Criteria).

Fundamentals of Opinion

We have conducted our audit in accordance with International Standards on Auditing (ISA). Our responsibilities under these standards are explained more fully in the section Responsibilities of the auditor in relation to the audit of the consolidated financial statements of our report. We are independent of the Parent Company in accordance with the Code of Ethics for Accounting Professionals of the International Standards Board for Accountants (IESBA Code of Ethics) and with the Mexican Institute of Public Accountants (IMCP Code of Ethics), And we have fulfilled all other ethical responsibilities in accordance with the IESBA Code of Ethics and the IMCP Code of Ethics. We believe that the audit evidence we have obtained provides a sufficient and adequate basis for our opinion.

Audit key issues

Key audit issues are those matters that, according to our professional judgment, have been of the greatest significance in our audit of the consolidated financial statements of the current period. These issues have been addressed in the context of our audit of the consolidated financial statements and in forming our opinion thereon, and we do not express a separate opinion on those issues. We have determined that the issues described below are the key audit issues to be reported in our report.

Preventive estimates of credit risks (see Note 4 and 11 to the consolidated financial statements)

The methodology for calculating the preventive estimate for credit risks requires that the expected loss for the next twelve months be evaluated in accordance with the Accounting Standards issued by the National Banking and Securities Commission (the Commission). This expected loss considers 3 credit risk factors that are (i) the probability of default, (ii) the severity of the loss and (iii) the exposure to non-compliance. It has been considered a key audit issue because of the relative importance of the integrity and accuracy of the source information used for its determination and updating of each of the aforementioned credit risk factors in the calculation of that estimate.
Our audit procedures to cover this key audit issue included:
A) Test the design and operational effectiveness of the relevant controls regarding the valuation of the Preventive Estimate for credit risks of the Holding Company.
B) Recalculate the valuation on a sample of credits, considering the risk factors and the source of information used to carry out this calculation. In addition, we review the source of information used to determine and update each of the risk factors in the calculation.
C) Involve our team of Regulatory Compliance specialists.
D) We validate the correct presentation and disclosure in the consolidated financial statements.
The results of our auditing procedures described above were reasonable and we found no exceptions.

Investments in securities (see note 4 and 6 to the consolidated financial statements)

We identified risks in (i) the classification of investments in securities since, according to their intention, valuation effects could be recorded in results or in stockholders' equity in accordance with the Accounting Criteria issued by the Commission and (ii) The Parent does not recognize the effect of impairment even if there is objective evidence that a security is impaired.

Our audit evidence, with respect to what was mentioned in the previous paragraph, included the following:

A) We review the integrity by confirmation of the custodian (SD INDEVAL, Institution for the Deposit of Securities, SA de CV or "INDEVAL") and its valuation according to the price vector, and that in turn, it is recorded in results or Stockholders' equity according to their intention and classification.

B) In the item of investments with characteristics of equity instruments, we reviewed i) the valuation, obtaining as evidence the fair value determined by an independent price provider and ii) the presentation according to the intention and classification of the instrument.

C) In investments that show signs of deterioration and for which the Management of the Company performed an impairment analysis, we verify that these calculations are carried out in accordance with the accounting regulations, in addition we prove the controls that the Company has implemented for said procedure .
The results of our auditing procedures described above were reasonable and we found no exceptions.

• *Derivative financial instruments (See notes 4 and 8 to the consolidated financial statements)*

The valuation of the financial instruments of the Company was considered as a key issue in our audit given the degree of complexity involved in the valuation techniques used for some of the financial instruments and the importance of the judgments and estimates made by the Management of the Tenedor.

In the accounting policies of the Parent Company, Management has described the main sources of information involved in determining the valuation of derivative financial instruments and in particular, how fair value is established using a valuation technique when the estimate can not Be carried out with inputs directly observed in an active market. Our audit included review of the evidence of valuation adjustments, including those by inclusion of the collateral.

Our auditing procedures to cover these significant items included:

A) Test the design and operational effectiveness of the key controls with respect to the valuation of derivative financial instruments of the Holding Company.

B) Review methodologies and inputs through the recalculation of valuation, on a sample of derivative financial instruments. In those cases where the results had presented differences in the valuations, we ensured that such variations were reasonable.

C) Involve our team of Capital Market specialists.

D) We review the correct presentation and disclosure in the consolidated financial statements.
The results of our auditing procedures described above were reasonable and we found no exceptions.

Subordinated debentures (see Notes 4 and 23)

On July 6, 2017, the Institution concluded an issuance of Subordinated NonPreferred Non-Cumulative Tier 1 Capital Notes (Tier 1) (Notes) in the international markets.

The Notes issued are perpetual and with write-down contingent, with payment of interest in a discretionary manner at the election of the issuer.

Our audit procedures with respect to the paragraphs referred to above, were the following:

a) Review that the notes issued shall be recorded in accordance with the consultation of accounting criterion issued by the Commission on January 28, 2018.

b) Review that the cash flow received was recorded on the bank statement on behalf of Banorte.

c) Review that the repayments of capital and interest shall be recorded in accordance with the consultation of accounting criterion issued by the Commission.

d) Review the correct presentation and disclosure in the consolidated financial statements.

The results of our audit procedures described above were reasonable and we did not find any exceptions.

Information other than the consolidated financial statements and the auditor's report

The administration is responsible for the other information. The other information will include the information that will be incorporated in the annual report, which will include the consolidated financial statements and our audit report. The annual report is expected to be available for our reading after the date of this audit report.
Our opinion of the consolidated financial statements will not cover the other information and we will not express any form of security about it.

In connection with our audit of the consolidated financial statements, our responsibility will be to read the other information mentioned, when available, and when we do so, to consider whether the other information contained therein is materially inconsistent with the financial statements or our knowledge obtained during The audit, or appears to contain a material error. If based on the work we have done, we conclude that there is a material error in the other information; we would have to report this fact. We have nothing to report on this matter.

Responsibilities of the management and those responsible for the Governance of the Company in relation to the consolidated financial statements

Management is responsible for the preparation and fair presentation of the accompanying consolidated financial statements in accordance with the Accounting Standards issued by the Commission and the internal control that management deems necessary to enable the preparation of consolidated financial statements free of material misstatement, Due to fraud or error.
In the preparation of the consolidated financial statements, management is responsible for evaluating the Company's ability to continue as a going concern, disclosing as appropriate, the issues related to the Operating Group and using the operating accounting principle , Unless management intends to liquidate the Holding Company or to stop its operations, or there is no other realistic alternative.

Those responsible for the Government of the Holding Company are responsible for supervising the financial information process of the Holding Company.

Responsibility of the Auditor for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance that the consolidated financial statements as a whole are free from material misstatement, due to fraud or error, and to issue an audit report containing our opinion. Reasonable security is a high level of security but does not guarantee that an audit performed in accordance with ISA will always detect a material error when it exists. Errors may be due to fraud or error and are considered material if individually or in aggregate form can reasonably be expected to influence the economic decisions that users make based on the consolidated financial statements.
As part of an audit performed in accordance with ISAs, we exercise our professional judgment and maintain professional skepticism throughout the audit. We also:

• We identify and evaluate the risks of material misstatement of the consolidated financial statements due to fraud or error, design and apply audit procedures to respond to those risks, and obtain audit evidence that is sufficient and appropriate to provide the basis for our opinion . The risk of not detecting a material misstatement due to fraud is higher than in the case of a material misstatement due to an error, since fraud may involve collusion, falsification, deliberate omissions, intentional misrepresentation, or circumvention of internal control .
• We obtain knowledge of the internal control relevant to the audit in order to design audit procedures that are appropriate to the circumstances and not in order to express an opinion on the effectiveness of the internal control of the Company.
• We evaluate the adequacy of the accounting policies applied and the reasonableness of the accounting estimates and the corresponding information disclosed by the Administration.
• We conclude on the adequacy of the use by the Administration of the accounting standard of operating company and, based on the audit evidence obtained, we conclude on whether or not there is a material uncertainty related to facts or conditions that may generate significant doubts about The ability of the Holding Company to continue as a going concern. If we conclude that material uncertainty exists, it is required that we draw attention in our audit report to the corresponding information disclosed in the financial statements or, if those disclosures are not adequate, express a modified opinion. Our findings are based on the audit evidence obtained so far from our audit report. However, future events or conditions may cause the Holding Company to cease to be a running company.
• We evaluate the overall presentation, structure and content of the consolidated financial statements, including disclosed information, and whether the consolidated financial statements represent the relevant transactions and events in a manner that achieves reasonable presentation.

We obtain sufficient and adequate evidence in relation to the financial information of the subsidiaries or business activities within the Institution to express an opinion on the consolidated financial statements. We are responsible for the management, supervision and execution of the audit of the Institution. We are the only ones responsible for our audit opinion.

We communicate to those responsible for the governance of the Company regarding, inter alia, the scope and timing of the planned audit, the significant findings of the audit, as well as any significant deficiencies in internal control that we identified in the course Of the audit.
We also provide those responsible for the Governor's Office with a statement that we have met the applicable ethics requirements regarding independence and communicated with them about all relationships and other issues that can reasonably be expected to affect our Independence and, where appropriate, the corresponding safeguards.

Among the issues that have been the subject of communications with those responsible for the Governor of the Company, we determine that they have been of the greatest significance in the audit of the consolidated financial statements of the current period and are therefore the key audit issues. We describe these issues in this audit report unless legal or regulatory provisions prohibit disclosure of the matter or, in extremely rare circumstances, we determine that an issue should not be reported in our report because it can reasonably be expected that the adverse consequences thereof would outweigh The benefits of the public interest of the same.

Galaz, Yamazaki, Ruiz Urquiza, S.C.
Member of Deloitte Touche Tohmatsu Limited

C.P.C. Daniel Castellanos Cárdenas
Registration in the General Administration
Of Federal Tax Audit No. 17195
February 21, 2018

BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2017 AND 2016
(In millions of Mexican pesos)

ASSETS	2017	2016
CASH AND CASH EQUIVALENTS	**Ps. 76,063**	**Ps. 65,844**
MARGIN SECURITIES	**1,986**	**2,185**
INVESTMENT IN SECURITIES		
Trading Securities	122,065	129,477
Securities available for sale	152,910	153,128
Securities held to maturity	6,834	6,258
	281,809	**288,863**
DEBTOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS	**5**	**-**
DERIVATIVES FINANCIAL INSTRUMENTS		
For trading purposes	25,511	40,881
For hedging purposes	205	742
	25,716	**41,623**
VALUATION ADJUSTMENTS FOR ASSETS HEDGING	**99**	**113**
PERFORMING LOAN PORTFOLIO		
Commercial loans		
Business loans	210,431	201,753
Financial institutions' loans	22,875	20,240
Government loans	132,816	133,540
Consumer loans	101,995	86,632
Credits of Housing		
Media and Residencial	131,563	110,825
Interest social	26	40
Earned Credits at INFONAVIT O FOVISSSTE	3,816	3,942
TOTAL PERFORMING LOAN PORTFOLIO	**603,522**	**556,972**
PAST-DUE LOAN PORTFOLIO		
Commercial loans		
Business loans	6,540	5,467
Financial institutions' loans	-	344
Consumer loans	4,329	3,200
Credits of Housing		
Media and Residencial		952
Interest social	1,179	1
Earned Credits at INFONAVIT O FOVISSSTE	1	96
TOTAL PAST-DUE LOAN PORTFOLIO	**12,192**	**10,060**
LOAN PORTFOLIO	**615,714**	**567,032**
(Minus) ALLOWANCE FOR LOAN LOSSES	(15,551)	(13,941)
LOAN PORTFOLIO, net	**600,163**	**553,091**
ACQUIRED COLLECTION RIGHTS	**1,925**	**1,400**
TOTAL LOAN PORTFOLIO, net	**602,088**	**554,491**
RECEIVABLES GENERATED BY SECURITIZATIONS	**141**	**155**
OTHER ACCOUNTS RECEIVABLE, net	**37,492**	**39,989**
FORECLOSED ASSETS, net	**752**	**1,222**
PROPERTY, FURNITURE AND EQUIPMENT, net	**13,474**	**11,927**
PERMANENT STOCK INVESTMENTS	**150**	**185**
LONG-TERM ASSETS AVAILABLE FOR SALE	**-**	**5,299**
DEFERRED TAXES AND PROFIT SHARING, net	**3,517**	**4,228**
OTHER ASSETS		
Deferred charges, advance payments and intangibles	13,051	11,214
Other short-term and long-term assets	80	3,097
TOTAL ASSETS	**Ps. 1,056,423**	**Ps. 1,030,435**

MEMORANDUM ACCOUNTS (Note 33)

These balance sheets were prepared according to accounting principles applicable to Credit Institutions issued by the Mexican National Banking and Securities Commission according to Articles 99, 101 and 102 of the Law of Credit Institutions. Such principles are consistently applied in the consolidated financial statements, which are presented according to sound practices and applicable legal and administrative provisions and reflect all the operations conducted by the Institution as of the consolidated balance sheet dates above.

As of December 31, 2017, the stockholders' equity amounts to Ps. 13,730.

The accompanying Consolidated Balance Sheets have been approved by the Board of Directors in accordance with the responsibility assigned to them.

"The attached notes are an integral part of these consolidated balance sheets."

LIABILITIES AND STOCKHOLDERS' EQUITY	2017	2016
DEPOSITS		
Demand deposits	Ps. 394,995	Ps. 382,409
Time deposits		
General public	245,288	190,536
Money market	3,679	1,459
Senior debt issued	3,003	-
Global account of deposits without movements	1,657	1,352
	648,622	**575,756**
INTERBANK AND OTHER LOANS		
Demand loans	-	4,019
Short-term loans	8,441	8,063
Long-term loans	6,797	9,178
	15,238	**21,260**
CREDITOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS	**190,363**	**234,490**
COLLATERAL SOLD OR PLEDGED		
Repurchase or resale agreements (creditor balance)	**3**	**-**
DERIVATIVES FINANCIAL INSTRUMENTS		
For trading purposes	24,608	40,403
For hedging purposes	12,401	9,372
	37,009	**49,775**
OTHER ACCOUNT PAYABLES		
Income tax	1,940	1,965
Employee profit sharing	405	396
Creditors from settlements of transactions	15,871	6,988
Creditors from settlements of transactions	11,083	10,326
Sundry creditors and other payables	16,897	14,444
	46,196	**34,119**
SUBORDINATED DEBENTURES	**32,445**	**21,917**
DEFERRED CREDITS AND ADVANCED COLLECTIONS	**485**	**331**
TOTAL LIABILITIES	**970,361**	**937,648**
STOCKHOLDERS' EQUITY		
PAID-IN CAPITAL		
Common Stock	18,105	18,105
Additional paid-in capital	648	72
	18,753	**18,177**
OTHER CAPITAL		
Capital reserves	13,013	11,509
Retained earnings from prior years	38,959	50,215
Result from valuation of securities available for sale	4	(1,645)
Result from valuation of instruments for cash flow hedging	(3,653)	(2,131)
Cumulative foreign currency translation adjustment	1,590	1,985
Benefit remedies for employees	(943)	(377)
Net income	18,339	15,044
	67,309	**74,600**
MINORITY INTEREST	**-**	**10**
TOTAL STOCKHOLDERS' EQUITY	**86,062**	**92,787**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$1,056,423**	**$1,030,435**

Act. José Marcos Ramírez Miguel
CEO

Eng. Rafael Arana de la Garza
Managing Director - COO, Administration and Finance

C.P. Isaías Velázquez González
Managing Director - Audit

Lic. Jorge Eduardo Vega Camargo
Deputy Managing Director - Controller

C.P.C. Mayra Nelly López López
Executive Director - Accounting

BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
CONSOLIDATED INCOME STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016
(In millions of Mexican pesos)

	2017	2016
Interest income	Ps. 95,710	Ps. 69,407
Interest expense	40,062	23,244
NET INTEREST INCOME	**55,648**	**46,163**
Allowance for loan losses	(14,983)	(13,070)
NET INTEREST INCOME AFTER ALLOWANCE FOR LOAN LOSSES	**40,665**	**33,093**
Commission and fee income	18,436	15,764
Commission and fee expense	(6,142)	(4,498)
Brokerage revenues	2,101	1,839
Other Operating Income (expenses)	2,365	2,078
Non Interest Expense	(31,750)	(29,155)
	(14,990)	**(13,972)**
OPERATING INCOME	**25,675**	**19,121**
Equity in earnings of unconsolidated subsidiaries and associated companies	62	1,043
INCOME BEFORE INCOME TAX	**25,737**	**20,164**
Current income tax	(6,781)	(5,479)
Deferred income taxes, net	(706)	116
	(7,487)	**(5,363)**
INCOME BEFORE NONCONTROLLING INTEREST	**18,250**	**14,801**
Minority interest	89	243
NET INCOME	**Ps. 18,339**	**Ps. 15,044**

These income statements were prepared according to accounting principles applicable to Credit Institutions issued by the Mexican National Banking and Securities Commission according to Articles 99, 101 and 102 of the Law of Credit Institutions. Such principles are consistently applied in the consolidated financial statements, which are presented according to sound practices and applicable legal and administrative provisions and reflect all the operations conducted by the Institution as of the consolidated income statements dates above.

The accompanying consolidated Income Statements have been approved by the Board of Directors in accordance with the responsibility assigned to them.

“The attached Notes are an integral part of these consolidated cash flow statements.”

Act. José Marcos Ramírez Miguel
CEO

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Managing Director - COO, Administration and Finance

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BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016
(In millions of Mexican pesos)

	PAID-IN CAPITAL		OTHER CAPITAL		
	Common Stock	Additional paid-in capital	Capital reserves	Retained earnings from prior years	Result from valuation of securities available for sale
Balances, January 1, 2016	**Ps.20,074**	**Ps.11,608**	**Ps.10,157**	**Ps.48,398**	**(Ps.1,310)**
TRANSACTIONS APPROVED BY STOCKHOLDERS:					
Transfer of prior year's result	-	-	-	13,518	-
Dividends declared at the General Stockholders' meetings on:					
August 12, December 15 2016	-	-	-	(5,967)	-
Creation of reserves as per General Stockholders' meeting on April 22, 2016	-	-	1,352	(1,352)	-
Excision of AFORE XXI Banorte	(1,969)	(12,052)	-	(68)	-
Special judgement of CNBV for sale of INB	-	-	-	(3,809)	-
Share-based payments payable in stock options	-	442	-	-	-
Total transactions approved by stockholders	**(1,969)**	**(11,610)**	**1,352**	**2,322**	**-**
COMPREHENSIVE INCOME:					
Net income	-	-	-	-	-
Result from valuation of securities available for sale	-	-	-	-	(335)
Effect of subsidiaries, affiliates and mutual funds	-	-	-	3	-
Cumulative foreign currency translation adjustment	-	-	-	-	-
Defined remedies for employees benefits	-	-	-	(37)	-
Modification of provisions on consumer loans rating	-	-	-	(471)	-
Result from valuation of instruments for cash flow hedging	-	-	-	-	-
Total comprehensive income	**-**	**-**	**-**	**(505)**	**(335)**
Minority interest	-	-	-	-	-
Balances, December 31, 2016	**18,105**	**72**	**11,509**	**50,215**	**(1,645)**
TRANSACTIONS APPROVED BY STOCKHOLDERS:					
Transfer of prior year's result	-	-	-	15,044	-
Dividends declared at the General Stockholders' meetings on:					
February 17, April 28, September 20, December 6 2017	-	-	-	(23,380)	-
Creation of reserves as per General Stockholders' meeting on April 28, 2017	-	-	1,504	(1,504)	-
Special judgement of CNBV for sale of INB	-	-	-	(364)	-
Share-based payments payable in stock options	-	576	-	-	-
Total transactions approved by stockholders	**-**	**576**	**1,504**	**10,204**	**-**
COMPREHENSIVE INCOME:					
Net income	-	-	-	-	-
Result from valuation of securities available for sale	-	-	-	-	1,649
Effect of subsidiaries, affiliates and mutual funds	-	-	-	1	-
Cumulative foreign currency translation adjustment	-	-	-	-	-
Defined remedies for employees benefits	-	-	-	(36)	-
Modification of provisions on consumer loans rating	-	-	-	(711)	-
Interest on subordinated debentures	-	-	-	(306)	-
Result from valuation of instruments for cash flow hedging	-	-	-	-	-
Total comprehensive income	**-**	**-**	**-**	**(1,052)**	**1,649**
Minority interest	-	-	-	-	-
Balances, December 31, 2017	**Ps.$18,105**	**Ps.$648**	**Ps.$13,013**	**Ps.$38,959**	**Ps.$4**

These statements of changes in stockholder's equity were prepared according to accounting principles applicable to Credit Institutions issued by the Mexican National Banking and Securities Commission according to Articles 99, 101 and 102 of the Law of Credit Institutions. Such principles are consistently applied in the consolidated financial statements, which are presented according to sound practices and applicable legal and administrative provisions and reflect all the operations conducted by the Institution as of the dates above.

"These consolidated statements of changes in stockholder's equity were approved by the Board of Directors in accordance with the responsibility assigned to them."

"The attached Notes are an integral part of these consolidated cash flow statements."

	OTHER CAPITAL						
	Result from valuation of instruments for cash flow hedging	**Cumulative foreign currency translation adjustment**	**Employee defined benefit Remedies**	**Net income**	**Total majority interest**	**Minority interest**	**Total stockholders' equity**
Balances, January 1, 2016	**(Ps.936)**	**Ps.990**	**Ps. -**	**Ps.13,518**	**Ps.102,573**	**Ps.10**	**Ps.102,583**
TRANSACTIONS APPROVED BY STOCKHOLDERS:							
Transfer of prior year's result	-	-	-	(13,518)	-	-	-
Dividends declared at the General Stockholders' meetings on:							
August 12, December 15 2016	-	-	-	-	(5,967)	-	(5,967)
Creation of reserves as per General Stockholders' meeting on April 22, 2016	-	-	-	-	-	-	-
Excision of AFORE XXI Banorte	-	-	-	-	(14,089)	-	(14,089)
Special judgement of CNBV for sale of INB	-	-	-	-	(3,809)	-	(3,809)
Share-based payments payable in stock options	-	-	-	-	442	-	442
Total transactions approved by stockholders	**-**	**-**	**-**	**(13,518)**	**(23,423)**	**-**	**(23,423)**
COMPREHENSIVE INCOME:							
Net income	-	-	-	15,044	15,044	-	15,044
Result from valuation of securities available for sale	-	-	-	-	(335)	-	(335)
Effect of subsidiaries, affiliates and mutual funds	-	-	11	-	14	-	14
Cumulative foreign currency translation adjustment	-	995	-	-	995	-	995
Defined remedies for employees benefits	-	-	(388)	-	(425)	-	(425)
Modification of provisions on consumer loans rating	-	-	-	-	(471)	-	(471)
Result from valuation of instruments for cash flow hedging	(1,195)	-	-	-	(1,195)	-	(1,195)
Total comprehensive income	**(1,195)**	**995**	**(377)**	**15,044**	**13,627**	**-**	**13,627**
Minority interest	-	-	-	-	-	-	-
Balances, December 31, 2016	**(Ps. 2,131)**	**Ps.1, 985**	**(Ps. 377)**	**Ps. 15,044**	**Ps. 92,777**	**Ps. 10**	**Ps.92,787**
TRANSACTIONS APPROVED BY STOCKHOLDERS:							
Transfer of prior year's result	-	-	-	(15,044)	-	-	-
Dividends declared at the General Stockholders' meetings on:							
February 17, April 28, September 20, December 6 2017	-	-	-	-	(23,380)	-	(23,380)
Creation of reserves as per General Stockholders' meeting on April 28, 2016	-	-	-	-	-	-	-
Special judgement of CNBV for sale of INB	-	-	-	-	(364)	-	(364)
Share-based payments payable in stock options	-	-	-	-	576	-	576
Total transactions approved by stockholders	**-**	**-**	**-**	**(15,044)**	**(23,168)**	**-**	**(23,168)**
COMPREHENSIVE INCOME:							
Net income	-	-	-	18,339	18,339	-	18,339
Result from valuation of securities available for sale	-	-	-	-	1,649	-	1,649
Effect of subsidiaries, affiliates and mutual funds	-	-	2	-	3	-	3
Cumulative foreign currency translation adjustment	-	(395)	-	-	(395)	-	(395)
Defined remedies for employees benefits	-	-	(568)	-	(604)	-	(604)
Modification of provisions on consumer loans rating	-	-	-	-	(711)	-	(771)
Interest on subordinated debentures	-	-	-	-	(306)	-	(306)
Result from valuation of instruments for cash flow hedging	(1,522)	-	-	-	(1,522)	-	(1,522)
Total comprehensive income	**(1,522)**	**(395)**	**(566)**	**18,339**	**16,453**	**-**	**16,453**
Minority interest	-	-	-	-	-	(10)	(10)
Balances, December 31, 2017	**(Ps. 3,653)**	**Ps. 1,590**	**(Ps. 943)**	**Ps. 18,339**	**Ps. 86,062**	**Ps. -**	**Ps. 86,062**

Act. José Marcos Ramírez Miguel
CEO

Eng. Rafael Arana de la Garza
Managing Director - COO, Administration and Finance

C.P. Isaías Velázquez González
Managing Director - Audit

Lic. Jorge Eduardo Vega Camargo
Deputy Managing Director - Controller

C.P.C. Mayra Nelly López López
Executive Director - Accounting

BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
CONSOLIDATED CASH FLOW STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2017 AND 2016
(In millions of Mexican pesos)

	2017	2016
Net income	**Ps. 18,339**	**Ps. 15,044**
Items not requiring (generating) resources:		
Real estate, furniture and equipment depreciations	1,533	1,084
Provisions	(246)	3,434
Current and deferred income tax	7,487	5,363
Discontinued Operations	89	243
Equity in earnings of unconsolidated subsidiaries and associated companies	(62)	(1,043)
	27,140	**24,125**
OPERATING ACTIVITIES:		
Changes in margin accounts	200	(2,094)
Changes in investments in securities	8,703	(85,738)
Changes in debtor balances under repurchase and resale agreements	(5)	493
Changes in asset position of derivatives	15,385	(23,539)
Change in loan portfolio	(47,762)	(61,882)
Changes in acquired collection rights	(524)	(24)
Changes in receivables generated by securitizations	15	29
Change in foreclosed assets	470	540
Change in other operating assets	3,661	(18,589)
Change in deposits	72,867	34,256
Change in interbank and other loans	(6,022)	6,270
Change in creditor balances under repurchase and sale agreements	(44,127)	63,357
Collateral sold or pledged	3	(1)
Change in liability position of derivative financial instruments	(15,796)	20,463
Change in subordinated debentures	10,952	4,464
Change in other operating liabilities	12,478	6,816
Change in hedging instruments related to operations	2,044	2,511
Assets for discontinued operations	(184)	(1,224)
Income tax	(6,886)	(4,910)
Net cash generated or used from operations	**32,612**	**34,677**
INVESTING ACTIVITIES:		
Proceeds on disposal of property, furniture and equipment	219	617
Payments for acquisition of property, furniture and equipment	(3,308)	(2,853)
Subsidiaries and associated companies acquisitions charges	3,195	2
Payment for disposal of other permanent investments	-	(2)
Discontinued operations	-	(10)
Charges for cash Dividends	1,214	1,122
Net investing activity cash flows	**1,320**	**(1,124)**
FINANCING ACTIVITIES:		
Dividends paid	(23,380)	(5,967)
Interest on subordinated debentures paid	(306)	-
Net financing activity cash flows	**(23,686)**	**(5,967)**
Net increase in cash and cash equivalents	10,246	(41,768)
Effects from changes in the value of cash and cash equivalents	(27)	155
Cash and cash equivalents at the beginning of the year	65,844	107,457
Cash and cash equivalents at the end of the year	**Ps.76,063**	**Ps.65,844**

These cash flow statements were prepared according to accounting principles applicable to Credit Institutions issued by the Mexican National Banking and Securities Commission according to Articles 99, 101 and 102 of the Law of Credit Institutions. Such principles are consistently applied in the consolidated financial statements, which are presented according to sound practices and applicable legal and administrative provisions and reflect cash income and outlays derived from the operations conducted by the Institution as of the dates above. The accompanying consolidated cash flow statements have been approved by the Board of Directors in accordance with the responsibility assigned to them. The attached Notes are an integral part of these consolidated cash flow statements. “The accompanying consolidated cash flow statements have been approved by the Board of Directors in accordance with the responsibility assigned to them”.
“The attached Notes are an integral part of these consolidated cash flow statements.”

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1 – ACTIVITY AND REGULATORY ENVIRONMENT

Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte (the Institution), is a full-banking institution whose main activities are regulated by the Credit Institutions Law (LIC), the Mexican Central Bank (Banco de México) and the Mexican National Banking and Securities Commission (the “Commission”). Its activities consist of receiving deposits, accepting and granting loans and credits, attracting public funds, making investments in securities, carrying out repurchase agreements, performing transactions with derivative financial instruments (futures, swaps, options and forward contracts), together with other full service banking operations, in accordance with the LIC. Its Subsidiaries' activities are supervised by the Commission.

The subsidiaries’ main activity involves financial operations such as managing retirement funds (Until October 17, 2016, the date on which the spin-off of the Holding Company became effective), issuing credit cards, and until march, 2017, providing full service banking services in the United States of America.

The main regulating aspect compel the Financial Group to maintain a minimum capitalization index for market and loan risks, to meet certain acceptance limits for deposits, obligations and other types of funding that may be denominated in foreign currency, as well as to establish the minimum limits for paid-in capital and capital reserves. The Institution complies satisfactorily will all of the above as of December 31, 2016.

The Institution is a subsidiary worth 98.22% of Grupo Financiero Banorte, S.A.B. de C.V. (the Financial Group).

The powers of the Commission in its capacity as banking institutions’ regulator include reviewing the Institution’s financial information and requesting modifications to such information.

The Institution performs its activities throughout Mexico and until march 2017, the United States of America.

The Institution’s consolidated financial statements have been approved by the Board of Directors at their January 25, 2018 meeting in accordance with the responsibility assigned to them.

2 – SIGNIFICANT EVENTS DURING THE YEAR

a) Sale of INB

On March 31, 2017, the Institution finalized through INB Financial Corporation (subsidiary of the Institution) the sale of its ownership in the representative shares of Inter National Bank, in favor of a group of investors in the United States of America.

On that date, the item of long-term assets available for sale that had been registered in December 2016 was discharged and the cash received from the sale was given in the amount of 170 million USD. Prior to the sale, a cash dividend was paid in the amount of 60 million USD.

The aforementioned derives from the corporate restructuring process that Financial Group is going through; further information may be checked in Institution's financial statements corresponding to 2016.

b) Prepayment of subordinated obligations Q Banorte 08

On January 3, 2017, the Institution prepaid Subordinated Non-Preferred and Non-Convertible Obligations Q Banorte 08 amounting to Ps 3 billion, issued on March 11, 2008 and due on February 27, 2018.

c) Issuance of capital notes Tier 1 for USD 900 (Subordinated debentures)

On July 6, 2017, the Institution successfully issued Subordinated NonPreferred Non-Cumulative Tier 1 Capital Notes for USD 900 million in the international markets (equivalent to $16,522), under the following features:

Tier 1 Capital Notes were issued in two series:

- BANORT 6 PERP (BANOD19 999999) for USD 350 million, callable at the fifth year, carrying a coupon rate of 6.875%.
- BANORT 7 PERP (BANOE91 999999) for USD 550 million, callable at the tenth year, carrying a coupon rate of 7.625.

Both series were rated by Moody's and S&P Ba2 and BB, respectively. The Capital Notes are Basel III-compliant.

Such issuance was registered in the liabilities and the interest generated by the Notes are payable against Retained earnings from prior years, given the established feature in the obligations to pay in a discretionary manner yields at the option of the issuer, it is considered a component of capital.

Proceeds from the issuance will be used for general corporate purposes and to strengthen the bank's regulatory capital.

d) Prepayment of subordinated obligations Q Banorte 12

On June 30, 2017, the Institution prepaid subordinated preferred & nonconvertible obligations Q Banorte 12 amounting to Ps 3,200, issued on June 8, 2012 and due on May 27, 2022.

e) Following-up on loan exposure to the housing development sector

Derived from the restructuring processes and agreements reached with Homex, S.A:B. de C.V., in 2017 the Institution received in exchange for the unsecured credits, shares for an amount equivalent to the unsecured credit exposure, net of reserves, which reduced the past due loans of this company in $138.

The shares received as payment in kind were initially recorded as "Foreclosed assets" based on the requirements established in the accounting criteria B-7 "Foreclosed assets".

Subsequently, in accordance with its intention and business plan, the Institution reclassified shares to Investments in Securities (in the "Securities available for sale" category, see Note 6b). The Institution records these assets at fair value.

3 – BASIS OF PRESENTATION

Monetary unit of the consolidated financial statements

The consolidated financial statements and notes as of December 31, 2017 and 2016 and for the years then ended include balances and transactions in Mexican pesos of purchasing power of such dates.

Consolidation of financial statements

The accompanying consolidated financial statements include those of the Institution and its subsidiaries mentioned below.

All significant consolidated intercompany balances and transactions have been eliminated.

As of December 31, 2017 and 2016, the Institution's consolidated subsidiaries and its equity ownership is as follows:

	2017	2016
Banorte USA Corporation y Subsidiarias	100.00%	100.00%

Administradora de Servicios Profesionales Especializados, S.A. de C.V.	99.99%	99.99%
Bonds Finance Company Limited*	100.00%	-%
Casa Servicios Administrativos, S.A. de C.V.	99.60%	99.60%
Fideicomiso BONY 469	100.00%	100.00%
Derivados Banorte, S.A. de C.V.	-%	51.00%

* Trust created on January 11, 2017 in accordance with the Cayman Islands Companies Act, its main activity is to act as a special purpose entity for the issuance of promissory notes in the Cayman Islands.

Equity investments in mutual funds and investments in associated companies are valued under the equity method according to the accounting principles established by the Commission.

Conversion of Financial Statements of Banorte USA, Corporation and Subsidiaries (indirect foreign subsidiary)

In order to consolidate the financial statements of Banorte USA, they are first adjusted in the recording and functional currency (U.S. dollar) to conform to the accounting criteria established by the Commission. The financial statements are then converted to the reporting currency (Mexican pesos) according to the following methodology:

Foreign operations whose recording and functional currency are one and the same convert their financial statements using the following exchange rates: a) year-end rate for assets and liabilities (19.66 for 2017), b) historical rate for non-monetary assets and liabilities as well as stockholders' equity, and c) the weighted average rate of the period for income, costs and expenses (18.92 for 2017). The conversion effects are presented in the Institution's stockholders' equity.

Dispose of INB and application of Special Accounting Criteria

During 2016, the Holding Company decided to dispose of the Inter National Bank (INB), as part of the corporate restructuring program given the constraints to develop its business strategy caused mainly by the change in the regulatory environment in the United States of America (USA).

Application of Special Accounting Criteria

In view of the fact that the Holding Company is carrying out a process of corporate restructuring, coupled with the complicated conditions of regulation in the US and with the objective of ensuring its adequate solvency and stability, the CNBV, based on Article 175 of the "General provisions applicable to credit institutions" issued a special accounting standard through Official Letter P071 / 2016. This criterion authorizes the Parent to recognize the income derived from the sale of INB shares in "Income from prior years" and not from the result of the year in accordance with the corresponding requirements set forth in the NIF.

As part of the sale process and as requirements established in Bulletin C-15 " Deterioration of long-term assets and their disposal " have been met, the Holding Company has classified its investment in INB as a long term asset available for sale, which was recorded at the end of the year at its estimated sale value. The intention to dispose of this entity meets the definition to be classified as a discontinued operation, therefore assets and liabilities as of December 31, 2017 presented net in the Consolidated Balance Sheet in accordance with the accounting criteria issued by the Commission whereas the profits of such entity have been presented as discontinued operations for the years ended December 31, 2017 and 2016.

As of December 2017 y 2016, the comparison between the net book value of the investment and the estimated sale value generated a difference of (Ps. 364) and (Ps. 3,809), respectively, which was recorded by decreasing the value of the investment in the assets against a reduction in "Income from prior years".

If the authorized Special Accounting Criteria were not applied, the amounts that would have been recognized and presented in the Balance Sheet as of December 31, 2017 and 2016 in the items affected would be:

	2017		
	Figures Without Special Accounting	**Figures with Special Accounting Criteria**	**Variation**

	Criteria		
Retained earnings from prior years	Ps. 39,323	Ps. 38,959	(Ps.364)
Net income	17,975	18,339	364
Total stockholders' equity	**86,062**	**86,062**	**-**
Total liabilities and stockholders' equity	**Ps. 1,056,423**	**Ps. 1,056,423**	**Ps.-**

	2016		
	Figures Without Special Accounting Criteria	**Figures with Special Accounting Criteria**	**Variation**
Retained earnings from prior years	Ps.54,024	Ps.50,215	(Ps.3,809)
Net income	11,235	15,044	3,809
Total stockholders' equity	**92,787**	**92,787**	**-**
Total liabilities and stockholders' equity	**Ps.1,030,435**	**Ps.1,030,435**	**Ps.-**

Assets, liabilities and discontinued results

As of December 31, 2016, the discontinued assets are comprised as follows:

ASSETS AND LIABILITIES	**2016**
Loan Portfolio	$21,479
Investment in securities	6,178
Cash and cash equivalents	3,519
Other assets	2,462
Property, furniture and equipment	862
Deposits	(26,644)
Interbank and other loans	(1,394)
Other account payables	(739)
Subordinated debentures	(424)
Total Long Term Assets Available for Sale:	**$5,299**

Results	**2017**	**2016**
Interest income	$283	$1,077
Interest expense	(22)	(81)
Net interest income	**261**	**996**
Allowance for loan losses	-	33
Adjusted financial margin	**261**	**1,029**
Non-interest income	59	259
Non-interest expenses	(195)	(887)
Operating income	**125**	**401**
Income tax	(36)	(158)
Net income	**$89**	**$243**

Comprehensive Income

This is the change in stockholders' equity during the year, for items other than distributions and activity in contributed common stock, and is comprised of the net income of the year, plus other comprehensive income (loss) items of the same period, which are presented directly in stockholders' equity without affecting the consolidated Income Statements, in accordance with the accounting practices established by the Commission. In 2017 and 2016, comprehensive income includes the net income of the year, the result from valuation of securities available for sale; the effect of subsidiaries, affiliates and mutual funds; reimbursement for benefits to employees, the effect of subsidiaries, affiliates and mutual funds; the cumulative conversion effect, modification in the normativity of the qualification of the consumption portfolio, Interest on subordinated debentures and the result from valuation of cash flow hedging instruments.

4 – SIGNIFICANT ACCOUNT POLICIES

The significant accounting policies of the Institution are in conformity with practices prescribed by the Commission which are included in the "General Provisions applicable to Credit Institutions" (the Provisions), in their circulars, and in specific and general trades issued for such purpose, which require Management to make certain estimates and use certain assumptions to determine the valuation of certain items included in the consolidated financial statements and make the required disclosures therein. Even though they may differ in their final effect, management considers the estimates and assumptions to have been adequate under the current circumstances.

Pursuant to accounting Circular A-1, “Basic Framework of the Accounting Criteria Applicable to Banking Institutions", prescribed by the Commission, the Institutions' accounting will adhere to Mexican Financial Reporting Standards (NIF), defined by the Mexican Board of Financial Reporting Standards (CINIF), except when the Commission deems it necessary to apply a specific accounting standard or criterion, considering the fact that banking institutions perform specialized operations.

Changes in accounting policies

A. NIF D-3, Employee benefits

On December 31, 2015, the Commission published a resolution amending the Provisions regarding the application of NIF D-3 Employee Benefits. The purpose of this provision is to publish the transitory articles that identify the options that institutions have to recognize the accounting effects as result of the entry into force of the new NIF.

Based on the above, the Holding Company took the option established in the third transitional article to progressively recognize in the stockholders' equity the changes by reformulation referred to in NIF D-3, issued by the CINIF, which became effective on January 1 of 2016, which was duly informed to the Commission in accordance with the deadlines established in the Provisions.

The recognition of the balances indicated in the NIF D-3, began in 2016 by registering 20% of the balances in that year and 20% additional in each of the subsequent years, reaching 100% in a maximum period of 5 years.

The total amounts to be recognized were determined using the corporate bonds' discount rate for market valuation of the Defined Benefit Obligation under the new Mexican NIF D-3, in the following terms:

I. The balance of changes to the plan not yet recognized is progressively registered, recording 20% during the year 2017, which affected the items “Earnings from prior years” and correspondingly "Provision for employee benefits” and in liabilities "Sundry creditors and other payables", as follows:

Discount rate	Total balance to be applied	Anual application 20%	Gradual recognition as of December 31 2017
Corporate Bonds	$183	$37	$74

II. In the case of the accumulated balance of gains or losses of the plan to be recognized (broker approach), it is progressively registered, recording 20% during the year 2017, which affected the items “Provision for employee benefits” and correspondingly " Other creditors & accounts payable” and in liabilities " Remeasurements of defined benefits for employees within “Earned Capital", as follows:

Discount rate	Total balance to be applied	Anual application 20%	Gradual recognition as of December 31 2016
Corporate Bonds	$2,729	$546	$1,092

The application of 20% per year is recognized on a monthly and proportional basis.

The amounts that would have been recognized and presented in the balance sheet as of December 31, 2017, had the aforementioned option not been applied in the affected items are

Concepto	Importe
Other assets and short and long term	($1,666)
Total of assets	**1,054,676**
Retained earnings from prior years	38,849
Reimbursement for benefits to employees	(2,580)
Total stockholders' equity	**84,315**
Total liabilities and stockholders' equity	**$1,054,676**

(1) In this item, the "Provision for employee benefits" account is netted to show "Net Asset for defined benefits" arising from the prepayments made by the Holding Company.

Improvements to NIF's 2017 - The following improvements were issued effective as of January 1, 2017, which generates accounting changes.

The improvements consist in specifying the scope and definitions of these NIF to indicate more clearly their application and accounting treatment.

NIF B-7, Business combinations - It is indicated that the recognition of change to this NIF effective as of January 2016 should be made prospectively and not retrospectively as previously indicated. Said change establishes that it is not the scope of NIF B-7 the acquisitions of entities under common control, regardless of how the amount of the consideration has been determined.

NIF B-13, Events after the reporting period – a reclassification of liability is allowed if at the date of authorization for the issuance of the financial statements an agreement is reached to maintain the payments a long term with the conditions of payment and in the one that has fallen into default, allowing its early application for the years beginning on or after January 1, 2016.

NIF C-11, Stockholders' Equity - Stipulates that the expenses of registering on a stock exchange the shares of an entity that the date of said registration were already owned by investors and so the issuer had already received the funds, have to be recognized in the net profit or loss at the time of its accrued, there was no capital transaction. It further clarifies that any expense incurred in the collection of repurchased shares must be recognized as a decrease in issued and placed capital.

NIF D-3, Employee benefits - It is modified to establish, as a basic principle, that the discount rate to the determination of the present value of the long-term labor liabilities should be a free market rate of, or with very low credit risk, representing the value of money over time; in an indistinct way, whether the government bond market rate or the market rate of high-quality corporate bonds in absolute terms in a deep market, provided that the last fulfillment with the requirements set out in Appendix B-Application guides, B1-Guide for the identification of high quality corporate bond issues in absolute terms in an efficient market. Early application allowed

Improvements to NIF 2017 - The following improvements were issued and don't generate accounting changes:

NIF C-3, Receivables

Bulletin C-15, Impairment of long-lived assets and their disposition

Recognition of the effects of inflation in financial information

Inflation recognition is done pursuant to MFRS B-10 "Inflation Effects" which considers two types of economic environments: a) inflationary, when the accumulated inflation of the three previous years is 26% or over, in which case the inflation effects must be acknowledged; b) non-inflationary, when in the same period inflation is less than 26%; in this case the effects of inflation should not be recorded in the financial statements.

The cumulative Mexican inflation over the three years prior to 2017 and 2016 was 9.97% and 10.39%, respectively. Therefore, the Mexican economy is considered as non-inflationary. However, assets, liabilities and stockholders' equity as of December 31, 2017 and 2016 include the restatement effects recorded up through December 31, 2007.

The Mexican inflation rates for the years ended December 31, 2017 and 2016 were 6.68% and 3.38%, respectively.

Cash and cash equivalents

Cash and cash equivalents are stated at nominal value, except for precious metal coins, which are stated at fair value at the end of the period. Funds available in foreign currency are valued at the FIX exchange rate published by Banco de México at the consolidated balance sheet date.

Trading Securities

Trading securities are securities owned by the Institution, acquired with the intention of selling them for a profit derived from the price differences in short-term purchase and sale operations made by the Institution as a market participant.

At the time of the acquisition they are initially recorded at fair value, which may include either a discount or premium.

These securities (including both capital and accrued interest) are stated at fair value, which is determined by the price vendor contracted by the Institution.

The trading securities valuation result is recorded in the results of the period.

Securities available for sale

Securities available for sale are debt or equity securities that are neither classified as trading nor held to maturity, therefore they represent a residual category, which means that, they are purchased with an intention different from the trading or holding them to maturity.

They are valued in the same way as trading securities, but with unrealized gains and losses recognized in other comprehensive income in stockholders' equity

Securities held to maturity

Securities held to maturity consist of debt instruments whose payments are fixed or can be determined with a set maturity, which are acquired with the intent and capability to hold them to maturity.

They are initially recorded at fair value and valued at amortized cost, which means that the amortization of the premium or discount (included in the fair value at which they were initially recorded), is part of the accrued interest.

<u>General valuation standards</u>

Upon the sale of trading securities, the valuation result previously recorded in the year's results is reclassified as part of the gain or loss on the sale. Similarly, upon the sale of securities available for sale, the cumulative valuation result recorded in other comprehensive income in stockholders' equity is reclassified as part of the gain or loss on the sale.

Accrued interest on debt instruments is determined using the effective interest method and is recorded in the corresponding category of investments in securities and in the year's results.

Dividends on equity instruments are recorded in the corresponding category of investments in securities and in the year's results when the right to receive such dividends is established.

The foreign exchange gain or loss on investments in securities denominated in foreign currency is recorded in the year's results.

Reclassification of securities held to maturity to available for sale is allowed, provided there is no intention or ability of holding them to maturity. In the case of reclassifications to securities held to maturity or from trading securities to available for sale, which can be done in extraordinary circumstances (lack of market liquidity, absence of an active market for such securities, among others), the Commission will evaluate such circumstances and, if it determines they are valid, it will issue its express authorization for their reclassification.

If securities held to maturity are reclassified as available for sale, the corresponding valuation result on the reclassification date is recorded in other comprehensive income within stockholders' equity.

In the case of debt instruments that have been authorized from reclassification from available for sale securities to held to maturity securities, the valuation result on the transfer date continues to be reported in the Institution's stockholders' equity, and it is amortized based on such instrument's remaining life.

Regarding authorized reclassifications from the trading securities to any other category, the valuation result on the reclassification date is already acknowledged in the year's results.

An impairment loss on a security is recorded against the year's results if there is objective evidence of such impairment as a result of one or more events, occurring after the initial recording of the security, that have had an impact on the estimated future cash flows that can be reliably determined. The effect of recording the impairment of securities is shown in Note 6.

A previously recorded impairment loss is reversed against the year's results if, in a later period, the amount of the loss decreases and such decrease is objectively associated with an event occurring after the impairment was recorded.

The Institution periodically verifies whether its available for sale securities and those held to maturity show any impairment loss, by means of an evaluation on the quarterly balance sheet date or whenever there are indications of an impairment loss.

Securities are deemed as impaired and therefore incurring an impairment loss if and only if there is objective evidence of the impairment loss as a result of a set of events that occurred after their initial value was recorded. Such events should have had an impact on the estimated future cash flows, which can be determined in a reliable manner.

These events may include: issuer's significant financial difficulties; likelihood of the issuer's filing for bankruptcy or financial reorganization; noncompliance with contractual clauses such as failure to pay interest or the principal; loss of an active market for the securities due to financial difficulties; lower credit rating and sustained decline in the issuance price, in combination with additional information.

In addition to the aforementioned events, objective evidence of impairment loss for a net asset instrument includes information about significant changes with adverse effects that occurred in the technological, market, economic or legal situation in which the issuer operates, and which indicates a possible loss of the cost of investing in the net asset instrument.

The events considered by the model are divided into:

a) Information that the Institution has about the securities (breach of contract covenants, financial, economic or legal problems).
b) Information that the Institution has about the issuer (issuer's probability of bankruptcy, financial reorganization and financial difficulties).
c) Information that the market has about the securities (rating assigned by Commission-approved agencies).
d) Information that the market has about the issuer (rating assigned by Commission-approved agencies).

The evaluation model that the Institution uses to determine impairment loss incorporates the aforementioned events according to their importance and rates them as per a severity average used to estimate the return on investment. Similarly, it incorporates the existence of guaranties, which contributes to lower impairment losses.

The investments on which impairment losses have been recognized are analyzed on a quarterly basis to identify the possible recovery of their value and, if applicable, reverse the recorded loss in the consolidated statements of income for the year such recovery is achieved.

Customer repurchase agreements (repos)

This is a transaction through which the purchaser acquires ownership of credit securities for a sum of money and is obliged to transfer the property of another amount of securities of the same kind to the seller of the securities within the agreed term and in exchange for the same price plus a premium. The purchaser keeps the premium unless agreed otherwise.

Repurchase transactions are recorded according to their economic substance, which is financing with collateral, through which the Institution, acting as the purchaser, provides cash as financing in exchange for financial assets as guarantee in case of non-compliance.

On the repurchase agreement transaction contract date, the Institution, acting as the seller, records the cash inflow, or else a settlement debtor account as well as a payable account at its fair value, initially at the agreed price, which represents the obligation to reimburse the cash to the purchaser. The account payable is subsequently valued over the term of the repurchase agreement at amortized cost by recognizing the interest from the repurchase agreement in the year's results using the effective interest method.

As to the collateral granted, the Institution reclassifies the financial asset in the consolidated balance sheets as restricted and values it according to the criteria mentioned earlier in this Note until the maturity of the repurchase agreement.

The Institution, acting as the purchaser, on the repurchase transaction contract date records cash and cash equivalents or a creditor settlement account, with an account receivable at its fair value, initially at the agreed price, which represents the right to recover the cash that was delivered. The receivable is subsequently valued over the life of the repurchase agreement at amortized cost by recognizing the repurchase agreement interest in the year's results using the effective interest method.

As to the collateral received, the Institution records it in off balance sheet memorandum accounts until the repurchase agreement's maturity, following the guidelines of Circular B-9, "Asset Custody and Management", issued by the Commission.

Derivatives financial instruments

The Institution is authorized to perform two types of transactions involving derivatives financial instruments:

Transactions to hedge the Institution's open risk position: Such transactions involve purchasing or selling derivatives financial instruments to mitigate the risk resulting from one or a group of given transactions.
Transactions for trading purposes: The Institution enters into such transactions as a market participant for reasons other than to hedge its exposed position.

Transactions with derivative financial instruments are presented in assets or liabilities, as applicable, under the heading "Derivatives financial instruments", separating derivatives for trading purposes from those for hedging purposes.

When entering into transactions involving derivatives financial instruments, the Institution's internal policies and norms require an assessment and if necessary determination of different risk exposures for each counterparty in the financial system that have been authorized by the Banco de México to enter into these types of transactions. Regarding corporate customers, a preauthorized credit line by the National Credit Committee must be granted or liquid guarantees must be given through a securitized collateral contract before entering into these types of transactions. Medium and small sized companies and individuals must provide liquid guarantees established in securitized collateral contracts with this type of transactions.

The recognition or cancellation of assets and/or liabilities resulting from transactions involving derivatives financial instruments occurs when these transactions are entered into, regardless of the respective settlement or delivery date of the goods.

Forward and futures contracts

Forward and futures contracts with trading purposes establish an obligation to buy or sell a financial asset or an underlying at a future date in the quantity, quality and prices pre-established in the contract. Futures contracts are recorded initially by the Institution in the consolidated balance sheets as an asset and a liability at fair value, which represents the price agreed in the contract in order to acknowledge the right and obligation of receiving and/or delivering the underlying, as well as the right and obligation of receiving and/or delivering the cash equivalent to the underlying, object of the contract.

The derivatives are presented in a specific line item of the assets or liability depending on whether their fair value (as a consequence of the rights and/or obligations it establishes) corresponds to the debtor balance or creditor balance, respectively. Such debtor or creditor balances in the consolidated balance sheets are offset when the Institution has the contractual right to offset the stated amount, the intention of liquidating the net amount or to realize the asset and cancel the liability simultaneously.

In the case of transactions for trading purposes, their balance represents the difference between the fair value of the contract and the established "forward" price.

Option contracts

By paying a premium, options contracts grant the right but not the obligation to buy or sell a financial asset or underlying instrument at a given price within an established term.

Options are divided into: options to buy (calls) and options to sell (puts). Both can be used as trading or hedging instruments.

Options can be executed on a specific date or within a certain period of time. The price is agreed in the option and may be exercised at the discretion of the buyer. The instrument to which said price is established is the reference or underlying value.

The premium is the price the holder pays the issuer for the option rights.

The holder of a call option has the right, but not the obligation, to purchase from the issuer a certain financial asset or underlying instrument at a fixed price (transaction price) within a certain term.

The holder of a put option has the right, but not the obligation, to sell a certain financial asset or underlying instrument at a fixed price (transaction price) within a certain term.

The Institution records the option premium as an asset or liability at the transaction date. The fluctuations resulting from market valuation of the option's premium are recorded by affecting the consolidated statement of income in "Trading results" and the corresponding consolidated balance sheet account.

Swaps

These are two-party contracts through which a bilateral obligation is established to exchange a series of cash flows for a certain period of time on pre-set dates at a nominal or reference value.

They are recorded at fair value which corresponds to the net amount between the asset and liability portion for the rights and obligations agreed upon; they are subsequently valued at fair value using the present value of the future flows to receive or grant according to the projections for future implicit applicable rates, discounting the market rate on the valuation date with yield curves given by the price provider. The result of such valuation is recorded in the year's results.

Management's policy regarding hedging contracts is to protect the Institution's consolidated balance sheets and to anticipate interest and exchange rate fluctuations, thereby protecting the Shareholders' Equity.

For hedging derivatives, the Institution applies in all cases the cash flow hedging method and the accumulated compensation method to measure effectiveness. Both methods are approved by current accounting standards. If the hedging is found to be ineffective, the case is reported in the year's results.

The Institution documents the hedging transactions as of the date on which the derivative financial instruments are designated for hedging. A file is created for each transaction with the documentary evidence as required in paragraph 72 of standard B-5 “Derivatives and Hedging Transactions” (B5) issued by the Commission, which establishes the conditions for hedging accounting usage.

Based on the above, the Institution acknowledges and documents its cash flow hedging transaction as per the following directives:

a. The effective portion of the hedging instrument’s gains or losses are recorded in the “Comprehensive Income” account in stockholders’ equity under the valuation result for cash flow hedging instruments using an asset or liability account called “Derivative financial instruments as offsetting account, as applicable within the current assets or liabilities. The portion determined as ineffective is measured by performing retrospective tests. When the result is over-hedging, it is immediately recorded in the period’s results under Trading Results.

b. The effective hedging component recorded in stockholders’ equity associated with hedging is adjusted to match the lowest amount (in absolute terms) from among the following items:

   i. The hedging instrument’s cumulative gain or loss since its inception.
   ii. The accumulated change in fair value (current value) of the expected future cash flows of the hedged item since its inception.

Valuation techniques

As the derivative products operated by the Institution are deemed Plain Vanilla, the standard valuation models contained in the Institution's derivatives operation and risk management systems are used.

All the valuation models used by the Institution render the fair value of the transactions as a result and are periodically calibrated and audited by independent third parties.

Valuation of the positions is done on a daily basis and a price provider generates the input used by the transaction and risk management systems. The price provider generates these valuations based on daily market conditions.

The valuation methods are based on the market’s accepted and commonly used principles. At present, derivatives are valued by the cash flow present value method, except in the case of options. This method consists of estimating future derivative flows, using the difference between the derivative's fixed level and the forward market curves on the valuation date, and then discounting such flows and updating them to the present value. Options are valuated under the Black and Scholes method, which in addition to the present value calculation, involves the volatility and probability of occurrence for calculating the premium. Once the option's market value is obtained, it is compared to the original premium accrued on the valuation date.

Cancellation of hedging accounting

A cash flow hedging relation is cancelled when:

1. The hedging instrument expires or is sold, terminated or enforced;
2. The hedging fails to meet the requirements of documentation, evaluation and effectiveness measuring;
3. The projected transaction is not expected to occur;
4. The hedging designation is revoked.

For cases 1 and 2, the profit or loss recorded in net income stays in that account until the projected transactions occurs. For case 3, the profit or loss recorded in net income should be immediately restated in results; and for case 4, if the hedging is on a projected transaction, the loss or profit stated in net income should stay in that account until the projected transactions is realized. Otherwise, it should be immediately restated in results.

A fair value hedging relation is canceled when:

1. The hedging instrument expires or is sold, terminated or enforced;
2. The hedging fails to meet the requirements of documentation, evaluation and effectiveness measuring;

3. The hedging designation is revoked.

Any adjustment to the result from the valuation adjustment of the hedged item attributable to the covered risk, should be amortized in the period's results. The amortization start as soon as the adjustment turns up, and under no circumstance after the hedged item is no longer adjusted due to changes in the fair value attributable to the risk covered. The adjustment should be amortized in full on the due date of the hedged item.

Operation strategies

Trading
The Institution participates in the derivatives market with trading purposes, and the risk exposures generated are computed within its overall VaR limit.

The trading strategy is submitted on a weekly basis to the Institution's Treasury Committee, which analyzes the current risks and then makes any necessary decisions.

The trading strategy is carried out according to market levels and expectations, maximizing the circumstances to obtain a benefit by trading, margin and volatility. Each trading strategy is submitted to the Treasury Committee on a weekly basis for its consideration. The Committee analyzes the risks and then decides accordingly.

Hedging

The hedging strategy is determined annually and when market conditions require it. Hedging strategies are submitted to the Risk Policies Committee.

Hedging transactions comply with the applicable norm set forth in Circular B-5 “Derivatives and hedging transactions” issued by the Commission. This implies, among other things, that the hedge's effectiveness must be evaluated both prior to its arrangement (prospective) as well as thereafter (retrospective). These tests are performed on a monthly basis.

The hedging strategy is determined annually and each time the market conditions require. Hedges are used to reduce foreign exchange risks, through exchange rate forwards and currency swaps, as well as interest rates by means of interest rate swaps. This is done with the purpose of locking the rates paid on the debt issued by the Institution, thereby ensuring the debt servicing, as well as to make investments that generate greater value for the customers. The main strategy is to ensure that the Institution's future income and expenses are covered, maximizing its profitability.

Hedging derivatives can be restated whole or partially due to hedging inefficiencies, maturity or sale of primary position.

Contingencies

To enter the derivatives market, the Institution is bound by an agreement to deliver its financial information in a timely manner and to abide by the applicable laws, regulations and provisions, as well as to provide written notice to the affected parties in case that an event arises that could be considered as early termination, which could lead to a credit contingency. These include the following: bankruptcy filing, payment suspension, restructuring, intervention, liquidation, dissolution or other similar judicial or extra-judicial proceedings that affect the Institution; if the statements stipulated in the contract are incorrect; the Institution's failure to fulfill its obligations and/or payments; breach of contract; the Institution's consolidates or merges with another entity thereby transferring a substantial portion of its assets; failure to provide the guarantees that were agreed in the event of noncompliance with obligations or if such guarantees are expired or diminished in value; the Institution's falls into insolvency, lower credit quality or illegality due to changes in the tax or legal legislation; the existence of a ruling, proceeding or embargo against the Institution that could substantially affect its ability to fulfill its obligations in a timely manner; or general noncompliance with obligations. Each ground for early termination is subject to the counter-party's consideration in order to determine its importance and significance regarding the Institution's ability to comply.

At present no such contingency situations have arisen.

Embedded derivatives

Embedded derivatives are those contract components that do not intend to explicitly originate a derivative financial instrument but rather that the implicit risks generated or hedged by those components differ in their economic and risk features from those of the contract, and therefore display a behavior and features similar to those of a common derivative.

Identified embedded derivatives are separated from the host contract for valuation purposes and are treated as a derivative when they meet the features outlined in Circular B-5 paragraph 22, unless the implicit derivative is denominated in a currency commonly used for the purchase and sale of non-financial items in the economic environment where the transaction takes place. The main embedded derivatives recognized by the Institution prior to January 2011 are from service and leasing contracts established in US dollars.

Loan Portfolio

The loan portfolio represents the balance of amounts effectively granted to borrowers plus uncollected accrued interest minus interest collected in advance. The allowance for loan losses from credit risks is presented as a reduction of the loan portfolio.

The unpaid loan balance is classified in the past-due portfolio as follows:

- Loans with bullet payment of principal and interest at maturity: 30 calendar days after being overdue.

- Loans involving a single principal payment at maturity, but with periodic interest payments, total principal and interest payments 30 and 90 calendar days after being overdue, respectively.

- Loans for which the payment of principal and interest is agreed based on partial periodic payments, 90 calendar days after the first payment is due.

- In the case of revolving loans, whenever payment is outstanding for two billing periods or when they are 60 or more days overdue.

- Overdrawn customer checking accounts are considered as part of the past-due portfolio when such situations arise.

Interest is recognized and accrued as income when earned. The accrual of interest income is suspended when loans are transferred to the past-due portfolio.

The fees charged for the initial granting, restructuring and renewal of loans will be recorded as a deferred credit, which will be amortized as interest income, using the straight line method over the loan’s contractual term, except those originating from revolving loans, which are amortized over a 12-month period.

Annual credit card fees, whether the first annual charge of a renewal, are recorded as a deferred credit and amortized over a 12-month period against the year’s results in the commission and fee income line item.

The costs and expenses associated with the initial granting, restructuring and renewal of a loan are stated as a deferred charge which is amortized against the year's earnings as interest expense for the duration of the loan, except those originating from revolving loans y credit cards as they are amortized over a 12-month period.

Restructured past-due loans are not considered in the performing portfolio until evidence of sustained payment is obtained; this occurs when credit institutions receive three timely consecutive payments, or a payment is received for periods exceeding 60 days.

The restructured credits or renewed with single payment of principal at maturity, regardless of whether the payment of interests is periodic or at maturity, it is considered that there is sustained payment of credit when, The accredited has covered at least 20%t of the original amount of the loan at the time of the restructuring or renewal, Or, has covered the amount of accrued interest in accordance with the scheme of payments by restructuring or renewal for a period of 90 days.

Accrued interest during the period in which the loan was included in the past-due portfolio is recognized as income when collected.

The recognition of interest income is renewed when the portfolio is no longer considered past-due, which occurs when the outstanding balances, including the principal, interest and any other item, are paid in full.

Restructured loans are those whose terms have been modified due to the borrowers' financial difficulties, and it was decided to grant them a concession. Such modifications may include reductions in the interest rate, debt forgiveness or term extensions.

The Institution regularly evaluates whether a past-due loan should remain the balance sheet or be written off. Such write-offs are done by canceling the outstanding loan balance against the allowance for loan losses. The Institution may opt to eliminate from its assets those past-due loans that are 100% provisioned according to the following parameters:

- Commercial loans – Must be classified in past-due loans, with an E risk rating, 100% reserved, unsecured by any fund.

- Consumer loans – 180 days or more overdue.

- Mortgage loans – 270 days or more overdue.

Allowance for loan losses

Modification in consumer not revolving and mortgage loans rating provisions

On 6 January 2017 the Commission published a resolution amending the provisions in which corresponds to the Methodologies for the rating of the portfolios of consumption not revolving and mortgage, which remain a focus of expected loss and incorporate most recent information on the performance of the industry in its new factors. The main change in both methodologies is that in addition to contemplate the credit experience of the accredited with the institution that grants the credit, also contemplate the credit behavior of those accredited with other institutions according to the information of the societies of credit information. New methodologies are effective as of June 1, 2017.

The financial effect recognized by the Institution at the end of June 2017 derived from the modified methodologies, less the allowance that would be taken by the balance of those portfolios with prior methodologies is Ps. 1.054. The accounting of this financial effect was an increase in the allowance for loan losses for Ps. 1.054 (liabilities), an increase of deferred tax liabilities for Ps. 316 (asset) and a decrease to retained earnings from prior years for Ps. 725 (equity)

Application of new portfolio rating criteria

The loan portfolio is classified according to the rules issued by the SHCP and the methodology established by the Commission. Internal methodology authorized by such Commission may also be used.

In the case of consumer mortgage and commercial loans, the Institution applies the Provisions for rating the loan portfolio as issued by the Commission and published in the Official Gazette of the Federation on June 24, 2013.

On June 24, 2013, the Commission issued changes to commercial loan rating Provisions. Such changes state that in order to rate a loan, the likelihood of default, gravity of the loss and exposure to noncompliance should be taken into account, as indicated later in this section.

Such provisions also establish general methodologies for the rating and calculating the allowance for each type of loan, while also allowing credit institutions to classify and calculate allowances based on internal methodologies, when previously approved by the Commission.

The commercial loan portfolio rating procedure requires credit institutions apply the established methodology (general or internal) based on quarterly information for the periods ending in March, June, September and December of each year, while also recording the allowances determined at the close of each month in their financial statements. Furthermore, during the months following each quarterly close, financial institutions must apply the respective rating to any loan used at the close of the immediately preceding quarter, based on the outstanding balance in effect on the last day of the aforementioned months. The allowances for loan risks that have exceeded the amount required to rate the loan will be cancelled against the period's results on the date of the following quarterly rating. Additionally, recoveries on the previously written-off loan portfolios are recorded in the period's results.

General Description of Rules Established By the Commission

The rules for rating the consumer, mortgage and commercial loans (excluding loans to financial intermediaries and loans intended for investment projects having their own source of payment) indicate that their allowance for loan loss should be determined based on the estimated expected loss of the loans over the next twelve month period.

Such methodologies stipulate that estimate of such loss evaluates the probability of breach of contract, the severity of the loss and the exposure to non-compliance. The result of multiplying these three factors is the estimated expected loss that is the same as the amount of the hedges that need to be created in order to face the loan risk.

Depending on the type of loan, the probability of breach of contract, severity of the loss and exposure to non-compliance are determined by considering the following:

Probability of breach of contract

- Non-revolving consumer loan – it takes into account the current delay, the payments made on the last due balances, how many times the original value is paid, the type of loan, the remaining terms, among other things.
- Revolving consumer loan – it considers the current situation and historical behavior regarding the number of outstanding payments, how old the accounts are, the payments on the balance, as well as what percentage of the authorized line of credit has been used.
- Mortgage loan – it considers the current delay, maximum number of delays over the last four periods, willingness to pay and the value of the property with respect to the loan balance.
- Commercial loans.- They consider the type of debtor, payment experience, INFONAVIT payment history, rating agencies' evaluation, financial risk, social-economical risk, financial soundness, country and industry risk, market positioning, transparency, standards and corporate governance.

Severity of the loss

- Non-revolving consumer loan – depends on the number of outstanding payments.
- Revolving consumer loan – depends on the number of outstanding payments.
- Mortgage loan – it considers the amount of the property sub-account, unemployment insurance and the state where the loan was granted.
- Commercial loans – they consider actual financial and non-financial guarantees as well as personal guarantees.

Exposure to Default

- Non-revolving consumer loan – loan balance at the rating date.
- Revolving consumer loan – considers the current use of the credit line to estimate how much its use would increase in the event of non-compliance.
- Mortgage loans – loan balance at the rating date.
- Commercial – for revocable loans, the loan balance at the rating date is considered. For irrevocable loans, the current use of the credit line to estimate how much its use would increase in the event of non-compliance is considered.

The Commission's rules for rating commercial loan debtors for loans intended for investment projects having their own source of payment, indicate that the rating be done by analyzing the risk of projects in the construction stage and operation evaluating the work's over-cost and the project's cash flows.

Acquired collection rights

This balance is represented by the acquisition cost of the various loan asset packages acquired by the Institution, which are subsequently valued by applying one of the three following methods:

Cost recovery method – Payments received are applied against the acquisition cost of the loan portfolio until the balance equals zero. Recoveries in excess of the acquisition cost are recognized in current earnings.

Interest method - The result of multiplying the acquired portfolio's outstanding balance by the estimated yield is recorded in current earnings. Differences between the Institution's collection estimates and actual collections are reflected prospectively in the estimated yield.

Cash basis method - The amount resulting from multiplying the estimated yield times the amount actually collected is recorded in the consolidated Income Statements provided it is not greater than the amount obtained by the interest method. The difference between the recorded amount and the amount collected reduces the outstanding portfolio balance, once the entire initial investment has been amortized. Any subsequent recovery will be recorded in the consolidated Income Statements.

For the portfolios valued using the interest method, the Institution evaluates them twice a year to verify if the cash flow estimate of its collection rights is consistent with actual recoveries and therefore considered to be effective. The Institution uses the cost recovery method on those collection rights in which the expected cash flow estimate is not highly effective. The expected cash flow estimate is considered as "highly effective" if the result of dividing the sum of the flows collected by the sum of the expected cash flows is between 0.8 and 1.25 when such effectiveness is evaluated.

Loan asset impairment.- The Institution performs an expected cash flow assessment periodically while collection rights are still effective, and if based on the events and information gathered, it determines that said cash flows will drop, it develops an estimate of non-recoverability or doubtful accounts vs. the period's results in the amount in which said expected cash flows are lower than the book value of the account receivable.

Securitization transactions

Through securitization transactions involving the transfer of ownership in mortgage and government loans, transfers those financial assets to a trust so that it publicly issues securities through an intermediary. The securities represent the right to the yield on the securitized portfolio and, as compensation; the Institution receives cash and a record, which grants it the right over the trust's residual cash flows after settling the certificates to their holders. This record is registered at its fair value under "Receivables generated by securitizations".

The Institution provides administration services for the transferred financial assets and records the revenue thereof in the period's earnings when accrued. Those revenues are recorded under "Other Operating Income (expenses)".

The valuation of the benefits to be received from securitization operations is recorded in the income statement under "Other Revenues", as applicable.

Other accounts receivable and payable

The Institution performs a study to quantify the different future events that could affect the amount in accounts receivable over 90 days and thus determine their percentage of non-recoverability to calculate its allowance for doubtful accounts, as per the Provisions. The remaining balance of accounts receivable is reserved at 90 calendar days from the initial recognition.

The balances of asset and liability settlement accounts represent transactions involving the sale and purchase of currency and securities, which are recorded when entered into and settled within 48 hours.

Impairment of the value of long-lived assets and their disposal

The Institution has established guidelines to identify and, if applicable, record losses derived from the impairment or decrease in value of long-lived tangible or intangible assets, including goodwill.

Foreclosed assets, net

Foreclosed property or property received as payments in kind are recorded at the lower of their cost or fair value minus the strictly necessary costs and expenses disbursed in the foreclosure. Cost is determined as the forced-sale value established by the judge upon foreclosure or, in the case of payments in kind, the price agreed between the parties involved.

When the value of the asset or the accrued or past due amortizations leading to the foreclosure, net of estimates, is higher than the foreclosed property, the difference is recorded in the period's results under "Other Operating Income (expenses)".

When the value of the asset or the accrued or past due amortizations leading to the foreclosure, net of estimates, is lower than the foreclosed property, its value is adjusted to the net asset's value.

The carrying value is only modified when there is evidence that the fair value is lower than the recorded carrying value. Reductions in the carrying value of the loan are recorded in the current earnings as they occur.

The provisions applicable to the new valuation methodology for the allowance for loan losses mentioned above define the valuation methodology for reserves related to either foreclosed property or those assets received as payment in kind, establishing that additional quarterly provisions must be created to recognize the potential decrease in value over time of property awarded under legal proceedings, out-of-court or received as payment in kind and the investments in securities received as foreclosed goods or payment in kind, based on the following guidelines:

I. In the case of collection rights and movable property, the provisions referenced in the preceding paragraph must be treated as follows:

Movable property reserves	
Time elapsed as of award date or receipt as payment in kind (months)	**Reserve percentage**
Up to 6	-%
More than 6 and up to 12	10%
More than 12 and up to 18	20%
More than 18 and up to 24	45%
More than 24 and up to 30	60%
More than 30	100%

The amount of the reserves to be created will be the result of applying the reserve percentage determined under the preceding table to the value of collection rights or foreclosed property, received as payment in kind or awarded in a court proceeding.

II. Investments in securities must be valued in accordance with the provisions of the Commission's accounting Circular B-2, using annual audited financial statements and monthly financial information of the investee.

Following the valuation of foreclosed assets or those received as payment in kind, the reserves resulting from applying the percentages established in the table of Section I above to the estimated value, must be created.

III. In the case of real estate property, provisions must be created as follows:

Real property reserves	
Time elapsed as of award date or receipt as payment in kind (months)	**Reserve percentage**
Up to 12	-%
More than 12 and up to 24	10%
More than 24 and up to 30	15%
More than 30 and up to 36	25%
More than 36 and up to 42	30%
More than 42 and up to 48	35%

More than 48 and up to 54	40%
More than 54 and up to 60	50%
More than 60	100%

The amount of the reserves to be created will be the result of applying the reserve percentage determined under the preceding table to the awarded value of the property based on the accounting criteria. Furthermore, when problems are identified regarding the realization of the value of the foreclosed property, the Institution records additional reserves based on management's best estimates. On December 31, 2015, there are no reserves in addition to those created by the percentage applied based on the accounting criteria that could indicate signs of impairment or realization problems with the values of the foreclosed properties.

If appraisals subsequent to the foreclosure or payment in kind result in the recording of a decrease in the value of the collection rights, securities, movable or real estate property, the reserve percentages contained in the preceding table can be applied to the adjusted value.

Property, furniture and equipment

Property, furniture and fixtures are recorded at acquisition cost. The balances of acquisitions made up to December 31, 2007 are restated using factors derived from the value of the UDI of that date.

Depreciation is calculated using the straight-line method based on the useful lives of the assets as estimated by independent appraisers.

Permanent stock investments

The Institution recognizes its investments in associated companies where it has significant influence but not control using the equity method, based on the book values shown in the most recent financial statements of such entities.

Profit taxes

Income Tax (ISR) is recorded in the year it is incurred. Deferred ISR is calculated by applying the corresponding tax rate to the applicable temporary differences resulting from comparing the accounting and tax bases of assets and liabilities and including, if any, future benefits from tax loss carryforwards and certain tax credits. The deferred tax assets are recorded only when there is a high probability of recovery.

The net effect of the aforementioned items is presented in the consolidated balance sheet under the "Deferred taxes, net" line.

Intangible assets

Intangible assets are recognized in the consolidated balance sheets provided they are identifiable and generate future economic benefits that are controlled by the Institution. The amortizable amount of the intangible asset is assigned on a systematic basis during its estimated useful life. Intangible assets with indefinite lives are not amortized and their value is subject to the regulatory provisions regarding annual impairment tests.

Goodwill

The Institution records goodwill when the total fair value of the acquisition cost and the Minority Interest is greater than the fair value of the net assets of the acquired business, pursuant to NIF B-7 “Business acquisitions”. As goodwill is considered an intangible asset with an indefinite life, it is subject to impairment tests at least annually according to Bulletin C-15, “Impairment in the value of long-lived assets and their disposal”. No indicators of impairment of goodwill have been identified as of December 31, 2017 and 2016.

Deposits

Liabilities derived from deposits, including promissory notes settled at maturity, are recorded at their funding or placement cost plus accrued interest, determined according to the number of days elapsed at each monthly close, which are charged against results when accrued as an interest expense.

Interbank and other loans

These loans are recorded based on the contractual value, recognizing the interest in the year's earnings as accrued. The Institution records in this item the direct loans obtained from domestic and foreign banks, loans obtained through bids with Banco de Mexico and development funds' financing. Furthermore, this includes discounted loan portfolios from funds provided by banks specializing in financing economic, productive or development activities.

Provisions

Provisions are recognized when the Institution has a current obligation that results from a past event and are likely to result in the use of economic resources and can be reasonably estimated.

Employee Retirement Obligations

According to Mexican Federal Labor Law, the Institution has obligations derived from severance payments and seniority premiums payable to employees that cease to render their services under certain circumstances.

Defined benefit plan

The Institution records a liability for seniority premiums, pensions and post-retirement medical services as incurred based on calculations by independent actuaries using the projected unit credit method, using nominal interest rates. Accordingly, this recognizes the liability whose present value will cover the obligation from benefits projected to the estimated retirement date of the Institution's overall employees, as well as the obligation related to retired personnel.

The balance at the beginning of each period of actuarial gains and losses derived from pension plans exceeding 10% of the greater amount between the defined benefits obligation and plan assets are amortized in future periods against current results, in the case of pension plan, medical service and seniority premiums to retirement.

In the case of seniority premiums related to termination and remuneration at the end of the employment relation, earnings or losses are recognized immediately in the period they are generated, as specified by the MFRS D-3 "Employee benefits".

The Institution applies the provision of MFRS D-3 related to the recognition of the liability for severance payments for reasons other than restructuring, which is recorded using the projected unit credit method based on calculations by independent actuaries.

Defined contribution plan

The Institution has a "defined contribution" pension plan in place. The participating employees are those hired as of January 2001 as well as those hired prior to such date that enrolled voluntarily. The pension plan is invested in a fund, which is included in "Other assets".

The employees who were hired prior to January 1, 2001 and who decided to enroll voluntarily in the defined contribution pension plan received a contribution from the Institution for prior services equivalent to the actuarial benefit accrued in their previous defined benefit plan that was cancelled. The initial contribution was made from the plan assets that had been established for the original defined benefit plan and participants were immediately assigned 50% of such amount with the remaining 50% to be assigned over 10 years.

The initial payment to the defined contribution plan for past services was financed with funds established originally for the defined benefit plan as a result of the early termination of its obligations and recognized in accordance with the provision guidelines.

The labor obligations derived from the defined contribution pension plan do not require an actuarial valuation as established in MFRS D-3, because the cost of this plan is equivalent to the Institution's contributions made to the plan's participants.

The provisions for PTU are recorded in the results of the year in which they are incurred as administrative expenses. The Institution determines employee statutory profit sharing based on the criteria established in the guidelines set forth by the Mexican Constitution.

Foreign Currency Conversion

Foreign currency transactions are recorded at the applicable exchange rate in effect at the transaction date. Monetary assets and liabilities denominated in foreign currency are translated into Mexican pesos at the applicable exchange rate at the close of each period. The exchange rate used to establish Mexican peso equivalence is the FIX exchange rate published by Banco de México. Foreign exchange fluctuations are recorded in the results of operations.

Interest from Outstanding Subordinated Debentures

Accrued interest from outstanding subordinated debentures is recognized as it is accrued and translated according to the exchange rate in effect at each monthly close.

Transfer of Financial Assets

The Institution can act as the assignor o assignee, as applicable, in this type of transactions. Moreover the Institution evaluates whether or not to retain the risks and benefits associated with the asset property to determine whether or not there was a transfer of property in a transaction. In transactions involving the transfer of ownership in financial assets, the assignor yields control and substantially transfers all the risks and benefits over such assets. Therefore, the assignor derecognizes such assets and records the consideration received from the transaction. Conversely, the assignee recognizes such financial assets and the transfer consideration in its accounting records.

Share-based Payments

The Institution grants stock options to key officers through different payment schemes based on stocks. The Institution has established trusts to manage the plans and contributes the necessary funds so that shares can be purchased directly from the market at the initiation of each plan.

The Institution records its stock option plans according to the guidelines of MFRS D-8, “Share-based payments”. The compensation expense is recorded at fair value as of the date the stock options are granted. As per MRFS D-8 and as the Institution grants stock of the Institution, the Institution reports the expense as a capital contribution by the Institution.

The fair value of each share is estimated as of the date granted using the Black-Scholes option pricing model or the forwards valuation model, depending on the plans’ features.

Memorandum Accounts

Memorandum accounts are used to record assets or commitments that are not part of the Institution’s general balance sheet, as no rights are acquired on the assets and such commitments are not acknowledged as liabilities until they materialize, respectively. The accumulated amounts in the memorandum accounts have only been subject to audit tests when their information is derived from an accounting record. The memorandum accounts not audited are indicated in each case:

- Contingent assets and liabilities (unaudited):

  It records the amount of economic penalties imposed by the administrative or judicial authorities until such payments are made, as a motion for revocation has been filed. It also records the exposure to risk line item for its participation in the Expanded Use Electronic Payments System.

- Loan commitments (unaudited):

The balance represents the amount of the letters of credit granted by the Financial Group that are considered as irrevocable commercial loans not disposed by the borrowers. It includes the lines of credit grated to client, not disposed.

- Assets in trust or mandate (unaudited):

For the assets in trust, the value of the goods is recorded and any information related to their individual administration is recorded independently. For assets under mandate, the declared value of the assets, subject to the mandates executed by the Institution is recorded.

- Assets in custody or under management (unaudited):

This account records the movement of others' assets and securities that are received in custody or are to be managed by the Institution.

- Collateral received:

The balance represents all the collateral received in securities repurchase agreement operations when the Institution is the buyer.

- Collateral received and sold or given as a pledge:

The balance represents all the collateral received in securities repurchase agreements when the Institution is acting as the buyer, and which in turn are sold by the Institution acting as the seller.

5 – CASH AND CASH EQUIVALENTS

This line item was composed as follows:

	2017	2016
Cash	Ps. 23,351	Ps. 20,155
Banks	52,644	45,584
Other deposits and available funds	68	105
	Ps. 76,063	**Ps. 65,844**

"Banks" is represented by cash in Mexican pesos and US dollars converted at the exchange rate issued by Banco de México of Ps. 19.6699 and Ps. 20.6194 as of December 31, 2017 and 2016, respectively and is made up as follows:

	Mexican pesos		USD		Total	
	2017	2016	2017	2016	2017	2016
Call money	Ps. 6,137	Ps. -	Ps. -	Ps. 5,155	Ps. 6,137	Ps. 5,155
Deposits with foreign credit institutions	-	-	11,779	14,476	11,779	14,476
Domestic banks	19	19	-	-	23	19
Banco de México	25,853	25,853	975	81	34,705	25,934
	Ps. 39,890	**Ps. 25,872**	**Ps. 12,754**	**Ps. 19,712**	**Ps. 52,644**	**Ps. 45,584**

In June 2014, Banco de Mexico issued Circular 9/2014, which establishes banking institutions' obligation to constitute a new monetary regulation deposit, and modifies the interest rate such deposits pay. As of December 31, 2015 and 2014, the Institution had made monetary regulation deposits of Ps. 25,687 and Ps. 25,683, respectively.

As of December 31, 2017 and 2016, the total sum of restricted cash and cash equivalents is Ps. 43,198 and Ps. 34,466, respectively. This includes monetary regulation deposits, futures placed in the domestic and foreign market, call money and contracted transactions pending liquidation in 24 and 48 hours. As of December 31, 2017 and 2016, the balance with Banco de México are Ps. 9,018 and Ps. 251, related to the deposit auctions.

As of December 31, 2017 and 2016, "Other Deposits and Available Funds" includes:

	2017	2016
Minted metals in gold and silver	Ps. 26	Ps. 52
Cashable checks received, pending payment at a 3-day term	19	40
Remittances	-	13
	Ps. 45	**Ps. 105**

The exchange rates used for the conversion of gold and silver coins (Centenarios and Troy ounces, respectively) was Ps. 624.35 and Ps. 370.94, per unit, respectively, in 2016; and Ps. 581.13 and Ps. 376.10, per unit, respectively, in 2015.

6 - INVESTMENT IN SECURITIES

a. Trading Securities

Trading securities are as follows:

	2017				2016
	Acquisition cost	**Accrued interest**	**Valuation increase (decrease)**	**Book value**	**Book value**
Government securities	**Ps. 88,556**	**Ps. 589**	**Ps. 85**	**Ps. 89,230**	**Ps. 106,977**
Not restricted	**(466)**	**-**	**-**	**(466)**	**(493)**
D Bonds	-	-	-	-	(447)
M Bonds	(468)	-	-	(468)	(4)
CEBUR	1	-	-	1	1
CETES	-	-	-	-	(5)
Eurobonds	11	-	-	11	12
UDIBONOS	(10)	-	-	(10)	(50)
Restricted	**89,022**	**589**	**85**	**89,696**	**107,470**
D Bonds	11,482	29	3	11,514	13,145
M Bonds	824	3	(4)	823	72
BPA	73,124	550	92	73,766	92,037
CEBUR	2,493	7	(6)	2,494	2,141
CETES	1,079	-	(1)	1,078	15
UDIBONOS	20	-	1	21	59
Bank securities	**32,197**	**94**	**9**	**32,300**	**21,862**
Not restricted	**32,197**	**94**	**9**	**32,300**	**21,862**
CEBUR – development bank	1,878	3	-	1,881	1,543
CEBUR – bank	9,531	35	9	9,575	10,844
CEDES	13,955	54	(1)	14,008	7,017
Other bank securities	569	2	-	571	571
Promissory Notes	6,264	-	1	6,265	1,887
Private securities	**418**	**-**	**117**	**535**	**638**
Not restricted	**263**	**-**	**117**	**380**	**526**
Shares	128	-	84	212	173
CEBUR – corporate	158	-	34	192	197
CEBUR – fiduciary	(26)	-	(1)	(27)	-
Eurobonds	3	-	-	3	156
Restricted	**155**	**-**	**-**	**155**	**112**
CEBUR – corporate	129	-	(1)	128	112
CEBUR – fiduciary	26	-	1	27	-
Other securities	-	-	-	-	537
	Ps. 121,171	**Ps. 683**	**Ps. 211**	**Ps. 122,065**	**Ps. 129,477**

During 2017 and 2016, the Institution recognized under “Trading Results” a net loss of Ps. 98 and a net profit of Ps. 142, respectively, for the fair value valuation of these instruments.

As of December 31, 2017 and 2016, there are Ps. 122,151 and Ps. 129,444, respectively, in restricted trading securities associated mainly with repurchase operations.

b. Securities Available for Sale

Securities available for sale were as follows:

	2017				2016
	Acquisition cost	**Accrued interest**	**Valuation increase (decrease)**	**Book value**	**Valor en libros**
Government securities	**Ps. 118,791**	**Ps. 2,017**	**Ps. 446**	**Ps. 121,254**	**Ps. 130,308**
Not restricted	**52,366**	**682**	**117**	**53,164**	**26,081**
D Bonds	100	-	-	100	100
M Bonds	374	1	(38)	337	339
BREMs	7,778	6	-	7,785	7,781
CEBUR – Government	6	-	-	6	18
CEBUR – Municipality	37	2	5	43	92
CETES	1,820	-	-	1,820	8
Eurobonds	42,251	672	150	43,073	17,743
Restricted	**66,425**	**1,336**	**330**	**68,090**	**104,227**
D Bonds	11,377	48	5	11,430	-
BPA	49,872	1,211	(60)	51,023	95,114
CEBUR – Government	2,355	7	(4)	2,358	4,521
CETES	96	-	(0)	96	101
Eurobonds	2,725	69	389	3,183	-
Bank securities	**6,160**	**7**	**(31)**	**6,136**	**-**
Not restricted	**6,160**	**7**	**(31)**	**6,136**	**-**
CEDES	5,736	7	-	5,743	4,125
Structured notes	424	-	(31)	393	366
Private securities	**26,391**	**429**	**(1,300)**	**25,520**	**22,820**
Not restricted	**24,686**	**385**	**(1,335)**	**23,736**	**21,180**
Shares	1,656	-	(1,286)	370	267
Investment funds	3,570	-	102	3,672	3,435
CEBUR – borhis	23	-	(4)	19	24
CEBUR – corporate	5,099	38	(514)	4,623	4,511
Eurobonds	14,338	347	367	15,052	12,943
Restricted	**1,705**	**44**	**35**	**1,784**	**1,640**
Eurobonds	1,705	44	35	1,784	1,640
	Ps. 151,342	**Ps. 2,454**	**(Ps. 886)**	**Ps. 152,910**	**Ps.153,128**

As of December 31, 2017 and 2016 there are Ps. 69,874 and Ps. 105,867, respectively, in restricted securities available for sale, mainly associated with securities repurchasing transactions.

As of December 31, 2016, there were 77,783,110 of BREMSR securities acquired as of May 2016, these BREMSRs were initially classified in the available-for-sale securities category due to the legal impossibility of being classified as trading securities since they did not Has a secondary market, ie they are not subject to trading operations. They could not be classified under the category of securities held to maturity because this category was restricted in accordance with of criterion B-2. In addition, it is contemplated to hedge these securities through cash flow hedging operations for changes in the TIIE28 interest rate, which is feasible only in the category of available-for-sale securities in accordance with of the Criterion B-5.

Derived from the processes of restructuring and agreements reached with HOMEX, during 2017 the Institution received in exchange for uncollateralized credits, 138,198,154 shares (see Note 2e).

During 2016, as a result of the restructuring processes and agreements reached with GEO and Homex in which the Tenedora participated, it received as payment in payment shares of said company for an amount equivalent to the outstanding unsecured credit exposure and net of reserves, which decreased The balance of past due loans at $ 1,476.

The shares and optional securities to subscribe shares received as payment in payment were initially recorded as "Assets awarded" based on the requirements established in the accounting criteria B-7 "Assigned Property".

Subsequently, in accordance with its intention and business plan, the Company reclassified shares and optional securities to subscribe shares to Securities Investments (in the "Available-for-sale securities" category, see Note 6b) and Derivatives (See Note 8), respectively. The Holding Company values these assets at fair value.

Shares received in exchange were initially recorded as a property awarded and subsequently reclassified to investments in securities within the category of securities available for sale and will be valued on the market in accordance with applicable accounting rules. At December 31, 2017 and 2016, the impairment on market value of these shares was (Ps. 631) and (Ps. 1,249), respectively, recorded in equity in the Income Statement for Valuation of available-for-sale securities.

c. Securities Held to Maturity

Securities held to maturity are as follows:

Medium and long-term debt instruments:

	2017			2016
	Acquisition cost	Accrued interest	Book value	Book value
Government securities	**Ps. 4,217**	**Ps. 16**	**Ps. 4,233**	**Ps. 3,494**
Not restricted	**1,670**	**2**	**1,672**	**951**
CETES specials	523	-	523	951
UDIBONOS	1,147	2	1,149	0
Restricted	**2,547**	**14**	**2,561**	**2,544**
CEBUR Municipality	2,547	14	2,561	2,544
Private securities	**2,592**	**9**	**2,601**	**2,763**
Restricted	**2,592**	**9**	**2,601**	**2,763**
CEBUR – borhis	1	-	1	22
CEBUR – corporate	2,591	9	2,600	2,741
	Ps. 6,809	**Ps. 25**	**Ps. 6,834**	**Ps. 6,258**

As of December 31, 2017 and 2016, there are Ps. 5,161 and Ps. 5,307, respectively, in restricted trading securities associated mainly with repurchasing operations.

As of December 31, 2016, the maturities of the securities (expressed at their acquisition cost), are as follows:

	More than one and up to 5 years	More and 5 and up to 10 years	More than 10 years	Total
CETES specials	Ps. 155	Ps. 368	Ps. -	Ps. 523
UDIBONOS	1,150	-	-	1,150
CEBUR – Municipality	-	-	2,560	2,560
CEBUR – Corporate	-	-	2,601	2,601
	Ps. 1,305	**Ps. 368**	**Ps. 5,161**	**Ps. 6,834**

Some of the investments in securities are given as collateral in derivative transactions without any restriction; therefore, the receiver has the right to trade them and offer them as collateral.

d. Collateral

The fair value of the collaterals granted in derivative transactions is made up as follows:

		2017	
		Fair value in millions	
Type of collateral:	**Instrument category**	**Pesos**	**USD**
Cash	-	Ps. 9	16,002
		Ps. 9	**Ps. 16,002**

		2016	
		Fair value in millions	
Type of collateral:	**Instrument category**	**Pesos**	**USD**
Cash	-	Ps. 9	Ps.16,002
		Ps.9	**Ps.16,002**

As of December 31, 2017 and 2016, the Institution had no instruments received as collateral.

During 2017 and 2016 the interest income from negotiable instruments is as follows:

Concept	2016	2015
Trading Securities	Ps. 11,193	Ps. 6,725
Securities available for sale	6,752	4,401
Securities held to maturity	472	344
	Ps. 18,417	**Ps. 11,470**

e. Impaired Negotiable Instruments

The objective proof that a negotiable instrument is impaired includes observable information on, among others, the following events:

a) considerable financial difficulties of the instrument's issuer;
b) the issuer may be declared bankrupt or in some other financial reorganization;
c) breach of contractual clauses, such as failure to pay interest or the principal;
d) unavailability of an active market for the instrument in question due to financial difficulties; or
e) a measurable reduction in future estimated cash flows of a group of instruments from the initial recording of such assets, although the reduction cannot be identified with individual instruments of the group, including:

   i. adverse changes in the payment status of the issuers in the group, or
   ii. local or national economic conditions that are correlated with the groups defaults.

As December 31, 2017 and 2016, the amount recorded for the impairment of securities held to maturity and available-for-sale securities amounts to Ps. 820 and Ps. 267, respectively.

During 2017 and 2016, not interest incomes were accounted related to securities impairment.

7 - CREDITOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS

The debtor and creditor balances in repurchase transactions consist of:

Acting as seller of securities

Instrument	2017	2016
CETES	Ps. 1,078	Ps. 10
Eurobonds	1,852	-
Bonds IPAB	16,466	7,141
Quarterly IPAB bonds	65,040	132,816
Semi-annual IPAB bonds	42,357	47,206
Development bonds	22,517	13,150
Government bonds	820	69
UDIBONOS	11	8
Government securities	**150,141**	**200,400**
CEBUR – bank	9,575	10,845
CEDES	11,006	7,017
Promissory notes	6,264	1,887
Financial Institution Negotiable Instruments	571	570
Bank securities	**27,416**	**20,319**
CEBUR – Municipality	2,715	2,563
CEBUR – Corporate	2,134	2,854
CEBUR – Government	4,924	6,784
CEBUR – Borhis	1	26
CEBUR – Development bank	1,881	1,543
Eurobonds	1,151	-
Private securities	**12,806**	**13,770**
	Ps. 190,363	**Ps. 234,490**

With the Institution acting as the vendor, accrued premiums were charged to the results of operations as of December 31, 2017 and 2016 for Ps. 17,039 and Ps. 10,435, respectively, and recorded under “Interest Expenses”.

During 2017, the period of repurchase transactions carried out by the Institution in its capacity as vendor ranged from 1 to 364 days.

Acting as securities purchaser

	2017				2016			
Instrument	Repurchase agreement from debtors	Received, sold collateral in repurchase	Debit difference	Credit difference	Repurchase agreement from debtors	Received, sold collateral in repurchase	Debit difference	Credit difference
Development Bonds	Ps. 2,001	Ps. 1,998	Ps. 3	Ps. -	Ps. -	Ps. -	Ps. -	Ps. -
Bonds IPAB	1,502	1,502	-	-	-	-	-	-
Quarterly IPAB bonds	48,218	48,216	2	-	13,004	13,004	-	-
Semi-annual IPAB bonds	5,002	5,002	-	-	1,080	1,080	-	-
M bonds	2,001	2,001	-	-	-	-	-	-
Bonds	-	-	-	-	101	101	-	-
CEBUR in UDIS	500	500	-	-	1,701	1,701	-	-
Government securities	**59,224**	**59,219**	**5**	**-**	**15,886**	**15,886**	**-**	**-**
CEDES	-	-	-	-	-	-	-	-
Bank bonds	-	-	-	-	-	-	-	-
Securitized bank certificates	389	389	-	-	916	916	-	-
Bank securities	**389**	**389**	**-**	**-**	**916**	**916**	**-**	**-**
Short-term CEBUR	2,628	2,631	-	3	3,322	3,322	-	-
Private securities	**2,628**	**2,631**	**-**	**3**	**3,322**	**3,322**	**-**	**-**
	Ps. 62,241	**Ps. 62,239**	**Ps. 5**	**Ps. 3**	**Ps. 20,124**	**Ps. 20,124**	**Ps. -**	**Ps. -**

With the Institution acting as the purchaser, accrued interest were charged to the results of operations as of December 31, 2017 and 2016 for Ps. 2,283 and Ps. 1,417, respectively, and reported under “Interest Income”.

During 2017, repurchase transactions carried out by the Institution in its capacity as purchaser ranged in term from 1 to 364 days

By December 31, 2017, the amount of goods corresponding to the guarantees given and received in repurchasing transactions that involved the transfer of property totaled Ps. 62,239 and Ps. 133,904, respectively, and by December 31, 2016, the totals were Ps. 20,124 in guarantees given and Ps. 82,192 in guarantees received.

8 - DERIVATIVES FINANCIAL INSTRUMENTS

The transactions carried out by the Institution involving derivatives correspond mainly to futures, swaps and options contracts. These transactions are done to hedge various risks and for trading purposes.

The Institution has evaluated the effectiveness of derivatives' transactions for hedging purposes and has concluded that they are highly effective

The Institution's derivatives positions held for trading purposes are as follows

Asset position	2017	2016
Forwards		
Foreign currency forwards	Ps. 120	Ps. 16
Options		
Interest rate options	849	1,059
Stock options	5	2
Currency options	111	4
Swaps		
Interest rate swaps	20,921	34,570
Exchange rate swaps	3,505	5,237
Total trading	**25,511**	**40,881**
Options		
Rate Options	25	46
Swaps		
Interest rate swaps	180	696
Total hedging	**742**	**742**
Total position	**Ps. 25,716**	**Ps. 41,623**

Liability position	2017	2016
Forwards		
Foreign currency forwards	Ps. 55	Ps. 28
Options		
Interest rate options	784	1,112
Currency options	177	1
Swaps		
Interest rate swaps	18,322	32,937
Exchange rate swaps	5,270	6,325
Total trading	**24,608**	**40,403**
Swaps		
Interest rate swaps	492	168
Exchange rate swaps	11,909	9,204
Total hedging	**12,401**	**9,372**
Total position	**Ps. 37,009**	**Ps. 49,775**

The following are notional bonds in different currencies, depending on the type of product, by December 31, 2017:

Trading Instruments

Instrument	MXN	USD	EUR
Foreign currency forwards	Ps. 8,389	Ps. 431	Ps. -
Interest rate options	132,865	705	-
Taking options	3	-	-
Foreign currency options	410	-	-
Foreign currency swaps (receiving leg)	46,006	1,629	-
Foreign currency swaps (paying leg)	35,890	2,226	-
Interest rate swaps (receiving leg)	1,235,531	19,888	-
Interest rate swaps (paying leg)	1,235,531	19,888	-

Hedging Instruments

Instrument	MXN	USD	EUR	GBP
Interest rate options	Ps. 7,900	$-	$-	$-
Foreign currency swaps (receiving leg)	25,325	-	-	-
Foreign currency swaps (paying leg)	-	820	462	128
Interest rate swaps (receiving leg)	48,227	-	-	-
Interest rate swaps (paying leg)	48,227	-	-	-

The hedging instruments operated and their main underlying instruments are as follows

Forwards	Options	Swaps	CCS
Fx-USD	Fx-USD	TIIE 28	TIIE 28
Fx-EUR	TIIE 28	TIIE 91	TIIE 91
Fx-CAD	TIIE 91	CETES 91	Libor
	Libor	Libor	Euribor
			UDI

Risk management policies and internal control procedures to manage the risks inherent in contracts related to derivative transactions are described in note 32.

Transactions carried out for hedging purposes have maturities from 2017 to 2032 and are intended to mitigate the financial risk derived from long-term loans offered by the Institution at fixed nominal rates, as well as the exchange rate risk generated by market instruments in the Institution's portfolio

The book value of collateral used to ensure compliance with obligations derived from currency swap contracts as of December 31, 2017 is USD 898,031 thousand, and Ps. 5,600 thousand, while as of December 31, 2016 it was USD 776,059 thousand and 8,700. IRS Swaps transactions are made through recognized markets, and as of December 31, 2017 they represent 38% of the nominal amount of all the derivatives' operations contracts; the remaining 62% correspond to option, swap and Fx forwards transactions in Over the Counter (OTC) markets.

As of December 31, 2017 and 2016, the collateral given was comprised mainly of cash, PEMEX bonds, and short-term government bonds restricted under the categories of Trading Securities and Available for sale securities. The restriction maturity date for this collateral is from 2017 to 2027. Their fair value is shown in Note 6 d).

As of December 31, 2017 and 2016 the Institution had no received collateral.

During 2017 and 2016, the net earnings from the valuation and realization of derivatives financial instruments were Ps. 1,223 and Ps. 371, respectively. ,

The net amount of estimated gains or losses originated by transactions or events recorded in Comprehensive income to date in the financial statements and that are expected to be reclassified to earnings within the next 12 months total Ps. 60.

As of December 31, 2017 and 2016, the main positions hedged by the Institution and the derivatives designated to cover such positions are:

Cash flow hedging:

- Forecast funding using TIIE rate Caps and Swaps.
- Recorded assets in foreign currency using Cross Currency Swaps.
- Recorded liabilities in foreign currency using Cross Currency Swaps.

As of December 31, 2017, there are 160 hedge files related to hedging transactions. Their effectiveness ranges between 100%, well within the range established by the accounting standards in effect (80% to 125%). Furthermore, there is no overhedging on any of the derivatives, so as of December 31, 2017, there are no ineffective portions that are recorded at the market value that the Institution has to record in earnings.

The following are the Institution's hedged cash flows as of December 31, 2017, expected to occur and affect earnings:

Concept	**Up to 3 months**	**More than 3 months and up to 1 year**	**More and 1 and up to 5 years**	**More than 5 years**
Forecast funding	Ps. 379	Ps. 899	Ps. 2,389	Ps. 570
Assets denominated in Euros	500	1,155	2,957	1,141
Assets denominated in GBP	10	9	144	472
	Ps. 907	**Ps. 2,082**	**Ps. 5,716**	**Ps. 2,493**

The fair value of the instruments designated as cash flows hedging, recognized in overall earnings in stockholders equity on December 31, 2017 and 2016 totaled (Ps. 5,514) and (Ps. 2,131), respectively. Furthermore, Ps. 184 and Ps. 63, respectively, were reclassified from stockholders' equity to results.

The gains recognized in derivatives financial instruments' results designated for trading were Ps. 783 and Ps. 382, on December 31, 2017 and 2016, respectively.

Trading derivatives and hedging derivatives: the loan risk is minimized through means of contractual compensation agreements, in which asset and liability derivatives with the same counterparty are settled for their net balance. Similarly, there may be other types of collateral such as credit lines, depending on the counterparty's solvency and the nature of the transaction.

The following table shows the cash flows hedging valuation balance:

Balance	**Valuation of cash flows hedging instruments**	**Net change in period**	**Reclassified to income**
Balance, December 31, 2013	(Ps. 1,541)	Ps. 1,244	Ps. 75
Balance, December 31, 2014	(Ps. 1,284)	Ps. 257	(Ps. 18)
Balance, December 31, 2015	(Ps. 1,398)	(Ps. 114)	Ps. 16
Balance, December 31, 2016	(Ps. 2,131)	(Ps. 773)	Ps. 63
Balance, December 31, 2017	(Ps. 5,214)	(Ps. 3,083)	Ps. 184

9 - LOAN PORTFOLIO

The loan portfolio by loan type is as follows:

	Performing Loan Portfolio		Past-due loan portfolio		Total	
	2017	2016	2017	2016	2017	2016
Commercial loans						
Denominated in domestic currency						
Commercial	Ps. 163,174	Ps. 154,500	Ps. 4,824	Ps. 5,076	Ps. 167,998	Ps. 159,576
Rediscounted portfolio	8,212	7,561	107	264	8,319	7,825
Denominated in USD						
Commercial	35,196	35,307	1,609	128	36,805	35,435
Rediscounted portfolio	3,849	4,384	-	-	3,849	4,384
Loans to financial institutions	22,875	20,240	-	344	22,875	20,584
Consumer loans						
Credit card	33,906	28,445	2,188	1,623	36,094	30,068
Other consumer loans	68,089	58,187	2,141	1,576	70,230	59,763
Mortgage loans						
Denominated in domestic currency	135,250	114,619	1,302	1,034	136,552	115,653
Denominated in USD				-		
Denominated in UDIS	155	189	21	15	176	204
Government loans	132,816	133,540	-	-	132,816	133,540
Total loan portfolio	**Ps. 603,522**	**Ps. 556,972**	**Ps. 12,192**	**Ps. 10,060**	**Ps. 615,714**	**Ps. 567,032**

Restructured loans

Below are the restructured loans, which changed the terms and rates, among others:

	2017		2016	
	Performing	Past-due	Performing	Past-due
Commercial loans				
Business loans	Ps. 13,115	Ps. 1,131	Ps. 5,018	Ps. 1,465
Consumer loans	33	65	8	8
Mortgage loans	32	279	20	63
	Ps. 13,180	**Ps. 1,475**	**Ps. 5,046**	**Ps. 1,536**

The past-due loans showed the following periods of delinquency:

	From 1 to 180 days	From 181 to 365 days	From 366 days to 2 years	More than 2 years	Total
Commercial loans	Ps. 2,463	Ps. 1,038	Ps. 701	Ps. 2,338	Ps. 6,540
Consumer loans	4,088	234	2	5	4,329
Mortgage loans	958	365	-	-	1,323
	Ps. 7,509	**Ps. 1,637**	**Ps. 703**	**Ps. 2,343**	**Ps. 12,192**

The past-due loans showed the following periods of delinquency:

	From 1 to 180 days	From 181 to 365 days	From 366 days to 2 years	More than 2 years	Total
Commercial loans	Ps. 452	Ps.-	Ps. -	Ps. 5,360	Ps. 5,812
Consumer loans	3,079	115	1	4	3,199
Mortgage loans	731	318	-	-	1,049
	Ps. 4,262	**Ps. 433**	**Ps. 1**	**Ps. 5,364**	**Ps. 10,060**

Past-due loan movements for the years ended on December 31, 2017 and 2016 are shown below:

	2017	2016
Balance at the beginning of the year	Ps. 10,060	Ps. 11,634
Liquidations	(2,621)	(2,165)
Write-offs*	(11,853)	(10,776)
Renewals	(442)	(2,538)
Loan portfolio purchases	-	1,776
Discounts	(626)	(1,205)
Foreclosures	(148)	(260)
Loan Portfolio Sales	-	(1,492)
Transfers to performing loans	(5,769)	(5,975)
Transfers from performing loans	23,559	21,034
Fluctuation from foreign exchange rate	32	27
Year-end balance	**Ps. 12,192**	**$10,060**

* Corresponds to 100% hedged loans.

As of December 31, 2017, the balance of deferred loan origination fees was Ps. 2,564, and the amount recorded in results was Ps. 1,169. Furthermore, the deferred balance of costs and expenses associated with initial loan originations was Ps. 2,653, and the amount recorded in results was Ps. 687. As of December 31, 2016, the balance of deferred loan origination fees was Ps. 2,455, and the amount recorded in results was Ps. 1,199. Furthermore, the deferred balance of costs and expenses associated with initial loan originations was Ps. 2,251, and the amount recorded in results was Ps. 485. The average term over which the deferred fee balance and the costs and expenses will be recorded is equivalent to the average term of the portfolio balance.

The collected fees and costs are presented net in the line item of Deferred Loans and Advance Collections within the consolidated balance sheets as well as in interest income and interest expenses, respectively, in the consolidated Income Statements.

The average terms of the portfolio's main balances are: a) commercial, 2.03 years; b) financial institutions, 3.49 years; c) mortgage, 18.81 years; d) government loans, 10.02 years; and e) consumer, 3.51 years.

During the periods ended on December 31, 2017 and 2016, the balance of fully reserved past-due loans that were written off was Ps. 12,153 and Ps. 10,776, respectively.

On December 31, 2017 and 2016, revenues from recoveries of previously written-off loan portfolios were Ps. 1,737 and Ps. 1,531, respectively.

The loans granted per economic sectors are shown below:

	2016		2015	
	Amount	**Concentration percentage**	**Amount**	**Concentration percentage**
Private (companies and individuals)	Ps. 217,000	35.24%	Ps. 207,220	36.55%
Financial institutions	22,875	3.72%	20,584	3.63%
Credit card and consumer	106,324	17.27%	89,832	15.84%
Mortgage	136,698	22.21%	115,856	20.43%
Government loans	132,817	21.57%	133,540	23.55%
	Ps. 615,714	**100.0%**	**Ps. 567,032**	**100.0%**

Policies and Procedures for Granting Loans

The granting, control and recovery of loans are regulated by the Institution's Credit Manual, which has been authorized by the Board of Directors. Accordingly, administrative portfolio control is performed in the following areas:

I. Business Areas (includes corporate, commercial, business, governmental and consumer banking), primarily through the branch network.
II. Operations Areas
III. General Comprehensive Risk Management
IV. Recovery Management

Similarly, the Institution has manuals establishing the policies and procedures to be utilized for credit risk management purposes.

The structure of the credit management process is based on the following stages:

a) Product design
b) Promotion
c) Evaluation
d) Formalization
e) Operation
f) Administration
g) Recovery

Procedures have also been implemented to ensure that past-due loans are timely transferred and recorded in the accounting, and those loans with recovery problems are properly and promptly identified.

Pursuant to Commission Circular B6, "Loan Portfolio", distressed portfolio is defined as the commercial loans which, based on the current information and facts as well as on the loan revision process, are very unlikely to be fully recovered (both principal and interest) pursuant to the original terms and conditions. The performing and past-due portfolios are susceptible to be identified as a distressed portfolio. The commercial loans rating's D and E risk degrees are shown below as distressed loans:

	2016	2016
Distressed commercial loans	**Ps. 6,355**	**Ps. 7,028**
Performing	1,481	1,375
Past-due	4,874	5,653
Commercial loans	**387,902**	**365,754**
Performing	386,236	365,595
Past-due	1,666	159
Total rated commercial loans	**394,257**	372,782
Total portfolio	**Ps. 637,182**	**Ps. 578,439**
Distressed Commercial Loans/Total Portfolio	**1.00%**	**1.21%**

The Institution's Treasury Department is the central unit responsible for balancing resource requirements and eliminating the interest rate risk derived from fixed rate transactions through the use of hedging and arbitrage strategies.

10 - LOANS RESTRUCTURED IN UDIS

As of December 31, 2017 and 2016 the Institution has no mortgage loans restructured in UDIS.

Early termination of mortgage loan borrower support programs

On June 30, 2010 the Federal Government through the SHCP and Banking Institutions signed an agreement for the early termination of the mortgage loan debtors support programs (punto final and UDIS trusts) (the Agreement) consequently as of January 1, 2011 the Institution absorbed its part of the early discount granted to mortgage loan debtors participating in the program.

The Agreement established a series of obligations for the Federal Government payable in 5 annual amortizations with a due date of June 1, 2015 which is when the last payment of Ps. 29 was received. Such payment included the monthly financial cost from the day immediately following the cut-off date and up to closing of the month immediately preceding the due date.

As of December 31, 2017 the remaining balance of SPECIAL CETES not repurchased by the Federal Government is Ps. 523 with maturities between 2017 and 2027.

11 - ALLOWANCE FOR LOAN LOSSES

The Institution's portfolio classification, which serves as the basis for recording the allowance for loan losses, is detailed below:

	2017						
	Loan portfolio	Required allowances for losses					
Risk category		Companies	Government	Financial institutions' loans	Consumer portfolio	Mortgage portfolio	Total
Risk A1	Ps. 496,602	Ps. 867	Ps. 479	Ps. 92	Ps. 833	Ps. 205	Ps. 2,476
Risk A2	50,260	229	161	6	498	37	931
Risk B1	32,473	88	24	11	866	23	1,012
Risk B2	13,977	89	-	-	378	35	502
Risk B3	12,918	133	20	2	464	21	640
Risk C1	8,197	87	-	7	462	76	632
Risk C2	6,065	60	-	3	654	130	847
Risk D	10,480	1,903	-	-	1,787	351	4,041
Risk E	6,338	828	-	-	3,395	56	4,279
Unclassified	(129)	-	-	-	-	-	-
	Ps. 637,181	**Ps. 4,284**	**Ps. 684**	**Ps. 121**	**Ps. 9,337**	**Ps. 934**	**Ps. 15,360**
Less: Recorded allowance							**15,551**
Reserve supplement*							**Ps. 191**

	2016						
	Loan portfolio	Required allowances for losses					
Risk category		Companies	Government	Financial institutions' loans	Consumer portfolio	Mortgage portfolio	Total
Risk A1	Ps. 440,096	Ps. 820	Ps. 518	Ps. 87	Ps. 599	Ps. 163	Ps. 2,188
Risk A2	49,381	233	46	9	532	50	870
Risk B1	24,130	128	33	3	522	23	709
Risk B2	24,088	60	57	1	781	35	934
Risk B3	13,375	140	58	2	419	10	629
Risk C1	6,877	87	16	2	416	46	567
Risk C2	5,331	52	-	-	672	75	799
Risk D	10,540	2,045	-	155	1,521	283	4,004
Risk E	4,652	856	-	2	2,132	62	3,052
Unclassified	(31)	-	-	-	-	-	-
	Ps. 578,439	**Ps. 4,421**	**Ps. 728**	**Ps. 261**	**Ps. 7,594**	**Ps. 747**	**Ps. 13,752**
Less: Recorded allowance							**13,941**
Reserve supplement*							**Ps. 189**

*The recorded reserves supplement conforms to the Provisions to cover 100% of the past-due interest and for the effects of inquiries in the credit bureau.

As of December 2017 and 2016, the amount of the rating base for loan portfolios includes Ps. 21,438 and Ps. 11,357, respectively, for Granted Guarantors and Loan Acquisitions, which were recorded in memorandum accounts. Ps. 30 and Ps. 52 were also added for loans to consolidated related parties.

The estimated allowance for loan losses is determined based on portfolio balances at those dates.

As of December 31, 2017 and 2016, the allowance for loan losses represents 128% and 139%, respectively, of the past-due portfolio.

The estimated allowance includes the classification of loans granted in foreign currency, which are evaluated at the exchange rate in effect as of December 31, 2017 and 2016.

Exposure to Default, Probability of Non-Compliance and Severity of the Loss are shown below for each type of loan as of December 31, 2017.

Type of portfolio	Exposure to Default	Weighted Probability of Non-compliance	Weighted Severity of Loss
Commercial*	318,250	5.9%	23.6%
Mortgage	136,728	3.3%	20.7%
Non-revolving consumer	70,233	9.4%	69.4%
Revolving Consumer loan	53,044	11.8%	76.3%

* Loans intended for investment projects having their own source of payment are not included.

Movements in Allowance for Loan Losses

An analysis of the movements in allowance for loan losses is detailed below:

	2017	2016
Balance at the beginning of the year	Ps. 13,941	Ps. 13,334
Increase charged to results	14,628	12,727
Discounts and write-offs	(13,691)	(12,669)
Rebates granted to housing debtors	(9)	(8)
Recognized against results of previous years	1,015	672
Reclassification INB	-	(197)
Venta de Cartera	(321)	-
Others	(12)	82
Year-end balance	**Ps. 15,551**	**Ps. 13,941**

As of December 31, 2017, the net amount of preventive loan loss reserves charged to the consolidated Income Statement totals Ps. 14,983, and is presented net of (Ps. 343) paid to Other income or expenses, and due to the variation of the USD (Ps. 12) exchange rate; such amounts are affected against results is comprised of Ps. 14,628 credited directly to the estimate. As of December 31, 2016, the net amount of preventive loan loss reserves charged to the consolidated Income Statement totals Ps. 13,070, and is presented net of (Ps. 424) paid to Other income or expenses, and due to the variation of the USD $81 exchange rate; such amounts are affected against results is comprised of Ps. 12,727 credited directly to the estimate.

12 - ACQUIRED COLLECTION RIGHTS

The acquired collection rights are comprised as follows:

Valuation Method	2017	2016
Cash Basis Method	Ps. 1,378	Ps. 936
Cost Recovery Method	526	425
Interest method	21	39
	Ps. 1,925	**Ps. 1,400**

As of December 31, 2017, derived from applying the valuation methods (described in Note 4), the Institution recognized income from credit asset portfolios of Ps. 435, together with the respective amortization of Ps. 304, the effects of which were recognized under the “Other income” heading in the consolidated Income Statement. For the year ended December 31, 2016, the Institution recognized income of Ps. 392, together with the respective amortization of Ps. 251.

The Institution performs an analysis based on events or information to estimate the amount of expected cash flows to determine the estimated rate of return used in applying the valuation method for the amortization of the accounts receivable. If based on current events information, the analysis demonstrates that the expected future cash flows will decrease to the degree that they will not cover the book value, it will constitute an estimate for non-recoverability or difficult collection against the year’s results for the amount that such expected cash flows are lower than the book value of the accounts receivable.

Assets other than cash that the Institution has received as part of portfolio collection or recovery have been mainly in real estate property.

The main feature considered for segmenting acquired portfolios has been the type of loan.

13 - OTHER ACCOUNTS RECEIVABLE, NET

This item is made up as follows:

	2016	**2015**
Loans to officers and employees	Ps. 2,595	Ps. 2,573
Debtors from liquidation settlements	12,710	17,754
Debtors from cash collateral	17,663	16,011
Real estate property portfolios	1,264	217
Sundry debtors in Mexican pesos	3,241	3,702
Sundry debtors in foreign currency	353	78
Others	122	8
	37,948	40,343
Allowance for doubtful accounts	(456)	(354)
	Ps. 37,492	**Ps. 39,989**

The loans to officers and employees mature in 3 to 30 years, and accrue an interest rate which goes from TIIE plus 0.6% to TIIE plus 1%.

14 -FORECLOSED ASSETS, NET

This item is made up as follows:

	2017	**2016**
Moveable property	Ps. 81	Ps. 86
Real estate property	2,437	2,610
Goods pledged for sale	8	10
	2,526	**2,706**
Allowance for losses on foreclosed assets	(47)	(30)
Allowance for losses on foreclosed real estate assets	(1,723)	(1,449)
Allowance for losses on assets pledged for sale	(4)	(5)
	(1,774)	**(1,484)**
	Ps. 752	**Ps. 1,222**

As of December 31, 2017, aging of the reserves for foreclosed assets is made up as follows:

Concept / Months	**18 to 24**	**More than 24**	**Total**
Moveable property	Ps. 25	Ps. 22	Ps. 47

Concept / Months	**12 to 24**	**24 to 30**	**30 to 36**	**36 to 42**	**42 to 48**	**More than 48**	**Total**
Real estate property	Ps. 11	Ps. 14	Ps. 8	Ps. 4	Ps. 101	Ps. 1,585	Ps. 1,723
Goods pledged for sale	-	-	-	-	-	4	4
	Ps. 11	**Ps. 14**	**Ps. 8**	**Ps. 4**	**Ps. 101**	**Ps. 1,589**	**Ps. 1,727**

15 - PROPERTY, FURNITURE AND FIXTURES, NET -

This item is made up as follows:

	2017	2016
Furniture and equipment	Ps. 10,241	Ps. 8,732
Property intended for offices	8,977	8,150
Installation costs	5,746	5,287
	24,964	**22,169**
Less - Accumulated depreciation and amortization	(11,490)	(10,242)
	Ps. 13,474	**Ps. 11,927**

The depreciation recorded in the results of 2017 and 2016 was Ps. 1,533 and Ps. 1,084, respectively.

The average estimated useful lives of the Institution's assets subject to depreciation are listed below:

	Useful Life
Furniture and equipment	4 to 10 years
Real estate	4 to 99 years
Installation costs	10 years

16 - PERMANENT STOCK INVESTMENTS -

Investments in associated companies are valued according to the equity method, as detailed below:

	Share %	2017	2016
Controladora PROSA, S. A. de C. V.	19.73%	Ps. 64	Ps. 101
Fondo Chiapas, S.A. de C.V.	11.11%	17	15
Others	Various	69	69
		Ps. 150	**Ps. 185**

The Institution exercises significant influence over its affiliates valued under the equity method through its representation in the board of directors or equivalent management body, as well as through significant intercompany transactions.

17 - DEFERRED TAXES, NET

The tax reported by the Institution is calculated based on the current taxable result of the year and enacted tax regulations. However, due to temporary differences between how income and expenses are recognized for accounting and tax purposes, as well as the differences between the accounting and tax balance sheet accounts, the Institution has recognized a recoverable net deferred tax asset of Ps. 3,517 and Ps. 4,228, respectively, as of December 31, 2017 and 2016 as detailed below:

	2017		2016	
	Temporary Differences	Deferred Effect ISR	Temporary Differences	Deferred Effect ISR
Temporary Differences - Assets				
Allowance for loan losses	Ps. 1	Ps. -	Ps. 1	Ps. -
Surplus preventive allowances for credit risks over the net tax limit	15,551	4,665	13,941	4,182
Excess of tax over book value of foreclosed and fixed assets	2,645	792	2,647	791
PTU	380	114	380	114
Fees collected in advance	2,843	853	2,571	771
Accounting provisions	3,060	918	3,043	913
Financial instruments valuation	2,280	684	4,306	1,292
Other assets	-	-	2	1

Total deferred assets	**Ps. 26,760**	**Ps. 8,026**	**Ps. 26,891**	**Ps. 8,064**
Temporary Differences_- Liabilities				
Advance contributions to pension fund	Ps. 2,968	Ps. 890	Ps. 3,254	Ps. 976
Portfolios acquired	486	146	606	182
Capitalizable projects’ expenses	11,559	3,468	8,882	2,665
Intangible assets	62	18	74	20
Effect from other items	(35)	(13)	(19)	(7)
Total deferred liabilities	**15,040**	**4,509**	**12,797**	**3,836**
Net accumulated effect				
Deferred tax, net		**Ps. 3,517**		**Ps. 4,228**

As explained in Note 26, for 2017, 2016 and subsequent years, the applicable ISR rate is 30%.

Banorte USA’s deferred tax assets and liabilities are determined using the liability method. According to this method, the net asset or liability of deferred taxes is determined based on the tax effects of temporary differences between the book and tax base of assets and liabilities. Derived from consolidating Banorte USA, as of December 31, 2017 and 2016 a net amount of Ps. 1 and 16, respectively, was added to deferred taxes determined at a rate of 21% and 35% as per the tax law of the USA.

18 - OTHER ASSETS

This item is made up as follows:

	2017	2016
Net asset forecast from labor obligations and savings fund	Ps. 80	Ps. 2,851
Payments to amortize	13,914	11,763
Accumulated payment amortization	(2,248)	(1,709)
Goodwill	1,385	1,406
	Ps. 13,131	**Ps. 14,311**

As of December 31, 2017 and 2016, goodwill is as follows:

	2017	2016
Banorte-Ixe Tarjetas, S.A. de C.V. SOFOM, ER*	1,005	1,005
Uniteller Financial Services	380	401
	Ps. 1,385	**Ps. 1,406**

Includes Ps. 727 of goodwill generated by the acquisition of Banorte-Ixe Tarjetas, S.A. de C.V. SOFOM, ER and Ps. 278 this business entity recorded at the time of the acquisition.

As mentioned in Note 4, goodwill is not amortized since 2007 and since then is subject to annual impairment tests. No impairment to goodwill value was detected as of December 31, 2017 and 2016.

19 - DEPOSITS

Liquidity Coefficient

The “Investment regime for transactions in foreign currency and conditions to be fulfilled during the term of transactions in such currency”, designed for credit institutions by Banco de México, establishes the mechanism for determining the liquidity coefficient of liabilities denominated in foreign currency.

In accordance with such regime, during 2017 and 2016 the Institution generated a liquidity requirement of USD 981,294 thousand and USD 383,170 thousand, respectively, and held investments in liquid assets of USD 1,525,564 thousand and USD 1,106,523 thousand, representing a surplus of USD 544,270 thousand and USD 723,353 thousand, respectively.

Deposits

The liabilities derived from core deposits are made up as follows:

	2017	2016
Demand deposits		
Non-interest Bearing Checking accounts:		
Cash deposits	Ps. 215,800	Ps. 210,850
Checking accounts in US dollars for individual residents on the Mexican border	3,093	2,621
Demand deposits accounts	18,677	16,572
Interest Bearing Checking accounts:		
Other bank checking deposit	82,625	80,433
Savings accounts	-	-
Checking accounts in US dollars for individual residents on the Mexican border	1,909	2,110
Demand deposits accounts	72,891	69,823
	394,995	**382,409**
Time deposits		
General public:		
Fixed-term deposits	21,656	18,938
Retail time deposits	221,746	169,687
Promissory note with interest payable at maturity PRLV primary market for individuals	794	1,248
Foreign residents deposits	12	14
Provision for interest	1,080	649
	245,288	**190,536**
Money market:		
Over the counter promissory notes	3,678	1,458
Provision for interest	1	1
	3,679	**1,459**
Senior debt issued	**3,003**	**-**
Global account with no movements	**1,657**	**1,352**
	Ps. 648,622	**Ps. 575,756**

The funding rates which the Institution uses as reference are: a) for Mexican pesos, Interbank Interest Rate (TIIE), Average Cost of Funds (CCP) and; b) for foreign currency, the London Interbank Offered Rate (LIBOR).

These liabilities incur interest depending on the type of instrument and average balance held in the investments. The average interest rates and their currency of reference are shown below:

Immediately Due and Payable Deposits:

	2017				2016			
Foreign exchange	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**
Mexican pesos and UDIS	0.52%	0.66%	0.80%	0.76%	0.49%	0.46%	0.47%	0.47%
Foreign Currency	0.02%	0.02%	0.02%	0.02%	0.02%	0.02%	0.02%	0.02%

Time Deposits:

	2017				2016			
Foreign exchange	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**
General public								
Mexican pesos and UDIS	4.85%	5.50%	5.86%	5.57%	2.75%	3.12%	3.43%	3.98%
Foreign Currency	0.18%	0.18%	0.19%	0.20%	0.37%	0.23%	0.18%	0.22%
Money market	4.31%	6.64%	7.40%	7.27%	3.52%	3.10%	2.76%	3.72%

As of December 31, 2017 and 2016, the terms set for these deposits are as follows:

	2017			
	1 to 179 days	**6 to 12 months**	**More than 1 year**	**Total**
General public:				
Fixed-term deposits	Ps. 19,293	Ps. 1,863	Ps. 500	Ps. 21,656
Retail time deposits	211,259	10,053	434	221,746
Promissory note with interest payable at maturity				
PRLV primary market for individuals	749	27	18	794
Foreign residents deposits	12	-	-	12
Provision for interest	862	204	14	1,080
	232,175	**12,147**	**966**	**245,288**
Money market:				
Promissory notes	-	-	3,678	3,678
Provision for interest	-	-	1	1
	-	**-**	3,679	3,679
	Ps. 232,175	**Ps. 12,147**	**Ps. 4,645**	**Ps. 248,967**

	2016			
	1 to 179 days	**6 to 12 months**	**More than 1 year**	**Total**
General public:				
Fixed-term deposits	Ps. 16,882	Ps. 1,384	Ps. 672	Ps. 18,938
Retail time deposits	163,040	6,388	259	169,687
Promissory note with interest payable at maturity				
PRLV primary market for individuals	1,143	63	43	1,248
Foreign residents deposits	14	-	-	14
Provision for interest	562	82	4	649
	181,641	**7,917**	**978**	**190,536**
Money market:				
Promissory notes	-	-	1,458	1,458
Provision for interest	-	-	1	1
	-	**-**	1,459	1,459
	Ps. 181,641	**Ps. 7,917**	**Ps. 2,437**	**Ps. 191,995**

20 - INTERBANK AND OTHER LOANS

The loans received from other banks as of December 31, 2017 and 2016 are as follows:

	Mexican pesos		**Denominated in USD**		**Total**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
Immediately due:						
Domestic banks (Call money)	Ps. -	Ps. 4,019	Ps. -	Ps. -	Ps. -	Ps. 1
Short-term:						
Commercial banking	-	-	104	15	104	15
Development banking	251	315	39	520	290	835
Public trusts	7,487	6,336	536	857	8,023	7,193
Provision for interest	17	14	7	6	24	20
	7,755	**6,665**	**686**	**1,398**	**8,441**	**8,063**
Long-term:						
Commercial banking	-	-	-	2,567	-	2,567
Development banking	-	-	2,804	2,751	2,804	2,751
Public trusts	3,530	3,537	463	323	3,993	3,860
	3,530	**3,537**	**3,267**	**5,641**	**6,797**	**9,178**
	Ps. 11,285	**Ps. 14,221**	**Ps. 3,953**	**Ps. 7,039**	**Ps. 15,238**	**Ps. 21,260**

These liabilities incur interest depending on the type of instrument and average balance of the loans.

The average interest rates are shown below:

	2017				2016			
Foreign exchange	**1Q**	**2Q**	**3Q**	**4Q**	**1Q**	**2Q**	**3Q**	**4Q**
Call money								
Mexican pesos and UDIS	5.82%	6.80%	6.79%	6.89%	3.27%	3.15%	4.15%	5.07%
Other bank loans								
Mexican pesos and UDIS	11.31%	10.66%	9.17%	10.50%	4.28%	4.33%	4.85%	5.14%
Foreign Currency	2.35%	2.53%	2.96%	3.37%	2.14%	2.06%	2.16%	2.39%

21 - SUNDRY CREDITORS AND OTHER PAYABLES

This item is made up as follows:

	2017	2016
Cashier and certified checks and other negotiable instruments	Ps. 2,803	Ps. 2,729
Provisions for indemnities	514	407
Provisions for other obligations	6,720	6,985
Others	6,860	4,323
	Ps. 16,897	**Ps. 14,444**

22 - EMPLOYEE RETIREMENT OBLIGATIONS

The Institution recognizes the liabilities for pension plans and seniority premiums using the "Projected Unit Credit" method, which considers the benefits accrued at the date of the consolidated balance sheets and the benefits generated during the year.

The amount of current and projected benefits as of December 31, 2017 and 2016, related to the defined benefit pension plan, seniority premiums and retiree medical coverage, determined by independent actuaries, is analyzed below:

	2017			
	Pension plan	**Seniority premiums**	**Medical services**	**Total**
Projected benefit obligation (PBO)	(Ps. 1,279)	(Ps. 248)	(Ps. 3,571)	(Ps. 5,098)
Fund market value	813	235	2,518	3,566
Funded status	(466)	(13)	(1,053)	(1,532)
Unrecognized prior service cost	-	-	110	110
Unrecognized actuarial losses	461	11	944	1,416
Net projected asset	**(Ps. 5)**	**(Ps. 2)**	**Ps. 1,967**	**(Ps. 6)**

	2016			
	Pension plan	**Seniority premiums**	**Medical services**	**Total**
Projected benefit obligation (PBO)	(Ps. 1,227)	(Ps. 239)	(Ps. 3,399)	(Ps. 4,865)
Fund market value	1,228	339	3,852	5,419
Funded status	1	100	453	554
Unrecognized prior service cost	-	-	146	146
Unrecognized actuarial losses	667	17	1,368	2,052
Net projected asset	**Ps. 668**	**Ps. 117**	**Ps. 1,967**	**Ps. 2,752**

Moreover, as of December 31, 2017, a separate fund amounting to Ps. 3,566, (Ps. 5,419 in 2016) has been set aside to meet the above-mentioned obligations, in accordance with NIF D-3 and is recorded under "Other assets". For the years ended December 31, 2017 and 2016, the net periodic pension cost is as follows:

	2017	2016
Service cost	Ps. 102	Ps. 123
Interest cost	428	406
Expected return on plan assets	(486)	(472)
Amortizations of unrecognized items:		
Profits (actuarial losses)	136	158
Cost of the advance reduction/liquidation of obligations	4	1
Net periodic pension cost	**Ps. 184**	**Ps. 215**

The rates used in the calculation of the projected benefit obligation and return on plan assets as of December 31, 2017 and 2016, are shown below:

Concept	2017 Nominal	2016 Nominal
Discount rate	9.25%	9.00%
Rate of wage increase	4.50%	4.50%
Long-term inflation rate	3.50%	3.50%
Expected long-term rate of return on plan assets	3.50%	8.75%

The liability for severance indemnities due to causes other than organization restructuring, which was also determined by independent actuaries, is comprised as follows:

Concept	2017	2016
Defined and projected benefit obligations	(Ps. 261)	(Ps. 248)
Net projected liability	**(Ps. 261)**	**(Ps. 248)**

For the years ended December 31, 2017 and 2016, the net periodic pension cost is as follows:

Concept	2017	2016
Service cost	Ps. 11	Ps. 34
Cost / (income) for immediate recognition of P/(G)	7	14
Net periodic pension cost	**Ps. 18**	**Ps. 48**

Pursuant to the law, the Institution makes payments equivalent to 2% of its workers' salary to the contribution plan defined for the retirement saving fund established by law. The expense for this concept was Ps. 128 in 2017 and Ps. 124 in 2016.

The balance of the employee retirement obligations presented in this Note refers to the Institution's defined benefit pension plan for those employees who remain enrolled.

The labor obligations derived from the defined contribution pension plan do not require an actuarial valuation as established in MFRS D-3, because the cost of this plan is equivalent to the Institution's contributions made to the plan's participants. This pension plan is invested in a fund as of December 31, 2017 and 2016, equivalent to Ps. 2,846 and Ps. 2,506, respectively, which is recorded under "Other assets" and is equivalent to the recorded plan liability.

23 - SUBORDINATED DEBENTURES

As of December 31, 2017 and 2016, the subordinated debentures in circulation are as follows:

	2017	2016
Non-preferred subordinated obligations not susceptible to be converted into share capital BANOC36 311004 with maturity in October 2031, denominated in USD, with an interest rate of 5.75% payable semiannually and amortizing the capital at maturity.	Ps. 9,831	Ps. 10,310
Preferred subordinated nonconvertible debentures, QBANORTE 12 maturing in May 2022, paying interest at the 28-day TIIE rate plus 1.5%, payable in 130 periods of 28 days each.	-	3,200
Non preferred subordinated nonconvertible debentures (Q BANORTE 08 debentures), maturing in February 2018, paying interest at the 28-day TIIE rate plus 0.60%.	-	3,000
Non-preferred subordinated obligations, non-preferent, perpetual, non-cumulative 5 years callable BANOD19 999999 denominated in USD, with an interest rate of 6.875%.**	6,882	-
Non-preferred subordinated obligations, non preferent, perpetual, non-cumulative 10 years callable BANOE91 999999 denominadas in USD, with an interest rate of 7.625%.**	10,815	-
Preferred subordinated nonconvertible debentures, Q BANORTE 08-U maturing in February 2028, interest at a 4.95% annual rate.	2,653	2,487
Nonpreferred subordinated nonconvertible debentures IXEGB40 141020, maturing in October 2020, denominated in US dollars, at an interest rate of 9.25%, payable semiannually with a final principal payment at maturity.	2,360	2,472
Subordinated debentures, maturing in June 2034, denominated in US dollars, at a 3-month LIBOR interest rate plus 2.75%.*	-	212
Preferred subordinated debentures maturing in April 2034, denominated in US dollars, at a 3-month LIBOR interest rate plus 2.72%.*	-	212
Accrued interest	229	24
Gastos de emisión y colocación.	(325)	-
	Ps. 32,445	**Ps. 21,917**

These obligations were liquidated prematurely as part of the sale of INB.
** The above mentioned emission was registered as a liability and the interests generated by the notes are payable against the retained earnings from prior years, considering the characteristic established in the obligations to pay in an optional way the yields to election of the issuer, what is considered to be a capital component.

The costs related to these debentures are amortized using the straight-line method over the term of the debt. The amortization charged to results was Ps. 18 and Ps. 10 in 2017 and 2016, respectively.

24 – TRANSACTIONS AND BALANCES WITH SUBSIDIARIES AND ASSOCIATED COMPANIES

The balances and transactions with subsidiaries and associated companies as of December 31, 2016 and 2015 are made up as follows:

	Revenues		Accounts receivable	
Institution	**2017**	**2016**	**2017**	**2016**
Arrendadora y Factor Banorte, S.A. de C.V.	Ps. 469	Ps. 207	Ps. 6,451	Ps. 5,272
Almacenadora Banorte, S.A. de C.V.	19	19	327	390
Seguros Banorte, S.A. de C.V.	815	694	105	62
Pensiones Banorte, S.A. de C.V.	1	1	-	-
Casa de Bolsa Banorte-Ixe, S.A. de C.V.	2,167	1,368	15	-
Ixe Fondos, S.A. de C.V.	460	369	50	35
Sólida Administradora de Portafolios, S.A. de C.V.	852	567	10,810	10,132
Total	**Ps. 4,783**	**Ps. 3,225**	**Ps. 17,758**	**Ps. 15,891**

Institution	Expenses		Accounts payable	
	2017	2016	2017	2016
Grupo Financiero Banorte, S.A.B. de C.V.	Ps. 240	Ps. 54	Ps. 10,996	Ps. 3,524
Arrendadora y Factor Banorte, S.A. de C.V.	20	15	255	94
Almacenadora Banorte, S.A. de C.V.	1	1	-	2
Seguros Banorte, S.A. de C.V.	720	648	310	320
Pensiones Banorte, S.A. de C.V.	-	-	1	1
Casa de Bolsa Banorte-Ixe, S.A. de C.V.	692	356	949	609
Operadora de Fondos Banorte-Ixe, S.A. de C.V.	19	15	324	265
Ixe Servicios, S.A. de C.V.	2	1	34	32
Sólida Administradora de Portafolios, S.A. de C.V.	3	4	98	19
Banorte Ahorro y Previsión, S.A. de C.V.	1	-	402	-
Total	**Ps. 1,698**	**Ps. 1,094**	**Ps. 13,369**	**Ps. 4,866**

The premiums paid and collected in repurchase operations with Banorte-Ixe Brokerage House and Grupo Financiero Banorteare among the most significant transactions, as well as the account receivable from Banorte Leasing and Factor and Sólida Administradora de Portafolios corresponding to loans granted.

Pursuant to Article 73 Bis of the LIC, the transactions granted by Banking Institutions to related parties may not exceed 35% of the basic part of its net capital.

For the years ended December 31, 2017 and 2016, the amount of the loans granted to related parties was as follows:

Institution granting the loan	2017	% over the limit	2016	% over the limit
Banco Mercantil del Norte, S.A.	Ps. 19,410	19.8%	Ps. 9,792	11.8%

The transactions granted by Banorte to related parties are under the 100% limit set forth by the LIC.

Loan Portfolio Sales

During June, 2017 the Institution realized the sale of consumer loans to Sólida. The contractual value of the acquired portfolio amounted to Ps. 3,134 (Ps. 3,000 net of allowance).

During September, 2017 the Institution realized the sale of consumer loans to Sólida. The contractual value of the acquired portfolio amounted to Ps. 4,166 (Ps. 4,000 net of allowance).

<u>Sale of loan portfolio packages between related parties (nominal values)</u>

In February 2003 Banorte sold Ps. 1,925 of its own portfolio (with interest) to its subsidiary Sólida at a price of Ps. 378. Of this transaction, Ps. 1,861 relates to past-due amounts and Ps. 64 to performing loans. The transaction was recorded based on figures as of August 2002, for which reason the final amount affecting the February 2003 balance sheet was Ps. 1,856, considering the collections made since August 2002. In conjunction with the sold loan portfolio, Ps. 1,577 of the associated allowance for loan losses was transferred as well.

In official letter 601-II-323110 dated November 5, 2003, the Commission established the accounting criteria to be applied to this transaction and issued a series of rulings whereby the Institution must provide detailed information on the activities of this transaction throughout its duration, in the understanding that this transaction was a one-time event and not a recurring portfolio transfer procedure.

Pursuant to the foregoing, below is a summary of the activity of the loan portfolio sold to Sólida since August 2002 and for the years of 2017 and 2016:

	Mexican pesos			Foreign Currency			Total		
Type of portfolio	**Aug 02**	**Dec 16**	**Dec 17**	**Aug 02**	**Dec 16**	**Dec 17**	**Aug 02**	**Dec 16**	**Dec 17**
Performing Loan Portfolio									
Commercial	Ps. 5	Ps. -	Ps. -	Ps. 5	Ps. -	Ps. -	Ps. 10	Ps. -	Ps. -
Mortgage	54	22	19	-	-	-	54	22	19
Total	**59**	**22**	**19**	**5**	**-**	**-**	**64**	**22**	**19**
Past-due loan portfolio									
Commercial	405	192	184	293	13	1	698	205	185
Consumer	81	71	71	-	-	-	81	71	71
Mortgage	1,112	203	205	-	-	-	1,112	203	205
Total	**1,598**	**466**	**460**	**293**	**13**	**1**	**1,891**	**479**	**461**
Total portfolio	**1,657**	**488**	**479**	**298**	**13**	**1**	**1,955**	**501**	**480**
Allowance for loan losses(1)									
Commercial	326	192	184	246	13	1	572	205	185
Consumer	77	71	71	-	-	-	77	71	71
Mortgage	669	214	205	-	-	-	669	214	205
Total allowance for loan loss	**1,072**	**477**	**460**	**246**	**13**	**1**	**1,318**	**490**	**461**
Net portfolio	**Ps. 585**	**Ps. 11**	**Ps. 19**	**Ps. 52**	**Ps. -**	**Ps. -**	**Ps. 637**	**Ps. 11**	**Ps. 19**

(1) Recorded reserves according to the Institution's rating methodology.

As of December 31, 2017 and 2016, the composition of the Institution's loan portfolio excluding its subsidiaries, including the loan portfolio sold to Sólida, is as follows:

	Mexican pesos		Foreign Currency		Total	
Type of portfolio	**Dec 16**	**Dec 15**	**Dec 16**	**Dec 15**	**Dec 16**	**Dec 15**
Commercial loans	Ps. 321,767	Ps. 313,319	Ps. 44,384	Ps. 42,279	Ps. 366,151	Ps. 355,598
Consumer loans	101,996	86,632	-	-	101,996	86,632
Mortgage loans	135,424	114,828	-	-	135,424	114,828
Performing Loan Portfolio	**559,187**	**514,779**	**42,279**	**42,279**	**603,571**	**557,059**
Commercial loans	5,115	5,862	141	141	6,725	6,003
Consumer loans	4,400	3,271	-	-	4,400	3,271
Mortgage loans	1,528	1,252	-	-	1,528	1,252
Past-due loan portfolio	**11,043**	**10,385**	**141**	**141**	**12,653**	**10,526**
Total portfolio	**570,230**	**525,164**	**42,220**	**42,220**	**612,224**	**567,584**
Allowance for loan losses	15,685	14,116	323	323	16,012	14,439
Net portfolio	**Ps. 554,545**	**Ps. 511,048**	**Ps. 45,667**	**Ps. 42,097**	**Ps. 600,012**	**Ps. 553,145**
Allowance for loan losses					**126.55%**	**137.18%**
% of past-due portfolio					**2.05%**	**1.85%**

25 – INFORMATION BY SEGMENT

The main operations and balances per concept and/or business segment in the general balance sheet and the statement of income are comprised as follows:

a. Interest and fees income is made up as follows:

	2017		
	Interest	**Fees**	**Total**
	MXP	**MXP**	**MXP**
Cash and cash equivalents	Ps. 2,354	Ps. -	Ps. 2,354
Margin securities	110	-	110
Investment in securities	18,417	-	18,417
Securities repurchasing and loans	2,283	-	2,283
Hedging transactions	5,073	-	5,073
Commercial loans	31,524	439	31,963
Mortgage loans	12,284	514	12,798
Consumer loans	22,488	216	22,704
Others	8	-	8
	Ps. 94,541	**Ps. 1,169**	**Ps. 95,710**

	2016		
	Interest	**Fees**	**Total**
	MXP	**MXP**	**MXP**
Cash and cash equivalents	Ps. 1,625	Ps. -	Ps. 1,625
Margin securities	119	-	119
Investment in securities	11,470	-	11,470
Securities repurchasing and loans	1,417	-	1,417
Hedging transactions	2,324	-	2,324
Commercial loans	21,690	465	22,155
Mortgage loans	10,501	471	10,972
Consumer loans	18,900	263	19,163
Others	162	-	162
	Ps. 62,808	**Ps. 1,199**	**Ps. 69,407**

b. The composition of interest expense, segmented by type of deposit, is as follows:

	2017			2016		
	MXP	**F.E.**	**Total**	**MXP**	**F.E.**	**Total**
Immediately Due and Payable Deposits:						
Checking accounts	Ps.1,903	Ps.-	Ps.1,903	Ps. 1,044	Ps. -	Ps. 1,044
Savings accounts	302	-	302	374	-	374
	2,205	-	2,205	1,418	-	1,418
Time Deposits:						
General public	12,073	26	12,099	6,259	36	6,295
Money market	501	-	501	73	-	73
	12,574	26	12,600	6,332	36	6,368
Total	**Ps.14,779**	**Ps. 26**	**Ps.14,805**	**Ps. 7,750**	**Ps. 36**	**Ps. 7,786**

c. The composition of interest and commission expense, segmented by type of loan, is as follows:

	2017			2016		
	MXP	F.E.	Total	MXP	F.E.	Total
Call money	Ps. 114	Ps. -	Ps. 114	Ps. 35	Ps. -	Ps. 35
Banco de México	5	-	5	6	-	6
Commercial banks	405	23	428	-	34	34
Development banking	767	-	767	512	-	512
Provision for interest	11	-	11	19	-	19
Total	**Ps. 1,302**	**Ps. 23**	**Ps. 1,325**	**Ps. 570**	**Ps. 34**	**Ps. 606**

d. The trading results are as follows:

	2017	2016
Trading results:		
Spot foreign currency	(Ps. 130)	Ps. 54
Derivatives financial instruments	737	386
Investments in securities	(722)	(125)
Valuation	**(115)**	**315**
Purchase-sales result, net		
Spot foreign currency	Ps. 1,729	Ps. 1,511
Derivatives financial instruments	137	(14)
Investments in securities	350	27
Total trading results	**2,216**	**1,524**
Total trading results	**Ps. 2,101**	**Ps. 1,839**

e. The current loan portfolio, grouped by economic sector and geographical location, is as follows

	2017				
	Geographical location				
Economic sector	**North**	**Center**	**West**	**South**	**Total**
Agriculture	Ps. 3,996	Ps. 1,232	Ps. 1,383	Ps. 1,516	Ps. 8,127
Mining	38	2,760	-	1	2,799
Manufacturing	14,389	12,774	2,246	1,849	31,258
Construction	9,625	20,543	758	2,049	32,975
Public utilities	387	6,192	5	7	6,591
Commerce	21,752	24,182	6,068	11,552	63,554
Transportation	3,144	15,657	364	964	20,129
Financial services	18,463	3,596	285	651	22,995
Communal, social services	14,756	23,957	2,755	3,564	45,032
Public administration and services	40,516	66,687	11,340	14,273	132,816
Credit card	-	-	-	-	33,908
Consumer	-	-	-	-	68,091
Mortgage	-	-	-	-	135,247
Performing loan portfolio	**Ps. 127,066**	**Ps. 177,580**	**Ps. 25,204**	**Ps. 36,426**	**Ps. 603,522**

	2016				
	Geographical location				
Economic sector	North	Center	West	South	Total
Agriculture	Ps. 3,590	Ps. 1,106	Ps. 1,431	Ps. 1,419	Ps. 7,546
Mining	50	94	2	4	150
Manufacturing	15,788	14,206	2,028	3,328	35,350
Construction	9,637	27,058	1,045	1,951	39,691
Public utilities	370	1,668	5	5	2,048
Commerce	20,921	18,647	5,570	7,928	53,066
Transportation	4,451	10,513	323	895	16,182
Financial services	28,614	18,227	2,513	3,126	52,480
Communal, social services	3,251	10,170	514	1,545	15,478
Public administration and services	41,325	66,710	11,425	14,080	133,540
INB	41,325	66,710	11,425	14,080	133,540
Credit card	-	-	-	-	28,445
Consumer	-	-	-	-	58,187
Mortgage	-	-	-	-	114,807
Performing loan portfolio	**Ps. 127,997**	**Ps. 168,399**	**Ps. 24,856**	**Ps. 34,281**	**Ps. 556,972**

f. The past-due loan portfolio, grouped by economic sector and geographical location, is summarized as follows

	2017				
	Geographical location				
Economic sector	North	Center	West	South	Total
Agriculture	Ps. 61	Ps. 37	Ps. 6	Ps. 16	Ps. 120
Mining	-	-	-	-	-
Manufacturing	58	200	40	1,617	1,915
Construction	86	2,263	9	70	2,428
Public utilities	-	15	-	-	15
Commerce	276	739	138	301	1,454
Transportation	30	45	8	16	99
Financial services	-	-	2	-	2
Communal, social services	120	234	24	129	507
Credit card	-	-	-	-	2,188
Consumer	-	-	-	-	2,141
Mortgage	-	-	-	-	1,323
Past-due loan portfolio	**Ps. 631**	**Ps. 3,533**	**Ps. 227**	**Ps. 2,149**	**Ps. 12,192**

	2016				
	Geographical location				
Economic sector	North	Center	West	South	Total
Agriculture	Ps. 86	Ps. 49	Ps. 31	Ps. 17	Ps. 183
Mining	62	251	114	66	493
Manufacturing	119	3,024	6	73	3,222
Construction	-	-	-	-	-
Public utilities	348	512	120	317	1,297
Commerce	31	25	5	26	87
Transportation	26	18	2	15	61
Financial services	91	244	19	115	469
Communal, social services	-	-	-	-	1,623
INB	-	-	-	-	1,576
Credit card	-	-	-	-	1,049
Consumer	62	251	114	66	493
Mortgage	119	3,024	6	73	3,222
Past-due loan portfolio	**Ps. 763**	**Ps. 4,123**	**Ps. 297**	**Ps. 629**	**Ps. 10,060**

g. The assigned loan portfolio by responsibilities is made up as follows:

	2017		
	Commercial	**Corporate**	**Total**
Commercial	Ps. 275,756	Ps. 90,366	Ps. 366,122
Consumer loans	101,995	-	101,995
Housing mortgage loans	135,405	-	135,405
Total performing loan portfolio	**513,156**	**90,366**	**603,522**
Commercial	3,061	3,479	6,540
Consumer loans	4,329	-	4,329
Housing mortgage loans	1,323	-	1,323
Total past-due loan portfolio	**8,713**	**3,479**	**12,192**
Total loan portfolio	**521,870**	**93,845**	**615,714**
Allowance for loan losses	(15,551)	-	(15,551)
Loan portfolio, net	**506,319**	**93,845**	**600,163**
Acquired collection rights	1,925	-	1,925
Total loan portfolio, net	**Ps. 508,243**	**Ps. 93,845**	**Ps. 602,088**

	2016		
	Commercial	**Corporate**	**Total**
Commercial	Ps. 263,280	Ps. 92,254	Ps. 355,533
Consumer loans	86,632	-	86,632
Housing mortgage loans	114,807	-	114,807
Total performing loan portfolio	**464,717**	**92,254**	**556,972**
Commercial	3,223	2,588	5,811
Consumer loans	3,200	-	3,200
Housing mortgage loans	1,049	-	1,049
Total past-due loan portfolio	**7,472**	**2,588**	**10,060**
Total loan portfolio	**472,189**	**94,842**	**567,032**
Allowance for loan losses	(13,941)	-	(13,941)
Loan portfolio, net	**458,248**	**94,842**	**553,091**
Acquired collection rights	1,400	-	1,400
Total loan portfolio, net	**Ps. 459,648**	**Ps. 94,842**	**Ps. 554,491**

h. Deposit accounts grouped by product and geographical location are as follows:

	2017							
	Geographical location							
Product	**Monterrey**	**Mexico City**	**West**	**Northwest**	**South-east**	**Treasury and other**	**Foreign**	**Total**
Non-interest bearing checking accounts	Ps. 46,881	Ps. 76,343	Ps. 23,016	Ps. 23,001	Ps. 27,536	Ps. 644	Ps. -	Ps. 197,421
Interest-bearing checking accounts	18,644	55,158	7,672	9,322	22,712	558	-	Ps. 114,066
Current account Ps. and pre-established	8,026	13,918	3,668	3,730	5,472	4	-	Ps. 34,818
Non-interest bearing demand deposits, USD	7,176	14,735	1,648	8,827	2,472	593	-	Ps. 35,451
Interest bearing demand deposits, USD	6,785	3,722	1,056	3,346	780	1	-	Ps. 15,690
Retail time deposits	37,255	78,331	17,176	15,142	24,698	1,083	-	Ps. 173,685
Time deposits, USD	3,819	10,963	1,605	2,146	755	27	3,003	Ps. 22,318
Customers Money market	17,651	19,539	4,297	1,465	2,475	6,074	-	Ps. 51,501
Financial intermediaries	-	-	-	-	-	3,672	-	Ps. 3,672
Total Deposits	**Ps. 146,237**	**Ps. 272,710**	**Ps. 60,138**	**Ps. 66,978**	**Ps. 86,900**	**Ps. 12,655**	**Ps. 3,003**	**Ps. 648,622**

	2016						
	Geographical location						
Product	**Monterrey**	**Mexico City**	**West**	**Northwest**	**South-east**	**Treasury and other**	**Total**
Non-interest bearing checking accounts	Ps. 46,533	Ps. 75,880	Ps. 23,494	Ps. 21,901	Ps. 27,042	Ps. 499	Ps. 195,349
Interest-bearing checking accounts	17,083	49,825	10,102	9,007	23,096	495	Ps. 109,608
Current account Ps. and pre-established	6,421	11,987	3,152	2,902	4,313	2	Ps. 28,777
Non-interest bearing demand deposits, USD	7,165	15,415	1,396	7,017	1,871	626	Ps. 33,490
Interest bearing demand deposits, USD	6,345	5,740	966	3,931	803	-	Ps. 17,785
Retail time deposits	31,467	68,789	14,734	12,367	20,704	650	Ps. 148,711
Time deposits, USD	7,675	4,788	1,741	2,519	1,036	27	Ps. 17,786
Customers Money market	11,362	6,956	2,007	1,368	1,054	44	Ps. 22,791
Financial intermediaries	-	-	-	-	-	1,459	Ps. 1,459
Total Deposits	**Ps. 134,051**	**Ps. 239,380**	**Ps. 57,592**	**Ps. 61,012**	**Ps. 79,919**	**Ps. 3,802**	**Ps. 575,756**

26 - PROFIT TAXES

The Institution is subject to Income Tax (ISR).

ISR

ISR According to the ISR Law, the rate for 2017 and 2016 and subsequent years is 30%

Conciliation of the accounting and fiscal results

The principal items affecting the determination of the current tax expense of the Institution were the annual adjustment for inflation, deduction of loan write-offs, and the valuation of financial instruments.

Reconciliation of the ISR legal rate and the effective rate expressed as a percentage of the profit before ISR and PTU is:

	2017	**2016**
Legal rate	30%	30%
Tax inflation	(4%)	(3%)
Non-tax accounting write-offs	2%	3%
Other entries	1%	(1%)
Effective rate	**29%**	**27%**

27 - STOCKHOLDERS' EQUITY

The Institution's shareholders' common stock is comprised as follows:

Paid-in Capital	Number of shares with a nominal value of Ps. 0.10	
	2017	2016
"O" Series	137,303,109,559	137,303,109,559

Paid-in Capital	Historical Amounts	
	2017	2016
"O" Series	Ps. 13,730	Ps. 13,730
Restatement in Mexican pesos through December 2007	4,375	4,375
	Ps. 18,105	**Ps. 18,105**

Restrictions on Profits

The distribution of stockholders' equity, except restated paid-in capital and retained tax earnings, will be subject to income tax on dividends payable by the Institution at the effective rate. Any tax paid on such distribution may be credited against that year's income tax paid on dividends and the two immediate fiscal years following such payment, charged against that year's tax and the provisional payments made.

The Institution's net profit is subject to Art. 99 A of the LIC that requires that net income of each year be transferred to the legal reserve until the reserve equals 10% of capital stock at par value. The legal reserve may not be distributed to the stockholders during the life of the Institution, except in the form of a stock dividend. As of December 31, 2017 and 2016, the legal reserve is Ps. 12,848 and Ps. 11,509 respectively, as of December 31, 2017 and 2016 represents 71% and 63% of paid-in capital.

Share-based Payments

During 2017 and 2016, the Institution recorded Ps. 576 and Ps. 408, respectively in administration expenses as compensarion for share-based payments against the paid-in capital.

As of December 31, 2017 and 2016, the Institution has 19,290,000 and 15,919,639 granted to its executives through various share-based payment plans. The share's average weighted price for all the plans during the year was Ps. 86.04 and Ps. 81.48.

During 2017 and 2016, 15,848,409 and 5,015,798 shares were operated, respectively.

Capitalization Ratio

The capitalization rules for financial institutions establish requirements for specific levels of net capital, as a percentage of assets subject to both market and credit risk.

The information for December 31, 2017 sent to Banco de México to review is shown below.

- The capitalization ratio of Banorte as of December 31, 2017 was 17.23% of total risk (market, credit and operational), and 21.18% of credit risk, which in both cases exceed the current regulatory requirements.

ANNEX 1-0

Table I.1

Format of disclosure of the integration of capital without considering transitory requirements in the application of regulatory adjustments

Reference	Common equity level 1 (CET1): securities and allowance	Amount
1	Ordinary shares that qualify for common capital of level 1 plus its corresponding premium	18,753
2	Retained earnings from prior years	38,959
3	Other elements of comprehensive income (and other allowances)	26,760
6	**Common equity level 1 before regulatory adjustments**	**84,472**
	Common equity level 1: regulatory adjustment	
8	Goodwill (net of deferred taxes to charge)	1,005
9	Other intangibles different to servicing asset of mortgage loans (net of deferred taxes to charge)	7,320
11	Result from valuation of instruments for cash flow hedging	(3,653)
13	Receivables generated by securitizations	141
15	Defined benefit pension plan	(943)
19 (conservative)	Significant investments in ordinary shares of banks, financial institutions and insurance companies outside the scope of regulatory consolidation, net of the short positions eligible, where the Institution holds more than 10% of the issued share capital (amount that exceeds the threshold of 10%)	**671**
26	Before regulatory national adjustments	1,591
A	of which: Other elements of comprehensive income (and other allowance)	1,591
28	**Total regulatory adjustments to common equity level 1**	**9,252**
29	**Common equity level 1 (CET1)**	**75,220**
	Additional equity level 1: securities	
30	Instruments issued directly that qualify as additional equity of level 1, plus premium	17,697
33	Instruments issued directly subject to gradual elimination of additional equity level 1	2,406
36	**Additional equity level 1 before regulatory adjustments**	20,103
	Additional equity: regulatory adjustments	
44	**Additional equity level 1 (AT1)**	20,103
45	**Equity level 1 (T1 = CET1 + AT1)**	95,323
	Equity level 2: instruments and allowances	
46	Instruments issued directly that qualify as equity of level 2, plus premium	9,968
47	Instruments issued directly subject to gradual elimination of additional equity level 2	2,653
50	Allowances	665
51	**Equity level 2 before regulatory adjustments**	13,286
	Equity level 2: regulatory adjustments	
58	**Equity level 2 (T2)**	13,286
59	**Total equity (TC = T1 + T2)**	108,609
60	**Weighted assets for total risk**	630,264
	Equity ratios and suplements	
61	Common equity level 1 (as a percentage of weighted assets for total risk)	11.93%
62	Equity level 1 (as a percentage of weighted assets for total risk)	15.12%
63	Total equity (as a percentage of weighted assets for total risk)	17.23%
64	Institutional specific supplement (at least must consist of: the requirement of Level 1 common equity plus the capital conservation mattress plus the countercyclical mattress plus the G-SIB mattress; expressed as a percentage of weighted assets for total risk)	7%
65	of which: equity conservation supplement	2.54%
67	of which: Supplement of global banks systemically important (G-SIB)	0.36%
68	Common equity level 1 available to cover supplements (as a percentage of weighted assets for total risk)	2.73%

Amounts below the thresholds for deduction (before risk weighting)		
75	Deferred tax asset due to temporary differences (net of deferred tax liability)	3,512
Limits applicable to the inclusion of reserves in the capital of Level 2		
76	Reserves eligible for inclusion in level 2 capital with respect to exposures subject to standardized methodology (prior to the application of the limit)	665
77	Limit on the inclusion of provisions in Level 2 capital under standardized methodology	6,118
Equity instruments subject to gradual elimination (applicable only between 1 January 2018 and 1 January 2022)		
82	Current limit of AT1 instruments subject to gradual elimination	2,406
84	Current limit of AT2 instruments subject to gradual elimination	2,653

Table II.1
Balance Sheet figures

Reference of balance sheet items	Balance Sheet figures	Amount presented in the balance sheet
	Assets	**1,055,733**
BG1	Cash and cash equivalents	75,480
BG2	Margin securities	1,986
BG3	Investments in securities	281,810
BG4	Debtor balances under repurchase en resale agreements	5
BG6	Derivatives financial instruments	25,716
BG7	Valuation adjustments for asset hedging	99
BG8	Loan portfolio, net	602,117
BG9	Receivables generated by securitization	141
BG10	Other accounts receivables	36,117
BG11	Foreclosed assets	752
BG12	Property, furniture and equipment	13,379
BG13	Permanent stock investment	1,953
BG15	Deferred taxes	3,512
BG16	Other assets	12,668
	Liabilities	**969,671**
BG17	Deposits	645,804
BG18	Interbank and other loans	15,134
BG19	Creditor balances under repurchase and resale agreements	193,365
BG22	Derivatives financial instruments	37,009
BG25	Other accounts payable	45,425
BG26	Subordinated debentures	32,445
BG28	Deferred credits and advance collections	485
	Stockholders' equity	**86,062**
BG29	Paid-in capital	18,753
BG30	Other capital	67,309
	Memorandum accounts	**1,151,520**
BG32	Contingent assets and liabilities	100
BG33	Credit commitments	213,098
BG34	Assets in trust or under mandate	290,749
BG36	Managed assets in custody	363,730
BG37	Collateral received	133,904
BG38	Collateral received and sold or given as a pledge	62,240
BG39	Investment banking transactions on account of third parties, (net)	87,333
BG40	Interest accrued but not charged of past due loans	365

Table II.2
Regulatory concepts considered for calculating the components of net Capital

Identifier	Regulatory concepts considered for calculating the components of net Capital	Reference to the disclosure format for the capital integration of subparagraph (I) of this Annex	Amount in accordance with the notes to the table concepts regulatory considered for the calculation of the components of the Net Capital	Reference (s) of the item of the balance sheet and amount related to the regulatory concept considered for the calculation of the net Capital coming from the mentioned reference.
	Assset			
1	Goodwill	8	1,005	BG16: 1,005(Goodwill)
2	Other Intangibles	9	7,320	BG16: 7,320 (Other Intangibles)
4	Receivables generated by securitization	13	141	BG9: 141 (Receivables generated by securitization)
11	Indirect investments in the capital of financial institutions where the institution owns more than 10% of the share capital issued	19	1,953	BG13: 1,953 (Permanent stock investment)
13	Reserves recognised as complementary capital	50	665	
	Liability			
24	Deferred tax (liability) associated to goodwill	8	1,005	BG16: 1,005 (Goodwill)
25	Deferred tax (liability) associated to other intangible	9	7,320	BG16: 7,320 (Other Intangibles)
30	Subordinated debentures subject to transitory computing as basic Capital 2	33	20,103	BG26: 20,103 (Subordinated debentures)
32	Subordinated debentures subject to transitory computing as complementary Capital	47	12,622	BG26: 12,622 (Subordinated debentures)
	Stockholders' equity			
34	Contributed Capital that complies with annex 1-Q	1	18,753	BG29; 18,753 (Contributed capital)
35	Retained earnings from prior years	2	38,959	BG30; 38,959 (Earned capital)
36	Result from valuation of instruments for cash flow hedging of items accounted at fair value	3	(3,653)	BG30; -3,653 (Earned capital)
37	Other elements of capital earned other than previous	3	32,003	BG30; 32,003 (Earned capital)
40	Result from valuation of instruments for cash flow hedging of items not accounted at fair value	3, 11	(3,653)	BG30; -3,653 (Earned capital)
41	Result from conversions	3, 26 - A	1,591	BG30; 1,591 (Earned capital)

Table III.1
Positions exposed at market risk by risk factor

Concept	Amount of equivalent positions	Capital requirements
Transactions in local currency with nominal rate	41,007	3,281
Transactions in local currency with securities in local currency with surcharge and a rate reviewable	5,121	410
Transactions in local currency with real rate or denominated in UDI's	5,574	446
Positions in UDI's or with yield referred to INPC	27	2
Operations in foreign currency with nominal rate	12,908	1,033
Positions in foreign currency or with yield indexed to a exchange rate	3,760	301
Positions in capital instruments or with yield indexed at the cost of a capital instruments group	2,147	172

Table III.2
Assets subject to credit risk

Concept	Risk Weighted Assets	Capital requirement
Group I B (weighted at 20%)	2	-
Group III (weighted at 20%)	10,570	846
Group III (weighted at 50%)	5,808	465
Group III (weighted at 100%)	3,227	258
Group IV (weighted at 20%)	369	30
Group V (weighted at 20%)	7,921	634
Group V (weighted at 50%)	100	8
Group V (weighted at 115%)	20,406	1,632
Group V (weighted at 150%)	7,321	586
Group VI (weighted at 50%)	3,176	254
Group VI (weighted at 75%)	31,832	2,547
Group VI (weighted at 100%)	14,293	1,143
Group VII_A (weighted at 20%)	147,684	11,815
Group VII_A (weighted at 50%)	3,665	293
Group VII_A (weighted at 100%)	5,795	464
Group VII_A (weighted at 115%)	150,583	12,047
Group VII_A (weighted at 150%)	1,282	103
Group VII B (weighted at 20%)	982	79
Group VIII (weighted at 115%)	816	65
Group VIII (weighted at 150%)	11,459	917
Group IX (weighted at 10%)	4,852	388
Group IX (weighted at 50%)	3,301	264
Group IX (weighted at 100%)	32,948	2,636
Securitizations with a Risk Degree of 1 (weighted at 20%)	1,194	96
Securitizations with a Risk Degree of 2 (weighted at 50%)	1,423	114
Securitizations with a Risk Degree of 3 (weighted at 100%)	552	44

Assets subject to operational risk:

	Risk Weighted Assets	Capital requirement
Total	**Ps. 46,406**	**Ps. 3,172**

Average requirement for market and credit risk in the past 36 months	Average of the annual positive net income of last 36 months
41,156	56,225

Table IV.1
Characteristics of the securities that are part of the net Capital

Reference	Characteristics	Q BANORTE 08U
1	**Issuer**	Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.
2	**identifier ISIN, CUSIP o Bloomberg**	MX0QBA070037
3	**Legal framework**	LMV, LIC, CIRCULAR 2019/95, LGTOC
Regulatory treatment		
4	**Level of capital with transience**	Complementary Capital
6	**Level of security**	Credit institution without consolidating

		subsidiaries
7	**Type of instrument**	Subordinated debenture
8	**Amount recognized in regulatory capital**	494’543,600 (Four hundred and ninety-four million five hundred and forty three thousand six hundred) UDIs, respective to $1,962,998,835.09 (One thousand nine hundred and sixty-two million nine hundred and ninety-eight thousand eight hundred and thirty-five pesos 09/100 M.N.).
9	**Nominal value**	100 (One hundred) UDIs
9A	**Currency**	UDI
10	**Accounting classification**	Liability at amortized cost
11	**Date of issuance**	11/03/2008
12	**Security term**	Maturity
13	**Date of maturity**	15/02/2028
14	**Clause of advance payment**	Yes
15	**First date of advance payment**	22/08/2023
15A	**Regulatory or fiscal events**	Yes
15B	**Settlement price of the advance payment clause**	Nominal value plus interest accrued at the date of the anticipated amortization
16	**Subsequent dates of payment in advance**	At any date of interest payment from the fifth year counted from the date of issue
Yields / dividends		
17	**Type of yields/Dividends**	Fix
18	**Interest rate/Dividends**	Real Gross (Yield)
19	**Clause of cancellation of dividends**	Yes
20	**Discretion in payment**	Partially discretionary
21	**Clause of increase of interest**	No
22	**Yields/Dividends**	Non-cumulative
23	**Security convertibility**	Non-convertibles
25	**Convertibility grade**	Non-convertible in shares
27	**Security convertibility type**	Non-convertibles
30	**Value decrease clause (*Write-Down*)**	No
35	**Position of subordination in the event of liquidation**	Preferential subordinated debentures
36	**Default characteristics**	No

Reference	Characteristic	D2 IXEGB40 141020
1	**Issuer**	Ixe Banco, S.A., Institución de Banca Múltiple, Ixe Grupo Financiero
2	**Identifier ISIN, CUSIP o Bloomberg**	USP59974AB40
3	**Legal framework**	New York Laws
Regulatory treatment		
4	**Level of capital with transience**	Basic Capital 2

6	**Level of security**	Credit institution without consolidating subsidiaries
7	**Type of instrument**	Subordinated debenture
8	**Amount recognized in regulatory capital**	U.S.$120,000,000 (One hundred and twenty million dollars 00/100USD)
9	**Nominal value**	U.S. $1,000.00 (Mil dólares 00/100 USD)
9ª	**Currency**	USD Dólar
10	**Accounting classification**	Liability at amortized cost
11	**Date of issuance**	14/10/2010
12	**Security term**	Maturity
13	**Date of maturity**	14/10/2020
14	**Clause of advance payment**	Yes
15	**First date of advance payment**	At any moment before maturity date
15ª	**Regulatory or fiscal events**	Yes
15B	**Settlement price of the advance payment clause**	Nominal value plus interest accrued at the date of the anticipated amortization
16	**Subsequent dates of payment in advance**	At any moment before maturity date
Yields / dividends		
7	**Type of yields/Dividends**	Fix
18	**Interest rate/Dividends**	IRUSD0Libor
19	**Clause of cancellation of dividends**	Yes
20	**Discretion in payment**	Discretionary
21	**Clause of increase of interest**	No
22	**Yields/Dividends**	Non-cumulative
23	**Security convertibility**	Non-convertibles
25	**Convertibility grade**	Non-convertible in shares
27	**Security convertibility type**	Non-convertibles
30	**Value decrease clause (*Write0Down*)**	No
35	**Position of subordination in the event of liquidation**	Non-preferential subordinated debentures
36	**Default characteristics**	Yes
37	**Default characteristics description**	Breach of 30 days in the interest payment, non-payment of principal on the due date or bankruptcy.

Table V.1
Weights involved in calculating the countercyclical Capital supplement of the institutions.

Countercyclical Capital supplement of the institution	
0.00 millions	
Jurisdiction	**Weighting**
Germany	0.00%
Saudi Arabia	0.00%
Argentina	0.00%
Belgium	0.00%
Brazil	0.00%
Canada	0.00%

China	0.00%
Spain	0.00%
United States	0.00%
France	0.00%
Holland	0.00%
Hong Kong	1.25%
Indica	0.00%
Indonesia	0.00%
Italy	0.00%
Japan	0.00%
Korea	0.00%
Luxembourg	0.00%
Mexico	0.00%
United Kingdom	0.50%
Russia	0.00%
Singapour	0.00%
South Africa	0.00%
Sweden	2.00%
Switzerland	0.00%
Turkey	0.00%
Other jurisdictions different to previous	0.00%

ANNEX 1-O BIS

TABLE I.1
DISCLOSURE OF INFORMATION REGARDING LEVERAGE RATIO

STANDARDIZED DISCLOSURE FORMAT FOR LEVERAGE RATIO		
REFERENCE	**ITEM**	**AMMOUNT**
	Exposure inside the balance	
1	Items within the balance sheet (excluding derivative financial instruments and securities lending operations-SFT for its acronym in English-but including collateral received and recorded in the balance sheet)	1,030,012
2	(amounts of assets deducted to determine level 1 capital of Basel III)	(10,843)
3	Exhibitions within the balance sheet (Net) (excluding financial derivatives and SFT, sum of lines 1 and 2)	1,019,169
	Exposures to derivative financial instruments	
4	Current cost of replacement associated with all operations with financial derivative instruments (net of margin of variation in cash admissible)	10,150
5	amounts of additional factors for potential future exposure, associated with all operations with derivative financial instruments	8,224
7	(Deductions to the account receivables for change margin in cash contributed in operations with derivative financial instruments)	(10,842)
11	Total exposures to derivative financial instruments (sum of lines 4 to 10)	7,532
	Exhibitions by financing operations with values	
12	Assets SFT gross (without recognition of compensation), after adjustments for accounting transactions for sales	62,241
13	(Accounts payable and for charging of compensated SFT)	(5)
14	Exposure of counterpart risk by SFT	1,375
15	Exposure by SFT acting on behalf of third parties	-
	Total exposures for financing operations with securities (sum of lines 12 to	63,610

16	15)	
Other exposures out of balance sheet		
17	Exposure out of balance (gross notional amount)	213,098
18	(Conversion adjustments to credit equivalents)	(170,234)
19	Off-balance sheet items (sum of the lines 17 and 18)	42,864
Capital and total exposure		
20	Equity level 1	95,323
21	Total exposures (Sum of lines 3, 11, 16 and 19)	1,133,176
Leverage ratio		
22	Leverage ratio of Basilea III	**8.41%**

TABLE I.2
Notes to standardized disclosure format for leverage ratio

REFERENCE	EXPLANATION
1	Total assets of the institution without consolidate subsidiaries or entities of specific purpose (less the assets presented in the above mentioned balance for: 1) operations with derivative financial instruments, 2) repurchase agreements and 3) securities.
2	Amount of deductions from the core capital laid down in subparagraphs (b) to (r) of the fraction I of article 2 bis 6 of the present provisions. The amount must be registered with a negative sign.
3	Sum of lines 1 y 2
4	Current Cost of replacement (RC) of transactions with derivative financial instruments, in accordance with those laid down in annex 1-L of these provisions, minus the partial cash settlements (cash variation margin) received, provided that The following conditions are fulfilled:
	a) In the case of counterparts other than the clearing houses referred to in the second subparagraph of article 2 Bis 12 (a), the cash received shall be available to the institution.
	b) The valuation at market of the operation is carried out daily and the received cash is exchanged with the same frequency.
	c) The cash received as well as the operation with the derivative instrument, are denominated in the same currency.
	d) The amount exchanged from the cash variation margin is at least the amount necessary to cover the market value considering the threshold and the minimum amount transferred agreed in the corresponding framework contract.
	e) The amount exchanged from the cash variation margin is at least the amount necessary to cover the market value considering the threshold and the minimum amount transferred agreed in the corresponding framework contract.
	In any case, the maximum amount of cash variation margins received that may be considered will correspond to the positive value of the current replacement cost of each counterpart.
5	Additional Factor in accordance with annex 1-L of these provisions, of operations with derivative financial instruments. In addition, in the case of credit-derived financial instruments which provide credit protection, the conversion value must be included at the credit risk in accordance with article 2 Bis 22 of these provisions.
	In no case may they be used the real guarantees financial that the institution has received to reduce the amount of the additional factor reported in this line.
6	Not applicable. The accounting framework does not allow the cancel of assets given as collateral.
7	Total of margins of change in cash delivered in operations with derivative financial instruments that fulfill with the conditions indicated in the line 4 to reduce the in cash received change margins. The total must register with negative sign.
9	Not applicable. The exhibition that is considered for the purposes of solvency framework in operations with financial derivative instruments of credit which provides credit protection corresponds to 100 per cent of the amount actually guaranteed in the operations concerned.

	This exhibition is regarded in the Line 5.
10	Not applicable. The exhibition that is considered for the purposes of solvency framework in operations with financial derivative instruments of credit which provides credit protection corresponds to 100 per cent of the amount actually guaranteed in the operations concerned. This exhibition is regarded in the Line 5.
11	Sum of lines 4 to 10
12	Amount of the assets recorded in the balance sheet (accounts receivable recorded) of operations of reported and securities lending. The amount shall not consider any compensation in accordance with the Accounting Criteria.
13	Positive amount resulting from deducting the accounts payable Accounts receivable generated by operations of reported and securities lending, by its own account, with a same counterpart, and provided that the following conditions are met:
	a) The corresponding operations have the same settlement date.
	b) The right to settle the operations at any time.
	c) The operations are liquidated in the same system and there is a mechanism or arrangements of liquidation (lines or guarantees) that allow the liquidation takes place at the end of the day in which it was decided to liquidate.
	d) Any problems related to the liquidation of collateral flows in the form of securities, do not obstruct the settlement of accounts payable and cash.
	The amount must be registered with a negative sign.
14	Value of conversion to credit risk of the operations of reported and loan of securities on their own account, in accordance with Article 2 bis 22 These provisions when there is not a framework contract of compensation. And in accordance with Article 2 bis 37 when there is such an agreement. The foregoing is without considering adjustments by eligible collateral that apply to the guarantee in the framework of capitalization.
15	In the case of operations of reported and securities lending for the account of third parties, in which the institution granted warranty with their clients before the breach of the counterpart, the amount that should be register is the positive difference between the value of the title or cash that the customer has delivered and the value of the guarantee that the borrower has provided.
	Additionally, if the institution can have the collateral delivered by their clients, for their own account, the amount equivalent to the value of the securities and/or cash delivered by the customer of the Institution.
16	Sum of lines 12 a 15
17	Amounts of credit commitments recognized in memorandum accounts according to accounting criteria.
18	Amounts of the reductions in the value of the credit commitments recognized in memorandum accounts by applying conversion factors to credit risk set out in the first title bis of the present provisions, considering that the conversion factor to credit risk is a minimum of 10 % (for those cases in which the conversion factor is 0 %).
	The amount must be registered with a negative sign.
19	Sum of lines 17 y 18
20	Basic Capital calculated in accordance with article 2 Bis 6 of provisions.
21	Sum of lines 3, 11, 16 y 19
22	Reason of Leverage. Quotient of the line 20 between the line 21.

TABLE II.1
COMPARATIVE OF TOTAL ASSETS AND ASSETS ADJUSTED

REFERENCE	DESCRIPTION	AMOUNT
1	totales assets	1,055,733
2	Adjustment for investments in the capital of banks, financial, insurance or commercial entities that are consolidated for accounting purposes, but are outside the scope of regulatory consolidation	(10,843)

4	Adjustment for derivative financial instruments	(18,184)
5	Adjustment for repurchase agreements and securities lending operations [1]	63,605
6	Adjustment for items recognized in memorandum accounts	42,864
8	Leverage coefficient exposure	1,133,176

[1] In which the value of the operation is the valuation at market of operations and are generally subject to margins agreements.

TABLE II.2
NOTES TO THE COMPARATIVE OF TOTAL ASSETS AND ASSETS ADJUSTED

REFERENCE	DESCRIPTION
1	Total assets of the institution without consolidate subsidiaries or entities of specific purpose
2	Total of the deductions of the basic capital contained in the interjections b), d), e), f), g), h), i), j) and l) of the fraction I, of the Article 2 bis 6 of dispositions.
	The amount must be registered with a negative sign.
3	Not applicable. The scope is on the institution without consolidate subsidiaries or entities of specific purpose.
4	Amount equivalent to the difference between the figure contained in line 11 of Table I.1 and the figure presented in transactions with financial derivative instruments contained in the balance sheet.
	The amount must be registered with the sign resulting from the difference mentioned, could be positive or negative.
5	Amount equivalent to the difference between the figure in line 16 of Table I.1 and the figure presented by repurchase agreements and lending operations of securities contained in the balance sheet.
	The amount must be registered with the sign resulting from the difference mentioned, could be positive or negative.
6	Amount recorded in line 19 of Table I.1.
	The amount must be registered with a positive sign.
7	Amount of the basic capital deductions contained in subparagraphs (c)), (k), M), N), (p), q) and R) of Fraction I, of article 2 Bis 6 of provisions.
	The amount must be registered with a positive sign.
8	Sum of lines 1 to 7, which must coincide with line 21 of table I.1.

TABLE III.1
CONCILIATION OF TOTAL ASSETS AND THE EXPOSURE INSIDE BALANCE

REFERENCE	CONCEPT	AMOUNT
1	Total assets	1,055,733
2	Operations in derivative financial instruments	(25,716)
3	Operations in repurchase agreements and lending of securities	(5)
5	Exposure inside balance	1,030,012

TABLE III.2
NOTES TO CONCILIATION OF TOTAL ASSETS AND THE EXPOSURE INSIDE BALANCE

REFERENCE	DESCRIPTION
1	Total assets of without consolidate subsidiaries or entities of specific purpose.
2	The amount corresponding to the operations in financial derivative instruments presented in the asset from the last financial statements.
	The amount must be registered with a negative sign.
3	The amount corresponding to the operations of repurchase agreements and loan of values presented in the assets of the final financial statements.
	The amount must be registered with a negative sign.

5	Sum of lines 1 to 4, which must coincide with Line 1 of table I.1

TABLE IV.1
MAIN CAUSES OF SIGNIFICANT VARIANCES OF THE ELEMENTS (NUMERATOR AND DENOMINATOR) OF THE LEVERAGE RATIO COVENANT

CONCEPT/TRIMESTRE	SEPTEMBER '17	DECEMBRE '17	VARIATION (%)
Basic capital	98,044	95,323	(2.776%)
Adjusted assets	1,114,376	1,133,176	1.687%
Razón de Apalancamiento	8.80%	8.41%	(4.389%)

Institution of Local Systemic Importance

During 2017, Banorte was designated an Institution of Local Systemic Importance, so it must maintain a capital preservation supplement of 0.90 pp, to be constituted progressively in a maximum term of four years and beginning in December 2016. With the above, Banorte's minimum Capitalization Index amounts to 10.95% at the end of 2017, corresponding to the regulatory minimum of 10.5% plus the capital supplement constituted

Management

Pursuant to the regulations in effect and the requirements of the CNBV, Banorte is developing its Capital Sufficiency Assessment which will consider the risks the Institution is exposed to as well as its major vulnerabilities in order to prove the Institution's solvency by means of financial forecasts with adverse macro-economic scenarios.
In order to manage capital, a weekly follow-up analysis is conducted on the requirements derived from the risk position, as well as supporting through strategy or transactions' simulations of the various areas of business operation in order to determine their consumption.

Additionally, with the purpose of managing the capital, weekly is carried out an analysis of follow-up to the requirements of the risk positions, in addition to supporting in simulations of operations or strategies to the different business areas in order to know their consumption.

28 - FOREIGN CURRENCY POSITION

As of December 31, 2016 and 2015, the Institution holds certain assets and liabilities in foreign currency, mainly US dollars, converted to the exchange rate issued by Banco de México at Ps. 20.6194 and Ps. 17.2487 per USD 1.00, respectively, as shown below:

	Thousands of US dollars	
	2017	**2016**
Assets	7,580,668	6,997,632
Liabilities	7,716,454	6,916,344
Net asset position in US dollars	**(135,786)**	**81,288**
Net asset position in Mexican pesos	**(Ps. 2,670)**	**Ps. 1,676**

29 – POSITION IN UDIS

As of December 31, 2016 and 2015, the Institution holds certain assets and liabilities denominated in UDIS, converted to Mexican pesos based on the current conversion factor of Ps. 5.562883 and Ps. 5.381175, per UDI, respectively, as shown below:

	Thousands of UDIS

	2017	2016
Assets	889,528	230,900
Liabilities	457,368	455,638
Net asset (liability) position in UDIS	**432,160**	**(224,738)**
Net asset (liability) position in Mexican pesos	**Ps. 2,565**	**(Ps. 1,250)**

30 - EARNINGS PER SHARE

Earnings per share is the result of dividing the net income by the weighted average of the Institution's shares in circulation during the year.

Earnings per share are shown below:

	2016			2015
	Net Income	**Weighted share average**	**Earnings per share**	**Earnings per share**
UPA continuous operations	Ps. 18,250	137,303,109,559	Ps. 0.1329	Ps. 0.1078
UPA discontinued operations	89	137,303,109,559	0.0006	Ps. 0.0018
Net income per share	Ps. 18,339	137,303,109,559	Ps. 0.1335	Ps. 0.1096

31 - RISK MANAGEMENT (unaudited)

Authorized Bodies

To ensure adequate risk management of the Institution, as of 1997, the Institution's Board of Directors created the Risk Policy Committee (CPR), whose purpose is to manage the risks to which the Institution is exposed, and ensure that the performance of operations adheres to the established risk management objectives, guidelines, policies and procedures.

Furthermore, the CPR provides oversight on the global risk exposure limits approved by the Board of Directors, and also approves the specific risk limits for exposure to different types of risk.

The CPR is comprised of regular members of the Board of Directors, the CEO of the Institution, the Managing Directors of the Institution's entities, the Managing Director of Comprehensive Risk Management and the Managing Director of Audits, who have the right to speak but not to vote.

To adequately carry out its duties, the CPR performs the following functions, among others:

1. Propose for the approval of the Board of Directors:

    - The objectives, guidelines and policies for comprehensive risk management
    - The global limits for risk exposure
    - The mechanisms for implementing corrective measures
    - The special cases or circumstances in which the global and specific limits may be exceeded

2. Approve and review at least once a year:

    - The specific limits for discretionary risks, as well as tolerance levels for nondiscretionary risks
    - The methodology and procedures to identify, measure, oversee, limit, control, report and disclose the different kinds of risks to which the Institution is exposed
    - The models, parameters and scenarios used to perform the valuation, measurement and control of risks proposed by the Comprehensive Risk Management Unit

3. Approve:
   - The methodologies for identification, valuation, measurement and control of risks of the new operations, products and services which the Institution intends to introduce into the market
   - The corrective measures proposed by the Comprehensive Risk Management Unit
   - The manuals for comprehensive risk management
   - The technical evaluation of Comprehensive Risk Management aspects.

4. Assign and remove the person responsible for the Comprehensive Risk Management Unit, who is ratified by the Board of Directors.

5. Inform the Board, at least every quarter, of the exposure to risk and its possible negative effects, as well as follow up on limits and tolerance levels.

6. Inform the Board of the corrective measures implemented.

32 - COMPREHENSIVE RISK MANAGEMENT UNIT (UAIR) (unaudited)

The Institution's Risk Management's function is to determine and execute the Institution's strategic planning. Furthermore the Institution's Risk management and policies comply with the regulations and the best market practices.

1. RISK MANAGEMENT'S OBJECTIVES, SCOPE AND FUNCTION

The main objectives of the Institution's Risk Management are to:

- Provide the different business areas with clear rules that help minimize risks and ensure that they are within the parameters established and approved by the Board of Directors and the Risk Policy Committee.
- Establish mechanisms that provide for follow-up on preventive risk-taking within the Institution and are backed up by sound systems and processes.
- Verify adherence to the Desired Risk Profile.
- Protect the Institution's capital against unexpected losses from market movements, credit losses and operating risks.
- Implement valuation methods for the different types of risks.
- Establish procedures for portfolio optimization and loan portfolio management.

Furthermore, the Institution has sound methodologies in place to manage quantifiable risks such as Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Concentration Risk, and Counterparty Risk.

Credit Risk: volatility of revenues due to the creation of provisions for impairment of credits and potential credit losses due to nonpayment by a borrower or counterparty.

Market Risk: volatility of revenues due to changes in the market, which affect the valuation of the positions from transactions involving assets, liabilities or generating contingent liabilities, such as: interest rates, rate spreads, exchange rates, price indexes, etc.

Liquidity Risk: potential loss derived from the impossibility of renewing or contracting debt under normal conditions for the Institution, due to the anticipated or forced sale of assets at unusual discounts to meet its obligations.

Operational Risk: Loss resulting from lack of adaptation or failure in processes, personnel, internal systems or external events. This definition includes Technological Risk and Legal Risk. Technological Risk groups includes all potential losses from damage, interruption, alteration or failures derived from the use of or dependence on hardware, software, systems, applications, networks and any other information distribution channel, while Legal Risk involves the potential loss from penalties for noncompliance with legal and administrative regulations or the issuance of adverse final court rulings in relation to the operations performed by the Institution.

Concentration Risk: potential loss attributed to the high and disproportionate exposure to specific risk factors within a single category or among different risk categories.

On the other hand, regarding Non-Quantifiable Risk, the Institution's objectives are set forth in the Risk Management Manual for:

Reputational Risk: potential loss in the development of the Institution's activity caused by a deteriorate perception of the various internal and external stakeholders' perception regarding its solvency and viability.

1.1. Risk Management Structure and Corporate Governance

Regarding the structure and organization for Comprehensive Risk Management, it is the responsibility of the Board of Directors to approve the general policies and strategies, such as:

- The Desired Risk Profile for the Institution
- The framework for Comprehensive Risk Management and the Contingency Financing Plan
- The Risk Exposure Limits, Risk Tolerance Levels, and the corrective action mechanisms.

The Board of Directors has designated the CPR as the responsible body to manage the risks to which the Institution is exposed as well as to verify that transactions are in keeping with the objectives, policies and procedures for Risk Management.

Furthermore, the CPR provides oversight on the global risk exposure limits approved by the Board of Directors, and also approves the specific risk limits for exposure to different types of risk.

The CPR is comprised of regular and replacement members of the Board of Directors, the CEO of the Institution, the Managing Directors of the Institution's entities, the Managing Director of Comprehensive Risk Management and the Managing Director of Audits, who have the right to speak but not to vote.

Moreover the Assets and Liabilities Committee (ALCO -Spanish acronym) and the Capital and Liquidity Group analyze, monitor, and make decisions regarding the risk rates in the balance sheet, the net interest margin, liquidity and net capital of the Institution.

The Comprehensive Risk Management Unit (UAIR - Spanish acronym) is in charge of the Office of Risk Management (DGAR). Its functions are to identify, measure, oversee, limit, control, report and disclose the different kinds of risk exposures of the Institution.

The DGAR reports to the CPR pursuant to the regulations regarding the DGAR's independence from the business units.

1.2. Scope and Nature of the Institution's Risk Management

Risk Management extends to all the Institution's subsidiaries. Depending on each one's line of business, Credit, Concentration, Market, Liquidity and Operational Risks are measured, managed and controlled.

To accomplish this, the DGAR relies on several information and risk measuring systems which comply with the regulatory standards and are aligned with the best international practices in Risk Management. The information contained in the risk systems as well as the reports they generate are continuously backed up as per the institutional data security procedures. Furthermore the risk systems contain operations subject to Credit, Market, Liquidity and Operational Risk. Such systems are processed and subject to different valid models and methodologies, periodically generating reports for each one of said risks.

The Institution has policies and processes in place, which are contained in the Risk Management models, methodologies and procedures, for hedging and mitigation strategies and compensation for each type of risk in and out of balance. This policies and processes include: the features, pension funds afore, legal aspects, instrumentation and hedging degree that should be considered for hedging when compensating for or mitigating the risk. Such policies and processes also contemplate the execution of guaranties as a risk compensation mechanism each time there is a case of un-remedied default by the debtors. As part of the strategies and processes to monitor the continual efficiency of the hedgings or mitigations of the different risks, there limits for each type of Risk (Credit, Market, Liquidity and Operational) which are monitored constantly. There are also procedures in place so that the surpluses and their causes are documented, and the relevant corrective actions are taken to return to acceptable risk levels.

2. CREDIT RISK

It refers to the risk that clients, issuers or counterparties default on their payments. Therefore the proper administration of such risk is essential to maintain the portfolio's credit quality.

The Institution credit risk management objectives are as follows:

- Fulfill the Desired Risk Profile defined by the Institution's Board of Directors.
- Improve the quality, diversification and composition of the loan portfolio to optimize the risk-return ratio.
- Provide senior management with reliable and timely information to support decision-making in credit matters.
- Provide the business departments with clear and sufficient tools to support credit placement and follow up.
- Support the creation of economic value for shareholders by means of efficient credit risk management.
- Define and constantly update the regulatory framework for credit risk management.
- Comply with the credit risk management reporting requirements established by the relevant authorities.
- Perform risk management in accordance with best practices; implementing models, methodologies, procedures and systems based on the latest international advances.
- Measure the Institution's vulnerability to extreme conditions, and consider such results for decision-making.

The Institution Credit Risk Management's policies apply to:

- Granting and managing consumer loans according to the best practices in the market through parametric models that make it possible to identify the risk, minimize the losses and increase quality loan placement.
- Granting and managing loans to companies and other entities in keeping with the best market practices by means of a loan strategy that includes Target Markets and Risk Acceptance Criteria, identifying and managing the risk through Loan Rating and Early Warning methodologies.
- Follow up and quality control of the loans by means of a Loan Rating System that indicates the treatment and general actions derived from specific situations as well as the areas or officers responsible for such actions.
- .Oversight and control of Credit Risk by Global and Specific Limits, loan rating policies and Credit Risk models for the portfolio by which to identify the expected and unexpected loss in a given trust level.
- Reporting and disclosure of the Credit Risk to the risk-taking areas, the CPR, Board of Directors, Financial Authorities and the investors.
- Definition of the powers in Credit Risk taking for the Institution.

In order to meet the objectives and comply with the policies, a series of strategies and procedures have been defined and which cover the origination, analysis, approval, management, follow-up, recovery and collection.

2.1. Credit Risk Scope and Methodologies

2.1.1. Individual credit risk

The Institution divides Credit Risk into two large groups: Minor and Major.

Individual credit risk for the consumer (Minor) portfolio is identified, measured and controlled by means of a parametric system (scoring) which includes models for each of the pymes and consumer products (mortgage, automotive, payroll credit, personal and credit card).

Individual risk for the corporate (Major) portfolio is identified, measured and controlled by means of the Target Markets, the Risk Acceptance Criteria, Early Warnings and the Banorte Internal Risk Rating (CIR Banorte).

The Target Markets, Risk Acceptance Criteria and Early Warnings are tools which, together with the Internal Risk Rating CIR, form part of the credit strategy of the Institution and support the estimate of the credit risk level.

The target markets are categories of economic activities for each region in which the Institution is interested in placing loans. Its definition is backed up by economic studies and loan behavior analysis as well as by expert opinions.

The Risk Acceptance Criteria are parameters which describe the risks identified by industries, facilitating an estimate of the risk involved for the Institution in granting a loan to a customer depending on the economic activity which it performs. The types of risks evaluated in the Risk Acceptance Criteria are the financial risk, operational risk, market risk, company lifecycle risk, legal and regulatory risk, credit history and quality of management.

Early Warnings are a set of criteria based on information and indicators of the borrowers and their environment that have been set forth for timely prevention and identification of likely impairment in the loan portfolio, in order to take credit risk mitigating preventive actions in a timely manner.

CIR Banorte is a debtor rating methodology that evaluates quantitative and qualitative criteria to determine their credit quality. It is applied to commercial loans equal to or over an amount equivalent in Mexican pesos to four million investment units (UDIs) on the rating date.

2.1.2. Portfolio Credit Risk

The Institution has designed a portfolio credit risk methodology which, while also including international practices with regard to identification, measurement, control and follow up, has been adapted to function within the context of the Mexican financial system.

The credit risk methodology identifies the exposure of all the loan portfolios of the Institution, overseeing risk concentration levels based on risk classifications, geographical regions, economic activities, currencies and type of product, for the purpose of identifying the portfolio profile and taking actions to diversify it and maximize profit with the lowest possible risk.

The calculation of loan exposure involves the generation of the cash flow from each of the loans, both in terms of principal and interest, for their subsequent discount. As exposure is sensitive to market changes, a sensitivity estimate can be made for different economic scenarios.

Apart from considering loan exposure, the methodology takes into account the probability of default, the recovery level associated with each customer and the sorting of the borrowers based on the Merton model. The probability of default is the probability that a borrower will not comply with its debt obligations to the Institution in the terms and conditions originally agreed. The probability of default is based on the transition matrixes which the Institution calculates according to the migration of borrowers to different risk classification levels. The recovery rate is the percentage of the total exposure that is expected to be recovered if the borrower defaults on its obligations. The classification of the borrowers based on the Merton model is intended to tie the future behavior of the borrower to credit and market factors on which, using statistical techniques, it has been determined, that the borrower's "credit health" depends.

The primary results obtained are the expected loss and unexpected loss over a one-year time horizon. The expected loss is the median of the distribution of losses of the loan portfolio, which enables a measurement of the average loss expected in the following year due to noncompliance or variations in the credit status of the borrowers. The unexpected loss is an indicator of the loss expected under extreme circumstances, and is measured as the difference between the maximum loss based on the distribution of losses, at a specific confidence level, which in the case of the Institution is 99.5%, and the expected loss.

The results obtained are used as a tool for better decision-making in granting loans and portfolio diversification, in accordance with the Institution's strategy. The individual risk identification tools and the portfolio credit risk methodology are reviewed and updated periodically to incorporate new techniques that can support or strengthen them.

2.1.3. Credit Risk of Financial Instruments

Financial Instrument Credit Risk Management is done through a series of fundamental cornerstones among which there is robust framework of Origination, Analysis, Approval and Management policies.

The origination policies define the type of financial instruments to operate and how to evaluate the credit quality of different types of issuers and counterparts. Credit quality is assigned by means of a rating obtained by an internal methodology, external rating evaluations or a combination of both. Additionally, there are maximum operating parameters depending on the type of issuer or counterparty, rating and operation type.

The analysis policies include the type of information and variables considered to analyze operations with financial instruments when they're presented for their authorization by the corresponding committee, including information about the issuer or counterparty, financial instrument, destination of the transaction within the Institution and market information.

The Credit Committee is the body that authorizes operation lines with financial instruments for customers and counterparties according to the authorization policies. The authorization request is submitted by the business area and the areas involved in the operation with all the relevant information to be analyzed and, if applicable, authorized by the Committee. Nevertheless, the UAIR has the power to approve counterparty lines (financial intermediaries, mainly) that meet certain criteria, using a parametric methodology approved by the CPR.

The policy to manage lines in order to operate financial instruments contemplates the procedures for registration, instrumentation, regulation compliance, revision, consumer monitoring, line management and responsibility of the areas and bodies involved in operating financial instruments.

Concentration of credit risk with financial instruments is managed continuously on an individual level, monitoring maximum operational parameters per counter-party or issuer depending on the rating and type of transaction. For portfolios there are economic and internal group risk diversification policies in place. Additionally, concentration is monitored by type of counter-party or issuer, size of the financial institutions and where they operate in order to get the right diversification and avoid unwanted concentrations.

Credit risk is measured by means of the rating associated with the issuer, issue or counterpart, which has an assigned degree of risk measured based on two elements:

1) The probability of default by the issuer, issue or counterparty; expressed as a percentage between 0% and 100%. The higher the rating (or the lower the differential of the instrument's rate vs. that of an equivalent government bond), the lower the probability of delinquency, and vice versa.

2) The severity of the loss with respect to the operation's total in the event of default, expressed as a percentage between 0% and 100%. The better the guarantees or credit structure, the lower the severity of the loss, and vice versa. In order to mitigate credit risk and reduce the severity of the loss in case of default, the Institution has signed ISDA contracts and netting agreements with its counterparties, which contemplate implementing credit lines and using collateral to mitigate losses as a result of defaults.

2.2. Exposure to Credit Risk

As of December 2017, the total amount of gross exposures subject to the Standard Method for calculating the Capital Index is as follows:

Gross Exposures subject to Standard Method	Institution
Commercial	Ps. 162,071
Revenues or Annual sales < 14 MM UDIS	60,942
Revenues or Annual sales >= 14 MM UDIS	101,128
States or Municipalities	83,176
Decentralized Government Agencies and State-controlled companies	49,640
Projects with their own source of payment	54,929
Financial institutions	22,875
Mortgage	136,728
Consumer	106,324
Credit card	36,093
Non-revolving	70,231

Total portfolio subject to Standard Method	Ps. 615,744

For transactions subject to credit risk, the Institution only uses external ratings issued by S&P, Moody's, Fitch, HR Ratings and Verum. Ratings are not assigned based on comparable assets.

2.2.1. Exposure with Financial Instruments

As of December 31, 2017, the credit risk exposure of the investments in securities was Ps. 280,139, of which 99.2% has a rating greater than or equal to A+(mex) on the local scale. This places them in investment grade; the three main issuers other than the Federal Government, Semi-Private agencies and Domestic Financial Institutions represent 9% of the basic capital as of September 2017. Additionally, the investment exposure with the same issuer other than the Federal Government that represents a concentration greater than or equal to 5% of the Net Capital as of September 2017 has a rating of A(mex) and is comprised of (*term in weighted average, amount in million pesos and interest rate*): stock certificates and Pemex bonds at 6 years and 1 months for Ps. 15, 382 at a rate of 3.9%; and stock certificates of Banco Interacciones at 2 months for Ps. 5,670 at a rate of 7.6%.

Regarding transactions with Derivative financial instruments, the 3 main counterparties other than the Federal Government, Semi-Private agencies and Domestic Financial Institutions represent 1% of the Basic Capital as of September 2017.

The counterparty's risk exposure for transactions with derivative financial instruments for Banorte, and the compensation effect (netting) and exposure mitigation based on adding guaranties for performed transactions is shown below:

	4Q17	Average 4Q17
Forwards	17	125
Opciones	24	7
Swap Interest Rate (IRS)	3,895	3,755
Cross Currency Swap (CCIRS)	(13,617)	(11,527)
Total	(9,682)	(7,639)
Positive Fair Value *(Positive Market Value)*	10,584	8,775
Netting effect*	20,265	16,415
Guaranties Given (-) / Received (+)		
Cash	(6,580)	(6,155)
Securities	-	-
Total	(6,580)	(6,155)

*The difference between the portfolio's positive market value (not considering position netting) and the market value. Futures are not included as they have no counterparty risk.

The following table presents the current exposure levels and future potential exposure at the year's end.

	Potential Risk		Current Risk	
Financial Counterparties	4Q17	Average 4Q17	4Q17	Average 4Q17
FWD	116	310	7	125
OPCIONES	1,117	935	711	560
SWAP RATE	15,621	13,202	5,921	4,602
CCS	865	932	(13,589)	(11,494)
Total	**4,142**	**4,283**	**(6,950)**	**(6,206)**
Clients (Non Financial)	4Q17	Average 4Q17	4 Q 17	Average 4Q17

FWD	45	38	10	-
OPCIONES	25	29	(687)	(553)
SWAP RATE	813	1,170	(2,026)	(847)
CCS	26	24	(28)	(33)
Total	**895**	**1,245**	**(2,731)**	**(1,433)**

Based on the conditions set forth in the derivative financial instrument transaction contracts, the exposure tolerance levels are considered in terms of the rating that the entities involved in the transaction have. The following table lists the amount of guaranties to give in the event of impairment due to a drop in the Institution's rating:

Net Cash Outlays ***(at year's end)***	**4Q17**	**Average 4Q17**
Outlays with 1-step downgrade	Ps. -	Ps. -
Outlays with 2-step downgrade	-	-
Outlays with 3-step downgrade	-	-

The market value according to rating ranges for the counterparties of the performed derivative financial instruments is shown below:

Range	**4Q17**	**Average 4Q17**
AAA/AA-	-	-
A+/A-	(5,401)	(5,025)
BBB+/BBB-	(1,540)	(1,144)
BB+/BB-	(1,348)	(793)
B+/B-	-	(32)
CCC/C	(4)	(4)
SC	(1,389)	(640)
Total	**(9,682)**	**(7,639)**

2.3. Loan Guarantee

Guaranties represent the second source of loan recovery when its hedging by means of the petitioner's predominant activity is compromised. Guaranties may be real or personal.

The main types of real guaranties are:

- Civil Mortgage
- Industrial Mortgage
- Ordinary Pledge
- Pledge without Ownership Transfer
- Pledge /Pledge Bond
- Pledge Bond
- Haircut (Repurchase agreement with haircut)
- Securities Pledge
- Management and Payment Trust
- Development Funds

In the case of physical assets given as a guarantee, the Institution has policies and processes in place for follow-ups and regular inspection visits to verify the existence, legitimacy, value and quality of the guaranties that were accepted as an alternate loan backup. On the other hand, when the guaranties are securities, there are policies and processes to follow up their market valuation and demand additional guaranties if necessary.

The following table lists the loan portfolio covered at the close of 2016 by type of guarantee:

Type of Guarantee	2017 Institution
Total portfolio	**Ps. 615,744**
Guarantee	
Real Financial Guaranties	17,580
Real Non-Financial Guaranties	333,134
Pari Passu	21,683
First Losses	33,321
Personal Guaranties	14,991
Total Portfolio Covered	**Ps. 420,709**

2.4. Expected Losses

As of December 31, 2017, the total loan portfolio of Banco Mercantil del Norte is Ps. 615,744. The expected loss represents 2.2% and the unexpected loss represents 4.4% of the total operating portfolio. The average expected loss was 2.3% for the period between October and December 2017.

2.5. Risk Diversification

In December 2005, the CNBV issued the "General Rules for Risk Diversification in Performing Asset and Liability Transactions Applicable to Credit Institutions. These regulations require that the Banks perform an analysis of the borrowers and/or loans they hold to determine the amount of their "Common Risk". Also, the Institution must have the necessary information and documentation to support that a person or group of persons represents a common risk in accordance with the assumptions established under such rules.

In compliance with the risk diversification rules for asset and liability transactions, the following information regarding **Banco Mercantil del Norte** is provided below:

Basic capital as of September 30, 2017	**Ps. 98,044**
I. Financing whose individual amount represents more than 10% of basic capital:	
Credit transactions	
Number	-
Overall amount	-
% in relation to basic capital	-%
Overnight operations	
Number	-
Overall amount	-
% in relation to basic capital	-%
II. Maximum amount of financing with the three largest debtors and common risk groups	**Ps. 41,187**

3. MARKET RISK

Market Risk management is done by means of a series of fundamental pillars, such as the use of models and methodologies like Value at Risk (VaR), Backtesting, Sensitivity Analysis and Stress Testing, all of which are used to measure the risk of the products and instrument portfolios that trade in financial markets.

Furthermore, risk management is backed up by a framework of policies and manuals that sets forth the Market Risk limit implementation and follow up, risk metrics reporting, and follow-up of the established limits.

The key risk indicators are made known in monthly reports to the CPR and daily reports to the Institution's top executives involved in Market Risk position taking.

3.1. Market risk Methodologies

The management of market risk is managed through a series of fundamental pillars, among which the use of models and methodologies such as the value at risk (VaR), the Retrospective Analysis (BackTesting), the analysis of sensitivity and tests under Extreme conditions (stress Testing), all are used to measure the risk of the products and portfolios of instruments that are quoted in the financial markets.

In addition, risk management is supported by a framework of policies and manuals, in which it sets the implementation and monitoring of risk limits Market, the revelation of the metrics of risk in question and its follow-up with regard to the limits.

Key risk indicators are reported by monthly reports to the CPR and by a daily report to the principal executives at the institution related to the taking of market risk positions.

3.2. Exposure to Market Risk

The Institution's financial instrument portfolio Market Risk exposure is measured using the industry's standard methodology known as Value at Risk (VaR).

The VaR model is based on the horizon of one day and a non-parametric historical simulation with a confidence level of 99% and 500 historical observations of risk factors. Moreover it considers all the financial instrument positions (money market, treasury, capitals, changes, and derivative financial instruments with trading purposes and hedging) recorded as trading and available for sale both on and off of the balance sheet.

The average VaR for 4Q17 is Ps. 37.1 (Ps. 20.2 loss than the 3Q16 average VaR).

The result shown below indicates that the potential loss will be over Ps. 37.1 on one of every one hundred days.

	Average 4Q17
VaR Banorte*	37.1
Banorte net capital**	108,345
VaR / net capital Banorte	**0.03%**

Also, the average of the VaR per risk factor for the Institution's portfolio of securities behaved as follows during the fourth quarter of 2017:

Risk factor	4Q17	Average 4Q17
Rates	28.4	32.8
FX	13.5	9.0
Variable income	8.8	8.0
Diversification effect	(17.3)	(12.7)
Banorte's Total VaR	**33.5**	**37.1**

The VaR at the end of 4Q17 corresponds to $37 million pesos. The contribution to the VaR for each risk factor is:

Risk factor	4Q17	Average 4Q17
Domestic rates	25.7	24.1
Foreign rates	3.7	-
FX	4.0	11.0
Variable revenue	0.1	2.1
Total VaR	**33.5**	**37.1**

The VaR by risk factor is determined by simulating 500 historical setting and performing a grouping of instruments by its main risk factor. It is important to emphasize that took into account all the positions are classified as negotiation, excluding the position of preserved at maturity and available for sale.

The concentration per market risk factor without the diversification effect is:

Risk factor	4Q17
Rates	56%
FX	27%
Variable income	17%

3.2. Sensitivity Analysis and Tests Under Extreme Conditions (Stress Testing)

As the VaR shows potential losses under normal market conditions, Banorte supplements the risk analysis by applying tests under extreme conditions, also known as Stress Testing. This submitted on a monthly basis to the CPR. Its main purpose is to gauge the impact on the Institution's positions given major risk factor shifts.

3.3. Backtesting

In order to verify the VaR effectiveness and accuracy, a backtesting analysis is submitted monthly to the CPR. This analysis makes it possible to compare the losses and profits observed with respect to the estimated Value at Risk and, if necessary, the relevant adjustments are made.

4. LIQUIDITY RISK

The objectives of Balance and Liquidity Risk in the Holding Company are:
• Comply with the Desired Risk Profile defined by the Group's Board of Directors.
• Provide an adequate follow-up to the Risk of Balance and Liquidity.
• Quantify the exposure to Balance and Liquidity Risk through the use of different methodologies.
• Measure the Company's vulnerability to extreme market conditions and that these results are considered for decision-making.
• To keep the Senior Management adequately informed in a timely manner of exposure to Balance and Liquidity Risk and any deviations from the limits and the risk profile.
• Monitor the institution's coverage policy and review it at least annually.
• Maintain a sufficient level of Liquid Assets eligible to guarantee the liquidity of the Institution even under stress conditions.
The Liquidity Risk policies in the Holding Company are:

• Establishment of Global and Specific Balance and Liquidity Risk Management Limits.
• Measurement and monitoring of Balance and Liquidity Risk.
• Information and disclosure of Liquidity Risk to the risk-taking areas, the CPR, the Board of Directors, the Financial Authorities and the Investor Public.

4.1. Methodologies and Exposure to Liquidity Risk

Balance and Liquidity Risk is managed through a series of fundamental pillars, among which we can highlight the use of key indicators, such as the Coverage of Liquidity Coverage (CCL), re-price and liquidity gaps, as well as Stress testing. This is based on a framework of policies and manuals, including a contingency financing plan and a contingency plan for the preservation of solvency and liquidity. It is similarly complemented by the monitoring of limits and levels of Desired Risk Profile on the Balance and Liquidity Risk metrics in question. The disclosure of the referred metrics and indicators and compliance with the limits and the Desired Risk Profile mentioned in this paragraph is done through monthly reports to the CPR, weekly to the capital and liquidity management group and Quarterly to the Board of Directors.

4.2 Financing Profile and Strategy

The bank's funding make-up and evolution during the quarter is shown below:

Source of Funding	3Q17	4Q17	Var vs. 1Q16
Demand deposits accounts			

Mexican pesos	Ps. 327,769	Ps. 345,650	5.5%
Foreign Currency	50,698	51,142	0.9%
Demand deposits accounts	**Ps. 378,467**	**Ps. 396,792**	**4.8%**
Retail Time Deposits			
Mexican pesos	Ps. 173,757	Ps. 174,297	0.3%
Foreign Currency	19,181	19,320	0.7%
Retail Deposits	**Ps. 571,406**	**Ps. 590,410**	**3.3%**
Money market			
Mexican pesos (1)	Ps. 51,685	Ps. 55,394	**(7.2%)**
Banking Sector Total Deposits	**Ps. 623,091**	**Ps. 645,804**	**3.6%**

1. Money Market and Time Deposits

4.3 Liquidity Coverage Ratio

The CCL enables quantifying the Liquidity Risk by means of a ratio between Liquid Assets and Net Cash Outlays in the next 30 days under the assumptions of a regulatory stress scenario.

The CCL is an indicator that should be interpreted as the Institution's liquidity sufficiency to cover its short-term obligations under an extreme scenario using only its highest quality liquid assets.

The following table shows the average development of the CCL components in 4Q17.

	CCL Components	**Bank and Sofomes**	
		Non-weighted Amount (Average)	**Weighted Amount (Average)**
COMPUTABLE LIQUID ASSETS			
1	Total Computable Liquid Assets	Not applicable	Ps. 105,614
OUTLAYS			
2	Non-guaranteed minor financing	Ps. 356,803	Ps. 23,622
3	Stable financing	241,169	12,058
4	Less stable financing	115,634	11,563
5	Non-guaranteed major financing	208,509	73,595
6	Operational deposits	145,289	31,863
7	Non-Operational deposits	58,681	37,193
8	Unsecured debt	4,539	4,539
9	Guaranteed major financing	253,245	17, 523
10	Additional requirements:	237,396	15,833
11	Outlays related to derivative financial instruments and other guarantee requirements	47,222	5,237
12	Outlays related to debt instrument financing losses	-	-
13	Lines of credit and liquidity	190,174	10,596
14	Other contractual financing obligations	-	-
15	Other contingent financing obligations	-	-
16	**TOTAL OUTLAYS**	**No aplica**	**$130,573**
CASH INFLOW			
17	Cash inflow from guaranteed transactions	Ps. 20,306	Ps. 543
18	Cash inflow from non-guaranteed transactions	52,633	40,890
19	Other cash inflows	2,962	2,962
20	**TOTAL CASH INFLOW**	No aplica	Ps. 44,395
			Adjusted amount
21	**TOTAL COMPUTABLE LIQUID ASSETS**	**Not applicable**	**Ps.105,614**
22	**TOTAL NET OUTLAYS**	**Not applicable**	**Ps. 86,177**

23 LIQUIDITY COVERAGE RATIO	Not applicable	123.42%

During 4Q17 the average CCL for the Bank and Sofomes was 123.42%, with a CCL at the close of 4Q17 equal to 108.23%, placing it above the Desired Risk Profile and the regulatory minimum set forth in the established regulations in effect. The aforementioned results indicate that Banorte is in a position to meet the entirety of its short-term obligations in a crisis scenario.[1]

4.4 CCL Component Development

The evolution of the components of the coverage ratio of liquidity between the closure of the 3Q17 and the closure of the 4Q17 is presented in the following table.

CCL Component	3Q17	4Q17	Var vs. 3Q17
Liquid assets	95,498	121,972	27.7%
Cash Inflow*	39,337	30,476	(22.5%)
Outlays*	123,511	143,171	15.9%

*See main causes of the CCL results.

The liquid assets computed for the Bank and Sofomes CCL during 3Q17 and 4QT are distributed as follows:

Type of Asset	3Q17	4Q17	Var vs. 3Q17
Total	**Ps. 95,498**	**Ps. 121,972**	**27.7%**
Level I	86,989	112,445	29.3%
Level II	8,509	9,527	12.0%
Level II A	7,091	7,762	9.5%
Level II B	1,418	1,765	24.5%

Net assets grew by 17.8% between 3Q17 and 4Q17, mainly driven by an increase in liquid assets level I and level II B during 2017

4.5 See Main Causes of the CCL Results

Changes in the Liquidity Coverage Ratio between 3Q17 and 4Q17 are mainly due to the issuance by Banorte in October of subordinated debentures for USD $ 500MM, which had a positive implication on the liquidity of the institution.

4.6 Liquidity Risk in Foreign Exchange

To quantify and follow up on the liquidity risk for its dollar portfolio, the Institution uses the criteria established by Banco de México to determine the Liquidity Ratio.

The liquidity ration in foreign currency should be interpreted as the Institution's capacity to cover its liquidity mismatches with liquid assets, both in foreign currency.

4.7 Exposure to Derivative Financial Instrument and Possible Margin Calls

The Institution applies the regulatory criterion to determine outlays for derivative financial instruments. During 2016 the net outlays for derivative financial instruments were as follows:

Outlays for Derivative Financial	3Q17	4Q17	Var vs. 3Q17

[1] The Liquidity Coverage Ratio is preliminary and subject to validation by Banco de México.

Instruments			
Net outlay at market value y for potential exposure	4,137	4,351	116.7%
Outlays due to a 3-step drop in the credit rating	-	-	(100.0%)

The above measurement indicates that by 4Q17 the potential outlays for derivative financial instruments may represent a liquidity requirement of up to Ps. 4, 351.

4.8 Liquidity Gaps

As part of the Bank's liquidity analysis, liquidity gaps in the Institution's 30-day asset and liability obligations are analyzed. This scheme is monitored Bank-wise with the following results for 4Q17.

Concept	3Q17	4Q17	Var vs. 3Q17
One month accumulated gap	(58,934)	(75,073)	27.4%
Liquid assets	60,297	78,540	30.3%

The mismatch between the inflow and outlays (gaps) for the next 30 days are covered with liquid assets. It should be noted that during the quarter, the Risk Policy Committee approved a new methodology for calculating the liquidity gap, which involves a model for determining the survival of demand and time deposits. The new methodology is the main reason for the difference against the calculations presented in the previous quarter. In addition, the new methodology allows us to make a more granular breakdown of the liquidity gaps, remaining as follows for 4Q17:

Concept (Millions of pesos)	1 day	7 days	1 month	3 months	6 months	12 months
Brecha Natural	(1,911)	(17,363)	(3,278)	7,530	(9,369)	2,810
Brecha Acumulada	(1,911)	(19,274)	(22,552)	(15,022)	(24,392)	(21,582)

4.9 Liquidity Stress Testing

As part of Liquidity Risk management, the Institution performs tests under extreme internal liquidity scenarios to evaluate its liquidity sufficiency under adverse conditions of the environment and inherent bank conditions. A total of 9 scenarios based on 3 risk sources (systemic, idiosyncratic and combined) each with 3 levels of severity (moderate, medium and severe) are considered for this purpose.

4.10 Contingency Financing Plan

Banorte implemented a contingency financing plan in order to have comprehensive practices in liquidity management and guarantee its operation in adverse liquidity situations. The plan incorporates elements to identify possible liquidity issues and to define available alternate funding sources.

4.11 Interest Rate Risk

The balance sheets structural or interest rate risk is managed using tools such as: domestic, foreign and actual interest shift sensitivity analysis obtaining their impact on the Net Interest Margin. The sensitivity analysis includes assumptions regarding the call deposits based on a stability model.

The Institution has policies and coverage limits for the fixed rate portfolio as part of the interest risk mitigation actions. The above is reported to the CPR on a monthly basis.

The effect on the Net Interest Margin of a 100-base point shift in rates is shown in the following table,
which considers Available for Sale, which at the close of 4Q16 corresponded to 153,128 million pesos, and on average during 4Q16 corresponded to 130.480 million pesos.

	3Q17	4Q17	Var vs. 3Q17
Margin Sensitivity	Ps. 870	Ps. 901	3.6%

5. OPERATIONAL RISK

The Institution established a formal operational risk department denominated "Operational Risk Management Department" that reports to the General Risk Management Office.

The Institution defines operational risk as the potential loss due to failures or deficiencies in internal controls because of errors in operations processing and storing or in data transfer, and adverse administrative and judicial rulings, frauds or theft (this definition includes Technology and Legal risk).

Operations Risk Management has three objectives: a) to enable and support the organization to reach its institutional objectives through operational risk prevention and management; b) to ensure that the existing operational risks and the required controls are duly identified, evaluated and aligned with the organization's risk strategy; and c) to ensure that operational risks are duly quantified in order to assign the proper capital for operational risk.

5.1. Policies, Objectives and Guidelines

The Institution has documented the operational risk policies, objectives, guidelines, methodologies and responsible areas.

The Operational Risk Department works closely with the Controllership Department to promote effective Internal Control that defines the proper procedures and controls the mitigation of Operational Risk. The Internal Audit Department follows up on compliance.

The Controllership Department, as part of the Internal Control System, performs the following risk mitigating activities: a) internal control validation; b) institutional regulations' management and control; c) monitoring of operating process' internal control by means of control indicator reports submitted by the process controllers in the various areas; d) money-laundering prevention process management; e) regulatory provisions controls and follow-up; and f) analysis and assessment of operating processes and projects with the participation of the directors in each process in order to ensure proper internal control.

5.2. Quantitative and Qualitative Measuring Tools

5.2.1. Operating Losses Database

To record operating loss events, a system is in place that enables the central information supplier areas to directly record such events online, which are classified by type of event in accordance with the following categories:

<u>Internal Fraud:</u> Losses derived from actions intended to defraud, illegally seize ownership or evade the regulations, law or policies of the Institution (excluding diversity/discrimination events) involving at least one internal party.

<u>External Fraud:</u> Losses derived from actions taken by third parties intended to defraud, illegally seize ownership or evade the law.

<u>Labor Relations and Job Safety:</u> Losses derived from actions inconsistent with laws or employment, health or safety agreements, or which result in the payment of claims for damages to personnel or diversity/discrimination claims.

<u>Customers, Products and Business Practices:</u> Losses derived from negligence or unintentional breaches which prevent compliance with professional obligations with customers (including trust and adaptation requirements or due to the nature or design of a product).

<u>Natural Disasters and Other Events:</u> Losses due to damage or harm to physical assets due to natural disasters or other events.

<u>Business Incidences and System Failures:</u> Losses derived from incidences in the business and system failures.

Process Execution, Delivery and Management: Losses derived from errors in transaction processing or in process management, as well as relations with counterparties and suppliers.

This historical database provides the statistics of the operating events experienced by the Institution in order to be able to determine the respective trends, frequency, impact and distribution. Furthermore, the database will serve to calculate capital requirements for advanced models in the future.

5.2.2. Legal and Tax Contingencies Database

For the recording and follow-up of legal, administrative and tax issues that may arise from adverse unappealable ruling, an internal system called “Legal Risk Issues Monitoring System” (SMARL) was developed. This system enables the central data supplying areas to record such events directly and on-line, which are then classified by company, sector and legal issue, among others.

As part of the Institution's Legal Risk management initiative, legal and tax contingencies are estimated by the attorneys that process the issues determining the risk degree of each issue based on an internal methodology. This makes it possible to create the necessary book reserve within a specific term (based on the duration of the suit) to face such estimated contingencies.

5.3. Risk Management Model

The Institution and its subsidiaries have defined objectives, which are achieved through different plans, programs and projects. Compliance with such objectives may be adversely affected due to operating risks, for which reason a methodology must be in place to manage them within the organization. Consequently, operational risk management is now an institutional policy defined and supported by senior management.

To perform operational risk management, each of the operating risks involved in the processes must be identified in order to analyze them. In this regard, the risks identified by the Regulations Control are recorded in a risk matrix and processed to eliminate or mitigate them (trying to reduce their severity or frequency) and to define the tolerance levels, as applicable.

5.4. Calculating Capital Requirement

Pursuant to the Operational Risk Capitalization Rules, the Institution has adopted a Basic Model, which is calculated and reported periodically to the authorities; Assets subject to operational risk are disclosed in the note corresponding to the rules for capitalization requirements.

5.5. Information and Reporting

The information generated by the databases and the Management Model is processed regularly in order to report the main operating events detected, trends, identified risks (risk matrix) and the mitigating strategies to the Risk Policy Committee and the Board of Directors. The status of the principal initiatives for operational risk mitigation implemented by the different areas of the organization is also reported.

5.6 Revelación de Riesgos Operacionales

With regard to the disclosure of the operational risks to which it is exposed the institution, it is reported that the operational losses accumulated in the past 12 months represent 1.5% of the net interest margin (accumulated. In the past 12 months).

5.7. Technology Risk

It is defined as the potential loss due to damage, interruption, alteration or failures in the use of or dependence on hardware, software, IT systems, applications, networks and any other data distribution channel for rendering services to customers. Technology risk forms an inherent part of operational risk, for which reason its management is performed throughout the entire organization

To address operational risk associated with data integrity, the Integrity Committee was created. Its objectives include aligning data security and control efforts to a preventive approach, defining new strategies, policies, processes or procedures and solving data security issues that affect or may affect the Institution's assets.

The Institution performs the Technology Risk Management functions set forth by the Commission under the guidelines established by the institutional Regulations and the Integrity Committee.

To address the operating risk caused by high impact external events, the Institution has a Business Continuity Plan (BCP) and Business Recovery Plan (BRP) based on a same-time data replication system at an alternate computer site. This guarantees the back-up and recovery of critical applications in the event of an operating contingency.

5.8. Legal Risk

Legal risk is defined as the potential loss due to noncompliance with applicable legal and administrative provisions, adverse administrative and judicial rulings, and imposed penalties regarding the transactions performed by the Institution.

The legal risk must be measured as an inherent part of Operational Risk in order to understand and estimate its impact. Therefore, those legal issues which result in actual operating losses in the SMARL system are recorded in the SCERO in accordance with a predetermined classification.

Based on the statistics of the current legal issues and real loss events, the Institution can identify specific legal or operating risks, which are analyzed in order to eliminate or mitigate them in an attempt to reduce or limit their future occurrence or impact.

Note: Additional information regarding Risk Management in compliance with article 88 of the Sole Bank Circular is found in the Risk Management note of Grupo Financiero Banorte's Quarterly Report.

33 - MEMORANDUM ACCOUNTS (not audited)

	2017	2016
Contingent assets and liabilities	Ps.100	Ps.44
Credit commitments	213,098	285,689
Assets in trust or mandate	290,749	292,173
Managed assets in custody	363,730	294,203
Collateral received	133,904	82,196
Collateral received and sold or given as a pledge	62,240	20,124
Investment banking transactions on account of third parties (net)	87,333	93,306
Interest accrued but not charged of past due loans	366	439
	Ps. 1,151,520	**Ps.1,068,174**

34 - COMMITMENTS

As of December 31, 2017 and 2016, the Institution had the following contingent obligations and commitments:

- Other contingent obligations and opening of credits totaling Ps. 213,198 (Ps. 285,735 in 2016), which are recorded in memorandum accounts (not audited).

- Certain operating equipment is leased. Total property lease payments for the years ended December 31, 2017 and 2016, were Ps. 87 and Ps. 130, respectively.

35 – CONTINGENCIES

As of December 31, 2017, there are lawsuits filed against the Institution in civil and labor court cases; however, the Institution's attorneys consider that the claims filed are unsubstantiated and, in the event of an adverse ruling, they would not significantly impact the Institution's consolidated financial position. As of December 31, 2017, the Institution has recorded a reserve for contentious matters of Ps. 488 (Ps. 601 in 2016).

36 - PREVENTIVE MECHANISM FOR SAVINGS' PROTECTION

The objective of the Institute for the Protection of Bank Savings (IPAB) is to protect the deposits of small customers and thereby contribute to maintaining the financial system's stability and the proper functioning of the payments systems.

According to the Law of Bank Savings Protection (LPAB), the IPAB manages a bank savings protection system that guarantees the payment of bank deposits or loans or credits to Full Service Banking Institution up to an amount equivalent to 400 thousand UDIS per individual or business entity, regardless of the number or type of such obligations in the customer's favor and charged to a single bank.

On July 30, 2007, general rules were issued for addressing joint accounts or those in which there is more than one account holder, referred to in art. 14 of the LPAB, as well as the rules banks must observe for classifying information relative to transactions associated with guaranteed obligations.

The IPAB plays a major role in the implementation of the LPAB resolutions methods and the Law of Credit Institutions (LIC) as timely and adequate mechanisms for salvaging and liquidating Full Service Banking Institutions in financial trouble that may affect their solvency. The purpose is to provide maximum protection to the public while minimizing the negative impact that salvaging an institution may have on others in the banking system.

During 2017 and 2016, the amount of contributions to the IPAB payable by Banorte for fees amounted to Ps 2,634 and Ps 2,325, respectively.

37 - NEW ACCOUNTING GUIDELINES

As of December 31, 2017, CINIF has issued the following NIF and improvements to current NIF which could generate accounting changes.

a. New NIF

In relation to the NIF issued by the CINIF, in accordance with the fourth article of the resolution amending the general provisions applicable to credit institutions published on December 27, 2017, will be applicable to credit institutions as of January 1, 2019.

The Institution is waiting for the CNBV to publish the final version of the criterion A-2 "Application of particular Rules" which currently has as a project in review, same that could include some clarification in the application of the NIF, derived from the recommendations and comments that credit institutions did through the Association of Banks of Mexico to the CNBV, considering that credit institutions perform specialized operations.

To date we are in the process of analysis of the impacts that these NIF may have in the financial statements, same that we will inform in due time considering the final version of the project once it is published in the Official Gazette of the Federation and according to the requirements of the NIF B-1 "accounting changes and corrections of errors".

The NIFs issued and which will be applicable to credit institutions from 1 January 2019 are:

- NIF B-17 "*Determination of fair value*".
- NIF C-2 "Investments in securities".
- NIF C-3 "Accounts Receivable".
- NIF C-9 "Provisions, contingencies and commitments".
- NIF C-10 "Derivatives Financial Instruments and hedging".
- NIF C-16 "*Impairment of financial instruments receivable*".
- NIF C-19 "*Financial instruments to be paid*".

- NIF C-20 “*Financial instruments to charge principal and interest*”.
- NIF D-1 “*Income from contracts with customers*”.
- NIF D-2 “Customer contract costs”.

b. Improvements to NIF 2018

The following improvements were issued with effect from January 1, 2018, which could generate accounting changes.

The improvements consist in specifying the scope and definitions of these NIF to indicate more clearly their application and accounting treatment.

NIF B-10, effects of inflation- in a non-inflationary environment, it is established to disclose the percentages of inflation accumulated by the three previous annual exercises and which served as the basis for qualifying the economic environment in which the entity operated in the financial year. Current, as non-inflationary; The accumulated that includes the two previous annual exercises and the period to which the financial statements relate.

NIF C-6, Properties, plant and equipment- indicates that the recognition of the change to this NIF valid from January 2018 must be made in prospective form. The change establishes that the depreciation method should be made in a method that reflects the pattern based on which the entity is expected to consume the future economic benefits of the component rather than revenues, as such income amount may be affected by factors other than the profit consumption pattern.

NIF C-8, intangible assets- indicates that the recognition of the change to this NIF valid from January 2018 must be made in prospective form. The change establishes that the method of depreciation should be made in a method that reflects the pattern based on which the entity is expected to consume the future economic benefits of the asset rather than revenue, since such an income amount may be affected by factors other than the pattern of consumption of economic benefits. However it will be allowed to use a method based on income in specific cases.

NIF C-14, transfer and lowering of financial assets-it is indicated that the recognition of the change to this NIF valid from January 2018 must be made retrospectively for all the financial statements that are presented in comparative form with those of the period Current. The change establishes that an entity must continue to recognize an asset transferred to the extent that it has continuous involvement, also that the subsequent recognition of such asset should be carried out on the basis of applicable rules, the recognition must be made depending on the type of asset in question and the classification of the same by the entity.

The following improvements were issued that do not generate accounting changes:

NIF B-7, business acquisitions- a contingent liabilities of the acquired business must be recognized on the date of purchase as a provision, if in the process of valuation of the net assets acquired, that item represents is a present obligation to the business acquired that arises from past events, and it can reliably determine its fair value, and there is likely to be an outflow of resources in the future to liquidate that obligation. It was previously required that all contingent liabilities were recognized, which contradicts the requirements of NIF C-9.

NIF B-15, conversion of foreign currencies - Due to the functional currency is the basis of the economy of an entity, it must carry out the valuation of its assets, liabilities, equity, income, costs and expenses on the information specified in its functional currency. On these values should be the testing of impairment that may be required.

NIF D-5, leases - establishes a single model for recognition of leases by the lessee and requires it to recognize the assets and liabilities of all leases with a duration of more than 12 months, unless the underlying asset is of low value, eliminating the classification of leases as operational and financial. For lessors are maintained almost without changing the current requirements.

In addition, in the resolution published on December 27, 2017 referred to in subparagraph (a) of this note, amendments to criterion B-6 were included, which require that the following concepts be recorded by decreasing the Item of "Provisions for loan losses" instead of registering for "other operating income (expenses)":

- excess of loan losses,
- Recoveries of loans write-off

These amendments come into force from January 1, 2019, establishing the option that credit institutions will be able to apply them in advance as of the day following their publication. GFNorte has decided to adopt them in advance.