BANORTE

Annual Report
Equator Principles

2017

January 1st – December 31st

Content

Introduction

The Equator Principles (EPs) represent the most important standard for the environmental and social risk management within the international financial sector; they were created as a voluntary framework intended to determine, evaluate and manage the environmental and social risks and impacts in financial transactions, accrediting only those projects that can demonstrate a socially and environmentally responsible management.

The EPs were developed in 2003 by EPFIs (Equator Principles Financial Institutions) in consultation with the International Finance Corporation (IFC). Currently, 92 financial institutions from 37 countries have officially adopted these principles[1], with Banorte being the second Mexican bank to adhere to this framework in 2012.

In such wise, we reiterate our commitment about prevent, minimize, restore and compensate for impacts generated by our operations, recognizing the importance of climate change, natural resources, biodiversity and human rights.

This document serves as a report on the implementation of the EPs in Banorte from January 1st to December 31st, 2017, according to Principle 10 (Reporting and Transparency) and Appendix B (Minimum Reporting Requirements) of the Equator Principles III-2013[2].

Implementation of the Equator Principles at Banorte

The Equator Principles and Risk Management

In 2009, Banorte signed an agreement with IFC under which it committed to establish its own system of environmental and social risk management. In March of 2012, Banorte adopted the EPs. In October 2012 the Social and Environmental Risk Management System (SEMS) started operating.

The SEMS defines a process of identification, categorization, selection, evaluation and management of social and environmental risks and impacts generated by the activities we finance, based on the rules of the EPs, the World Bank Group Environmental, Health, and Safety Guidelines.

Thus, the objective of the SEMS is to analyze the environmental and social risk of the Corporate Banking, Commercial Banking and Structured Financing loan portfolio, in order to promote that projects receive financing or advisory from Banorte, cause the least amount of harm possible, are developed in a socially responsible manner and apply strict environmental practices.

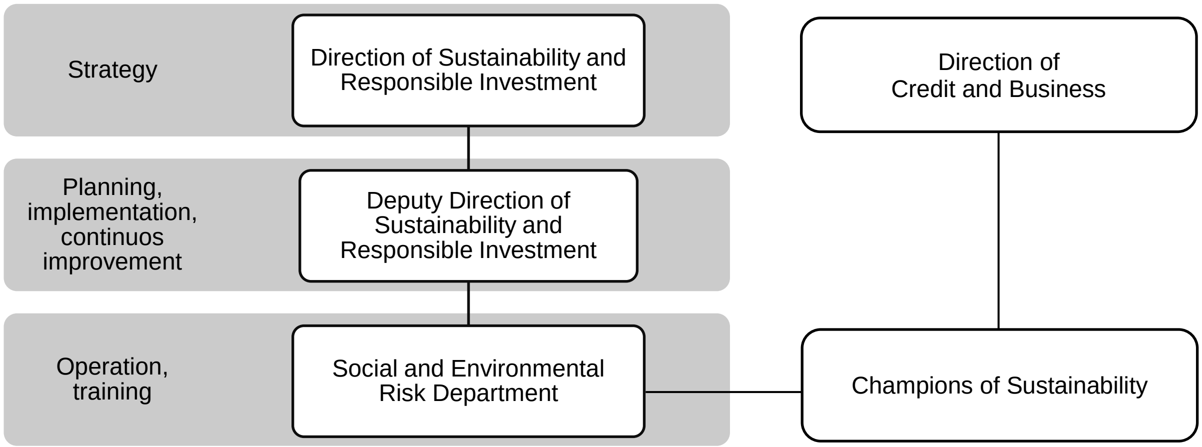
Organizational Structure

The implementation of the EP’s through the SEMS is in charge of the Social and Environmental Risk department (Área de Riesgo Socio-Ambiental - ARSA), which is part of the Direction of Sustainability and Responsible Investment. ARSA is integrated by a team with specialized education, experience and skills related to social and environment issues.

[1] http://equator-principles.com/about/
[2] http://equator-principles.com/wp-content/uploads/2017/03/equator_principles_III.pdf

Moreover, SEMS is supported by the Champions of Sustainability, a group of Credit department partners who act as a link between ARSA and the Business area of the Bank to disseminate at national level, an adequate social and environmental risk management.

Organizational Structure of the SEMS



Social and Environmental Analysis Process

The Social and Environmental Risk Management System of Banorte follows a process of identification, categorization, selection, evaluation and management that operates in parallel with the credit procedures. In this manner, credits are analyzed previous to its authorization by the Credit Committee.

Analysis Process of the SEMS

Identification

The process begins with the identification of potential social and environmental risks, based on a review of the characteristics of the financing. So, ARSA confirm with the Credit area the customer's activity, the financial product, the destination of the credit, the amount and the term.

In this stage, the exclusion list of the Bank (Appendix 1) is used to rule out any activity considered as a risk or prohibited situation. Likewise, a research is carried out about the reputation of the project and/or company to know its exposure to this type of risk.

Categorization and Selection

The categorization consists of assigning a level of social and environmental risk to credits, depending on the magnitude of their impacts and the possibility of mitigating them. Risk is classified into three categories: low risk (C), medium risk (B) and high risk (A). In addition, special attention is paid to sensitive industrial sectors such as mining, oil and gas, chemicals, among others, due to its high potential for affecting natural areas, indigenous communities and cultural heritage.

Categories of social and environmental risk

Category A	Category B	Category C
Projects with potential significant adverse environmental and social risks and/or impacts that are diverse, irreversible or unprecedented. For example, oil and gas projects, development of large infrastructures, mining, foundry, among others.	Projects with potential limited adverse environmental and social risks and/or impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures. This is the case of food processing, pulp and paper industry, housing construction, hospitals.	Projects with minimal or no adverse environmental and social risks and/or impacts. We can mention the purchase of machinery, the service industry, consulting agencies, among others.

Once financings are categorized, we proceed to choose those that must be evaluated considering the assigned risk category, the destination of the credit, the sector, the reputational background and the amount of the loan. Priority, we evaluate category A and B projects belonging to sensitive sectors.

Evaluation

The evaluation consists in verifying the compliance of the projects and/or companies with the current national legal framework, as well as with the established international guidelines on social and environmental risk for the financial sector, the Performance Standards and the EP's.

Loans over 1 million dollars are evaluated by the IFC Performance Standards, credits over 10 million dollars are analyzed under the EP's framework and loans lower than 1 million dollars pass through the SEMS Evaluation[3].

Phase of evaluation

Equator Principles	Performance Standards	SEMS Evaluation
• Review and Categorisation • Environmental and Social Assessment • Applicable Environmental and Social Standards • Environmental and Social Management System and Equator Principles Action Plan • Stakeholder Engagement • Grievance Mechanism • Independent Review • Covenants • Independent Monitoring and Reporting • Reporting and Transparency	• Assessment and Management of Environmental and Social Risks and Impacts • Labor and Working Conditions • Resource Efficiency and Pollution Prevention • Community Health, Safety, and Security • Land Acquisition and Involuntary Resettlement • Biodiversity Conservation and Sustainable Management of Living • Natural Resources • Indigenous Peoples • Cultural Heritage	• Social risks and impacts • Environmental risks and impacts • Reputational risks and impacts

3 SEMS evaluation represents the third evaluation framework created for credits less than 1 million dollars. Its objective is to analyze the most relevant environmental, social and reputational impacts of credits and its compliance with the current national legislation and international guidelines.

Thus, ARSA requests to the client, through the Credit area, the necessary information to elaborate a due diligence that validates the compliance with standards. Among the documentation requested are authorizations, permits, resoluteness, licenses, plans, programs, protocols, specialized studies and good practices.

The evaluation of the social and environmental risks includes recommendations for both, the Credit Committee and the customer, regarding the social and environmental viability of the project. So, the Committee considers ARSA's opinion and conditions to grant financing, and customers receive guidance to improve their environmental and social responsibility management practices. In this way, we disseminate the World Bank Group Environmental, Health, and Safety Guidelines.

Management

Finally, risk management stage refers to the monitoring of the environmental and social performance of the projects, during the life cycle of financings. This monitoring applies to loans that were evaluated, mainly projects analyzed under the EP's framework.

During this stage, ARSA provides continuous advice to Credit area in order to guide clients in complying with assessment frameworks and developing action plans. These action plans must contain personnel in charge, deadlines and measures defined face of conditions established by ARSA and the external and internal experts of the project.

ARSA conducts in addition, annual documentary reviews, reputational monitoring and on-site visits for financed projects and/or companies to verify the attention on opportunity areas detected, as well as the implementation of action plans.

Review of the implementation of the Equator Principles

As a part of the Banorte's SEMS continuous improvement process, the Direction of Sustainability and Responsible Investment, in partnership with ARSA, verify the SEMS operation and the EP's application conducting annual reviews. These reviews consider the results attained, the objectives achieved, the feedback of the different stakeholders (Credit, Normativity, Compliance Legal and Specialized Credit Areas) and the identification of opportunity areas and its corrective actions.

Training

The Credit and Business area plays a key role in environmental and social risk management. Therefore, raising awareness and developing expertise in these issues is essential. Addressing this need, ARSA provides training for Credit's analysts, executives and directors in person mode, online and by telephone. Also we published the monthly informative newsletter "SEMS en breve" [4].

During 2017, we reached to train more than 375 executives in topics such as sustainability in the financial sector, social and environmental risk management, SEMS operation, sensitive sectors, case studies, sustainable and responsible customers and reputational risk.

As mentioned above, ARSA is formed by a team with specialized education and experience in social and environmental matters, who in addition receive periodically training on specific topics for the adequate risk management such as human rights, indigenous people and cultural heritage, among others.

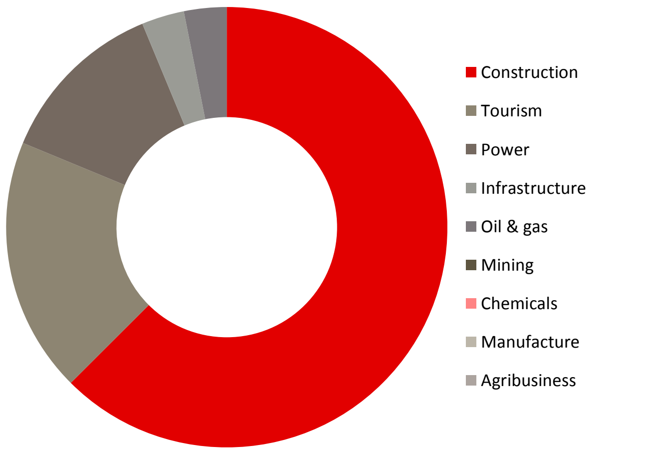
4 SEMS en breve is a newsletter that addresses high social and environmental risk cases, nationally and internationally, as well as relevant issues related to the operation and bases of SEMS.

Report of Results of the Equator Principles 2017

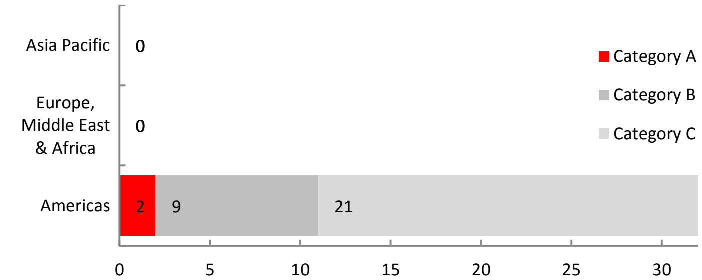
SEMS operations considered the guidelines of Equator Principles III-2013 for non-designated countries like Mexico, in Americas region. Regarding to the provision of credits from January 1st to December 31st, 2017, the EP's application produced the results detailed below.

Project Finance

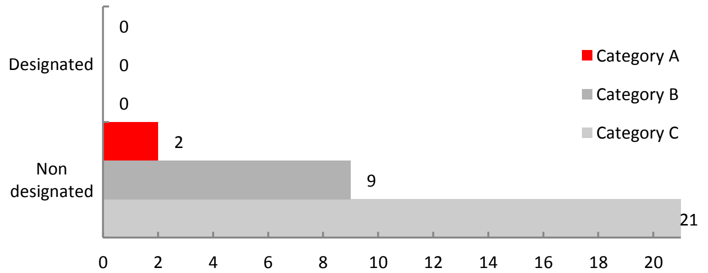
Sector				
	Category A	Category B	Category C	TOTAL
	2	**9**	**21**	**32**
Mining	0	0	0	0
Infrastructure	1	0	0	1
Oil & gas	1	0	0	1
Power	0	4	0	4
Others	0	0	0	26
Chemicals	0	0	0	0
Construction	0	1	19	20
Manufacture	0	0	0	0
Agribusiness	0	0	0	0
Tourism	0	4	2	6



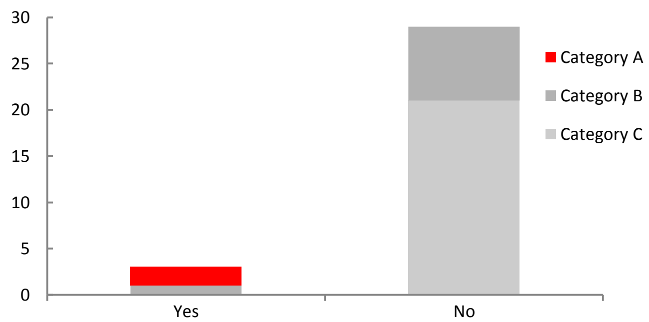
Region				
	Category A	Category B	Category C	TOTAL
Americas	2	9	21	32
Europe, Middle East & Africa	0	0	0	0
Asia Pacific	0	0	0	0



Designated country				
	Category A	Category B	Category C	TOTAL
Designated	0	0	0	0
Non designated	2	9	21	32



Independent review				
	Category A	Category B	Category C	TOTAL
Yes	2	1	0	2
No	0	8	21	30

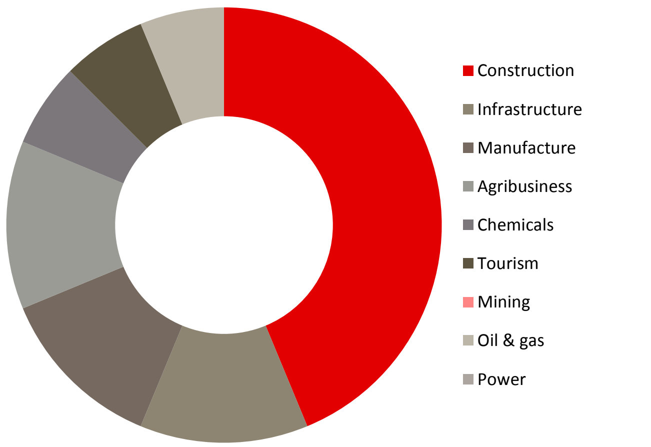


As it is possible to observe, most of the projects financed during 2017 are in category C with minimum and non-adverse environmental and social risks and impacts (21 projects). In category B, nine projects were financed and in category A only two loans were granted.

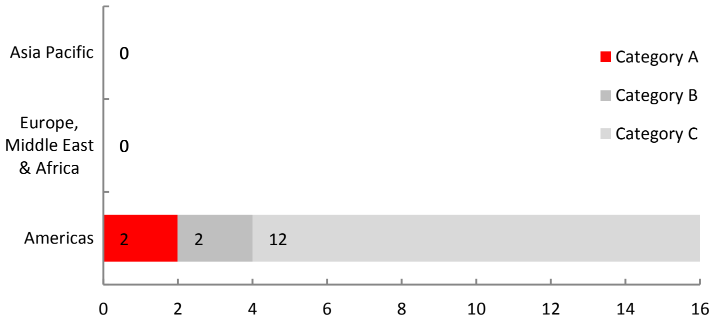
Of the total projects, only three, two in category A and one in category B, presented an independent consultant review in the first compliance review with the EP's. However, as part of the recommendations and conditions that ARSA establishes in the due diligences to follow up annually, it urges to clients to have an independent consultant who support the execution of their projects.

Project-Related Corporate Loans

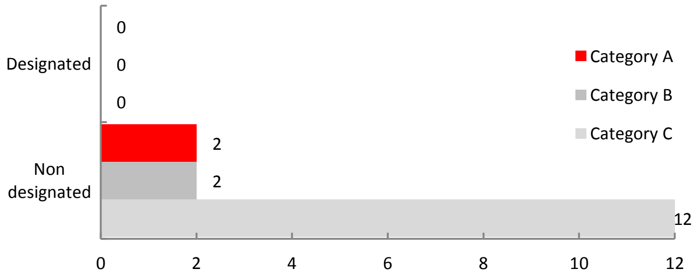
Sector				
	Category A	Category B	Category C	TOTAL
	2	**2**	**12**	**16**
Mining	0	0	0	0
Infrastructure	1	1	0	2
Oil & gas	1	0	0	1
Power	0	0	0	0
Others	0	1	12	13
Chemicals	0	0	1	1
Construction	0	0	7	7
Manufacture	0	1	1	2
Agribusiness	0	0	2	2
Tourism	0	0	1	1



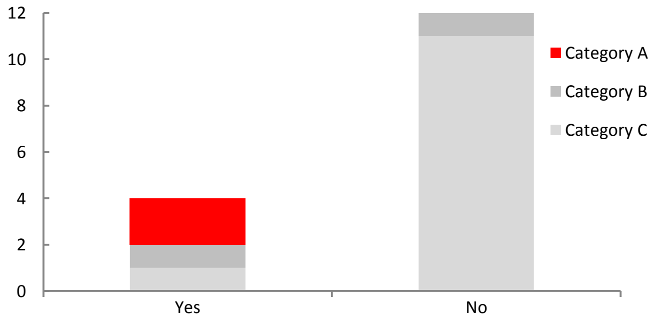
Region				
	Category A	Category B	Category C	TOTAL
Americas	2	2	12	16
Europe, Middle East & Africa	0	0	0	0
Asia Pacific	0	0	0	0



Designated country				
	Category A	Category B	Category C	TOTAL
Designated	0	0	0	0
Non designated	2	2	12	16



Independent review				
	Category A	Category B	Category C	TOTAL
Yes	2	1	1	4
No	0	1	11	12



The majority of Project-Related Corporate Loans financed during 2017 are in category C with minimum and non-adverse environmental and social risks and impacts (12 credits). In category B, two projects were financed and in category A two other loans were granted.

Of the total projects, only four, two in category A, one in category B and one in category C, presented an independent review. As part of the recommendations and conditions that ARSA establishes in the due diligences to follow up annually, it urges to clients to provide these review for the next year of evaluation.

Project Finance Advisory Services

Banorte did not authorize any transaction of 10 million dollars or more for Project Finance advisory services with significant social and/or environmental risks.

Bridge loans

Due to their nature, the information about the bridge loans is not subject to specific reporting requirements of the report[5]**.**

Project Name Reporting for Project Finance

In Mexico, according to the Law on Credit Institutions [6], we cannot disclosure the project name of financings because its publication would violate current rules. In particular, Article 142 stating that the information and documentation relating to operations and services shall be confidential.

So credit institutions in protecting the right to privacy of its customers and users, they can only give news or information the owner, their representatives and when requested by the judicial authority, the National Banking and Securities Commission, Bank of Mexico, the Institute for Protection of Bank Savings and the Commission for the Protection and Defense of Financial Services Users.

Conclusions

The implementation of the Equator Principles at Banorte through its Social and Environmental Risk Management System continue representing an important challenge to the institution. During 2017, we achieve to strength the SEMS performance across improving the tools of information analysis and organization, the continuous training of the Credit area and our interaction with Business departments. For more information consult https://www.banorte.com/cms/archivos/AR_BANORTE_2017.pdf

[5] http://equator-principles.com/wp-content/uploads/2017/03/equator_principles_III.pdf
[6] http://www.diputados.gob.mx/LeyesBiblio/pdf/43_170616.pdf

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Appendix 1. Exclusion list

Exclusion list of Banorte

03.02 Prohibited Risk Situations

The following activities and operations are considered prohibited. For this reason, these activities do not require a preliminary analysis to determinate their disapproval.

a. Production or activities that involve forced labor [(1)] or child labor exploitation.

b. Production or commerce of any product or activity considered as illegal, all in the current legal framework.

c. Any business related to pornography and prostitution.

d. Wildlife crime regulated by the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).

e. Production or trade of radioactive material (including warehousing and treatment of radioactive wastes.) asbestos, polychlorinated biphenyl (PCB) and others chemical products that have been prohibited internationally.

f. Production and trade of pharmaceutical or pesticide and herbicides that has been prohibited internationally.

g. Production or trade of harmful substances that destroy ozone, which have been prohibited internationally.

h. Sea fishing using nets more than 2.5 km long.

i. Commercial forestry at commercial level in primary tropical rainforest.

j. Any other activity that is in violation of environmental, health or industrial safety laws.

k. Churches

l. Gambling

m. Military Equipment

n. Candidates, Political Exposed Persons, Unions, Political Organizations. , the Central Credit Committee, has the exclusivity authority to approve the financing; this process also requires the signature of the CEO. Banorte can only provide financing the three largest political parties in the country registered with the National Electoral Institute (Instituto Nacional Electoral: INE); an exception can be made for the financing of other political parties registered in the INE, but only for 4 million Units of Investment (UDI) this process further requires that the Risk Policy Committee (Comité de Políticas de Riesgo) is informed about any such exceptions.

(1) Forced labor means all labor or service that is involuntary, that is obtained through the use of threat, force or punishment.

[(2)] Child labor exploitation means the employment of children characterized by economic exploitation, , or with a probable risk of danger for the child, or interferes with the formal education of the child, or that causes harm to the health of the child, or has a negative impact on the physical, mental, spiritual, moral or social welfare of the child.

For the case of SOFOL (Limited Scope Financial Institutions) mortgage loans, the prior authorization of the Risk Policy Committee is required, due to the "zero limit" according to the number 1.1.5.3.2.2. Specific Limit for Credit Risk for SOFOL Mortgages (Límite Específico de Riesgo de Crédito para Sofoles Hipotecarias) in the Risks Manual.

Transaction with applicants, whose credit score, which is determined by the Credit Bureau (Buró de Crédito) has one the following characteristics:
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- Suspension of payments or bankruptcy, except expired procedures (1).
- Fraud, except when the Credit Bureau and/or the creditor determine that the fraud is not attributable to the client (2).
- Prevention Code 78, business receptors of credit cards that result in losses for the institution.
- Bankruptcy to 2,000 UDI.
- Observation Code UP. Account that result in bankruptcy. Amount superior to 2,000 UDI.
- Prevention Code 86; Client that have guarantees that support their line of credit, without authorization of the guarantor.

(1) The Codes that determine Suspension of Payments or Bankruptcy are:
- Prevention Code 80. Client declared to be Bankrupt, Suspension or Payments or Insolvency.

(2) The Codes that determine Fraud are:
- Prevention Code 82. Client that results in a loss to the guarantor by proven fraud.
- Observation Code FD. Fraudulent Account.

MOP 99. Fraud committed by the consumer.