

Equator Principles Annual Report Term: January 1st - December 31st, 2016

Introduction

The Equator Principles (EPs) represent the most important international standard for environmental and social risk management within the financial sector. The EPs constitute a voluntary framework intended to determine, evaluate, and manage the environmental and social risks and impacts in financial transactions.

The EPs were created in 2003 by EPFIs (Equator Principles Financial Institutions) in consultation with the International Finance Corporation (IFC); during the first ten years of operation, 80 global and local banks from 35 countries were added¹ The EPs apply globally to all industrial sectors. According to these principles, only projects in compliance with the established social and environmental standards are able to receive financing.

In 2012 Banorte became the second Mexican bank to adopt the EPs, on the basis that they offer important benefits to the institution, its customers and its stakeholders. Banorte recognizes that its function as a financial institution provides it with the opportunity to promote efficient environmental management and socially responsible development² in the projects that it finances.

This document serves as a report on the implementation of the EPs in Banorte from January 1st to December 31st, 2016, according to Principle 10 (Reporting and Transparency) and Annex B (Minimum Reporting Requirements) of the Equator Principles III-2013.

Implementation of the Equator Principles at Banorte

Adoption of the Equator Principles and its insertion in the processes

In 2009, Banorte signed an agreement with the 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, evaluation and management of social and environmental risks associated with the provision of credit, based on the rules of the EPs, the IFC Performance Standards and The World Bank Group Environmental, Health and Safety Guidelines.

Thus, the objective of the SEMS and the EPs is to analyze the environmental and social risk of the Corporate Banking, Commercial Banking, Government Banking and Structured Financing loan portfolio, in order to ensure that projects that receive financing or advisory from Banorte are developed in a socially responsible manner, reflect the application of strict environmental management practices which cause the least amount of harm possible³.

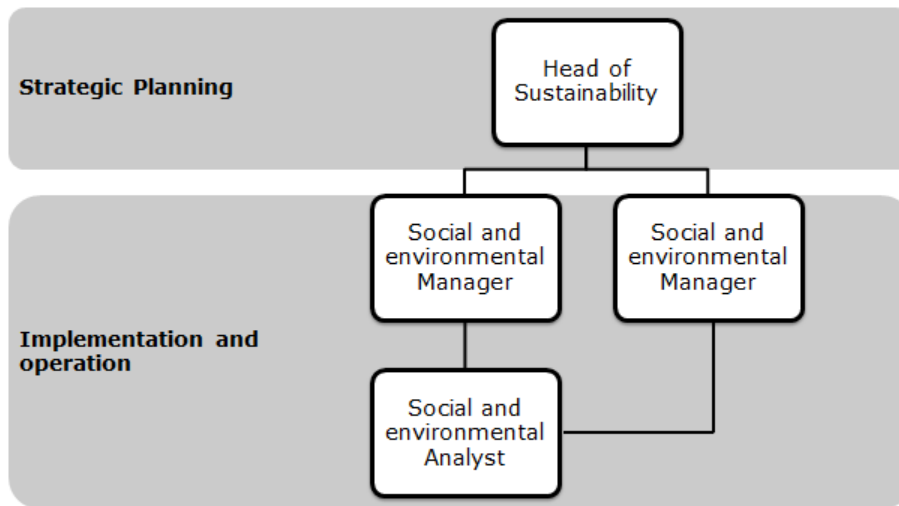
¹ <http://www.equator-principles.com/index.php/about-ep/about-ep>

² http://www.equator-principles.com/resources/equator_principles_III.pdf

³ http://www.equator-principles.com/resources/equator_principles_III.pdf

Administrative structure of the Equator Principles

The SEMS and the EP's are in charge of the leadership of Sustainability and Responsible Investment department, who created the Social and Environmental Risk Area (Gerencia de Riesgo Socio-Ambiental: GRSA) in order to successfully administrate and operate the system. The GRSA is integrated by two manager positions and one analyst with education, experience, competence and specialized skills related to social and environment issues.



Graphic 1. Administrative Structure of the SEMS and EP's.

Social and Environmental Risk Management System and the Equator Principles

The SEMS of Banorte is responsible for the social and environmental risk analysis process, which consists of the identification, categorization, evaluation and management of the social and environmental risks associated with the financial transactions.

1. Identification of social and environmental risks

The process begins with the identification of potential social and environmental risks. This is achieved by analyzing the characteristics of potential investments proposed by the credit officers based on information provided by the Selective Credit Alliance System (Sistema Alianza Crédito Selectivo: SACS), by telephone or through questionnaires⁴ prepared by the SEMS (in case of the Government Banking and Structured Finance). The characteristics include customer activity, credit destination, financial product, amount of the credit, and the corresponding deadlines.

At this stage the use of bank exclusion list is very important to rule out any activity considered prohibited. Additionally a reputational risk analysis is performed to better understand the exposure of Banorte to this type of risk.

⁴ See Appendix 2. Questionnaire for Government Banking also see Annex 3. Questionnaire for Structured Finance

2. Categorization of social and environmental risks

The categorization is assigning a social and environmental level to credits depending on the magnitude of impacts and risks that generate. The risk is classified in the following categories: low risk (C), medium risk (B) or high risk (A). Also, the categorization pays special attention to sensitive industrial industries (mining, chemicals, forestry, agribusiness, tourism, etc.) and its impact on natural areas, cultural heritage and indigenous people.

The determination of the social and environmental risk level is made based on the initial risk, which is automatically provided by SACS, according to a predetermined matrix that relates the purpose of the loan with a specific risk level from each industrial activity. Thus, once the potential risks are identified, the GRSA will then confirm or reassign the level of risk.

3. Evaluation of social and environmental risks

The evaluation of social and environmental risks consists of the projects compliance verification under the current national regulatory framework and according the international guidelines on social and environmental issues for the financial sector (Performance Standards and Equator Principles).

Loans over 1 million dollars are evaluated by the IFC Performance Standards, and loans over 10 million dollars are analyzed under the Equator Principles framework. All the loans related to sensitive industries are evaluated. Thus, GRSA requires that investment officers obtain the necessary information to conduct due diligence⁵ that ensure compliance.

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 and improvements in social and environmental performance. The Committee considers the GRSA opinion to grant funding and customers receive guidance to improve their environmental management practices and social responsibility.

4. Management of social and environmental risks

The risk management stage refers to the monitoring of the project's environmental and social performance 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, GRSA establishes continuous contact with the executives and analysts in order to guide clients in complying with assessment frameworks, through annual documentary reviews, site visits and monitoring projects and/or company's reputational risk.

Review of the implementation of the Equator Principles

As part of the Banorte's SEMS continuous improvement process, the Head of Sustainability and Responsible Investment department, in partnership with GRSA, assesses the SEMS operation and the EP application conducting an annual review of the results attained and the objectives achieved. This review considers the feedback of the different departments of the bank which are involved in the system (Credit, Normativity, Compliance Legal and Specialized Credit Areas).

⁵ See Appendix 4. Due Diligence

Training of the Equator Principles staff

The GRSA, responsible for the operation of the SEMS, is comprised of personnel with specialized education and skills on social and environmental issues. In addition, the GRSA periodically receives in-person or online training related to specific topics regarding environmental and social risk management including human rights, indigenous communities, cultural heritage, impact evaluation and environmental risks, among others.

Also, GRSA trains the Credit Areas about the definition, objectives, responsibilities, scope and operation of SEMS and PE, through personal contact at the time of investment analysis, online training and the monthly distribution of a newsletter "SEMS en breve" showcasing of high social and environmental risk at national and international level.

Report of results of the Equator Principles of 2016

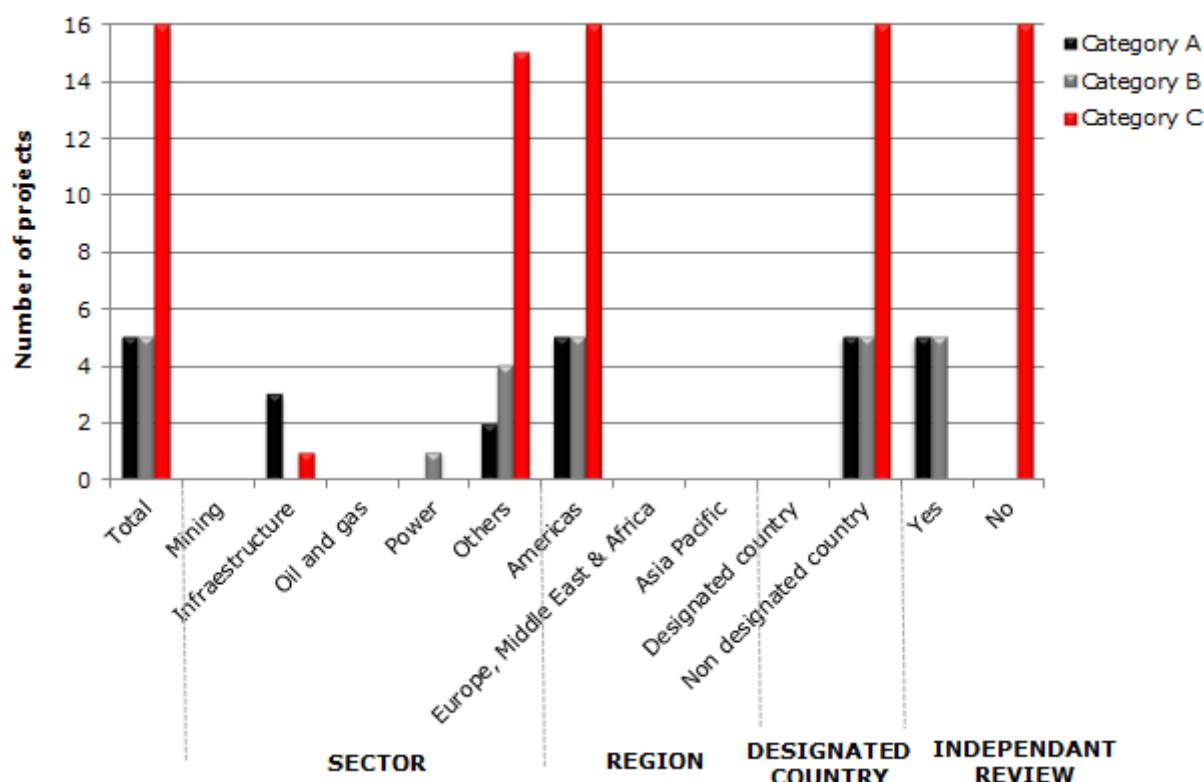
Since June 2013, the SEMS and EP operations have taken into account the Equator Principles III - 2013 for "Non-Designated Countries" like Mexico, in the region of the Americas. Regarding to the provision of credit from January 1st to December 31st, 2016, the EP application produced the results detailed below.

▪ Project Finance

CATEGORY	A	B	C
Total	5	5	16
SECTOR			
Mining	0	0	0
Infrastructure	3	0	1
Oil & gas	0	0	0
Power	0	1	0
Others	2	4	15
REGION			
Americas	5	5	16
Europe, Middle East & Africa	0	0	0
Asia Pacific	0	0	0
DESIGNATED COUNTRY			
Designated country	0	0	0
Non designated country	5	5	16
INDEPENDENT REVIEW			
Yes	5	5	0
No	0	0	16

Table 1. 2016 Project Finance

The majority of Project Finance (16 projects) are category C with minimal or no adverse environmental and social risks and/or impacts; 5 projects are category B and 5 others are in category A. Category A and B projects presented independent review when applying for funding.



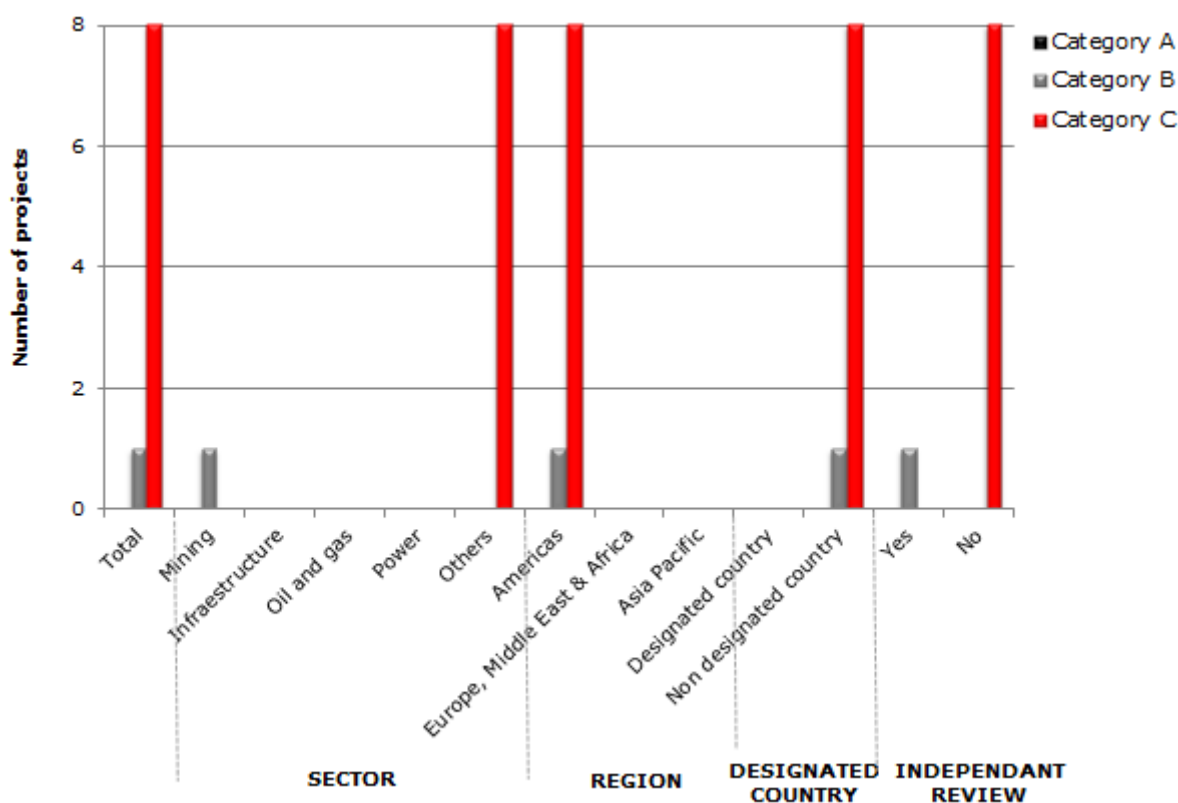
Graphic 2. Total number of project finance transactions that reached financial close in 2016.

▪ Project-Related Corporate Loans

CATEGORY	A	B	C
Total	0	1	8
SECTOR			
Mining	0	1	0
Infrastructure	0	0	0
Oil & gas	0	0	0
Power	0	0	0
Others	0	0	8
REGION			
Americas	0	1	8
Europe, Middle East & Africa	0	0	0
Asia Pacific	0	0	0
DESIGNATED COUNTRY			
Designated country	0	0	0
Non designated country	0	1	8
INDEPENDENT REVIEW			
Yes	0	1	0
No	0	0	8

Table 2. 2016 Project-Related Corporate Loans

The majority of Project-Related Corporate Loans (8 projects) are category C with minimal or no adverse environmental and social risks and/or impacts. Only 1 project is category B and no project is category A. Category B project presented independent review when applying for funding.



Graphic 3. Total number of Project-Related Corporate Loans transactions that reached financial close in 2016.

▪ **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 report⁶.

Project Name Reporting for Project Finance

We cannot disclose 'Project Name Reporting for Project Finance' data for applicable transactions from January 1st to December 31st, 2016, as disclosure would violate applicable local laws and regulations.

In particular, Article 142 of the Law on Credit Institutions, 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.

⁶ http://www.equator-principles.com/resources/equator_principles_spanish_2013.pdf

Conclusions

The adoption and implementation of the Equator Principles at Banorte has represented an important challenge. During this reporting period we strengthened the operation and implementation of our SEMS and EP's practices thanks to a better integration and communication with the different business areas involved, optimizing risk analysis tools and screening methodologies. We are convinced that continuous improvement in implementing the EP's, will allow for environmentally and socially responsible economic growth for the institution and for our customers.

Hyperlink to Data and Implementation Reporting

<https://www.banorte.com/wps/portal/gfb/Home/investor-relations/financial-information/annual-reports>

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Appendix 1

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.

(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.

In the case of the following activities or operations, the Central Credit Committee, has the exclusivite authority to approve the financing; this process also requires the signature of the Director General de Banorte.

- Candidates, Political Exposed Persons, Unions, Political Organizations.
- Banorte can only provide financing the three largest political parties in the country registered with the Federal Electoral Institute (Instituto Federal Electoral:IFE); an exception can be made for the financing of other political parties registered in the IFE, but only for 4 million Units of Investment (UDI) [this process also requires](#) that the Risk Policy Committee (Comité de Políticas de Riesgo) is informed about any such exceptions.

- Churchs
- Gambling
- Military Equipment.

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:

- 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.

Appendix 2

Equator Principles Questionnaire Government Banking

Folio Date

Client Data

CASB Requested amount

The following questions are aimed at determining whether a new project will require further due diligence under the Equator Principles. If you answer is YES to any of the following questions in either the financial criteria (A) or the non-financial criteria (B) please contact the Social and Environmental Risk Department.

A. **Financial Criteria**

1. Is it a new project? (*Restructuring is not eligible*)
 Yes No
2. Is it a funding project with a total investment of USD \$10 million or more?
 Yes No

B. **Non-Financial Criteria (Climate Change)**

1. The project expects to be more than 100,000 tons of CO₂ equivalent annually?
 Yes No
2. The project to be financed is of high intensity in carbon emission or it belongs to one of the following sectors:
 Production of cement & lime
 Thermal power plants
 Iron & Steel Industry
 Foundry
 Melting & refining of metals

Project Description

(Location, goal, capacity, sector, particularities)

Credit Executive:

Appendix 3

Equator Principles Questionnaire Structured Finance

Folio Date

Client Data

CASB Requested amount

Total Cost of Capital

The following questions are aimed at determining whether a new project will require further due diligence under the EPs. If you answer YES to any of the following questions in either the financial criteria (A) or the non-financial criteria (B) please contact the CSA.

A. Financial criteria

1. The financing is an advisory service, whose total amount of investment is \$10 million USD or more.
 Yes No
2. Is it a funding project with a total investment of USD \$10 million or more?
 Yes No
3. The financing is a business loan and complies with the following five criteria:
 Related to a single project
 Total amount of financing is USD \$100 million more
 The initial exposure of Banorte is at least USD \$50 million.
 The term of the loan is at least two years
 The borrower has the cash operating control (direct or indirect) on the project
4. The financing is a temporary credit with a duration of less than two years, with the intention of being refinanced by a project loan for a business loan related to a project, and it is anticipated that this will comply with any of the criteria listed in questions 1 to 3?
 Yes No

B. Non-financial criteria (Climate Change):

1. The project expects to be more than 100,000 tons of CO₂ equivalent annually?

Yes No

2. The project to be financed has high-intensity carbon emissions or belongs to one of the following sectors:

Production of cement & lime

Thermal power plants

Iron & Steel Industry

Foundry

Melting & refining of metals

Project Description

(Location, goal, capacity, sector, particularities)

Credit Executive:

Appendix 4⁷
**Due Diligence
Equator Principles**

Date:	
Due Diligence Type:	

Finance							
Folio:							
Client Name:						Client CAS:	
Description:							
Destination loan:						Destination CAS:	
Description:							
Total Amount:			Required Amount:			Term:	
Specialized área:	Real state		Tourism		Agrobusiness		

Project							
Name:							
Description:							
Life cycle stage:	Site preparation			Operation			
	Construction			Closing			
Evaluation:	Initial		Follow up		Site monitoring		
Participating banks:							

Social and Environmental Risk							
Social and environmental risk level	A		B		C		
Adverse environmental risks and/or impacts							
Adverse social risks and/or impacts							
Reputational risk	A		B		C		
Compliance with applicable national legal framework	Yes		On track		No		
Compliance with Equator Principles	Yes		On track		No		

Dictum			
Opinion	Favourable		Not favourable
Notes			
Annual Review	<ul style="list-style-type: none"> Date: Documentation to be submitted 		

⁷ The due diligence format provided in this appendix corresponds only to the analysis summary. The rest of the document refers to the technical assessment of the environmental and social aspects.

Diagnosis of social and environmental client performance

	YES	NO	Evidence
1. Does the customer have environmental and/or social responsibility policy?			
2. Does the customer have any environmental, social, safety or quality certification (ISO 14001, OHSAS 18001, ISO 9001)?			
3. Does the customer have any social and/or environmental recognition?			
4. Does the customer have any social and/or environmental penalty fee/sanction?			
5. Is there any complaint from neighboring communities to the company/project?			
6. Is there any environmental and/or social negative precedent by the client?			

Compliance with Equator Principles

Principle	Description	Comply	Fails	Requirements
1	Review and Categorization			
2	Environmental and Social Assessment			
3	Applicable Environmental and Social Standards			
4	Environmental and Social Management System and Equator Principles Action Plan			
5	Stakeholder Engagement			
6	Grievance Mechanism			
7	Independent Review			
8	Covenants			
9	Independent Monitoring and Reporting			
10	Reporting and Transparency			