



U.S.\$ 500,000,000
Banco Mercantil del Norte, S.A.,
Institución de Banca Múltiple, Grupo Financiero Banorte,
acting through its Cayman Islands Branch

8.375% Perpetual 10-Year Callable Subordinated Non-Preferred Non-Cumulative Tier 1 Capital Notes

Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte (the “Bank” or the “Issuer”), a multiple purpose bank incorporated in accordance with the laws of the United Mexican States (“Mexico”), acting through its Cayman Islands Branch, is offering U.S.\$500,000,000 in aggregate principal amount of its 8.375% Perpetual 10-Year Callable Subordinated Non-Preferred Non-Cumulative Tier 1 Capital Notes (the “Notes”). The Notes are perpetual instruments with no fixed maturity or fixed redemption date, unless previously redeemed as described in this offering memorandum. The Bank may redeem the Notes, in whole or in part, subject to certain regulatory requirements, at its option on October 14, 2030 (the “First Call Date”) and on any Interest Payment Date (as defined below) thereafter. **THE BANK MAY ALSO REDEEM THE NOTES, IN WHOLE BUT NOT IN PART, SUBJECT TO CERTAIN REGULATORY REQUIREMENTS AND APPROVALS, AT ANY TIME, IF THERE ARE SPECIFIED CHANGES IN (1) MEXICAN OR CAYMAN ISLANDS LAWS AFFECTING THE WITHHOLDING TAX APPLICABLE TO PAYMENTS UNDER THE NOTES; (2) MEXICAN LAWS THAT RESULT IN A CAPITAL EVENT (AS DEFINED IN THIS OFFERING MEMORANDUM); OR (3) APPLICABLE TAX LAWS THAT RESULT IN INTEREST ON THE NOTES NOT BEING DEDUCTIBLE BY THE BANK, IN WHOLE OR IN PART, FOR MEXICAN INCOME TAX PURPOSES. SEE “DESCRIPTION OF THE NOTES—REDEMPTION—WITHHOLDING TAX REDEMPTION,” AND “DESCRIPTION OF THE NOTES—REDEMPTION—SPECIAL EVENT REDEMPTION.”**

PRINCIPAL AND INTEREST ON THE NOTES WILL NOT BE PAID UNDER CERTAIN CIRCUMSTANCES. IF A TRIGGER EVENT (AS DEFINED HEREIN) OCCURS, THE PRINCIPAL AMOUNT OF THE NOTES WILL BE WRITTEN DOWN AS DESCRIBED IN THIS OFFERING MEMORANDUM, WITHOUT THE POSSIBILITY OF ANY FUTURE WRITE-UP OR REINSTATEMENT OF SUCH PRINCIPAL, AND HOLDERS OF THE NOTES WILL AUTOMATICALLY BE DEEMED TO HAVE IRREVOCABLY WAIVED THEIR RIGHT TO CLAIM OR RECEIVE REPAYMENT OF ANY WRITTEN DOWN PRINCIPAL AMOUNT, OR ANY ACCRUED AND UNPAID INTEREST WITH RESPECT THERETO, AS FURTHER DESCRIBED IN THIS OFFERING MEMORANDUM. SEE “DESCRIPTION OF THE NOTES—TRIGGER EVENT AND WRITE-DOWN—WRITE-DOWN.” INTEREST ON THE NOTES WILL BE DUE AND PAYABLE ONLY AT THE BANK’S SOLE DISCRETION AND THE BANK WILL HAVE SOLE AND ABSOLUTE DISCRETION AT ALL TIMES AND FOR ANY REASON TO CANCEL ANY INTEREST PAYMENT IN WHOLE OR IN PART THAT WOULD OTHERWISE BE PAYABLE ON ANY INTEREST PAYMENT DATE. ADDITIONALLY, INTEREST DUE ON THE NOTES FROM THE BANK WILL BE MANDATORILY AND AUTOMATICALLY CANCELED IF (A) THE BANK IS CLASSIFIED AS CLASS II OR BELOW PURSUANT TO ARTICLES 121 AND 122 OF THE MEXICAN BANKING LAW (*LEY DE INSTITUCIONES DE CRÉDITO*) AND REGULATIONS THEREUNDER, WHICH SPECIFY CAPITALIZATION REQUIREMENTS, OR (B) AS A RESULT OF THE APPLICABLE PAYMENT OF INTEREST, THE BANK WOULD BE CLASSIFIED AS CLASS II OR BELOW (AN “INTEREST CANCELLATION EVENT”). PAYMENTS OF INTEREST DUE ON THE NOTES WILL NOT BE CUMULATIVE, SO THAT IN THE EVENT THAT PAYMENTS OF INTEREST ARE CANCELED, HOLDERS OF THE NOTES WILL NOT HAVE THE RIGHT TO CLAIM AND RECEIVE CANCELED INTEREST, EVEN IF THE BANK THEREAFTER SATISFIES APPLICABLE CAPITALIZATION REQUIREMENTS. IF AN INTEREST CANCELLATION EVENT IS IN EFFECT ON ANY WRITE-DOWN OF THE NOTES UPON THE OCCURRENCE OF A TRIGGER EVENT, THE NOTES WILL BE WRITTEN DOWN AND ANY AND ALL INTEREST WILL CONTINUE TO BE CANCELED. SEE “DESCRIPTION OF THE NOTES—INTEREST CANCELLATION—MANDATORY CANCELLATION OF INTEREST PAYMENTS.”

The Notes are denominated in U.S. dollars and, subject to a prior redemption and/or one or more Write-Downs (as defined herein), will bear interest on the then Current Principal Amount (as defined herein) from time to time outstanding from and including July 14, 2020 (the “Issue Date”), to (but excluding) the First Call Date at an initial fixed rate *per annum* equal to 8.375%. Subject to a prior redemption and/or one or more Write-Downs, the Notes will bear interest on the then Current Principal Amount from time to time outstanding from (and including) the First Call Date (such date, and each tenth anniversary thereafter, a “Reset Date”) to (but excluding) the next succeeding Reset Date, at a fixed rate *per annum* equal to the sum of (a) the then-prevailing Treasury Yield (as defined herein) on the second Business Day (as defined herein) immediately preceding the applicable Reset Date (the “Reset Determination Date”) and (b) 776.0 basis points (rounded to two decimal places, with any value equal to or less than 0.005 being rounded down). The interest rate following any Reset Date may be less than the initial interest rate and/or the interest rate that applies immediately prior to such Reset Date. Subject to the conditions described under “Description of the Notes—Interest Cancellation” and “Description of the Notes—Trigger Event and Write-Down—Write-Down,” the Bank will pay interest on the Notes quarterly in arrears on October 14, January 14, April 14 and July 14 of each year (each an “Interest Payment Date”), commencing on October 14, 2020.

The Notes will be issued by the Bank, acting through its Cayman Islands Branch, and will be the Bank’s unsecured subordinated general non-preferred obligations, ranked equally with other unsecured subordinated general non-preferred obligations of the Bank. The Notes will rank (i) subordinate and junior in right of payment and in liquidation to all of the Bank’s present and future senior indebtedness and subordinated preferred indebtedness, (ii) *pari passu* without preference among themselves and with all the Bank’s present and future other unsecured subordinated non-preferred indebtedness and (iii) senior only to all classes of the Bank’s present and future equity or capital stock, as described in this offering memorandum. See “Description of the Notes—Subordination.” **THE NOTES ARE NOT DEPOSITS WITH THE BANK, WILL BE UNSECURED AND NOT INSURED OR GUARANTEED BY ANY MEXICAN GOVERNMENTAL AGENCY, INCLUDING, WITHOUT LIMITATION, THE MEXICAN SAVINGS PROTECTION AGENCY (*INSTITUTO PARA LA PROTECCIÓN AL AHORRO BANCARIO*) (THE “IPAB”), THE UNITED STATES FEDERAL DEPOSIT INSURANCE CORPORATION, ANY OTHER UNITED STATES GOVERNMENTAL AGENCY OR ANY GOVERNMENTAL AGENCY OF THE CAYMAN ISLANDS.** The Notes will be obligations of the Bank and will not be guaranteed by Grupo Financiero Banorte, S.A.B. de C.V., the parent company of the Bank, or any other member of the financial group to which the Bank belongs.

Payments of interest (or amounts deemed interest under Mexican law) made by the Bank through its Cayman Islands Branch are generally not subject to Mexican or Cayman Islands withholding tax. See “Taxation—Certain Mexican Income Tax Consequences” and “Taxation—Certain Cayman Islands Income Tax Consequences.” However, if any such withholding tax were to apply, subject to certain exceptions described in this offering memorandum, the Bank will pay additional amounts so that the net amount received by holders of the Notes after Mexican or Cayman Islands withholding tax, if imposed, will equal the amount that would have been received if no withholding tax had been applicable. See “Description of the Notes—Payment of Additional Amounts.”

Application is expected to be made to list the Notes on the Singapore Exchange Securities Trading Limited (“SGX-ST”). The SGX-ST assumes no responsibility for the correctness of any of the statements made, opinions expressed or reports contained in this offering memorandum. Admission to the SGX-ST is not to be taken as an indication of the merits of the Notes or the Bank.

Investing in the Notes involves risks. See “Risk Factors” beginning on page 37.

Price: 100.00%, plus accrued interest, if any, from July 14, 2020.

The Notes have not been and will not be registered under the United States Securities Act of 1933, as amended (the “Securities Act”). The Notes may not be offered or sold within the United States or to U.S. persons, except to qualified institutional buyers (“QIB”) in reliance on the exemption from registration provided by Rule 144A under the Securities Act and to non-U.S. persons in offshore transactions in reliance on Regulation S under the Securities Act (“Regulation S”). You are hereby notified that sellers of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A.

The Notes are not intended to be offered, sold or otherwise made available and should not be offered, sold or otherwise made available to retail clients in the European Economic Area (“EEA”) or in the United Kingdom (“UK”), as defined in the rules set out in the Markets in Financial Instruments Directive 2014/65/EU, as amended or replaced from time to time. Prospective investors in the EEA and in the UK are referred to the section headed “Restrictions on marketing and sales to retail investors in the EEA and in the UK” on page iii of this offering memorandum for further information.

THE INFORMATION CONTAINED IN THIS OFFERING MEMORANDUM IS EXCLUSIVELY THE RESPONSIBILITY OF THE BANK AND HAS NOT BEEN REVIEWED OR AUTHORIZED BY THE MEXICAN NATIONAL BANKING AND SECURITIES COMMISSION (*COMISIÓN NACIONAL BANCARIA Y DE VALORES*) (“CNBV”). THE NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED WITH THE MEXICAN NATIONAL SECURITIES REGISTRY (*REGISTRO NACIONAL DE VALORES*) (“RNV”) MAINTAINED BY THE CNBV AND THEREFORE THE NOTES MAY NOT BE PUBLICLY OFFERED OR SOLD IN MEXICO, EXCEPT THAT THE NOTES MAY BE OFFERED AND SOLD IN MEXICO, ON A PRIVATE PLACEMENT BASIS, TO INVESTORS THAT QUALIFY AS INSTITUTIONAL INVESTORS (*INVERSIONISTAS INSTITUCIONALES*) OR ACCREDITED INVESTORS (*INVERSIONISTAS CALIFICADOS*), PURSUANT TO THE PRIVATE PLACEMENT EXEMPTION SET FORTH IN ARTICLE 8 OF THE MEXICAN SECURITIES MARKET LAW (*LEY DEL MERCADO DE VALORES*) AND THE REGULATIONS THEREUNDER. AS REQUIRED UNDER THE MEXICAN SECURITIES MARKET LAW, THE BANK WILL NOTIFY THE CNBV OF THE OFFERING AND ISSUANCE OF THE NOTES OUTSIDE OF MEXICO AND THE TERMS OF THE NOTES. SUCH NOTICE WILL BE SUBMITTED TO THE CNBV TO COMPLY WITH ARTICLE 7, SECOND PARAGRAPH, OF THE MEXICAN SECURITIES MARKET LAW AND REGULATIONS THEREUNDER, AND FOR STATISTICAL AND INFORMATIONAL PURPOSES ONLY. THE DELIVERY OF SUCH NOTICE TO, AND THE RECEIPT OF SUCH NOTICE BY, THE CNBV DOES NOT IMPLY ANY CERTIFICATION AS TO THE INVESTMENT QUALITY OF THE NOTES, THE BANK’S SOLVENCY, LIQUIDITY OR CREDIT QUALITY OR THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH HEREIN. THIS OFFERING MEMORANDUM MAY NOT BE PUBLICLY DISTRIBUTED IN MEXICO. THE ACQUISITION OF THE NOTES BY AN INVESTOR WHO IS A RESIDENT OF MEXICO WILL BE MADE UNDER SUCH INVESTOR’S RESPONSIBILITY.

Delivery of the Notes will be made in book-entry form on or about July 14, 2020, through The Depository Trust Company (“DTCC”) and its direct and indirect participants, including Euroclear Bank S.A./N.V. (“Euroclear”) and Clearstream Banking, société anonyme, Luxembourg (“Clearstream”).

Global Coordinator

Goldman Sachs & Co. LLC
Joint Book-Running Managers

Goldman Sachs & Co. LLC

BofA Securities

Credit Suisse

MUFG

The date of this offering memorandum is July 9, 2020.

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BANCODE MÉXICO (THE “MEXICAN CENTRAL BANK”) HAS AUTHORIZED THE ISSUANCE OF THE NOTES, AS REQUIRED UNDER APPLICABLE MEXICAN LAW. FURTHERMORE, THE INDENTURE GOVERNING THE NOTES WILL BE EXECUTED BY AN AUTHORIZED OFFICIAL OF THE CNBV, AS REQUIRED UNDER MEXICAN LAW. AUTHORIZATION OF THE ISSUANCE OF THE NOTES BY THE MEXICAN CENTRAL BANK DOES NOT ADDRESS THE LEGAL, TAX OR OTHER CONSEQUENCES TO THE HOLDERS OF THE NOTES, NOR DOES IT IMPLY ANY CERTIFICATION AS TO THE INVESTMENT QUALITY OF THE NOTES OR AS TO THE BANK’S SOLVENCY, LIQUIDITY OR CREDIT QUALITY, OR THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH HEREIN, OR THE TRANSLATION OF THE TERMS OF APPLICABLE MEXICAN LAW AND REGULATION, INCLUDING ARTICLES 121 AND 122 OF THE MEXICAN BANKING LAW (*LEY DE INSTITUCIONES DE CRÉDITO*), RELEVANT PROVISIONS OF CIRCULAR 3/2012 ISSUED BY THE MEXICAN CENTRAL BANK AND THE GENERAL RULES APPLICABLE TO MEXICAN BANKS (*DISPOSICIONES DE CARÁCTER GENERAL APLICABLES A LAS INSTITUCIONES DE CRÉDITO*) ISSUED BY THE CNBV.

Neither we nor the initial purchasers have authorized anyone to provide you with different or additional information from that contained in this offering memorandum, and neither we nor the initial purchasers take responsibility for any other information that others may give you. Neither we nor the initial purchasers are making an offer of the Notes in any jurisdiction where the offer is not permitted. You should not assume that the information contained in this offering memorandum is accurate as of any date other than the date on the front of this offering memorandum, regardless of the time of delivery of this offering memorandum or any sale of the Notes.

Unless otherwise specified or the context otherwise requires, references in this offering memorandum to “the Bank” or “the Issuer” are references to Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte. References to “Banorte,” “we,” “us” and “our” are references to Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte, together with our subsidiaries, but are not references to Grupo Financiero Banorte, S.A.B. de C.V., our parent company. References to “GFNorte” are to Grupo Financiero Banorte, S.A.B. de C.V., together with its subsidiaries and joint ventures.

In connection with the issuance of the Notes, the initial purchasers (or persons acting on behalf of the initial purchasers) may over-allot Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the initial purchasers (or persons acting on behalf of the initial purchasers) will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the final terms of the offer of the Notes is made and, if begun, may be ended at any time. Any stabilization action or over-allotment must be conducted by the initial purchasers (or persons acting on behalf of the initial purchasers) in accordance with all applicable laws and rules.

We are relying upon an exemption from registration under the Securities Act for offers and sales of securities that do not involve a public offering. By purchasing the Notes, you will be deemed to have made the acknowledgements, representations and agreements described under “*Transfer Restrictions*” in this offering memorandum. We are not, and the initial purchasers are not, making an offer to sell the Notes in any jurisdiction except where such an offer or sale is permitted. You should understand that you will be required to bear the financial risks of your investment for an indefinite period of time.

Neither the CNBV nor the U.S. Securities and Exchange Commission (the “SEC”) nor any state or foreign securities commission or regulatory authority has approved or disapproved the offering of the Notes or determined if this offering memorandum is truthful, accurate or complete. Any representation to the contrary is a criminal offense.

We have submitted this offering memorandum solely to a limited number of QIBs in the United States and to non-U.S. persons, as defined in Regulation S, so that they can consider a purchase of the Notes. This offering memorandum has been prepared solely for use in connection with the placement of the Notes. We have not authorized the use of this offering memorandum for any other purpose. This offering memorandum may not be copied or reproduced in whole or in part. This offering memorandum may be distributed and its contents disclosed only to those prospective investors to whom it is provided. By accepting delivery of this offering memorandum, you agree to these restrictions. See “*Transfer Restrictions*.” The SGX-ST takes no responsibility for the contents of this offering memorandum, makes no representations as to its accuracy or completeness and expressly disclaims any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this offering memorandum. The Notes will be traded on the SGX-ST in a minimum board lot size of 200,000 Singapore dollars (“SGD”) (or its equivalent in foreign currencies) for so long as the Notes are listed on the SGX-ST.

This offering memorandum is based on information provided by us and by other sources that we believe are reliable, but no assurance can be given as to the accuracy or completeness of any such information obtained from third-party sources. The initial purchasers assume no responsibility for the accuracy or completeness of the information contained herein (financial, legal or otherwise). In making an investment decision, prospective investors must rely on their own examinations of us and the terms of this offering and the Notes, including the risks involved. Moreover, the contents of this offering memorandum are not to be construed as legal, business or tax advice. You are urged to consult your own attorney, business or tax advisor for legal, business or tax advice.

This offering memorandum does not constitute an offer of, or an invitation by or on behalf of, us or the initial purchasers, or any of our or their respective directors, officers and affiliates, to subscribe for or purchase any securities in any jurisdiction to any person to whom it is unlawful to make such an offer in such jurisdiction. Each prospective purchaser of the Notes must comply with all applicable laws and regulations in force in each jurisdiction in which it purchases, offers or sells such Notes or possesses or distributes this offering memorandum and must obtain any consent, approval or permission required by it for the purchase, offer or sale by it of such Notes under the laws and regulations in force in any jurisdiction to which it is subject or in which it makes such purchases, offers or sales.

Notwithstanding anything in this document to the contrary, you (and each of your employees, representatives or other agents) may disclose to any and all persons, without limitation of any kind, the U.S. federal income tax treatment and tax structure of the offering of Notes and all materials of any kind (including opinions or other tax analyses) that are provided to you relating to such tax treatment and tax structure. For these purposes, “tax structure” is limited to facts relevant to the U.S. federal income tax treatment of the offering of Notes.

Pursuant to Article 119 of the Mexican Financial Groups Law (*Ley para Regular las Agrupaciones Financieras*) (“Financial Groups Law”), a financial services holding company such as GFNorte, our holding company, is secondarily (*subsidiariamente*) and unlimitedly (*ilimitadamente*) liable for the performance of the obligations undertaken by the members of our financial group (including Banorte), in respect of the operations that each company is allowed to carry out pursuant to applicable law. In addition, GFNorte is unlimitedly liable for the losses of each and every company comprising our financial group; provided that for such purposes, a company is deemed to have losses when its assets are insufficient to fulfill its payment obligations. The enforcement of GFNorte’s liability pursuant to Article 119 of the Financial Groups Law is subject to a specific proceeding provided for in the Financial Groups Law and may not be enforced expeditiously. Thus the timing and outcome of an action against GFNorte is uncertain. For the avoidance of doubt, the Notes offered hereby are not guaranteed by GFNorte or any other entity, including any of the regulated subsidiaries of GFNorte.

We reserve the right to reject any offer to purchase, in whole or in part, for any reason, or to sell less than the full amount of the Notes offered hereby.

Any purchaser or holder of Notes or any interest therein will be deemed to have represented by its purchase or holding thereof that either (i) it is not a Plan, it is not purchasing securities on behalf of or using the assets of any such Plan, and it is not a Non-ERISA Arrangement (as defined below) or (ii) its purchase, holding and any subsequent disposition of the Notes will not result in a prohibited transaction under Section 406 of the U.S. Employee Retirement Income Security Act of 1974, as amended (“ERISA”) or Section 4975 of the U.S. Internal Revenue Code of 1986, as amended (the “Code”) (or, in the case of a Non-ERISA Arrangement, any other laws or regulations that are substantially similar to the provisions of Title I of ERISA or Section 4975 of the Code (“Similar Laws”) for which an exemption is not available). Prospective purchasers must carefully consider the restrictions on purchase set forth in “Transfer Restrictions” and “Certain ERISA Considerations.”

Restrictions on marketing and sales to retail investors in the EEA and in the UK

The Notes are not intended to be offered, sold or otherwise made available to, and should not be offered, sold or otherwise made available to, any retail investor in the EEA or in the UK. For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of the Markets in Financial Instruments Directive 2014/65/EU (as amended, “MiFID II”); or (ii) a customer within the meaning of Directive (EU) 2016/97 (as amended, the “Insurance Distribution Directive”), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II. Consequently, no key information document required by Regulation (EU) No. 1286/2014 (as amended, the “PRIIPs Regulation”) for offering or selling the Notes or otherwise making them available to retail investors in the EEA or in the UK has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA or in the UK may be unlawful under the PRIIPs Regulation.

This communication is only being distributed to and is only directed at (i) persons who are outside the UK or (ii) persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “Order”) or (iii) high net worth entities falling within Article 49(2) of the Order, and other persons to whom it may lawfully be communicated (all such persons together being referred to as “relevant persons”). The Notes are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire the Notes will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this document or any of its contents. Persons into whose possession this Offering Memorandum may come are required by the Issuer and the initial purchasers to inform themselves about and to observe such restrictions.

The Notes are complex financial instruments and are not a suitable or appropriate investment for all investors. In some jurisdictions, regulatory authorities have adopted or published laws, regulations or guidance with respect to the offer or sale of securities such as the Notes to retail investors.

In particular, in June 2015, the U.K. Financial Conduct Authority (the “FCA”) published the Product Intervention (Contingent Convertible Instruments and Mutual Society Shares) Instrument 2015 (“PI Instrument”), which took effect from 1 October 2015. In addition, **(i)** on January 1, 2018, the provisions of the PRIIPs Regulation on key information documents for packaged and retail and insurance-based investment products became directly applicable in all EEA member states and **(ii)** MiFID II was required to be implemented in EEA member states by January 3, 2018. Together, the PI Instrument, the PRIIPs Regulation and MiFID II are referred to as the “Regulations.”

The Regulations set out various obligations in relation to **(i)** the manufacturing and distribution of financial instruments and **(ii)** the offering, sale and distribution of packaged retail and insurance-based investment products and certain contingent write down or convertible securities, such as the Notes.

Potential investors should inform themselves of, and comply with, any applicable laws, regulations or regulatory guidance with respect to any resale of the Notes (or any beneficial interests therein), including the Regulations.

The Issuer and each of the initial purchasers is required to comply with some or all of the Regulations. In addition, by purchasing, or making or accepting an offer to purchase, any Notes (or a beneficial interest in such Notes) from the Issuer and/or the initial purchasers, each prospective investor in relation to the Notes (or any beneficial interests therein) represents, warrants, agrees with and undertakes to the Issuer and each of the initial purchasers that:

- (i)** it is not a retail client in the EEA or in the UK as defined in MiFID II or the PI Instrument (as applicable);
- (ii)** whether or not it is subject to the Regulations, it will not:
 - (A)** sell or offer the Notes (or any beneficial interests therein) to retail clients in the EEA or in the UK (as defined in MiFID II or the PI Instrument (as applicable)); or
 - (B)** communicate (including the distribution of this offering memorandum) or approve an invitation or inducement to participate in, acquire or underwrite the Notes (or any beneficial interests therein) where that invitation or inducement is addressed to or disseminated in such a way that it is likely to be received by a retail client in the EEA or in the UK (in each case as defined in MiFID II or the PI Instrument (as applicable)). In selling or offering Notes or making or approving communications relating to the Notes, that prospective investor may not rely on the limited exemptions set out in the PI Instrument; and,
- (iii)** it will at all times comply with all applicable laws, regulations and regulatory guidance (whether inside or outside the EEA or the UK) relating to the promotion, offering, distribution and/or sale of the Notes (or any beneficial interests therein), including (without limitation) MiFID II and any such other applicable laws, regulations and regulatory guidance relating to determining the appropriateness and/or suitability of an investment in the Notes (or any beneficial interests therein) by investors in any relevant jurisdiction.

Each prospective investor further acknowledges that:

- (i)** the identified target market for the Notes (for the purposes of the product governance obligations in MiFID II) is eligible counterparties and professional clients; and
- (ii)** no key information document (“KID”) under the PRIIPs has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA or in the UK may be unlawful under the PRIIPs.

Solely for the purposes of each manufacturer’s product approval process, the target market assessment in respect of the Notes has led to the conclusion that: (i) the target market for the Notes is eligible counterparties and professional clients only, each as defined in MiFID II; and (ii) all channels for distribution of the notes to eligible counterparties

and professional clients are appropriate. Any person subsequently offering, selling or recommending the Notes (a “distributor”) should take into consideration the manufacturers’ target market assessment in respect of the Notes; however, a distributor subject to MiFID II is responsible for undertaking its own target market assessment in respect of the Notes (by either adopting or refining the manufacturers’ target market assessment) and determining appropriate distribution channels.

Where acting as agent on behalf of a disclosed or undisclosed client when purchasing, or making or accepting an offer to purchase, any Notes (or any beneficial interests therein) from us and/or the initial purchasers the foregoing representations, warranties, agreements and undertakings will be given by and be binding upon both the agent and its underlying client.

CAYMAN ISLANDS SELLING RESTRICTIONS

NO INVITATION, WHETHER DIRECTLY OR INDIRECTLY, MAY BE MADE TO MEMBERS OF THE PUBLIC IN THE CAYMAN ISLANDS TO SUBSCRIBE FOR THE NOTES UNLESS THE ISSUER IS LISTED ON THE CAYMAN ISLANDS STOCK EXCHANGE. THE NOTES MAY, HOWEVER, BE OFFERED AND SOLD TO ORDINARY NON-RESIDENT AND EXEMPTED COMPANIES IN THE CAYMAN ISLANDS.

AVAILABLE INFORMATION

We are not subject to the information requirements of the United States Securities Exchange Act of 1934, as amended (the “Exchange Act”). To preserve the exemption for resales and transfers under Rule 144A under the Securities Act, we have agreed that we will promptly provide any holder or any prospective purchaser of the Notes who is designated by that holder and is a “qualified institutional buyer,” as defined under Rule 144A, upon the request of such holder or prospective purchaser, with information meeting the requirements of Rule 144A(d)(4), unless we either furnish information in accordance with Rule 12g3-2(b) under the Exchange Act or furnish information to the SEC pursuant to Section 13 or 15(d) of the Exchange Act. For so long as the Notes are outstanding, such information will be available at our specified offices and, for so long as the Notes are listed on the SGX-ST, through the Singapore Paying Agent. Following completion of this offering, we are not otherwise obligated to furnish holders or others with any supplemental information, discussion or analysis of our business or financial reports, other than as required by the Indenture governing the Notes.

Application is expected to be made to list the Notes on the SGX-ST, in accordance with its rules. We will be required to comply with any undertakings given by us from time to time to the SGX-ST in connection with the Notes, and to furnish to it all such information as the rules of the SGX-ST may require in connection with the listing of the Notes.

ENFORCEMENT OF JUDGMENTS

The Bank is a multiple purpose bank (*institución de banca múltiple*) incorporated and organized in accordance with the laws of Mexico with limited liability (*sociedad anónima*). All of our directors and officers and experts named herein are non-residents of the United States and substantially all of the assets of such non-resident persons and substantially all of our assets are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon such persons or to enforce against them or us in United States courts judgments predicated upon the civil liability provisions of United States federal securities laws. We have been advised by our Mexican counsel, White & Case, S.C., that there is doubt as to the enforceability, in original actions in Mexican courts, of liabilities predicated solely on United States federal securities laws and as to the enforceability in Mexican courts of judgments of United States courts obtained in actions predicated upon the civil liability provisions of United States federal securities laws.

We have been advised by such Mexican counsel that no bilateral treaty is currently in effect between the United States and Mexico that covers the reciprocal enforcement of civil foreign judgments. In the past, Mexican courts have enforced judgments rendered in the United States by virtue of the legal principles of reciprocity and comity, consisting of the review in Mexico of the United States judgment, in order to ascertain, among other matters, whether Mexican legal principles of due process and the non-violation of Mexican law and/or Mexican public policy (*orden público*), among other requirements set forth under Mexican law, have been duly complied with, without reviewing the merits of the subject matter of the case, provided that U.S. courts recognize the principles of reciprocity and would enforce Mexican judgments as a matter of reciprocity.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This offering memorandum contains forward-looking statements. Examples of such forward-looking statements include, but are not limited to: **(i)** statements regarding our future results of operations and financial position; **(ii)** statements of plans, objectives or goals, including those related to our operations; and **(iii)** statements of assumptions underlying such statements. Words such as “believes,” “anticipates,” “should,” “consider,” “estimates,” “seeks,” “forecasts,” “will,” “expects,” “may,” “assume,” “intends,” “plans” and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

You should not place undue reliance on forward-looking statements, which are based on current expectations. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. We caution investors that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed or implied in such forward-looking statements, including the following factors:

- changes in economic, political, social and other conditions in Mexico and elsewhere as a result of the coronavirus pandemic (2019-nCov, referred to as “COVID-19”);
- competition in the banking industry in Mexico;
- the profitability of our business;
- credit and other lending risks, including an increase in defaults on our loan portfolio;
- limitations on our access to sources of financing on competitive terms;
- restrictions on foreign currency convertibility and remittance outside of Mexico;
- failure to meet capital requirements or other requirements;
- limitations on our ability to freely determine interest rates, commissions and fees;
- interruptions or failures in our technology systems;
- changes in reserve and/or capital requirements, changes in the laws or regulations applicable thereto, or the interpretation of how such reserve or capital requirements are to be calculated, especially in light of the current COVID-19 pandemic;
- additional capital requirements relating to our classification as a systemically important local bank and to countercyclical risks;
- actions taken by the Mexican Antitrust Commission (*Comisión Federal de Competencia Económica*) (the “Mexican Antitrust Commission”) with respect to our business and the Mexican banking industry generally, and by the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*) (“SHCP”) with respect to our lending to certain sectors;
- inability to timely and duly enforce our claims on collateral provided by borrowers;
- cyberattacks, terrorist and organized criminal activities, as well as geopolitical events;
- changes in requirements to make contributions to, or the receipt of support from, programs organized by the Mexican government;

- changes in overall economic, business, international trade, social and political conditions in Mexico and internationally, particularly in the United States;
- the impact of the COVID-19 pandemic on our loan portfolio, especially, and our business generally;
- United States-Mexico-Canada Trade Agreement (the “USMCA”) implementation and other changes in international trade barriers and tariffs;
- changes in exchange rates, market interest rates, tax rates or the rate of inflation;
- changes in our or Mexico’s domestic and international credit ratings;
- changes in the regulatory framework of the Mexican banking industry and in regulations relating to the products and services we offer or otherwise;
- the effect of new legislation, intervention by regulatory authorities, government directives and monetary and/or fiscal policy in Mexico by the government of Andrés Manuel López Obrador, who took office on December 1, 2018;
- acquisitions and divestitures, and our ability to successfully integrate the operations of businesses or assets that we acquire;
- changes in accounting principles and rules applicable to us;
- inability to retain certain key personnel and ability to hire additional key personnel; and
- other factors discussed under “*Risk Factors*” in this offering memorandum.

Should one or more of these factors or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated, expected or intended.

Additional factors affecting our business may arise periodically and we cannot predict such factors, nor can we assess the impact of all these factors on our business or the extent to which such factors or combination of factors could cause our results to materially differ from those contained in any forward-looking statement. Although we consider the plans, intentions, expectations, and estimates reflected in, or suggested by, forward-looking statements included in this offering memorandum to be reasonable, we cannot provide any assurance that our plans, intentions, expectations and estimates will be achieved. Additionally, historical trends in our statements should not be interpreted as a guarantee that these trends will continue in the future.

Prospective investors should read the sections of this offering memorandum entitled “*Risk Factors*,” “*Management’s Discussion and Analysis of Financial Condition and Results of Operations*” and “*Business*” for a more complete discussion of the factors that could affect our future performance and the markets in which we operate. In light of these risks, uncertainties and assumptions, the forward-looking events described in this offering memorandum may not occur. All forward-looking statements included in this offering memorandum are based upon information available to us as of the date of this offering memorandum, and we undertake no obligation to update or revise any forward-looking statement, whether as a result of new information or future events or developments.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Financial Statements

This offering memorandum includes:

- our audited consolidated financial statements as of December 31, 2019 and 2018 and for the years ended December 31, 2019, 2018 and 2017, together with the notes thereto (our “Audited Consolidated Financial Statements”), and
- our unaudited condensed consolidated interim financial statements as of March 31, 2020 and for the three month periods ended March 31, 2020 and 2019, together with the notes thereto (our “Unaudited Condensed Consolidated Interim Financial Statements”), and together with the Audited Consolidated Financial Statements, our “Financial Statements”).

Our Financial Statements have been prepared in accordance with the accounting principles and regulations prescribed by the CNBV for credit institutions, as amended (“Mexican Banking GAAP”).

Accounting Principles

Mexican Banking GAAP differs in certain significant respects from accounting principles generally accepted in the United States of America (“U.S. GAAP”). For a summary of the principal differences between Mexican Banking GAAP and U.S. GAAP, as they relate to our Financial Statements, see “*Annex A - Significant Differences Between Mexican Banking GAAP and U.S. GAAP.*” No reconciliation of any of our Financial Statements to U.S. GAAP has been prepared for the purposes of this offering memorandum. Any such reconciliation would likely result in material differences. Mexican Banking GAAP also differs from Mexican Financial Reporting Standards (*Normas de Información Financiera*) (the “MFRS”), as currently in effect and issued by the Mexican Council of Financial Information Standards (*Consejo Mexicano de Normas de Información Financiera, A.C.*) (“CINIF”).

The Financial Statements and the other financial information contained in this offering memorandum are presented on a consolidated basis.

Effects of the Merger of Banco Interacciones into the Bank

On July 13, 2018, the merger of Grupo Financiero Interacciones, S.A.B. de C.V. (“GFInter”) into our parent company, GFNorte, became effective. Subsequently, on the same date, Banco Interacciones, S.A., Institución de Banca Múltiple, Grupo Financiero Interacciones (“Banco Interacciones”), the banking subsidiary of GFInter, merged into the Bank (the “Interacciones Merger”). As a result of the Interacciones Merger, we consolidated our position as the fourth largest bank in Mexico in terms of total assets, performing loans and core deposits, according to information published by the CNBV, and we strengthened our government lending business.

As a result of the Interacciones Merger, our Financial Statements for the years ended December 31, 2018 and 2017 are not fully comparable to our financial information for the year ended on December 31, 2019 contained in this offering memorandum. See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Principal Factors Affecting Our Financial Condition and Results of Operations—Effects of the Merger of Banco Interacciones into the Bank.*”

Currencies

The financial information appearing in this offering memorandum is presented in Mexican Pesos. In this offering memorandum references to “Pesos” or “Ps.” are to Mexican Pesos and references to “U.S. dollars,” “dollars,” “U.S.\$” or “\$” are to United States dollars. This offering memorandum contains translations of certain Peso amounts into U.S. dollars at specified rates solely for the convenience of the reader. These translations should not be construed as representations that the Peso amounts actually represent such U.S. dollar amounts or could be converted into U.S. dollars at the rate indicated. Unless otherwise indicated, U.S. dollar amounts that have been translated from Pesos have been so translated at an exchange rate of Ps.23.4847 per U.S. dollar, the rate calculated by the Mexican Central Bank on March 31, 2020, and published on April 1, 2020, in the Mexican Official Gazette of the Federation (*Diario Oficial de la Federación*) (the “Official Gazette”), based on the average of wholesale foreign exchange market quotes for transactions settling within two banking business days (the “Mexican Central Bank Exchange Rate”). As of June 26, 2020, the noon buying rate in New York City for cable transfers in Pesos per U.S. dollar as certified for customs purposes by the Federal Reserve Bank of New York was Ps.22.9460 per U.S. dollar.

References herein to “UDIs” are to investment units (*unidades de inversión*), a Peso equivalent unit of account indexed for Mexican inflation. UDIs are units of account whose value in Pesos is indexed to inflation on a daily basis, as measured by the change in the National Consumer Price Index (*Índice Nacional de Precios al Consumidor*) (the “N CPI”). Under a UDI-based loan or financial instrument, the borrower’s nominal Peso principal balance is converted either at origination or upon restructuring to a UDI principal balance, and interest on the loan or financial instrument is calculated on the outstanding UDI balance of the loan or financial instrument. Principal and interest payments are made by the borrower in an amount of Pesos equivalent to the amount due in UDIs at the stated value of the UDIs on the day of payment. As of March 31, 2020, one UDI was equal to Ps.6.499174 (U.S.\$0.276741).

Terms Relating to Our Loan Portfolio

As used in this offering memorandum, the following terms relating to our loan portfolio and other credit assets have the meanings set forth below, unless otherwise indicated.

The terms “total performing loans” and “total performing loan portfolio” refer to the aggregate of:

- the total principal amount of loans outstanding as of the date presented;
- amounts attributable to “accrued interest;”
- “rediscounted loans” (as described below); and
- the “UDI Trusts” (as described below).

Under Mexican Banking GAAP, we include as income for any reporting period interest that is accrued but unpaid during that period. Such “accrued interest” is reported as part of our total performing loan portfolio in our Financial Statements until it is paid or becomes part of the total non-performing loan portfolio in accordance with the CNBV’s rules.

“Rediscounted loans” are Peso- and dollar-denominated loans made to finance projects in industries that qualify for priority status under the wholesale lending programs of the Mexican government’s development banks and are generally funded by such development banks. In accordance with Mexican Banking GAAP, rediscounted loans are recorded on the balance sheet as outstanding loans. As mandated by the CNBV, total performing loans include the portfolio trusts (the “UDI Trusts”) holding our loans converted into UDIs that are consolidated in our Financial Statements. Under the UDI program, we are liable for all future losses, if any, on the loans in the UDI Trusts. See “*Selected Statistical Information—Debtor Support Programs.*”

Unless otherwise specified herein, the terms “total performing loans” and “total performing loan portfolio” do not include “total non-performing loans,” as defined below. The term “net total performing loans” refers to total performing loans less allowance for loan losses on these loans.

The terms “total non-performing loans” and “total non-performing loan portfolio” include past-due principal and past-due interest. For a description of our policies regarding the classification of loans as non-performing, see “*Selected Statistical Information—Non-Performing Loan Portfolio*.” The term “net non-performing loans” refers to total non-performing loans less allowance for loan losses on these loans.

References in this offering memorandum to “allowance” are to the aggregate loan loss allowance or reserves shown as of a particular date as a balance sheet item. References in this offering memorandum to “provisions” are to additions to the loan loss allowance or reserves recorded in a particular period and charged to income.

The terms “total loans” and “total loan portfolio” include total performing loans plus total non-performing loans, each as defined above. The terms “net total loans” and “net total loan portfolio” refer to net total performing loans plus net non-performing loans, as defined above.

Terms Relating to Our Capital Adequacy

As used in this offering memorandum, the following terms relating to our capital adequacy have the meanings set forth below, unless otherwise indicated.

“*Capital Conservation Buffer*” refers to a minimum capital conservation buffer required to be maintained and comprised of Fundamental Capital (as defined below), which as of the date hereof is equivalent to 2.5% of total risk weighted assets, pursuant to Section III a) of Article 2 Bis 5 of the General Rules Applicable to Mexican Banks. See “*Summary—Recent Developments—Measures Adopted by the Mexican Government in Connection with the COVID-19*.”

“*Capital Ratios*” refers to each of the ratios of **(i) (a)** the Total Net Capital, **(b)** Tier 1 Capital or **(c)** Fundamental Capital to **(ii)** risk weighted assets subject to market risk, credit risk and operational risk, calculated in accordance with the methodology established from time to time by the CNBV, as the case may be, pursuant to the Mexican Capitalization Requirements.

“*Capital Supplement*” means the Countercyclical Capital Supplement and the Systemically Important Bank Capital Supplement, together with any other additional capital conservation or loss absorbency capital requirement to be constituted by the banks and comprised of Fundamental Capital, pursuant to the Mexican Banking Law (*Ley de Instituciones de Crédito*) (the “Mexican Banking Law”) and the Mexican Capitalization Requirements.

“*Countercyclical Capital Supplement*” means the additional countercyclical amount of capital that, in its case, is required from banks and is comprised of Fundamental Capital, as determined by the CNBV, pursuant to the Mexican Banking Law and the Mexican Capitalization Requirements.

“*D-SIBs*” means any domestic systemically important bank, as determined by the CNBV from time to time pursuant to the Mexican Banking Law and the Mexican Capitalization Requirements.

“*G-7 Mexican Banks*” means the seven largest banks in Mexico by total assets, according to the CNBV, which are Banorte, Banco Nacional de México, S.A., Integrante del Grupo Financiero Citibanamex (“Banamex”), BBVA Bancomer, S.A., Institución de Banca Múltiple, Grupo Financiero BBVA Bancomer (“BBVA Bancomer”), Banco Santander (México), S.A., Institución de Banca Múltiple, Grupo Financiero Santander México (“Santander”), Scotiabank Inverlat, S.A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat (“Scotiabank”), HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC (“HSBC”), and Banco Inbursa, S.A., Institución de Banca Múltiple, Grupo Financiero Inbursa (“Inbursa”).

“General Rules Applicable to Mexican Banks” means the General Rules Applicable to Mexican Banks (*Disposiciones de Carácter General Aplicables a las Instituciones de Crédito*) published by the CNBV, and as such regulations may be amended or superseded.

“Fundamental Capital” (*capital básico fundamental*) or “Core Equity Tier 1 Capital” or “CET1” means the amount of core capital of Tier 1 Capital, as such term is used in, and determined pursuant to, the Mexican Capitalization Requirements, principally including, but not limited to, common equity and surplus, contributions for future capital increases, retained earnings and capital reserves.

“Mexican Capitalization Requirements” means the capitalization requirements for commercial banks set forth under the Mexican Banking Law and the General Rules Applicable to Mexican Banks, as such laws and regulations may be further amended or superseded.

“Non-Fundamental Capital” (*capital básico no fundamental*) or “Non-Core Tier 1 Capital” or “Additional Tier 1 Capital” means the amount of non-core capital of Tier 1 Capital, as such term is used in, and determined pursuant to, the Mexican Capitalization Requirements, principally including, but not limited to, perpetual and convertible subordinated non-preferred indebtedness.

“Systemically Important Bank Capital Supplement” means the additional loss absorbency capital to be constituted and comprised of Fundamental Capital by D-SIBs to reflect the greater risk that they pose to the Mexican financial system.

“Tier 1 Capital” refers to the basic capital (*capital básico*) portion of the Total Net Capital, as such term is used in, and determined pursuant to, the Mexican Capitalization Requirements, also known as Fundamental Capital *plus* Non-Fundamental Capital, as such determination may be further amended from time to time.

“Tier 2 Capital” refers to the additional capital (*capital complementario*) portion of the Total Net Capital, as such term is used in, and determined pursuant to, the Mexican Capitalization Requirements, principally including, but not limited to, subordinated preferred indebtedness.

“Total Net Capital” refers to the net capital (*capital neto*), as such term is used in, and determined pursuant to, the Mexican Banking Law and the Mexican Capitalization Requirements, also known as Tier 1 Capital *plus* Tier 2 Capital.

Market Share and Ranking Information

Unless otherwise indicated, the market share and ranking information included in this offering memorandum is derived from statistics available through the CNBV, the Mexican Central Bank, the SHCP, the Mexican Bankers’ Association (*Asociación de Bancos de México, A.C.*) (the “ABM”) or Controladora Prosa, S.A. de C.V. (“Prosa”), a Mexican clearing agency for automated teller machines (“ATMs”), and credit cards.

SUMMARY

This summary highlights selected information from this offering memorandum and may not contain all the information that is important to you. For a more complete understanding of us, our business and this offering, you should read this entire offering memorandum, including, without limitation, the sections entitled “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Selected Statistical Information,” and our Financial Statements and notes thereto, appearing elsewhere in this offering memorandum.

We are a multiple purpose bank (*institución de banca múltiple*) incorporated as a limited liability corporation (*sociedad anónima*) in accordance with the laws of Mexico and licensed by the SHCP to operate as a commercial bank. We are the largest bank in Mexico in terms of total assets, deposits and stockholders’ equity, that is not controlled by or affiliated to a non-Mexican financial institution. As of March 31, 2020, we ranked second among all Mexican banks in terms of loan portfolio and fourth in core deposits (a combination of demand deposits and time deposits), according to information published by the CNBV. With more than 120 years of operation as a financial entity in the Mexican banking sector, we have developed an extensive experience and in-depth knowledge of the Mexican market, providing a full range of banking services to over 11.3 million customers in Mexico as of March 31, 2020.

We are the banking subsidiary of GFNorte, the fourth largest financial services holding company in Mexico in terms of total assets as of March 31, 2020, according to the latest information published by the CNBV. Through us and its other subsidiaries, GFNorte provides financial and related services primarily in Mexico, including banking products; annuities and insurance products; retirement savings funds; mutual funds; leasing and factoring; warehousing; and a wide array of broker-dealer services, including securities trading, offering and underwriting. We are GFNorte’s most significant subsidiary, representing approximately 74.8% of GFNorte’s total assets and 57.5% of its total stockholders’ equity, as of March 31, 2020.

As of March 31, 2020, we had total assets of Ps.1,293.6 billion (representing a market share of 11.3% according to CNBV), total liabilities of Ps.1,179.9 billion (including total deposits of Ps.791.8 billion) and stockholders’ equity of Ps.113.6 billion. In the three-month period ending March 31, 2020, we generated net income of Ps.6,180 million, and had a return on average equity (“ROAE”) of 21.7% and a return on average total assets (“ROAA”) of 2.0%. In 2019, we generated net income of Ps.27,493 million, and had a ROAE of 24.2% and a ROAA of 2.4%. In 2018, we had a ROAE of 25.7% and a ROAA of 2.3%. For an explanation regarding the calculation of ROAE and ROAA, see footnotes (2) and (3) to the table on page 2 below.

Our Capital Ratios were 18.97% for Total Net Capital, 17.86% for Tier 1 Capital and 12.18% for Core Equity Tier 1 Capital as of March 31, 2020, exceeding the minimum Capital Ratios that we are required to comply under Mexican banking regulations, and applicable to us, of 11.40%, 9.40% and 7.90%, respectively. These Capital Ratios are inclusive of the Systemically Important Bank Capital Supplement. Given our status as a bank of systemic importance in Mexico, we were required by the CNBV to constitute a Systemically Important Bank Capital Supplement of 0.90% over a four-year period, to be constituted in four equal parts in December of each year, on a cumulative basis, commencing in December 2016; accordingly, all portions of this supplement are now in place, which amount to 0.90%.

Over the years, we have successfully expanded our banking operations through strategic mergers and acquisitions, as well as consistent organic growth. This expansion has allowed us to increase our market share, especially in loans and deposits, as well as expand our geographic coverage and enhance the diversity and quality of our customer base. We have created a multi-channel network to provide a wide range of commercial and retail banking services, consisting of a network of 1,178 branches, 9,090 ATMs (57% of which are located outside of our branches) and 168,478 points of sale (“POSs”), in each case, as of March 31, 2020. Our branch network extends throughout Mexico, with a particular focus on the areas with the highest concentration of economic activity, including the Northeast of Mexico and Mexico City. We process approximately 273 million banking transactions per month, as of March 31, 2020. We had 24,099 employees as of March 31, 2020.

The following table presents certain of our financial and operating data as of and for the years indicated:

	As of or for the three-month period ended March 31,		As of or for the year ended December 31,			
	2020	2020	2019	2019	2018	2017
	(U.S.\$ millions, except percentages) ⁽¹⁾	(Ps. millions, except percentages)	(U.S.\$ millions, except percentages) ⁽¹⁾	(Ps. millions, except percentages)	(Ps. millions, except percentages)	(Ps. millions, except percentages)
Total loan portfolio.....	33,038	775,918	32,186	755,898	769,174	615,714
Total assets.....	55,083	1,293,647	48,948	1,149,536	1,180,492	1,056,423
Total deposits.....	33,718	791,870	31,693	744,272	759,235	648,622
Total liabilities.....	50,244	1,179,984	44,083	1,035,276	1,072,090	970,361
Total stockholders' equity.....	4,839	113,663	4,866	114,260	108,402	86,062
Net income for the period.....	262	6,180	1,170	27,493	24,834	18,339
Return on average total assets (ROAA) ⁽²⁾	2.0%	2.0%	2.4%	2.4%	2.3%	1.8%
Return on average equity (ROAE) ⁽³⁾	21.7%	21.7%	24.2%	24.2%	25.7%	20.3%
Net interest margin ⁽⁴⁾	6.3%	6.3%	6.4%	6.4%	6.3%	5.8%

- (1) Solely for the convenience of the reader, Peso amounts as of and for the three-month period ended March 31, 2020 and as of and for the year ended December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See "Exchange Rates and Currency."
- (2) Net income for the year divided by the average of the last five quarters of total assets, based on end-of-period balances (excluding minority interest). For the three-month period ended March 31, 2020, net income is determined on an annualized basis and is divided by the last two quarters of total assets based on end-of-period balances, in this case, March 31, 2020 and December 31, 2019.
- (3) Net income for the year divided by the average of the last five quarters of stockholders' equity, based on end-of-period balances (excluding minority interest). For the three-month period ended March 31, 2020, net income is determined on an annualized basis and is divided by the last two quarters of total assets based on end-of-period balances, in this case, March 31, 2020 and December 31, 2019.
- (4) Net interest income divided by the average of the last five quarters of total interest-earning assets, based on end-of-period balances (excluding minority interest). For the three-month period ended March 31, 2020, net income is determined on an annualized basis.

The following map shows our network of branches in Mexico as of March 31, 2020.



The following table sets forth our current market share in each region of Mexico in terms of the criteria specified below as of March 31, 2020.

Banorte's Market Share								
	North	Central	West	Northwest	Mexico City	Peninsula	South	National
Branches	13.3%	12.1%	7.7%	9.2%	9.5%	8.0%	6.5%	9.2%
ATMs.....	23.4%	23.1%	13.7%	17.6%	13.0%	14.3%	11.6%	15.9%
Bank employees.....	25.7%	8.6%	7.0%	8.3%	6.4%	6.2%	4.4%	9.0%

Source: CNBV

Our Lines of Business

Our business is organized in two main segments: retail banking and wholesale banking. As of March 31, 2020, our retail banking loan portfolio was Ps.295,512 million and wholesale banking was Ps.480,405 million, representing 38.1% and 61.9% of our total loan portfolio, respectively.

- **Retail Banking.** This segment serves clients through our branches, A TM network, alternate channels (POSs, third-party correspondents and online, telephone and mobile banking) and our contact center. The retail banking segment offers services to individuals, small- and medium-size enterprises (“SME”) and state and municipal governments. Products and services offered through this segment include checking and deposit accounts, credit and debit cards, mortgages, car loans, payroll and personal loans, payroll dispersion accounts, as well as car, home and life insurance offered through a cross-selling agreement with our affiliate Seguros Banorte, S.A. de C.V. (“Seguros Banorte”).
 - *Consumer Banking:* We offer financial products and services for individuals through a multi-channel approach. Our investments in systems and technology over the past four years allow us to better target our products and services and to focus on the most profitable clients. The main products that we offer in this segment include mortgages, payroll loans, credit cards and automobile loans. As of March 31, 2020, our mortgage loan portfolio was Ps.175,295 million, our payroll loan portfolio was Ps.51,703 million, our credit card portfolio was Ps.41,090 million and our automobile loan portfolio was Ps.27,425 million, representing 59%, 17%, 14% and 9% of our total consumer loan portfolio, respectively.
 - *SME Banking:* We offer financial products and services for SMEs or individuals with business activities. We service our more than 443,185 clients in this segment through a specialized team of executives distributed through a network of 12 service centers in Mexico as of March 31, 2020. We provide, among others, the following main solutions: savings and investment, financing, and business insurance offered through a cross-selling agreement with Seguros Banorte. Products and services may be contracted individually, adapting to the volume of transactions of each company, or through our “Solución Integral PyME,” which allows contracting and activating several products and services through a single agreement. One of our main products is Crediactivo, a loan product targeted towards SMEs and issued in amounts of approximately Ps.12 million. As of March 31, 2020, our total SME loan portfolio was Ps.64,806 million, representing 8.3% of our total loan portfolio.
 - *State and Municipal Governments:* We offer products and services for Mexican state and municipal governments, including checking accounts, financing (short and long-term loans frequently secured by federal contributions (*aportaciones federales*), cash management and payroll payment services. As of March 31, 2020, our total state and municipal government loan portfolio, which is a subset of government portfolio, was Ps.112,758 million, representing 14.5% of our total loan portfolio.

- **Wholesale Banking.** Our wholesale banking segment comprises Corporate and Enterprise Banking, Transactional Banking, Federal Government Banking and International Banking.
 - *Corporate and Enterprise Banking.* Through this segment we specialize in comprehensive financial solutions for corporate and enterprise clients through several forms of specialized financing, including structured loans, syndicated loans, financing for acquisitions and investment plans. We also offer cash management, collections, trust services, payroll payment, checking accounts, lines of credit, and loans such as *CrediActivo Empresarial* (a product partially guaranteed by a Mexican development bank *Nacional Financiera, S.N.C., Institución de Banca de Desarrollo* (“NAFIN”). Our clients in this segment generally consist of multi-national companies, large Mexican corporations and midsize enterprises operating in a wide range of sectors. We offer a client-oriented banking model, which establishes the role of the relationship managers as the central axis to attend all of our customers’ financial needs. As of March 31, 2020, our total corporate and enterprise banking loan portfolio was Ps.283,691 million, representing 36.6% of our total loan portfolio.
 - *Transactional Banking.* Through our transactional banking division, we offer corporate and enterprise clients a comprehensive model of cash management solutions and online banking, encompassing sale, implementation and post-sale service, aiming to increase cross-selling levels. We launched a consolidated business model in 2014, which has resulted in a higher cross-selling ratio, better service and stronger ties with our clients.
 - *Federal Government Banking.* Through this segment we provide financial services to the federal government, productive state enterprises, decentralized entities (such as social security institutions and public trusts) and other entities at the federal level. Products and services offered include checking accounts, loans, cash management and payroll payment services. We also offer comprehensive advisory services on public finance to increase tax collections and control and manage expenses, and we prepare financial diagnoses to design adequate profiles for debt payment through a solid financial and legal structure, aiming to strengthen our clients’ financial condition and credit quality. Serving these institutions also allows us to cross-sell checking accounts, credit card services and loan products. As of March 31, 2020, our total federal government loan portfolio was Ps.48,523 million, representing 6.3% of our total loan portfolio.
 - *International Banking.* Through this segment we offer products and services to our corporate and enterprise banking and SME clients to assist them with international trade needs, as well as providing correspondent banking services to foreign financial institutions. We have strategic agreements with financial institutions abroad, which allow us to offer highly competitive solutions and financial services to our clients, both locally and globally. On February 12, 2020, Banorte and the official Export Credit Agency of the government of Denmark, Eksport Kredit Fonden, entered into a bilateral “Framework Cooperation Agreement” to support Mexican companies in foreign trade activities. This agreement establishes the cooperation framework to support imports from Denmark, as well as energy and infrastructure projects in Mexico that involve Danish companies as providers of goods and services. Among the products and services offered to our import and export clients and to those with international or risk mitigation needs are: letters of credit, documentary collections, banking guarantees, stand-by letters of credit, letters of credit financing, cross-border financing for import and export transactions, and international transfer services. We also provide specialized local banking services to foreign-based companies with operations in Mexico.

Our History

We were founded in 1899 as Banco Mercantil de Monterrey, with a strong regional presence in Northeastern Mexico, particularly in the metropolitan area of Monterrey, Nuevo León, one of the country’s most important industrial centers.

Together with other Mexican commercial banks, Banco Mercantil de Monterrey was nationalized by the Mexican government in 1982. In 1986, Banco Mercantil de Monterrey merged with Banco Regional del Norte, another financial institution with headquarters in Monterrey, and became Banco Mercantil del Norte, *Sociedad Nacional de*

Crédito. In 1987, under a Mexican government privatization initiative, the government sold approximately 34% of our capital stock to the Mexican public. In 1990, the Mexican Constitution was amended to allow the total privatization of Mexican commercial banks, and the government enacted the Mexican Banking Law, which provided for private ownership of Mexican commercial banks. The privatization of Mexican commercial banks began in 1991.

GFNorte, our parent company, was incorporated in 1992 under the name “Grupo Financiero AFIN, S.A. de C.V.” (“AFIN”) as part of the privatization process of the Mexican banking system. In 1993 our shareholders acquired AFIN through a stock-for-stock exchange. As a result of this exchange, we became a subsidiary of AFIN and AFIN changed its name to “Grupo Financiero Banorte, S.A. de C.V.”

The 1995 Mexican Peso crisis and the entrance of foreign institutions in Mexico prompted a consolidation of the Mexican banking system which resulted in the absorption of many smaller Mexican banks into larger institutions. In September 1997, we acquired Banco del Centro, S.A., Institución de Banca Múltiple (“Bancentro”), increasing our market share in the Central and Western regions of Mexico and adding 195 branches. In August 1997, GFNorte acquired 81% of the shares of Banpaís, S.A., Institución de Banca Múltiple (“Banpaís”), and in January 2000, we merged with Banpaís consolidating the banking activities of GFNorte under Banorte and enabling further expansion of our client base, geographical position and national coverage through the addition of 161 branches. In December 2001, GFNorte acquired Bancreer, S.A., Institución de Banca Múltiple (“Bancreer”) and in September 2002 we merged with and into Bancreer. The surviving entity was renamed “Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.”

In 2006, we expanded our operations into the United States, through the acquisition of Inter National Bank (“INB”), a regional bank based in Texas with primary presence in the Rio Grande Valley and headquartered in McAllen, Texas. We sold our equity interest in INB in March 2017. Also in 2006, we acquired UniTeller, a New Jersey-based remittances company, and in 2007 we acquired Motran, a money transfer company based in California.

In 2011, GFNorte merged with IXE Grupo Financiero, S.A.B. de C.V. (“IXE”) in a stock-for-stock transaction. IXE conducted its business through its own subsidiaries, the largest one being Ixe Banco, S.A., Institución de Banca Múltiple, IXE Grupo Financiero (“IXE Banco”), a commercial bank in Mexico focusing on middle- and upper-income customers. In 2012, GFNorte expanded its pension fund manager joint venture, first through a merger with Afore XXI, S.A. de C.V. (“Afore XXI”), and later in 2013, with the acquisition of Administradora de Fondos para el Retiro Bancomer, S.A. de C.V. (“Afore Bancomer”), resulting in the largest pension fund manager in Mexico. On April 15, 2013 and May 7, 2013, IXE Banco and Fincasa Hipotecaria, S.A. de C.V., *Sociedad Financiera de Objeto Múltiple, Entidad Regulada* (“Fincasa”), IXE’s specialized mortgage lender, received the authorization from the CNBV to be merged with and into us, with Banorte as the surviving entity. On May 2, 2017, we consolidated our credit card operations by merging our wholly-owned subsidiary Banorte-Ixe Tarjetas, S.A. de C.V., SOFOM, E.R, with and into the Bank.

On July 13, 2018, the merger of GFInter into our parent company, GFNorte, became effective. Subsequently, on the same date, Banco Interacciones, the banking subsidiary of GFInter, merged into the Bank. As a result of the Interacciones Merger, we consolidated our position as the fourth largest bank in Mexico in terms of total assets, performing loans and core deposits, according to information published by the CNBV, and we strengthened our government lending business.

On January 25, 2018, the Board of Directors of Banorte approved the spin-off of Banorte USA Corporation (“Banorte USA”) and the subsequent investment of Banorte USA’s assets, including the total shareholders’ equity of INB Financial Corporation (“INBFC”) and the total shareholders’ equity of Uniteller Financial Services in Banorte Financial Services. The spin-off and the transfer of these assets occurred in December 2018. This spin-off did not have any effect on our financial statements because the Bank consolidated both Banorte USA and Banorte Financial Services as of December 31, 2018. Subsequent to the transfer of Uniteller Financial Services and INBFC’s assets to Banorte Financial Services, on January 14, 2019, Banorte USA was liquidated.

GFNorte’s common shares are publicly traded in the Mexican Stock Exchange (*Bolsa Mexicana de Valores, S.A.B. de C.V.*) and the Institutional Stock Exchange (*Bolsa Institucional de Valores, S.A. de C.V.*) under the ticker symbol “GFNORTEO.”

Market Opportunity

Despite the uncertainties related to the COVID-19 pandemic, we believe that the credit market in Mexico offers potential for growth given the relatively low levels of access to banking services among the Mexican population, coupled with the country's young population, low levels of credit to the private sector and expected economic recovery.

The Mexican economy was the second largest in Latin America in terms of GDP in 2019. Despite a mild contraction of the GDP in 2019 by 0.1% and an additional contraction of 2.2% in the first quarter of 2020, in recent years the Mexican economy showed resiliency in spite of foreign exchange volatility and a complex global environment, posting real GDP growth rates of 2.1%, 2.0% and 2.3% in 2018, 2017 and 2016, respectively. Due to the COVID-19 pandemic, recent economic indicators in Mexico such as GDP, manufacturing index and employment have suffered a negative impact and the contraction in economic activity is expected to accentuate during the second quarter of 2020.

The combination of a low unemployment rate (3.3% as of March 31, 2020), a slight average increase of 3.1% for the three-month period ended March 31, 2020 of salaries in real terms and a relatively contained inflation (3.4% annualized inflation rate, for the three -month period ended March 31, 2020) has provided support to the economy through domestic demand. Mexico's favorable demographics further support the growth prospects in the financial sector. Mexico has the second largest population in Latin America and its young, economically active population is expected to expand considerably through 2030, supporting further the transition from the informal economy to the formal sector. According to the Mexican Institute of Statistics and Geography (*Instituto Nacional de Estadística y Geografía*) ("**INEGI**"), informal economy represented 56.0% of the total economically active population as of March 31, 2020. Additionally, according to the World Bank, as of December 31, 2018, the domestic credit to private sector as a percentage of GDP in Mexico reached 34.6%, compared to 116.6% in Chile, 61.2% in Brazil and 179.3% in the United States. Mexico's low credit penetration represents a clear opportunity that has been reinforced by the government's efforts to increase access to bank lending and financial services in general in Mexico through the financial reform enacted in 2013.

Such stable macroeconomic environment and favorable country demographics, coupled with low credit penetration, has resulted in a healthy and consistent growth trend for the banking sector in Mexico in the last several years. According to CNBV data, Mexico's banking system has experienced loan growth of 9.8% compounded annual growth rate for the last five years from 2014 to 2019, with stable non-performing loan ratios oscillating between 3.4% and 2.1%. The growth rate of total loans in the country has been supported by consistent growth in the deposit base, growing at 10.7% compounded annual growth rate from March 31, 2015 to March 31, 2020, allowing for a sound liquidity of the banking sector with loans-to-deposits ratios at 99.4% on average since 2014. Such combination of loans and deposits growth has led to sustained attractive returns for the Mexican banking system, with ROAE of 14.2% on average and persistently above 12.1% since 2014, as well as a strongly capitalized banking system with an average Total Net Capital at or above 14.2% since 2012. The G-7 Mexican Banks represent over 83% of the total loan portfolio and also over 83% of total deposits since 2014. The ROAE for the G-7 Mexican Banks has been above 14.6% on average since 2014 and the average Total Net Capital for the same group has been at or above 12.1% since 2014.

Lastly, Mexico has been at the forefront in the implementation of a strong regulatory banking framework, which results in capitalization requirements, and alerts relating to such requirements, that are consistent with global standards. Mexico was one of the first countries in the world to implement Basel III rules. Unlike other countries that implemented or are in the process of implementing Basel III capitalization rules over the course of several years, the Mexican government took advantage of the strong capitalization levels of the Mexican banking system and required that all banks operating in Mexico adopt Basel III capitalization rules beginning in 2013. Additionally, in May 2016, the CNBV imposed additional capital requirements to certain D-SIBs, including us, and also mandated the constitution of a Countercyclical Capital Supplement to further shield the Mexican banking system. Though Mexican banks were required to constitute and comply with these additional capital requirements over a period of four years, to be constituted in four equal parts in December of each year, on a cumulative basis, commencing in December 31, 2016, many of the banks, including Banorte, already fully complied with such capital requirements given their high capitalization levels.

Competitive Strengths

We believe the following competitive strengths differentiate us from our competitors:

Deep Knowledge of the Mexican Market and Strong Brand Recognition

We are part of GFNorte, which was the fourth-largest financial group in Mexico as of March 31, 2020 in terms of assets, deposits and loan portfolio, and the largest controlled by Mexican investors, according to CNBV data. GFNorte has operated in the Mexican financial industry for 24 years under the “Banorte” brand name. We believe GFNorte’s long standing history in the Mexican market is recognized by our customers and the general public, who associate GFNorte with quality and social responsibility within the Mexican financial industry, based on the various awards received by GFNorte. In January 2019, Global Finance magazine recognized Banorte as the “Best Trade Finance Bank” in Mexico and the “Best Trade Finance Products Provider.” Additionally, on November 1, 2019, GFNorte was named bank of the year in Mexico by Latin Finance.

GFNorte has an in-depth knowledge of the Mexican market and local efficient decision-making processes that allow us to provide timely, specialized and integral responses to our clients’ requests and rapidly adapt to changes in the Mexican banking sector. For instance, during the global financial crisis of 2008, while international groups retrenched to shore up capital, GFNorte seized the opportunity and filled the void by expanding its presence in Mexico. GFNorte focuses on providing comprehensive services to our clients through a multi-product, multi-entity strategy that seeks to meet all of its clients’ banking, insurance, retirement saving and brokerage needs.

GFNorte has consolidated itself as a leading player in commercial banking, asset management, insurance and annuities, and brokerage services in Mexico. We are able to do this as a fully integrated financial group. As of March 31, 2020, GFNorte had the largest retirement fund manager (*administradora de fondos para el retiro*) (“Afore”) in Mexico in terms of assets under management, with a market share of 22.1% of the pension system managed by Afores.

Leading Market Presence across Core Businesses

We believe that our leadership position across our core businesses in Mexico allows us to offer a comprehensive suite of financial products and services to our customers, with access to a customer base of over 3,165 corporate clients and over 11.0 million individual customers as of March 31, 2020. This creates important synergies and efficiencies, as well as cross-selling opportunities.

Through the implementation of our organic growth strategy and acquisitions, we have transformed ourselves from being a regional bank with a 3.0% market share in terms of performing loans in 1992 to becoming the fourth-largest bank in Mexico in terms of total assets (Ps.1,293.6 million), performing loans (Ps.763.1 billion) and total deposits (Ps.791.8 billion), with nationwide presence and a 13.4% market share of total loans as of March 31, 2020, according to the CNBV.

We are the third largest operator of POSs in Mexico (representing a market share of 12.4%), the fourth in ATMs (representing a market share of 15.9%) and the fifth in branches (representing a market share of 9.2%), according to the CNBV, as of March 31, 2020. As of the same date, we had a 28.5% market share of the government banking sector, the largest in the Mexican banking system. As of the same date, we had a market share of 18.9% and 13.4% of mortgage loans and commercial loans, the second and third largest in the Mexican banking system, respectively.

Profitable Business Platform Supported by Prudent Risk-Management Practices

We believe that the successful implementation of our business strategy has allowed us to become one of the most profitable banks in Mexico. We have maintained a solid financial performance, evidenced by the consistent net income yearly growth we have experienced in 35 of the last 41 operating quarters (considering the period from January 2010 through March 2020). During the same period, we maintained a strong capitalization profile and continue to benefit from prudent risk management practices. We serve our customers through an extensive network of branches and ATMs, alternate channels and contact center with products and differentiated services. With a clear segmentation of customers, in retail banking we can offer services according to their specific profiles, through appropriate channels.

This has allowed us to develop and strengthen our banking relationship with our clients, as well as increase our profitability by improving efficiency and following a value-oriented approach.

The positive trend of our financial performance continued in 2019 as we increased our net income by 11% as compared to 2018, while our ROAE and ROAA remained consistent at 24.2% and 2.4%, respectively, in 2019 compared to 25.7% and 2.3%, respectively, in 2018. Our efficiency ratio was stable year over year at 41.4% in 2018 compared to 42.3% in 2019. As of December 31, 2019, we had non-performing loans to total loans ratio of 1.6% and a coverage ratio, defined as allowance for loan losses divided by total non-performing loans, of 137.9%. Recurring net income totaled Ps 6.18 billion in the three-month period ended March 31, 2020, reflecting stability when compared to the first quarter of 2019. In the first quarter of 2020, there was a slight contraction of ROAE and ROAA, at 21.7% and 2.0% respectively. Our efficiency ratio was 43.7% as compared to 40.5% for the corresponding period in 2019. As of March 31, 2020, we had non-performing loans to total loans ratio of 1.7% and a coverage ratio, defined as allowance for loan losses divided by total non-performing loans, of 139.8%.

We believe these ratios reflect our prudent risk management practices. We plan to maintain a balanced growth profile, emphasizing an efficient use of capital, prudent financial and operational risk management and efficient operations.

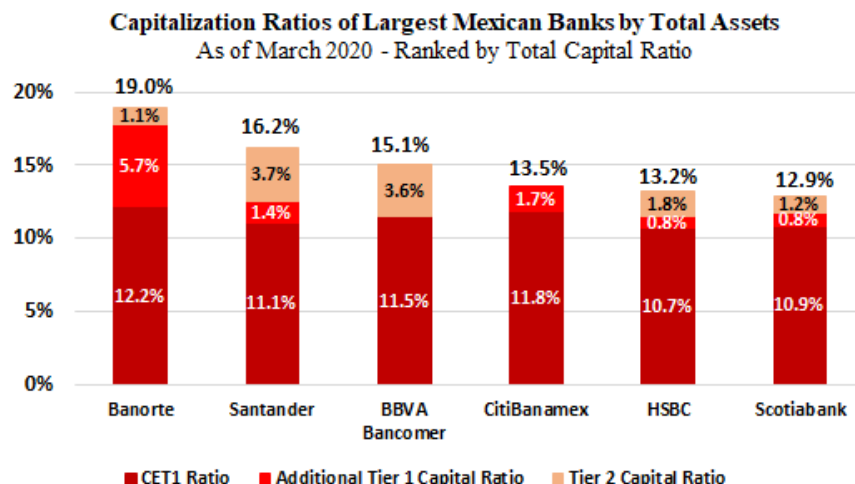
Strong Capital Base and Capitalization Ratios

We believe we have a strong capital base, as evidenced by each of our Capital Ratios, which have been above the average for the G-7 Mexican banks during the past 17 quarters (considering the period from January 2016 through March 2020). Mexican banks already comply with Basel III capitalization requirements and are well capitalized compared to other banks in more developed economies, and within this group of Mexican banks, we compare very favorably in terms of capitalization levels and composition of capital. As of March 31, 2020, our Fundamental Capital ratio was 12.18%, the second highest among the G-7 Mexican banks; our Additional Tier 1 Capital was 5.68%, the highest among the G-7 Mexican banks; and our Total Net Capital ratio was 18.97%, also the highest among the G-7 Mexican banks; in each case, according to data published by the CNBV.

Tier 1 Capital is also an important component of our capitalization and with a Tier 1 Capital ratio of 17.86% as of March 31, 2020, we have 8.46% of our Tier 1 Capital ratio above the current minimum of 9.40% required for us by the Mexican banking regulations to be classified as a grade II D-SIB.

In May 2016, given our status as a grade II D-SIB in Mexico, we were required by the CNBV to constitute a Systemically Important Bank Capital Supplement of 0.90%. In July 2018, the CNBV ratified this requirement, confirmed the Bank as a grade II D-SIB and required to implement an additional Countercyclical Capital Supplement, which we have estimated would correspond to 0.001%. We were required to implement and comply with these Capital Supplements over a four-year period to be constituted in four equal parts in December of each year, on a cumulative basis, commencing on December 31, 2016 through December 31, 2019. Given our strong capital base, our Capital Ratios as of March 31, 2020 are well above such Capital Supplement requirements.

The chart below presents the Capital Ratios for our main competitors by total assets as of March 31, 2020, ranked by Total Capital Ratio.



Source: CNBV

Expanding Business Platform with a Focus on Customer-Oriented Multi-Channel Banking

We have made significant investments to develop what we believe is one of the broadest integrated financial services platforms in Mexico. Between January 1, 2013 and March 31, 2020, we increased the number of ATMs and POSs by 40% and 69%, respectively, reaching a total of 9,090 ATMs and 168,478 POSs, ranking fourth in ATMs and third in POSs in the Mexican banking system. During the same period, we implemented a series of branch consolidations to improve efficiency, ranking fifth in terms of market share for number of branches. In addition, we have developed electronic distribution channels, such as *Banorte por Internet* and *Banorte Móvil*, which we believe are more cost-effective than traditional physical banking channels and provide a high degree of flexibility and convenience to our customers. As of March 31, 2020, we had approximately 2.6 million active internet banking customers and around 2.0 million of our customers utilized *Banorte Móvil*. We also consider ourselves pioneers in banking services through third parties in Mexico, reaching a total of 13,694 contact points as of March 31, 2020.

Over the years, we have moved from a product-oriented to a customer-oriented business approach. We believe our new focus provides us with more value by generating opportunities and giving our clients a better customized service. In 2013, we entered into a strategic agreement with IBM de México, Comercialización y Servicios, S.A. de C.V. (“**IBM**”), which allows us to further align our information systems with our customer-oriented business philosophy and benefit from increased cross-selling opportunities and a better overall experience for our customers.

Organic Growth and Successful Integration of Acquisitions

Our organic growth has been complemented with focused strategic and transformational acquisitions that have strengthened our market position across our different lines of business. Since 1996, we have consummated over 15 mergers and acquisitions, which have expanded our geographic reach and complemented our product portfolio and the quality of our professionals. This demonstrates our track record of successfully integrating acquisitions into our platforms and our expertise in deriving important scale and efficiency benefits from acquired assets and businesses. Our acquisition strategy has traditionally been centered on:

- assets and businesses that are aligned with our business model and growth strategy;
- transactions that are accretive to earnings;

- operations that offer potential for significant synergies; and
- transactions with limited integration risk and disruption to our business.

Track Record of Product Innovation

We have a history of innovation and new product development that has been fundamental to our growth story and competitive position. We have been leaders in the development of the banking sector in Mexico through new product launches; for example, we launched a new and easy way for customers to access online mortgages; and mortgages with rate reduction mechanisms for timely payment of interest. Over the years, we have demonstrated the ability to introduce new product offerings focused on our individual, corporate and SME customers. Among the innovative products and services that we have successfully launched are our *Adelanto Nómina* payroll loan product for individuals which can be drawn through ATMs and online banking, and *Banorte Móvil*, our state-of-the-art mobile banking platform. In June 2019, we also finalized a new agreement with Payclip, Inc. to strengthen our existing commercial alliance and to continue to work together on our digital strategy and technological innovation. Through this alliance, we aim to bring important payment method innovations to the Mexican market, and offer to our clients user-friendly, customized and cutting-edge products.

Experienced Leadership and Effective Governance

Our operations are supported by an experienced management team. Our senior management team has, on average, 14 years of experience with us and has more than 22 years of experience in the financial services industry. In recent years, our management team has integrated multiple large-scale acquisitions and improved our competitive position, including throughout the global financial crisis, to become the fourth largest bank in Mexico, generating significant profitability while maintaining effective risk management and a merit-based corporate culture that permeates all levels of our organization. As a consequence of these acquisitions, key employees of acquired companies have remained with our team and have broadened the experience of our team. We are also focused on attracting, developing and maintaining highly qualified personnel.

In addition, our Board of Directors is composed by a majority of independent directors (currently 64%), which ensures collegial decision-making for the benefit of our stakeholders, as well as having several supporting committees, including an audit committee and a risk policies committee, each chaired by independent directors with recognized experience. Our corporate governance model not only complies with applicable standards, but also seeks to apply best practices used in world-class organizations. Over the last several years, we have taken important steps to further improve leadership and governance at all levels of our organization.

Strategy

As part of our short- to medium-term strategy, we intend to:

Selectively Increase our Market Share

We have been able to increase our market share in banking products in a competitive environment. Our market share in total loans and deposits has increased from 8.0% and 6.6%, respectively, as of December 31, 2000, to 13.4% and 12.4% respectively, as of March 31, 2020. We intend to focus on increasing our market share in certain targeted segments through the following initiatives:

Expand our Payroll Loan Business

We are enhancing the use of distribution channels, such as ATMs, mobile devices and the internet banking to increase the origination of payroll loans in Mexico. As of March 31, 2020, we had a 19.2% market share of payroll loans in Mexico according to the CNBV. We also intend to continue to develop specialized sales forces, telemarketing efforts and *Banorte Visita*, through which we have more direct contact with companies in order to increase the channels through which we originate payroll loans. We intend to focus on cross-selling and same-time origination by encouraging customers to open payroll accounts when they request a loan and vice-versa. We intend to leverage our central customer repository ("CCR") database to better target our potential payroll loan customer base. Finally, we

intend to continue to determine fees and pricing for our payroll loans based on thorough risk assessment models in order to maximize profitability.

Expand our Credit Card Business

We have enhanced our fees and risk-based pricing strategy, improved our underwriting standards, implemented cross-selling initiatives in response to market demand and have developed new sales channels to increase credit card issuance. We believe we have an opportunity to increase our market share in this segment through further product penetration of our existing banking customers.

We issue personal credit cards (associated with both MasterCard and Visa) and offer the following products to our customers depending on their needs: *Banorte Básica; Banorte Fácil; Banorte Clásica; Banorte Oro; Tarjeta de Crédito Mujer Banorte; Banorte Pachuca; Banorte Platinum; Banorte Infinite; Banorte Empresarial; Tarjeta 40; Ixe Clásica; Ixe Oro; Ixe Platino; Ixe Infinite* and *Banorte Por Ti*. We also have two credit cards which are co-branded with United Airlines, the Platinum and Universe – Infinite. In addition, we offer various rewards programs for our credit card holders.

Our market share in the Mexican credit card segment was 10.1% as of March 31, 2020, according to the CNBV. As of that date, we had approximately 1.7 million credit cards outstanding, with a non-performing loan ratio of 5.8%. We believe we can increase our credit card market share in the medium-term while maintaining prudent underwriting practices and monitoring our credit quality ratio through more active marketing and promotions to our current customers. We believe we could increase our market share in the credit card segment to a level consistent with our market share in other products such as performing loans and deposits.

Expand our Car Loan Business

We are expanding our car loan business to customers with lower credit risk by increasing our presence at car dealerships and expanding our business partnerships with automobile manufacturers and distributors in Mexico. As of March 31, 2020, our market share on pre-approved car loans was 18.0% according to the CNBV, excluding financings by automobile manufacturers against whom we compete in this business. We also believe that, given the expected contraction in GDP in Mexico, the automobile sector, and consequently the automobile loan business will not experience growth in the coming years.

Increase our Mortgage Originations

We offer long-term mortgage financing for individuals and families acquiring houses or apartments. Such financings are generally secured by the purchased property and are denominated in Pesos with fixed interest rates for the entire life of the mortgage. The term of a mortgage ranges from one to 20 years for financing of up to 90% of loan-to-value. We offer financings exclusively for residential mortgages. Other products we offer include home equity; home improvement; construction; land acquisition; and construction and land acquisition. For the three-month period ended March 31, 2020, we originated 4,535 mortgages, and the aggregate outstanding balance due from our mortgage loan portfolio at the end of such period was Ps.9,125 million. For the year ended December 31, 2019, we originated 18,661 mortgages, and the aggregate outstanding balance due from our mortgage loan portfolio at the end of such year was Ps.172,059 million, compared to Ps.157,261 million for the year ended December 31, 2018.

The current average of the initial amounts of our mortgage loans (Ps.2.01 million) is 7.9% higher than the current average for other financial institutions (Ps.1.85 million) reflecting our higher income target segment. We also have the lowest delinquency rate in the mortgage loan portfolio in the industry with 1.18% as of March 31, 2020. We plan to continue to attract customers from these segments by providing high-quality service and quick approval response times; offering financings for purchases, refinancing and real estate improvements.

Strengthen our Relationships with Government Entities and their Employees

We intend to strengthen our relationship with Mexican federal, state and municipal governmental entities, which, as of March 31, 2020, together comprised 21.1% of our total loan portfolio. We see an opportunity to cross-sell other

products and services to government employees, whose low levels of staff turnover minimize the risk of non-payment. This opportunity to cross-sell has been enhanced by the merger with Banco Interacciones, whose government lending business has complemented our successful operation. The suite of products and services we offer to government entities includes checking and payroll deposit accounts for employees, cash management services, payment of money orders, trust services, financings, investments and tax bill collection services, which are available through all of our branches as well as through our websites and ATMs. In addition, we believe that developing our relationships with government entities will provide us with access to a broader customer base to market our retail products and services, such as credit cards, payroll loans and mortgage products. We believe that this sector provides us with cross-selling opportunities and attractive return on equity.

Emphasize Multi-Channel Distribution Capabilities

Our customer-oriented business model emphasizes a multi-channel banking strategy aimed at more effectively reaching our target customer segments. We seek to implement this strategy by understanding the channels used by our diverse customer base and by leveraging each channel effectively to generate cost efficiencies. For example, for our broader customer base, we expect to leverage internet and mobile banking as well as our correspondent banking through different initiatives. The use of the internet to research and apply for personal loans, car loans, mortgage loans and credit cards is commonplace today. Our emphasis on multi-channel distribution is aligned with our paperless initiative, which was fully implemented by the end of 2019. As a result of the COVID 19 pandemic, the number of mobile banking transactions has increased.

For instance, Banorte Go is an add-on to Banorte Móvil, our mobile banking platform. Banorte Go allows our customers to check their account balances, transfer funds and make payments among users of Banorte Móvil through social media mobile applications or any mobile application where an alphanumeric keyboard is used without the need to login to the Banorte Móvil mobile application. This allows users to enjoy the benefits of our mobile banking capabilities without having to exit their favorite mobile application.

We intend to continue to develop new specialized sales forces, telemarketing efforts and use “*Banorte Visita*” in order to increase the channels through which we originate payroll loans. In addition, we have steadily increased the number of ATMs, providing us with a 15.9% of market share as of March 31, 2020, according to the CNBV.

Enhance our Customer-Oriented Business Model

We seek to strengthen our customer-oriented organizational model, focusing on customer segments instead of product segments, optimizing and consolidating processes per business instead of per product and investing in information technology (“IT”) infrastructure. We intend to stay connected with our customers and devote resources to learning more about our customers’ needs and expectations from their banking relationships. Our strategic agreement with IBM is aimed at helping us increase our knowledge of our customers by creating a CCR database that consolidates all available customer information, enabling us to gain deeper insight into ways to build more loyal and profitable customer relationships. Our project with IBM has redesigned business processes and applications around customer segments instead of around products and developed a new IT infrastructure to support these new processes.

We believe this IT platform, which will allow us to manage large transaction volumes, will further improve the quality of service and segmentation as well as cross-selling, which will drive revenue increases, higher loyalty, cost efficiencies and increased profitability.

Increase Wallet-Share Penetration with Corporate and SME Customers

We have developed a role as a “relationship banker” for our corporate and SME customers by offering a variety of transactional banking and investment banking products through our network of regional service centers dedicated to these customers. Our transactional banking team intends to offer liability management solutions in the foreign exchange markets as well as cash management services to support our customers’ international operations. Our investment banking team intends to offer a full range of services in advisory and capital markets transactions.

Continue to Increase our Profitability

We intend to continue increasing profitability based on the following initiatives:

Improve the Profitability of our Branches and Optimize Cost Efficiencies

We seek to improve the profitability of our branches by:

- increasing loan origination, particularly in the areas of consumer loans, mortgage loans and credit cards;
- diversifying deposit base by increasing the volume of core deposits in order to achieve a lower cost of funding, based on our wide network of branches;
- increasing non-interest income through the offering of services and using cross-selling efforts;
- implementing continuous cost reduction initiatives, such as streamlining our senior management structure as well as headcount reduction; and
- channeling less value-added transactions to online and mobile services.

We will continue to review the profitability of our branch network by determining its optimal size and seeking to identify non-profitable units.

A central strategy to improve our cost efficiencies is to lower our IT and operational costs as a result of our customer-oriented business model. Another source of efficiency is to reduce personnel and administrative costs, as a result of rationalization efforts that are continuously implemented. For the three-month period ended March 31, 2020, our efficiency ratio was 43.7%, as compared to 40.5% for the corresponding period in 2019 and 42.3% for the year ended December 31, 2019.

Promote Synergies within the GFNorte Group

We intend to increase our market share and profitability by increasing our cross-selling of services and products to our customers and customers of GFNorte's other subsidiaries. We have introduced processes that facilitate our ability to offer additional financial services to our customers and those of GFNorte's other subsidiaries, with an emphasis on service and innovation. We cross-sell consumer loan products, credit cards and mortgages to our checking and savings account customers and to GFNorte's insurance and pension fund customers. We also plan to continue improving synergies and efficiencies within GFNorte's other subsidiaries.

Increase Our Non-Interest Income

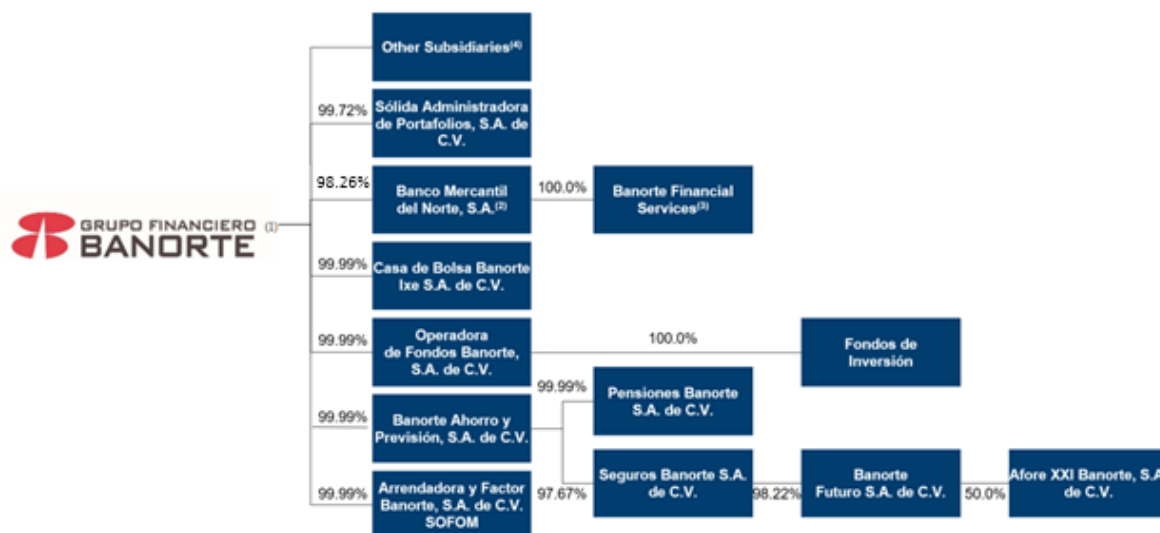
Our non-interest income is comprised primarily of commissions and fees, income from trading and foreign exchange activities, income from advisory activities, income from trust activities and income from recovery bank activities. Increasing fee income is a central component of our business strategy. Subject to applicable law and to prevailing market conditions, we seek to increase our fee income by:

- continuously reviewing the fees associated with our products and services in order to find new opportunities or to adjust to market conditions and practices;
- increasing our cross-selling efforts within the GFNorte group;
- promoting the use of technological and electronic payment methods, as well as mobile and internet banking;
- establishing new relationships with businesses generating high volume point-of-sale transactions; and

- optimizing customer profitability by increasing fees and reducing transactional costs to low-value customers and increasing cross-selling within affluent customer base.

Our Ownership Structure

The following chart presents our ownership structure, indicating our principal shareholder, affiliates and our principal subsidiaries as of the date of this offering memorandum.



(1) Grupo Financiero Banorte, S.A.B. de C.V.

(2) The Notes will be issued by Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte, acting through its Cayman Islands Branch.

(3) Subsidiaries of Banorte Financial Services include UniTeller Financial Services (which includes UniTeller México, S.A. de C.V., UniTeller Filipino Inc., UniTeller Card Services Inc., UniTeller Canada ULC and Servicio UniTeller, Inc.) and INB Financial Corporation.

(4) "Other Subsidiaries" includes Almacén Banorte, S.A. de C.V., Ixe Servicios, S.A. de C.V. and Fundación Banorte, A.B.P.

Principal Offices

Our registered office is located at Avenida Revolución 3000, Colonia Primavera, Monterrey, Nuevo León, México 64830, and the telephone number at this office is +52 (81) 83-19-65-00. Our corporate headquarters are located at Prolongación Paseo de la Reforma 1230, Colonia Cruz Manca, Santa Fe, Alcaldía Cuajimalpa, 05349, Mexico City, Mexico.

Recent Developments

Downgraded Mexico's sovereign debt

Fitch Ratings downgraded Mexico's sovereign debt on April 15, 2020, reflecting an assessment of the overall financial capacity of the government of Mexico to pay its obligations and its ability to meet its financial commitments as they become due, from BBB to BBB- citing increased risk due to PEMEX's deteriorating credit profile and weakness in the macroeconomic outlook due to, among other things, trade tensions. In addition, Moody's downgraded Mexico's rating on April 17, 2020, from A3 to Baa1, maintaining the negative outlook. On the same date, Fitch Ratings also revised the outlook of Mexico's state oil company, PEMEX, from stable to negative, citing insufficient investment to restore declining production. These downgrades could adversely affect the Mexican economy and, consequently, our ratings as well as our business, financial condition, operating results and prospects.

On March 26, 2020, S&P downgraded Mexico's long-term foreign currency and local currency ratings to "BBB" (from BBB+) and to "BBB+" (from A+), respectively. The downgrade reflected the expected economic impact of the combined shocks of COVID-19 in Mexico and in the U.S. and lower global oil prices.

Banorte's Downgraded rating by S&P, Moody's and Fitch Ratings

As a result of Mexico's weakening economic resilience, on March 27, 2020, S&P took various rating action on financial institutions. Banorte's rating was lowered to BBB (from "BBB+") on global scales and our Junior Subordinated Securities to BB- from BB.

On April 21, 2020, Fitch Ratings announced it conducted a portfolio review of Mexican banks with international scale ratings following the downgrade of the country's sovereign rating, lowering Banorte's rating to BBB- from BBB. According to Fitch Ratings, the ratings primarily reflect our risk appetite, which results in higher-than-peers exposure to government-related businesses. Although Fitch Ratings believes we have a good financial profile to face the challenges of the operating environment, our financial metrics could weaken relative to previous performance, which is reflected in the rating downgrade and negative outlook. We have been resilient over the past years to a deteriorating operating environment, with a growing franchise, high profitability, sound impairment ratios as well as what we believe is a good funding and liquidity profile; however, if the operating environment continues to worsen, our ratings could face larger downside potential relative to peers due to our more concentrated business mix.

While the ultimate economic and financial market implications of the COVID-19 pandemic are unclear, Fitch Ratings considers the already deteriorated and challenging operating environment to be clearly skewed to the downside, which has driven the agency's adjustment on the operating environment mid-point score to BB+ from BBB with a negative outlook. Fitch Ratings' assessment of the operating environment has a direct influence on bank ratings, and for many banks this is a high influence rating factor. Fitch Ratings expects deteriorating operating conditions from the COVID-19 outbreak to pressure asset quality and weigh on earnings due to lower loan growth, decreasing interest rates and higher credit costs over the medium term.

On April 22, 2020, Moody's downgraded to Baa1, from A3, our long-term global local and foreign currency deposit, issuer and debt ratings. In the same rating action, Moody's affirmed our Aaa.mx/MX-1 long- and short-term Mexican National Scale ratings. The outlook of Banorte remains negative according to Moody's. The reasons for these actions were (1) Mexico's medium-term economic growth prospects have materially weakened, (2) the continued deterioration in PEMEX's (Ba2 negative) financial and operational standing is eroding the sovereign's fiscal strength, and (3) weakened policy making and institutional capacity. The rating actions reflect the high inter-linkages between Mexican banks' ratings and those of the sovereign as a result of holdings of government bonds for liquidity purposes or lending to entities such as state-owned enterprises or regional and local governments that benefit from cash flows from revenues of the federal government. Moreover, the global spread of the COVID-19 is resulting in simultaneous supply and demand shocks. Moody's expects these shocks to materially slow global economic activity, particularly in the first half of this year. In Mexico, according to Moody's, the COVID-19 outbreak will mire an already weak economy into a recession, and as such Moody's forecasts a significant GDP contraction this year followed by a weak recovery, all of which are likely to have a material impact on our operations and financial condition.

Impact of the COVID-19 on our Operations

We have been, and will continue to be affected by the outbreak of COVID-19 both directly and indirectly, through an impact on our customers (which could in turn increase our delinquency rates and past due loan ratios resulting in the need to create additional loan loss reserves), our counterparties, employees and other stakeholders, as a result of, among other things, public health measures such as closing of "non-essential" businesses and restrictions on travel and gatherings in Mexico. The exact ramifications of the COVID-19 are highly uncertain and, as of the date of this offering memorandum, it is difficult to predict the spread or duration of the pandemic or its full effect on the Mexican and global economies.

While the impact of the COVID-19 has been significant, our results for the first quarter of 2020 were not significantly affected by the pandemic, given that, among other reasons, most of the public-health restrictions in

Mexico were implemented after the second week of March 2020. Given the uncertainty around the extent and timing of the future spread of COVID-19, the potential imposition of additional protective measures or the relaxation of existing measures, it is not possible to predict the full extent of the effects that this pandemic will have on our operations and financial condition, as well as on those of our clients, counterparties and other stakeholders.

Furthermore, despite the measures implemented by the CNBV and the Mexican Central Bank described below, there can be no assurance that the adverse impact of the COVID-19 outbreak will not lead to a tightening of liquidity conditions or funding uncertainty in the future.

Measures Adopted by the Mexican Government in Connection with the COVID-19

After the Mexican government and the World Health Organization acknowledged local COVID-19 transmission, the Mexican government announced the commencement of “Stage 3” of its strategy to control the spread of the virus. Measures under such strategy included the suspension of non-essential public and private activity until May 30, 2020. Such date was later extended based on a stop-light mechanism that will be updated by the Mexican government.

In order to mitigate the economic effects of the COVID-19 pandemic, the CNBV and the Mexican Central Bank have implemented a number of temporary measures and recommendations applicable to banking institutions to, among others, strengthen the financial system and ensure liquidity in the system, standardize accounting and disclosure, maintain the flow of credit in the economy and assist debtors:

- On March 25, 2020, the CNBV announced certain special temporary accounting criteria for non-performing loans, loan loss provisions and other measures applicable to banking institutions in connection with their mortgages, credit cards, automobile, personal, payroll and SME loans. These measures include, among others: (i) permitting borrowers under such loans to defer the payment of principal and/or interests of their loans for a period of four months, with the possibility to extend it for two additional months, without requiring banks to create loan-loss provisions for these deferrals, and (ii) allowing to freeze the balances of existing loans that were in good standing as of February 28, 2020, without interest charges, without considering such loans as non-performing. We implemented a debtor relief program in response to these measures. As of April 15, 2020, 18% of our total eligible portfolio had taken advantage of these measures.
- On March 31, 2020, the CNBV issued a recommendation to banks, advising them to: (i) refrain from paying dividends to their shareholders or implementing any other mechanisms that result in a transfer of economic benefits to the shareholders, including the distribution of reserves, or assuming an irrevocable commitment to pay any dividends or benefits with respect to the fiscal years ended December 31, 2019 and 2020, in case of financial groups, this recommendation is also applicable to the holding company and other entities of the group, and (ii) refrain from repurchasing shares or any other mechanism aimed to reward shareholders. These measures aim to strengthen banking institutions against potential losses resulting from the COVID-19 pandemic and will enable them to have more resources to support the local economy during the pandemic. According to the CNBV, these measures are consistent with those taken by other central banks and regulators around the world, such as the European Central Bank and regulators in Sweden, Italy, Russia, Argentina, Canada, Great Britain, Belgium, Austria, Denmark and Japan. Following this recommendation, our Board of Directors proposed to the shareholders meeting to defer the approval of dividends with respect to the fiscal year ended December 31, 2019. Following the Board of Directors’ proposal, the shareholders’ meeting of the Bank agreed to defer the distribution of dividends related to the fiscal year ended December 31, 2019, until a future date, to be determined by our shareholders at a future shareholders’ meeting; therefore, we have not paid these dividends to our shareholders, including GF Norte.
- On April 8, 2020, the CNBV issued a number of temporary regulatory measures aimed to enable banks to continue granting credits to their customers in a high volatility environment while mitigating the impact of the COVID-19 pandemic. These temporary measures will be effective from April 1, 2020 to March 31, 2021 and include, among others, enabling banks to use their Capital Conservation Buffer without triggering any sanctions or corrective measures. In the same line, the CNBV extended to January 1, 2022 the entry into force of certain international standards and prudential provisions, including the implementation of IFRS-9 and the corresponding obligation to adjust the banks’ commercial loan portfolios.

- On April 8, 2020, the Committee of Banking Liquidity Regulation, comprised of the Mexican Central Bank, the SHCP and the CNBV, issued a number of exceptions to the liquidity requirements applicable to banks, to foster the banks' capacity to continue their lending activities in the midst of the COVID-19 pandemic. Among other things, these exceptions provide that: (i) banks can consider as liquid assets those assets that were eligible to be considered as such as of February 28, 2020, even if they would otherwise no longer be eligible as a result of the recent volatility in financial markets, (ii) banks can exclude the data corresponding to March 2020 from the calculation of liquidity reserves for potential margin calls or for changes in the valuation of derivative portfolios, and (iii) banks will be temporarily exempt from the application of certain corrective measures that would be applicable when their Liquidity Coverage Ratio (*Coefficiente de Cobertura de Liquidez* or "LCR") falls below 100%. These temporary measures will be in place for a period of six months starting on February 28, 2020, which could be extended by additional six months.
- On April 17, 2020, the Mexican Central Bank announced a temporary exemption to banks and other financial institutions from their obligation to charge clients with the minimum amounts payable in connection with the credit cards issued by such banks or financial institutions, without any sanctions. According to an additional bulletin issued by the Mexican Central Bank on June 6, 2020, this exception will be valid from April 1, 2020 to September 30, 2020.
- On April 21, 2020, the Mexican Central Bank announced several measures to provide liquidity to the financial markets in light of the COVID-19 pandemic. Among such measures are: (i) reduction of the reference interest rate by 50 basis points, to 6.0% (which was reduced again to 5.5% on May 14, 2020 and to 5.0% on June 25, 2020), (ii) expand the types of securities that Mexican banks may pledge to the Mexican Central Bank in order to obtain liquidity lines from the Central Bank, (iii) provide up to Ps.750 billion of funding to Mexican banks, to enable them to continue granting loans to SMEs and individuals, (iv) grant liquidity lines to government-owned development banks, (v) ability to enter into long-term repo transactions with respect to Mexican government securities, and (vi) exchange corporate debt collateral held by Mexican banks for government securities.
- In the first week of April, the Mexican Central Bank carried out two financing auctions in U.S. dollars, pursuant to Bulletin 8/2009. As a result, we obtained a U.S.\$1.5 billion short-term loan from the Mexican Central Bank.
- On June 19, 2020, the Mexican Central Bank announced that it was making available lines of credit to Mexican banks, pursuant to which the Central Bank, through loan agreements secured by loans made by such Mexican banks to rated borrowers, would make funds available exclusively for the purpose of financing SMEs.

Measures We Have Adopted in Connection with the COVID-19

We began implementing our business continuity plan to safeguard the health of our employees and support our business continuity amid the COVID-19 pandemic, among other measures, we enacted safety and health protocols to prevent contagion at the workplace; all domestic and foreign trips were suspended; we closed temporarily several of our branches in Mexico (as of June 15, 2020, 15% of our branches remain closed); visitors and family are restricted from entering work sites; we limited gatherings and group events; home-office was promoted for those positions that do not require physical presence at our offices; hygiene measures have been reinforced in our branches, corporate offices, ATMs and contact centers; and we are encouraging customers' and employees' to use our digital channels. We developed an app called Banorte-AsisMed through which we provide medical and psychological assistance to our employees 365 days a year. There are continuous communication campaigns to keep our employees informed of the protocols and measures we are implementing as well to encourage the general population to stay at home.

On April 30, 2020, between 65% to 75% of our administrative staff and 50% of our contact center staff were working from home. As of the same date, all of our 68 critical processes and channels, our mobile banking channel and our contact centers were operating at a 100% capacity; 85.1% of our branches were operating (1,002 out of 1,178); 97.4% of our private banking branches were operating (38 out of 39); and 97.2% of our ATMs were functioning (8,762 out of 9,013).

See “Risk Factors – Risks Relating to our Business - Our operations and results have been impacted by the COVID-19 pandemic, which we expect will have a continued and likely material adverse effect on our business, results of operations and financial condition.”

Availability of Second Quarter 2020 Financial Results

Our consolidated interim financial statements as of and for the six-month period ended June 30, 2020 (the “2Q2020 Financial Statements”) are not expected to be reported and filed with the CNBV until after the offering of the Notes is completed. According to CNBV regulations, GFNorte, our parent company, is required to report its financial results, including our financial statements, no later than 20 business days after June 30, 2020.

Certain Financial Information as of April 30, 2020 reported to the CNBV

We are obligated to report financial information monthly to the CNBV and our most recent information published by the CNBV corresponds to the end of April 2020. This financial information is derived from internal reports prepared by our management and approved by our Board of Directors; however, our monthly financial information as of April 30, 2020 has not been audited or reviewed by our auditors, Galaz, Yamazaki, Ruiz Urquiza, S.C., a member of Deloitte Touche Tohmatsu Limited.

Although we expect that the trends for the second quarter of 2020 will be consistent with the trends seen during the month of April 2020, the financial information presented in this section is not indicative of the results that may be expected for the second fiscal quarter of 2020, the current fiscal year or any other period and there could be trends for the second fiscal quarter of 2020, the current fiscal year or any other period that differ from those experienced in the month of April 2020, including as a result of the impact of the adverse macroeconomic environment that has resulted from the COVID-19 pandemic. See “—Impact of the COVID-19 on our Operation,” “Risk Factors—Risk Relating to Our Business—Our results of operations have been, and may continue to be, adversely affected by U.S. and international financial market and economic conditions” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Principal Factors Affecting Our Financial Condition and Results of Operations” in this offering memorandum.

This information should be read in conjunction with “Presentation of Financial and Other Information,” “Selected Consolidated Financial Information,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our Financial Statements and the notes thereto included elsewhere in this offering memorandum.

The table below sets forth our capital, liquidity and leverage ratios for the periods indicated, derived from internal non-audited financial information as of April 30, 2020, as reported to the CNBV.

	Minimum Ratios	As of December 31, 2019	As of March 31, 2020	As of April 30, 2020
Capital Ratios (credit, market and operational risk):				
Fundamental Capital (CET1) to risk-weighted assets	7.90%	12.74%	12.18%	12.84%
Tier 1 Capital to risk-weighted assets	9.40%	17.45%	17.86%	18.33%
Total Net Capital to Total Risk-Weighted Assets	11.40%	18.55%	18.97%	19.48%

		<u>For the three-month period ended</u>		<u>For the month ended</u>
	<u>Minimum Ratios</u>	<u>December 31, 2019</u>	<u>March 31, 2020</u>	<u>April 30, 2020</u>
Liquidity and Leverage Ratios:				
LCR (average) ⁽¹⁾	100%	133.72%	119.84%	131.82%
Net Stable Funding Ratio (NSFR) ⁽²⁾	100%	130%	131%	134.05%
Leverage Ratio ⁽³⁾	3.00%	10.84%	10.88%	10.53%

(1) As reported to the CNBV. See “*Risk Management—Liquidity Risk.*”

(2) As reported to Risk Committee. Ratio of total available stable funding and total required stable funding.

(3) As reported to Risk Committee. Ratio of Tier 1 Capital and risk exposure.

With the exception of our proactive creation of additional reserves and the impairment of non-COVID-19 past due loans during the month of June 2020 as described below under “*Additional Reserves,*” or except as otherwise disclosed in this offering memorandum, as of the date of this offering memorandum, there has been no material change in our capitalization since April 30, 2020.

The table below sets forth certain internal non-audited financial information as of and for the four months ended April 30, 2020, as reported to the CNBV.

	<u>For the four-month period ended April 30, 2020</u>	
	<u>(U.S.\$ millions, except percentages) ⁽¹⁾</u>	<u>(Ps. millions, except percentages)</u>
Total Assets	58,933	1,384,034
Net Loan Portfolio	32,721	768,439
Shareholder's Equity	4,960	116,488
Net income	367	8,631
Return on Average Equity (ROAE) ⁽²⁾	22.6%	22.6%
Return on Average Total Assets (ROAA) ⁽³⁾	2.0%	2.0%
Non-Performing Loan Ratio	1.7%	1.7%
Equity/Assets	8.4%	8.4%
Total Net Capital Ratio	19.5%	19.5%

(1) Solely for the convenience of the reader, Peso amounts as of and for the four-month period ended April 30, 2020 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “*Exchange Rates and Currency.*”

(2) For the four-month period ended April 30, 2020, net income is determined on an annualized basis and is divided by the last two quarters and the current month of stockholder's equity based on end-of-period balances, in this case, April 30, 2020, March 31, 2020 and December 31, 2019.

(3) For the four-month period ended April 30, 2020, net income is determined on an annualized basis and is divided by the last two quarters and the current month of total assets based on end-of-period balances, in this case, April 30, 2020, March 31, 2020 and December 31, 2019.

According to management's estimates, which are based on available information as of the date of this offering memorandum, we expect our 2Q2020 Financial Statements to be substantially consistent with the trends and performance reflected in the financial information included in this offering memorandum, including but not limited to those seen during the month of April 2020, other than as disclosed throughout this offering memorandum and with the financial information reported for the corresponding period in 2019. Nevertheless, the reviews and processes necessary to finalize our 2Q2020 Financial Statements have not yet been completed and the financial information presented above is not indicative of the results that may be expected for the second fiscal quarter of 2020, the current fiscal year or any other period. As a result, we cannot assure you that our 2Q2020 Financial Statements, which we will release following the completion of the offering of the Notes, will be consistent with the trends and performance reflected in the financial information included in this offering memorandum, or that the market perception to the results set forth in our 2Q2020 Financial Statements will not adversely affect the trading price of our Notes.

Additional Reserves

The COVID-19 pandemic has had a negative impact on various commercial and economic activities in Mexico and abroad, which have caused an economic recession in Mexico. Despite the various measures and programs that we have implemented to mitigate the progression of liquidity risk to default risk, the depth of the economic recession in Mexico is expected to cause a systemic risk and a future deterioration in the credit quality of our clients. Such potential deterioration is not currently considered by the rating and reserving methodologies we are authorized to use to generate reserves for credit risks. Therefore, in order to proactively reflect this potential deterioration in our financial statements, at the end of June 2020, we created Ps.3,000 million in additional reserves, in excess of those required by our rating and reserving methodologies, that will impact our second quarter results. This amount covers our estimated additional reserves impact for 2020 and a significant portion of 2021. Additionally, with the intention to prepare the Bank's balance sheet to absorb the new past due loan portfolio estimated from the pandemic, we also charged an impairment on non-COVID-19 past due loans for a total of Ps.4,618 million, of which only Ps.1,868 million affected our June 2020 statement of income given that the remaining Ps.2,750 million were previously reserved. As a result, the aggregate impact of these measures in our statement of income for the second quarter of 2020 was Ps.4,868 million. We may create additional reserves in the future, in response to the economic recession caused by the pandemic.

Alliance with Rappi

On June 22, 2020, GFNorte executed a strategic alliance agreement with Rappi, pursuant to which each entity will own 50% of a newly created fintech company ("New Co.") that will initially offer digital financial services to Rappi's clients. This agreement is subject to obtaining the required regulatory authorizations from the financial and antitrust authorities. Rappi is a global leader in its market, dedicated to connecting third parties to facilitate the delivery of retail products and other services, including food and groceries, through an IT platform.

GFNorte committed to make available to New Co., up to Ps.4 billion in a period of 18 months; however, provided that the delivery of Ps.3 billion is subject to achieving certain performance metrics. This operation is aligned with GFNorte's digital and technological strategy through which it seeks to be continuously present and gain market share in the digital financial services sector, in addition to providing digital banking and financial services to its clients.

GFNorte expects this strategic alliance to allow it to become a part of a broad digital financial ecosystem and to gain access to a broader base of young users seeking digital solutions, who quickly adapt to new technologies and innovative product offerings. We do not expect that this new alliance at our parent company's level will have a direct impact on the business or operations of the Bank.

THE OFFERING

The following is a brief summary of certain terms of this offering. For a more complete description of the terms of the Notes, see “Description of the Notes” in this offering memorandum.

Issuer	Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte, acting through its Cayman Islands Branch.
Notes	8.375% Perpetual 10-Year Callable Subordinated Non-Preferred Non-Cumulative Tier 1 Capital Notes.
Principal Amount	U.S.\$500,000,000.
Interest	Interest on the Notes will be due and payable at the Bank’s sole discretion and the Bank shall have sole and absolute discretion at all times and for any reason to cancel any interest payment (in whole or in part) that would otherwise be payable on any Interest Payment Date. See “—<i>Interest Payments Discretionary and Non-Cumulative</i>” below. Subject to a prior redemption and/or one or more Write-Downs (as defined below), the Notes will bear interest on the then Current Principal Amount (as defined below) from time to time outstanding from and including the Issue Date, to (but excluding) the First Call Date, at an initial fixed rate <i>per annum</i> equal to 8.375%. Interest, to the extent paid, shall be paid from amounts maintained in the Bank’s net retained earnings (<i>utilidades netas acumuladas</i>) account. Subject to a prior redemption and/or one or more Write-Downs, the Notes will bear interest on the then Current Principal Amount from time to time outstanding from and including each Reset Date, including the First Call Date, to (but excluding) the next succeeding Reset Date, at a fixed rate <i>per annum</i> equal to the sum of (a) the Treasury Yield (as defined in “<i>Description of the Notes — Interest</i>”) and (b) 776.0 basis points (rounded to two decimal places, with any value equal to or lesser than 0.005 being rounded down). Upon the occurrence of a Write-Down, any holder of the Notes will be deemed to have irrevocably waived its right to claim or receive the Written Down Principal (as defined below) of the Notes or any interest with respect thereto (or Additional Amounts (as defined below)), including any and all unpaid interest.
Issue Price	100.000% of the principal amount, plus accrued and unpaid and not canceled interest, if any, from and including July 14, 2020.
Issue Date	July 14, 2020.

First Call Date	October 14, 2030.
Reset Date.....	The First Call Date and every tenth anniversary thereafter.
Reset Determination Date.....	With respect to any Reset Date, the second Business Day immediately preceding such Reset Date.
Interest Payments Discretionary and Non-Cumulative	Interest on the Notes will be due and payable at the Bank's sole discretion and the Bank shall have sole and absolute discretion at all times and for any reason to cancel any interest payment (in whole or in part) that would otherwise be payable on any Interest Payment Date. Subject to the limitations set forth under " <i>—Other Restrictions on Certain Payments</i> " below, the Bank may use the funds corresponding to such canceled payments to meet the Bank's other obligations as they become due or to be maintained by it to satisfy capitalization requirements under the Mexican Capitalization Requirements or for any other reason.

If the Bank elects not to make an interest payment on the relevant Interest Payment Date, or if the Bank elects to make a payment of a portion, but not all, of such interest payment, such non-payment shall evidence its exercise of discretion to cancel such interest payment, or the portion of such interest payment not paid, and accordingly such interest payment, or portion thereof, shall be canceled and shall not be or become due and payable. For the avoidance of doubt, if the Bank provides notice to cancel a portion, but not all, of an interest payment in respect of the Notes, and the Bank subsequently does not make a payment of the remaining portion of such interest payment on the relevant Interest Payment Date, such non-payment will evidence the Bank's exercise of its discretion to cancel such remaining portion of such interest payment, and accordingly such remaining portion of the interest payment will also not be due and payable.

Such canceled interest shall not accumulate or be due and payable at any time thereafter and the holders and the beneficial owners of the Notes shall not have any right to or claim against the Bank with respect to such unpaid interest amount. Any such cancellation of any interest payment shall not constitute a default or an Enforcement Event (as defined below) under the terms of the Notes or the Indenture and the holders and beneficial owners of the Notes shall have no rights thereto or to receive any additional interest or amounts, penalty or compensation as a result of such cancellation.

Mandatory Cancellation of Interest Payments	Interest due on the Notes from the Bank will be automatically canceled if (A) the Bank is classified as Class II or below pursuant to Articles 121 and 122 of the Mexican Banking Law and the regulations thereunder, which specify capitalization requirements, or (B) as a result of the applicable payment of interest, the Bank would be classified as Class II or below (an “ <u>Interest Cancellation Event</u> ”). Currently, the minimum Capital Ratios to be classified as Class I (and as a result, not Class II or below), including the Capital Conservation Buffer, are (i) 10.5% in respect of Total Net Capital, (ii) 8.5% in the case of Tier 1 Capital and (iii) 7.0% in the case of Fundamental Capital, plus in each case, any other applicable Capital Supplement (currently, a Systemically Important Bank Capital Supplement for grade II D-SIBs of 0.90% and any other Countercyclical Capital Supplement applicable to the Bank).
Restrictions on Certain Payments	Unless the most recent payable interest and any Additional Amounts payable in connection therewith on the Notes have been paid, the Bank shall not: (1) declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of its capital stock; or (2) make any payment of premium, principal or interest on or repay, repurchase or redeem any other Subordinated Non-Preferred Indebtedness of the Bank.
Current Principal Amount	In respect of each Note, at any time, the outstanding principal amount of such Note, being the Original Principal Amount (as defined below) of such Note, as such amount may be reduced, on one or more occasions, as a result of a Write-Down or a redemption of the Notes as permitted under the Indenture, as the case may be.
Original Principal Amount.....	In respect of each Note, the amount of the denomination of such Note on the Issue Date.
Indenture.....	The Notes will be issued under an indenture, dated as of July 14, 2020 among us and the Trustee, and executed by an officer of the CNBV.
Unsecured; Not Guaranteed	The Notes will be unsecured and not guaranteed, or otherwise eligible for reimbursement, by the IPAB or any other Mexican governmental agency, any United States governmental agency, GFNorte or by any of its subsidiaries (other than the Bank), and the Notes are not convertible, by their terms, into any of our debt securities, shares or any of our equity capital or any debt securities, shares or equity capital of any of our subsidiaries or affiliates.

Trigger Event..... A Trigger Event will be deemed to have occurred if:

- the CNBV publishes a determination, in its official publication of capitalization levels for Mexican banks, that the Bank's Fundamental Capital Ratio, as calculated pursuant to the applicable Mexican Capitalization Requirements, is equal to or below 5.125%; or
- both **(A)** the CNBV notifies the Bank that it has made a determination, pursuant to Article 29 Bis of the Mexican Banking Law, that a cause for revocation of the Bank's license has occurred resulting from **(x)** the Bank's assets being insufficient to satisfy its liabilities, **(y)** the Bank's non-compliance with corrective measures imposed by the CNBV pursuant to the Mexican Banking Law, or **(z)** the Bank's non-compliance with the capitalization requirements set forth in the Mexican Capitalization Requirements and **(B)** the Bank has not cured such cause for revocation, by **(a)** complying with such corrective measures, or **(b)(1)** submitting a capital restoration plan to, and receiving approval of such plan by, the CNBV, **(2)** not being classified in Class III, IV or V and **(3)** transferring at least 75% of its shares to an irrevocable trust, or (c) remedying any capital deficiency, in each case, on or before the third (in the case of (A)(x)) or the seventh (in the case of (A)(y) and (A)(z)) business day in Mexico, as applicable, following the date on which the CNBV notifies the Bank of such determination.

Write-Down

If a Trigger Event occurs, the following write-downs (each, a “Write-Down”) shall be deemed to have occurred on the Write-Down Date (as defined below), automatically and without any additional action by the Bank, the Trustee or the holders of the Notes: **(i)** the then Current Principal Amount of the Notes will automatically be reduced by one or more Write-Downs by each applicable Write-Down Amount and any such Write-Down shall not constitute a default or an Enforcement Event; and **(ii)** any holder of Notes will automatically be deemed to have irrevocably waived its right to claim or receive, and will not have any rights against the Bank or the Trustee with respect to, repayment of, the Written Down Principal of the Notes or any interest with respect thereto (or Additional Amounts payable in connection therewith), including any and all unpaid interest with respect to such Written Down Principal as of the Write-Down Date, irrespective of whether such amounts have become due and payable prior to the date on which the Trigger Event shall have occurred.

“Write-Down Amount” means an **(i)** amount of the then Current Principal Amount of the Notes that would be sufficient, together with any concurrent *pro rata* write down or conversion of any other Subordinated Non-Preferred Indebtedness issued by the Bank and then outstanding, to return the Fundamental Capital ratio of the Bank to the level of the then-applicable Fundamental Capital ratio required by the CNBV in accordance with Section IV, c), 1 iii) of Annex 1-R of the General Rules Applicable to Mexican Banks or any successor regulation, which as of the date of this offering memorandum is 7% (which includes the Capital Conservation Buffer) plus the amount required to restore any Countercyclical Capital Supplement and any Systemically Important Bank Capital Supplement to the minimum amounts required under the Mexican Capitalization Requirements on such Write-Down Date, or **(ii)** if any Write-Down of the Current Principal Amount, together with any concurrent *pro rata* write down or conversion of any Subordinated Non-Preferred Indebtedness, would be insufficient to return the Fundamental Capital ratio of the Bank to the aforementioned amount, then the amount necessary to reduce the Current Principal Amount of each outstanding Note to zero.

“Write-Down Date” means the date on which a Write-Down will be deemed to take effect, which shall be the next Business Day succeeding the date of the Trigger Event.

As required under the Mexican Capitalization Requirements and in accordance to the CNBV request, a full Write-Down (whereby the principal amount of the Notes has been written down to zero) shall be completed before any public funds are contributed or any public assistance is provided to the Bank in the terms of Article 148, Section II, Subsections (A) and (B) of the Mexican

Banking Law, including, among others, in the form of (i) subscription of shares, (ii) receiving of loans (iii) payment of liabilities of the Bank, (iv) granting of collateral and (v) the transfer of assets and liabilities.

Subordination.....	The Notes constitute Subordinated Non-Preferred Indebtedness and will rank (i) subordinate and junior in right of payment and in liquidation to all of the Bank's present and future Senior Indebtedness and Subordinated Preferred Indebtedness (ii) <i>pari passu</i> without preference among themselves and with all other present or future unsecured Subordinated Non-Preferred Indebtedness of the Bank and (iii) senior only to all classes of the Bank's present and future equity or capital stock.
Redemption.....	The Bank may not redeem the Notes, in whole or in part, other than as described below under " <i>Optional Redemption</i> ," " <i>Withholding Tax Redemption</i> " and " <i>Special Event Redemption</i> ."
Optional Redemption	The Bank has the option, but no obligation, under the Indenture to redeem the Notes on the First Call Date and on any Interest Payment Date thereafter, in whole (up to the then Current Principal Amount) or in part, at par plus accrued and unpaid (and not canceled) interest due on, or with respect to, the Notes, plus Additional Amounts, if any, up to (but excluding) the date of redemption.
Special Event Redemption.....	The Bank has the option, but no obligation, under the Indenture to redeem the Notes at any time, in whole (up to the then Current Principal Amount) but not in part, at par plus accrued and unpaid (and not canceled) interest due on, or with respect to, the Notes, plus Additional Amounts, if any, up to but excluding the date of redemption, upon the occurrence of a Special Event affecting the Notes. A " <u>Special Event</u> " is the occurrence of certain changes in the treatment of the Notes under the Mexican Capitalization Requirements or tax deductibility of interest payments under the Notes.

Withholding Tax Redemption The Bank has the option, but no obligation, under the Indenture to redeem the Notes at any time, in whole (up to the then Current Principal Amount) but not in part, at par plus accrued and unpaid (and not canceled) interest due on, or with respect to, the Notes, plus Additional Amounts, if any, up to, but excluding, the date of redemption, upon the occurrence of a Withholding Tax Event affecting the Notes. A “Withholding Tax Event” is defined in the Indenture to mean **(i)** the receipt by the Bank and the delivery to the Trustee of an opinion of a nationally recognized law firm experienced in such matters to the effect that certain changes in applicable law affecting the payment of Additional Amounts under the Notes have occurred and **(ii)** the delivery to the Trustee of an officer’s certificate stating that the requirement to pay such Additional Amounts cannot be avoided by taking reasonable measures available to the Bank.

Enforcement Events and Remedies..... There are no events of default under the Notes. In addition, under the terms of the Indenture, any Write-Down or cancellation of interest will not constitute an Enforcement Event.

Each of the following events is an “Enforcement Event”:

- (1)** certain events involving the insolvency (*resolución*) or liquidation (*liquidación*) of the Bank;
- (2)** a Principal Non-Payment Event (as defined below); or
- (3)** breach of a Performance Obligation (as defined below).

(1) If a insolvency (*resolución*) or liquidation (*liquidación*) of the Bank occurs, the Current Principal Amount of the Notes, without any accrued and unpaid interest to the date of such occurrence, shall become immediately due and payable and neither the Trustee nor the holders of the Notes are required to declare such amount to be due and payable. In that event, holders of the Notes may not be able to collect the full amount payable under the Notes and laws applicable to an insolvency (*resolución*) or liquidation (*liquidación*) may affect the timing or amount paid to holders of the Notes.

(2) In the event of any redemption of the Notes, if the Bank does not make payment of principal in respect of the Notes for a period of fourteen (14) calendar days or more after the date on which such payment is due (a “Principal Non-Payment Event”), then the Trustee, on behalf of the holders and beneficial owners of the Notes, may, at its discretion, or shall at the direction of holders of 25% or more of the aggregate principal amount of outstanding Notes, subject to any applicable laws, institute proceedings for the Bank’s declaration of insolvency (*resolución*) or liquidation (*liquidación*).

In such event, whether or not instituted by the Trustee, the Trustee may prove the claims of the holders and beneficial owners of the Notes and the Trustee.

(3) In the event of a breach of any term, obligation or condition binding on the Bank under the Notes or the Indenture (other than any of the Bank’s payment obligations under or arising from the Notes or the Indenture, including payment of any principal or interest, including any damages awarded for breach of any obligation) (such obligation, a “Performance Obligation”), the Trustee may without further notice institute such proceedings against the Bank as it may deem fit to enforce the Performance Obligation; *provided* that the Bank shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums, in cash or otherwise (including any damages) earlier than the same would otherwise have been payable under the Notes or the Indenture, if any.

Other than the limited remedies specified above, no remedy against the Bank shall be available to the Trustee (acting on behalf of the holders of the Notes) or to the holders and beneficial owners of the Notes.

The Notes are perpetual securities in respect of which there is no fixed redemption date or maturity date. Holders and beneficial owners of the Notes may not request redemption of the Notes at any time.

Use of Proceeds.....

We expect to use the net proceeds from the offering of the Notes for general corporate purposes.

Payment of Additional Amounts	All payments made by or on our behalf in respect of the Notes will be made free and clear of and without withholding or deduction for or on account of any present or future taxes, duties, levies, imposts, assessments or governmental charges of whatever nature, imposed or levied by or on behalf of Mexico, the Cayman Islands, or any other jurisdiction through which payments are made (each a “<u>Relevant Jurisdiction</u>”) or any authority or agency therein or thereof having power to tax (collectively, “<u>Relevant Tax</u>”), unless the withholding or deduction of such Relevant Tax is required by law. In that event, subject to certain exceptions and limitations as described in “<i>Description of the Notes—Payment of Additional Amounts</i>,” we will pay as further distributions of interest and principal such additional amounts (“<u>Additional Amounts</u>”) as may be necessary so that the net amounts received by the holders or beneficial owners of the Notes or their nominees (the term “holders” only refers to registered holders) after such withholding or deduction, will equal the amount which would have been received in respect of the Notes in the absence of such withholding or deduction, to the extent described in this offering memorandum in “<i>Description of the Notes—Payment of Additional Amounts</i>.” We will also pay any stamp, administrative, court, documentary, excise or similar taxes arising in a Relevant Jurisdiction in connection with the Notes and will indemnify the holders for any such taxes paid by the holders.
Book-Entry Issuance, Settlement and Clearance ...	The Notes will be represented by one or more fully global notes registered in the name of a nominee of DTC. Investors will hold beneficial interests in the Notes through DTC and its direct and indirect participants, including Euroclear and Clearstream, and DTC and its direct and indirect participants will record your beneficial interest on their books. We will not issue certificated notes except as described in this offering memorandum. Settlement of the Notes will occur through DTC. For information on DTC’s book-entry system, see “<i>Form of Notes, Clearing and Settlement</i>.”
Listing.....	Application will be made to list the Notes on the Singapore Exchange Securities Trading Limited — SGX-ST. No assurance can be given that the Notes will be approved for listing on the Singapore Exchange Securities Trading Limited — SGX-ST.

Governing Law	The Indenture and the Notes will be governed by, and construed in accordance with, the law of the State of New York. Whether a Trigger Event (leading to a Write-Down) or an Interest Cancellation Event (leading to a Cancellation of Interest) has occurred is based upon a determination by the applicable Mexican regulator, as set forth in this offering memorandum, in accordance with Mexican law (as amended from time to time). Whether a Withholding Tax Event or a Tax Event has occurred is based upon a determination in accordance with Mexican law (or other applicable law in the case of a Withholding Tax Event involving a jurisdiction other than Mexico), as amended from time to time, evidenced by an opinion of a nationally recognized law firm and, if required, a certification by the Bank. Whether a Capital Event (as defined below) has occurred is determined by the Bank, as set forth in this offering memorandum, in accordance with Mexican law (as amended from time to time). The ranking and subordination of the Notes, will be governed by, and construed in accordance with, Mexican law (as amended from time to time). Any proceedings in respect of the Bank's insolvency (<i>resolución</i>) or liquidation (<i>liquidación</i>) will be conducted in accordance with the Mexican Banking Law, and any merger or consolidation shall be subject to applicable approvals under the Mexican Banking Law and any other applicable Mexican laws, as amended from time to time.
Form and Denomination	The Notes will be issued in minimum denominations of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof and the Notes will initially be represented by global notes.
Transfer Restrictions	The Notes have not been registered under the Securities Act. As a result, the Notes are subject to limitations on transferability and resale. The Notes are not intended to be offered, sold or otherwise made available and should not be offered, sold or otherwise made available to retail clients in the EEA or in the UK, as defined in the rules set out in the Markets in Financial Instruments Directive 2014/65/EU, as applicable, as amended or replaced from time to time. See “<i>Transfer Restrictions</i>” and “<i>Plan of Distribution</i>.” The Notes have not been and will not be registered with the RNV and may not be offered or sold publicly in Mexico. The Notes may be offered to investors in Mexico, on a private placement basis, if such investors qualify as institutional investors (<i>inversionistas institucionales</i>) or accredited investors (<i>inversionistas calificados</i>) pursuant to the private placement exemption set forth in Article 8 of the Mexican Securities Market Law.
Trustee and Paying Agent	The Bank of New York Mellon.

Risk Factors.....

You should carefully consider all of the information in this offering memorandum. See “*Risk Factors*” for a description of the principal risks involved in making an investment in the Notes.

SUMMARY CONSOLIDATED FINANCIAL AND OPERATING DATA

The summary consolidated financial and operating data presented in this section is derived from our accounting records or from our Financial Statements and relates only to us and our consolidated subsidiaries. This information should be read in conjunction with “Presentation of Financial and Other Information,” “Selected Consolidated Financial Information,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our Financial Statements and the notes thereto included elsewhere in this offering memorandum.

Our Financial Statements have been prepared in accordance with Mexican Banking GAAP, which differs in certain important respects from U.S. GAAP. For a summary of the differences between Mexican Banking GAAP and U.S. GAAP, see “Annex A – Significant Differences Between Mexican Banking GAAP and U.S. GAAP.”

Summary Statement of Income Data:	For the three-month period ended			For the Year ended December 31,			
	March 31,						
	2020	2020	2019	2019	2019	2018	2017
	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)		(U.S.\$ millions) ⁽¹⁾	(Ps. millions)		
Interest income.....	1,276	29,978	32,643	5,417	127,208	117,979	95,710
Interest expense.....	(531)	(12,462)	(15,712)	(2,496)	(58,621)	(53,466)	(40,062)
Net interest income.....	745	17,516	16,931	2,921	68,587	64,513	55,648
Allowance for loan losses.....	(181)	(4,262)	(3,700)	(643)	(15,104)	(15,635)	(14,983)
Net interest income after allowance for loan losses.....	564	13,254	13,231	2,278	53,483	48,878	40,665
Commission and fee income.....	246	5,782	5,303	975	22,906	21,379	18,436
Commission and fee expense.....	(91)	(2,135)	(1,951)	(363)	(8,516)	(7,849)	(6,142)
Intermediation revenues.....	45	1,048	934	194	4,560	3,799	2,101
Other operating income.....	1	31	1,820	112	2,624	2,869	2,365
Non-interest expense.....	(414)	(9,718)	(9,341)	(1,622)	(38,095)	(35,079)	(31,750)
	(213)	(4,992)	(3,235)	(704)	(16,521)	(14,881)	(14,990)
Operating income.....	351	8,262	9,996	1,574	36,962	33,997	25,675
Equity in earnings of unconsolidated subsidiaries and associated companies.....	1	29	14	5	128	161	62
Income before income tax.....	352	8,291	10,010	1,579	37,090	34,158	25,737
Current income tax.....	(110)	(2,576)	(2,176)	(342)	(8,021)	(8,565)	(6,781)
Deferred income tax (expense) benefit.....	20	465	(472)	(67)	(1,576)	(759)	(706)
Discontinued operations.....	-	-	-	-	-	-	89
Net income.....	262	6,180	7,362	1,170	27,493	24,834	18,339

- (1) Solely for the convenience of the reader, Peso amounts for the three-month period ended March 31, 2020 and for the year ended December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “Exchange Rates and Currency.”

	As of March 31,		As of December 31,			
	2020	2020	2019	2019	2018	2017
Balance Sheet Data:						
	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)		
Assets:						
Cash and cash equivalents.....	3,776	88,668	2,652	62,282	75,233	76,063
Margin securities.....	413	9,701	252	5,926	1,458	1,986
Investment in securities						
Trading securities.....	3,405	79,968	3,201	75,169	92,418	122,065
Securities available for sale.....	6,686	157,021	6,499	152,630	147,986	152,910
Securities held to maturity.....	839	19,711	834	19,593	8,492	6,834
	<u>10,930</u>	<u>256,700</u>	<u>10,534</u>	<u>247,392</u>	<u>248,896</u>	<u>281,809</u>
Debtor balances under repurchase and resale agreements.....	82	1,930	86	2,016	405	5
Derivatives financial instruments.....						
For trading purposes.....	2,084	48,940	949	22,295	28,083	25,511
For hedging purposes.....	55	1,291	7	162	156	205
	<u>2,139</u>	<u>50,231</u>	<u>956</u>	<u>22,457</u>	<u>28,239</u>	<u>25,716</u>
Valuation adjustments for assets hedging.....	3	66	3	69	84	99
Performing loan portfolio						
Commercial loans						
Business loans.....	12,281	288,409	11,345	266,442	275,979	210,431
Financial institutions' loans.....	1,022	24,011	877	20,595	21,088	22,875
Government loans.....	6,866	161,246	7,245	170,155	192,234	132,816
Consumer loans.....	4,948	116,200	4,949	116,228	111,237	101,995
Mortgage loans.....	7,376	173,226	7,242	170,086	155,797	135,405
Total performing loan portfolio.....	32,493	763,092	31,658	743,506	756,335	603,552
Past-due loan portfolio						
Commercial loans						
Business loans.....	285	6,700	262	6,147	7,044	6,540
Financial Institutions loans.....	-	4	-	4	-	-
Government loans.....	1	35	-	-	-	-
Consumer loans.....	171	4,018	182	4,268	4,331	4,329
Mortgage loans.....	88	2,069	84	1,973	1,464	1,323
Total past-due loan portfolio.....	545	12,826	528	12,392	12,839	12,192
Loan portfolio.....	33,038	775,918	32,186	755,898	769,174	615,714
(Less) allowance for loan losses.....	(764)	(17,932)	(727)	(17,083)	(18,264)	(15,551)
Loan portfolio, net.....	32,274	757,986	31,459	738,815	750,910	600,163
Acquired collection rights.....	54	1,261	58	1,359	2,001	1,925
Total loan portfolio, net.....	32,328	759,247	31,517	740,174	752,911	602,088
Receivables generated by						
securitizations.....	7	161	6	139	61	141
Other accounts receivable, net.....	3,545	83,264	1,252	29,410	36,082	37,492
Foreclosed assets, net.....	35	818	37	860	738	752
Property, furniture and equipment, net	646	15,167	642	15,088	13,547	13,474
Permanent stock investments.....	20	468	18	418	342	150
Long Term Assets Available for Sale .	-	-	-	-	-	-
Deferred taxes, net.....	185	4,352	47	1,104	4,839	3,517
Other assets.....	974	22,874	946	22,201	17,657	13,131
Total Assets.....	55,083	1,293,647	48,948	1,149,536	1,180,492	1,056,423
Liabilities:						
Deposits						
Demand deposits.....	19,240	451,842	18,542	435,453	412,118	394,995
Time deposits						
General public.....	11,734	275,566	11,143	261,705	277,576	245,288
Money market.....	1,145	26,894	772	18,122	55,552	3,679
Time deposits.....	94	2,213	89	2,085	1,891	1,657
Senior debt issued.....	1,505	35,355	1,146	26,907	12,098	3,003

	As of March 31,		As of December 31,			
	2020	2020	2019	2019	2018	2017
Balance Sheet Data:						
	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)		
	<u>33,718</u>	<u>791,870</u>	<u>31,692</u>	<u>744,272</u>	<u>759,235</u>	<u>648,622</u>
Interbank and other loans						
Demand loans.....	213	5,000	21	500	-	-
Short-term loans.....	355	8,332	395	9,276	13,523	8,441
Long-term loans	179	4,197	207	4,854	22,199	6,797
	<u>747</u>	<u>17,529</u>	<u>623</u>	<u>14,630</u>	<u>35,722</u>	<u>15,238</u>
Creditor balances under repurchase and resale agreements	<u>7,481</u>	<u>175,685</u>	<u>6,927</u>	<u>162,684</u>	<u>163,507</u>	<u>190,363</u>
Collateral sold or pledged						
Repurchase or resale agreements (creditor balance)	1	16	4	105	2	3
Derivatives financial instruments						
For trading purposes	2,153	50,574	884	20,752	23,605	24,608
For hedging purposes.....	447	10,487	180	4,221	10,963	12,401
	<u>2,600</u>	<u>61,061</u>	<u>1,064</u>	<u>24,973</u>	<u>34,568</u>	<u>37,009</u>
Other account payables						
Income tax.....	102	2,402	64	1,513	1,696	1,940
Employee profit sharing.....	27	639	22	508	485	405
Creditors from settlements of transactions.....	1,277	29,983	400	9,397	4,402	15,871
Creditors from cash collateral.....	312	7,331	106	2,493	14,319	11,083
Sundry creditors and other payables ...	1,482	34,824	1,118	26,265	24,059	16,897
	<u>3,200</u>	<u>75,179</u>	<u>1,710</u>	<u>40,176</u>	<u>44,961</u>	<u>46,196</u>
Subordinated debentures.....	<u>2,488</u>	<u>58,423</u>	<u>2,046</u>	<u>48,050</u>	<u>33,560</u>	<u>32,445</u>
Deferred credits and advanced collections.....	9	221	16	386	535	485
Total liabilities	<u>50,244</u>	<u>1,179,984</u>	<u>44,082</u>	<u>1,035,276</u>	<u>1,072,090</u>	<u>970,361</u>
Stockholders' equity						
Paid-in capital						
Common stock.....	800	18,794	800	18,794	18,794	18,105
Additional paid-in capital.....	99	2,336	90	2,123	1,184	648
	<u>899</u>	<u>21,130</u>	<u>890</u>	<u>20,917</u>	<u>19,978</u>	<u>18,753</u>
Other capital						
Capital reserves.....	738	17,330	738	17,330	14,847	13,013
Retained earnings from prior years.....	3,304	77,595	2,167	50,883	53,133	38,959
Result from valuation of securities available for sale	(120)	(2,824)	80	1,885	(1,994)	4
Result from valuation of instruments for cash flow hedging	(169)	(3,965)	(97)	(2,287)	(3,430)	(3,653)
Cumulative foreign currency translation adjustment	8	177	(1)	(34)	1,659	1,590
Remeasurements defined benefits for employees.....	(84)	(1,963)	(82)	(1,930)	(628)	(943)
Net income	262	6,180	1,171	27,493	24,834	18,339
	<u>3,940</u>	<u>92,530</u>	<u>3,976</u>	<u>93,340</u>	<u>88,421</u>	<u>67,309</u>
Noncontrolling interest.....	-	3	-	3	3	-
Total stockholders' equity	<u>4,839</u>	<u>113,663</u>	<u>4,866</u>	<u>114,260</u>	<u>108,402</u>	<u>86,062</u>
Total liabilities and stockholders' equity.....	<u>55,083</u>	<u>1,293,647</u>	<u>48,948</u>	<u>1,149,536</u>	<u>1,180,492</u>	<u>1,056,423</u>

(1) Solely for the convenience of the reader, Peso amounts as of March 31, 2020 and as of December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See "Exchange Rates and Currency."

	As of or for the three-month period ended March 31,		As of or for the year ended December 31,			
	2020	2020	2019	2019	2018	2017
	(U.S.\$ millions, except percentages) (1)	(Ps. millions, except percentages)	(U.S.\$ millions, except percentages) ⁽¹⁾	(Ps. millions, except percentages)		
Profitability and Efficiency:						
Return on average total assets ⁽²⁾	2.0%	2.0%	2.4%	2.4%	2.3%	1.8%
Return on average equity ⁽³⁾	21.7%	21.7%	24.2%	24.2%	25.7%	20.3%
Net interest margin ⁽⁴⁾	6.3%	6.3%	6.4%	6.4%	6.3%	5.8%
Efficiency ratio ⁽⁵⁾	43.7%	43.7%	42.3%	42.3%	41.4%	43.8%
Credit Quality Data:						
Total performing loans.....	32,493	763,092	31,658	743,506	756,335	603,522
Total non-performing loans.....	545	12,826	528	12,392	12,839	12,192
				755,89		
Total loans.....	33,038	775,918	32,186	8	769,174	615,714
Loans graded “C,” “D” and “E” ⁽⁶⁾	1,834	43,079	1,644	38,616	48,067	31,080
Allowance for loan losses.....	764	17,932	727	17,083	18,264	15,551
Credit Quality Ratios:						
Allowance for loan losses as a percentage of total loans.....	2.3%	2.3%	2.3%	2.3%	2.4%	2.5%
Allowance for loan losses as a percentage of total non- performing loans ⁽⁷⁾	139.8%	139.8%	137.9%	137.9%	142.3%	127.6%
Allowance for loan losses as a percentage of loans graded “C,” “D” and “E” ⁽⁶⁾	41.6%	41.6%	44.2%	44.2%	38.0%	50.0%
Total non-performing loans as a percentage of total loans.....	1.7%	1.7%	1.6%	1.6%	1.7%	2.0%
Net non-performing loans (total non-performing loans less allowance for loan losses) as a percentage of net total loans (total performing loans plus net non-performing loans).....	(0.7%)	(0.7%)	(0.6%)	(0.6%)	(0.7%)	(0.6%)
Net non-performing loans (total non-performing loans less allowance for loan losses) as a percentage of stockholders’ equity	(4.5%)	(4.5%)	(4.1%)	(4.1%)	(5.0%)	(3.9%)
Loans graded “C,” “D” and “E” as a percentage of total loans ⁽⁶⁾	5.6%	5.6%	5.1%	5.1%	6.2%	5.0%

- (1) Solely for the convenience of the reader, Peso amounts as of and for the three-month period ended March 31, 2020 and as of and for the year ended December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See "Exchange Rates and Currency."
- (2) Net income for the year divided by the average of the last five quarters of total assets, based on end-of-period balances (excluding minority interests). For the three-month period ended March 31, 2020, net income is determined on an annualized basis.
- (3) Net income for the year divided by the average of the last five quarters of stockholders' equity, based on end-of-period balances (excluding minority interests). For the three-month period ended March 31, 2020, net income is determined on an annualized basis.
- (4) Net interest income divided by the average of the last five quarters of total interest-earning assets, based on end-of-period balances (excluding minority interests). For the three-month period ended March 31, 2020, net income is determined on an annualized basis.
- (5) Efficiency ratio is equal to non-interest expense divided by the aggregate of net interest income and non-interest income (commissions and fees, intermediation revenues and other operating income). For this purpose, net interest income is calculated before allowance for loan losses.
- (6) Refers to our loan portfolio classified pursuant to the General Rules Applicable to Mexican Banks. Under applicable regulations, such classification is determined by reference to our loan portfolio at the end of the preceding quarter. See "Selected Statistical Information—Grading of Loan Portfolio."
- (7) Corresponds to end-of-year balance, which is different from guidelines prescribed by the CNBV regarding calculation of required additional reserves. See "Selected Statistical Information—Allowance for Loan Losses."

Capital Ratios

The table below presents our risk-weighted assets and Capital Ratios for the periods indicated.

	As of March 31,		As of December 31,			
	2020	2020	2019	2019	2018	2017
	(U.S. millions, except for percentages) ⁽¹⁾	(Ps. millions, except for percentages)	(U.S.\$ millions, except for percentages) ⁽¹⁾	(Ps. millions, except for percentages)		
Capital:						
Fundamental Capital (CET1).....	4,292	100,805	4,340	101,927	94,970	75,220
Additional Tier 1 Capital.....	2,000	46,969	1,607	37,728	18,865	20,103
Tier 2 Capital.....	391	9,194	374	8,783	14,472	13,286
Total Net Capital.....	6,684	156,968	6,321	148,438	128,307	108,609
Risk-Weighted Assets:						
Credit risk.....	27,687	650,213	26,696	626,953	627,479	507,721
Market risk.....	4,749	111,536	4,614	108,359	66,119	72,848
Operational risk.....	2,805	65,882	2,760	64,812	53,865	46,406
Total Risk-Weighted Assets.....	35,241	827,630	34,070	800,125	747,464	626,976
Capital Ratios (credit, market and operational risk):						
Fundamental Capital (CET1) to risk-weighted assets.....	12.18%	12.18 %	12.74%	12.74%	12.71 %	12.00 %
Tier 1 Capital to risk-weighted assets.....	17.86%	17.86 %	17.45%	17.45 %	15.23 %	15.20 %
Tier 2 Capital to risk-weighted assets.....	1.11%	1.11 %	1.10%	1.10%	1.94%	2.12 %
Total Net Capital to Total Risk-Weighted Assets.....	18.97%	18.97 %	18.55%	18.55%	17.17 %	17.32 %

- (1) Solely for the convenience of the reader, Peso amounts as of March 31, 2020 and as of December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “*Exchange Rates and Currency.*”

RISK FACTORS

Before making a decision to invest in the Notes, you should carefully consider the risks described below as well as the other information contained in this offering memorandum. Our business, financial condition and results of operations could be materially adversely affected by any of these risks. The risks described below are not the only ones we or prospective investors in the Notes in general face and the importance of the risk that we attribute to it today may change in the future. Additional risks and uncertainties not currently known to us or that we currently consider immaterial may also materially adversely affect our ability to make payments on the Notes.

Risks Relating to Our Business

Our operations and results have been impacted by the COVID-19 pandemic, which we expect will have a continued and likely material adverse effect on our business, results of operations and financial condition.

Since December 2019, the COVID-19 has spread throughout the world. On March 11, 2020, COVID-19 was categorized as a pandemic by the World Health Organization. On March 30, 2020, the Mexican Federal Government declared a health emergency as a result of the COVID-19 pandemic, announcing the implementation of several protective measures, including the suspension of any and all non-essential activities and a voluntary shelter in place order. These measures, as well as other measures implemented across the world, including border closures and travel restrictions, have led to a suspension or a material decrease of a significant number of commercial activities, including international flights, operation of hotels, restaurants, retail stores and other establishments, disruption of supply chains worldwide and falls in production and demand, among others, causing unprecedented commercial disruption in a number of jurisdictions, including Mexico.

In Mexico, several industries and sectors to which we have exposure have been particularly impacted by the COVID-19 pandemic and related economic disruption, including, but not limited to, transportation, tourism and restaurants, oil and gas and automotive industries. As of March 31, 2020, approximately 15.9% of our total loan portfolio was comprised of loans to borrowers in these sectors.

As a result of this disruption and other macroeconomic factors such as declining international crude oil prices, the World Bank estimated on June 8, 2020 that Mexico's GDP could contract by as much as 7.5% in 2020 and forecasts by several analysts and financial institutions estimate a more pronounced contraction. Furthermore, as of the date of this offering memorandum, the Mexican Central Bank has reduced the reference interest rate several times since the beginning of 2020, from 7.25% to 5.0%, and may continue to decrease it in the future.

In addition to the impact on human lives and the health of millions of people globally, the pandemic is expected to lead to sharp declines in the GDP of those countries which are most affected by the pandemic and have an overall negative impact on global GDP in 2020, increases in unemployment levels, a sharp deterioration in the valuation of financial assets and investments, increased volatility in the financial markets, including with respect to the value and trading of our debt securities, exchange rate volatility, an increase in loan defaults by both companies and individuals and increases in public debt due to actions taken by governmental authorities in response to the pandemic.

As of March 31, 2020, the Mexican peso had depreciated to Ps.23.4847 per U.S.\$1.00, a 24.5% depreciation since the beginning of 2020, and continuing volatility could cause the peso to depreciate even further. The Mexican government's shelter in place order and other related measures, in the context of a weakened economy, lower interest rates and a weaker exchange rate, have affected us both directly and indirectly, through an impact on our customers, counterparties, employees and other stakeholders, and these measures will continue to adversely affect us in the future by, among other things, decreasing lending volumes, decreasing fee-generating transactions, reducing margins on lending, putting pressure on our capitalization ratios, increasing our delinquency rates and past due loan ratios and requiring additional allowances for impairment of loans.

In response to the pandemic, some of our clients have drawn on credit lines and we anticipate that more of our clients could do so in the near future. While our liquidity position remains strong, we expect these draws to lead to a reduction in our liquidity ratio. Substantial draws in the future could again reduce our liquidity ratios and our overall liquidity.

In response to the outbreak and business disruption, first and foremost, we have prioritized the health and safety of our employees and clients and we have developed and implemented a plan covering several preventive measures

required to minimize the effects of the pandemic. The main items of said plan are listed below:

- Temporarily closed some of our branches in Mexico as a result of the COVID-19 pandemic. As of June 15, 2020, 15% of our branches remain closed. While we still have branches open as of the date of this offering memorandum, we may generally provide only a limited number of services through them; and
- Definition of staggered home office rotation for a significant number of our personnel. The measure aims to safeguard our employees, reducing the number of people in the same workspace and the exposure to public spaces, such as buses, subways and elevators, to mitigate the risks of virus transmission. See “Summary—Recent Developments—Measures We Have Adopted in Connection with the COVID-19.” Remote work has increased cybersecurity risks given greater use of computer networks outside the corporate environment (see “—We are subject to the risk of cybersecurity incidents and attacks that could result in a loss of customer data and other sensitive information, financial theft and regulatory penalties”).

As part of the actions taken to mitigate the impact of the COVID-19 pandemic, on March 25, 2020, the CNBV announced certain special temporary accounting criteria applicable to banks, which allow a partial or total deferral of principal and/or interest payments due on mortgages, credit cards, automobile, personal, payroll and SME loans that were not impaired as of February 28, 2020, for up to four months, with the possibility of extending it for an additional two months, without requiring banks to create loan-loss provisions for these deferrals. See “Summary—Recent Developments—Measures Adopted by the Mexican Government in Connection with the COVID-19.” In response to these measures, we launched a debtor relief program, offering debtors of such loans the possibility of deferring payment of principal and interest for up to four months. As of April 15, 2020, 18% of our total eligible portfolio had taken advantage of these measures.

If our clients default on their payment obligations at the end of the grace period provided by this program, or otherwise fail to timely comply with their obligations under our outstanding loans, this will result in higher levels of non-performing loans, leading to the recognition of additional allowances for impairment losses. Furthermore, defaults by our clients that are not covered by payment deferral measures enacted by the CNBV would also lead to increased recognition of allowances for impairment losses. We recognized new provision and impairment charges in an aggregate amount of Ps.4,868 million in the second quarter of 2020, in response to the expected increase in non-performing loans as a result of the pandemic, and we may recognize additional charges in the future. The impact on our allowance for impairment losses is currently uncertain, as it is highly dependent on the duration of the COVID-19 pandemic and the extent and length of the ensuing economic downturn.

The extent to which the COVID-19 pandemic impacts our results will depend on its duration and the level of continued disruption to Mexican, regional and global economic activity. Even though both the Mexican federal government and several states in Mexico have announced programs to progressively reopen their economies starting in June 2020, it is impossible to predict with certainty the duration of the pandemic, how the disease will evolve or the restrictions and preventive measures implemented by the government. In addition, customer habits, even following the pandemic and the termination of the governmental restrictions described above, may have been altered, which may have a material adverse effect on our business. Moreover, the spread of COVID-19 could also negatively impact the business and operations of third-party service providers who perform critical services for us. There can also be no assurance that the adverse impact of the COVID-19 pandemic will not lead to a tightening of liquidity conditions or funding uncertainty.

According to the temporary regulatory measures published by the CNBV on April 8, 2020, the Bank is enabled to use its Capital Conservation Buffer without triggering any sanctions or corrective measures, from April 1, 2020 to March 31, 2021. While this may imply a potential deterioration in the Capital Conservation Buffer (and the capital position of the Bank), as of the date of this offering memorandum, the Bank has not used its Capital Conservation Buffer.

Future developments with respect to COVID-19 are highly uncertain and new information may emerge concerning the severity of the COVID-19 pandemic and the actions taken to contain it. Furthermore, there are no indications that the Mexican government will be implementing extraordinary loan programs, tax relief or other forms of economic relief or financial assistance for private sector entities such as us. If the pandemic continues and further government programs are not initiated, or the ones in place are not effective, this could have a material adverse effect on us.

Any of the foregoing, and any future adverse conditions related to the COVID-19 pandemic not yet known, could have a material adverse effect on our business, financial condition and results of operations and adversely affect our ability to access capital and liquidity on financial terms acceptable to us or at all.

Our results of operations have been, and may continue to be, adversely affected by U.S. and international financial market and economic conditions.

Since 2008, financial systems worldwide have experienced periods and events of difficult credit and liquidity conditions and disruptions leading to less liquidity, greater volatility, loss of confidence in the financial sector, declining interest rates, currency devaluations, restrictions on the convertibility of funds and erosion of consumer confidence. Global economic conditions deteriorated significantly between 2007 and 2009, and many countries, including the United States, fell into recession. Although macroeconomic conditions have generally improved since 2012, the sharp decline and volatility in oil prices (including those triggered by the recent crude oil price disagreements between Russia and Saudi Arabia), uncertainty in global economic growth, a high volatility environment resulting from widespread illnesses or epidemics, including the COVID-19 pandemic and diverging monetary policies around the world have exacerbated global imbalances and risks. Many major financial institutions, including some of the world's largest global commercial banks, investment banks, mortgage lenders, mortgage guarantors and insurance companies, experienced, and some continue to experience, significant difficulties. Around the world there have also been runs on deposits at several financial institutions, numerous institutions have sought additional capital or have been assisted or taken over by governments, and many lenders and institutional investors have reduced or ceased providing funding to borrowers (including to other financial institutions). Within this context, volatility of oil prices beginning in 2014 and a reduction in Mexico's oil production, including as a consequence of the significant reduction of output agreed by members of the OPEC+ alliance in April 2020, to lift crude oil prices from 20-year lows, together with weaker-than-expected manufacturing activity in the U.S., constitute significant risks for the Mexican economy and its growth prospects, which could have an adverse effect on our business. In addition, normalization of U.S. monetary policy and different monetary policies around the world, might also have a negative impact on the Mexican economy and adversely affect our business and results of operations.

In particular, we may face, among others, the following risks related to international market and economic conditions:

- an economic downturn or insufficient recovery of the economy generally and the financial markets and any adverse social or political developments for any reason, including illnesses or epidemics such as the COVID-19 outbreak, which could result in reduced demand for financial products and services and may adversely impact our business, financial condition and results of operations;
- increased regulation of the financial industry. Compliance with such regulation will continue to increase our costs, may require us to increase our capital or reserves, may affect the pricing of our products and services, and may limit our ability to grow our loan portfolio or pursue business opportunities;
- trade disputes and barriers occurring around the globe;
- inability of corporate and individual borrowers to timely or fully comply with their existing obligations;
- the process we use to estimate losses inherent in our credit exposure requires complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of borrowers to repay their loans, as well as the operational risks we face. The degree of uncertainty concerning economic conditions may adversely affect the accuracy of these estimates, which may, in turn, impact the reliability of the process;
- the derivatives markets and similar operations, including volatility affecting those instruments, could impact financial systems and the solvency of their participants; and
- the value and liquidity of our portfolio of investment securities may be adversely affected.

Uncertainty remains concerning the future economic environment in the United States, Mexico and the international markets. There can be no assurance that local or global economic conditions as a whole will improve

significantly. Such economic uncertainty could have a negative impact on our business and results of operations. Global investor confidence remains cautious. A slowing or failing of the economic recovery in the U.S., the global economic effect of pandemics, such as the COVID-19 outbreak, fluctuations in crude oil prices, and the uncertainty of the U.S. monetary policy would likely aggravate the adverse effects of these difficult economic and market conditions on us and on others in the financial services industry. Increased disruption and volatility in the global financial markets could have a material adverse effect on us, including our ability to access funding, capital and liquidity on financial terms acceptable to us, if at all. If capital markets financing ceases to become available, or becomes excessively expensive, we may be forced to raise the rates we pay on deposits to attract more customers and/or become unable to maintain certain liability maturities. Any such increase in capital markets funding costs or deposit rates could have a material adverse effect on our interest margins and liquidity.

If all or some of the foregoing risks were to materialize, this could have a material adverse effect on our financial condition and our results from operations.

Our financial results are subject to fluctuations in interest rates and other market risks.

Market risk refers to the probability of variations in our net interest income, or in the market value of our assets and liabilities and securities positions, due to changes in interest rate and other market risk factors, such as exchange rates and equity market volatility. Changes in the above mentioned market risks affect the following areas, among others, of our business:

- our net interest income;
- our cost of funding;
- the value of our capital;
- the volume of loans we originate;
- the market value of our financial assets; and
- our gains and losses from the sale of loans and securities.

Interest rates are sensitive to many factors beyond our control, including increased regulation of the financial sector, monetary policies, domestic and international economic and political conditions and other factors. A significant portion of our assets, including our loans, are long-term assets. At the same time, a significant percentage of our financial borrowings are short-term. Variations in short-term interest rates could affect our net interest income, which comprises the majority of our revenue. When interest rates rise, we may be required to pay higher interest on our borrowings while interest earned on our assets may not rise as quickly, which could cause profits to grow at a reduced rate or decline in some parts of our portfolio. Accordingly, increases in short-term interest rates may reduce our net interest income, which could affect our ability to meet our short-term obligations. We monitor our interest rate risk using the Net Interest Margin (“NIM”) sensitivity, which is the difference between the return on assets and the financial cost of our financial liabilities based on a one-year time frame and a parallel movement of 100 basis points (1%) in market interest rates. As of March 31, 2020, the 1% NIM sensitivity was Ps.1,032 million.

If interest rates decrease, although this is likely to decrease our funding costs, it is likely to adversely impact the income we receive arising from our investments in securities as well as loans with similar maturities, which could in turn adversely affect our net interest income. In addition, we may also experience increased delinquencies in a low interest rate environment when such an environment is accompanied by high unemployment and recessionary conditions.

The market value of a security with a fixed interest rate generally decreases when interest rates rise, which may have an adverse effect on our earnings and financial position. In addition, we may incur costs (which, in turn, will impact our results) as we implement strategies to reduce future interest rate exposure. The market value of an obligation with an adjustable interest rate can be adversely affected when interest rates increase, due to a lag in the determination of a new interest rate and in the implementation of repricing terms.

Increases in interest rates may reduce gains or require us to record losses on sales of loans or securities. Until December 2018, the Mexican government engaged in “monetary restricting,” a monetary policy designed to reduce money supply by increasing interest rates. As a result, the Mexican interbank interest rate (*tasa de interés interbancaria de equilibrio*) increased between 2015 and December 2018, averaging 3.32%, 4.47%, 7.06% and 7.99% during 2015, 2016, 2017 and 2018, respectively. Recent international financial volatility and volatile oil prices as a result of geopolitical and economic factors, such as the USMCA negotiations, U.S. monetary policy normalization, the outbreak of the COVID-19 pandemic and the recent crude oil price disagreements between Russia and Saudi Arabia, among others, have had a negative impact on the Mexican economy, affecting macroeconomic variables, such as the exchange rate between U.S. dollars and Pesos. As a result, in August 2019, the Mexican Central Bank decreased the overnight interbank interest rate (*tasa de fondeo interbancario*) by 25 basis points to 8.00% and has continued to decrease the reference rate to 5.50% as of May 14, 2020.

We are also exposed to foreign exchange rate risk as a result of mismatches between assets and liabilities denominated in different currencies. Fluctuations in the exchange rate between currencies may negatively affect our ability to repay our foreign currency-denominated liabilities, net interest income, our earnings and the value of our balance sheet.

Furthermore, we are exposed to equity price risk in connection with our trading investments in equity securities. The performance of financial markets may cause adverse changes in the value of our investment and trading portfolios. The volatility of world equity markets due to the continued economic uncertainty has had a particularly strong impact on the financial sector. Continued volatility may affect the value and liquidity of our investments in entities in this sector and, depending on their fair value and recovery expectations, could become a permanent impairment, which would be subject to write-offs against our results. To the extent any of these risks materialize, our net interest income or the market value of our assets and liabilities could be adversely affected, impacting us.

Our loan and investment portfolios are subject to prepayment risk, which could negatively affect our net interest income.

Our loan and investment portfolios are subject to prepayment risk, which results from the ability of a borrower or issuer to pay a debt obligation prior to maturity. Generally, in a low interest rate scenario, prepayment activity increases, reducing the weighted average lives of our interest earning assets and therefore our expected results relating to these assets. To date, prepayment activity in our loan portfolio has not had a significant effect on our financial results, but if such activity were to increase, we would also be required to amortize net premiums into income over a shorter period of time, thereby reducing the corresponding asset yield and net interest income. Prepayment risk also might have a significant adverse impact on credit card and collateralized mortgage loans, since prepayments could shorten the weighted average life of these portfolios, which would negatively impact our business, financial condition and results of operation. Prepayment risk is inherent to our commercial activity and an increase in prepayments could have a material adverse effect on us.

We engage in transactions with our parent GFNorte and its subsidiaries or affiliates that may not be on an arm’s-length basis.

No assurance can be given that transactions between us and our parent GFNorte or any of its subsidiaries or affiliates have been or will be conducted on a basis as favorable to us as could be obtained by us from unaffiliated parties. For example, we have also entered into certain service agreements with our affiliates Casa de Bolsa Banorte, S.A. de C.V. (“Casa de Bolsa Banorte”), Operadora de Fondos Banorte, S.A. de C.V., Seguros Banorte and Pensiones Banorte, S.A. de C.V., to allow these companies to offer their products and services within our branch network in consideration for certain fees. In addition, we, GFNorte and other subsidiaries or affiliates have entered into a number of agreements providing for the sharing of revenues or expenses in connection with the performance of certain activities, including loan recovery.

Mexican law applicable to publicly traded companies and financial groups and institutions, as well as our bylaws, provide for several procedures designed to ensure that the transactions entered into with or among companies in our financial group are carried out on an arm’s-length basis, including the requirement that our Board of Directors approve such transactions and that transactions with affiliates do not exceed certain thresholds.

We are likely to continue to engage in transactions with our parent and any of its subsidiaries or affiliates, and no assurance can be given that we will do so on an arm’s-length basis. In addition, future conflicts of interest between

us and GFNorte or any of its subsidiaries or affiliates may arise, which conflicts are not required to be and may not be resolved in our favor. See “*Related Party Transactions*.”

While in the past the CNBV has not disagreed with our determinations that the terms of these transactions are “substantially on market conditions,” we can provide no assurances that the CNBV will agree with any of our future determinations. There can be no assurance that future transactions involving GFNorte or any of its subsidiaries or affiliates will not have an adverse effect on our financial position.

Resources could be diverted, or our business or business opportunities could be diverted, to other entities within the financial group controlled by GFNorte, or operations of other subsidiaries of GFNorte may be transferred to us.

We are part of a financial group controlled by GFNorte. Other entities within the group include, among others, Sólida Administradora de Portafolios, S.A. de C.V. (“Sólida”), which maintains some non-performing loan portfolios, and Casa de Bolsa Banorte, which maintains trading positions. GFNorte could, at any time, devote more resources or divert our business or business opportunities to other subsidiaries of GFNorte that directly or indirectly compete with us, as well as transfer certain operations of other subsidiaries of GFNorte to us, on grounds of capital efficiency, regulatory constraints or other criteria. Sólida generated Ps.145 million in losses for the three-month period ended March 31, 2020, Ps.172 million in losses for the year ended December 31, 2019 and Ps.797 million for the year ended December 31, 2018. Casa de Bolsa Banorte contributed 2.3% of GFNorte’s net income for the three-month period ended March 31, 2020 and approximately 2.4% of GFNorte’s net income in 2019. Sólida currently has no employees of its own and primarily relies upon Banorte to conduct its business. Should more of our resources be diverted, or our business or business opportunities be diverted, to other subsidiaries of GFNorte, or if unprofitable operations of other subsidiaries of GFNorte are transferred to us, our financial position and results of operations could be adversely affected.

We may be unable to successfully implement and continue to improve our credit risk management system, which could substantially and adversely affect our results of operations and financial position.

As a commercial bank, one of the principal types of risks we face is credit risk. Our credit risk management system may not effectively identify and quantify our credit risk exposure. For example, an important part of our credit risk management system is to employ an internal credit rating system to assess the particular risk profile of a customer. As this process involves detailed analyses of the customer or credit risk, taking into account both quantitative and qualitative factors, it involves judgments by our management team and employees and, therefore, it is subject to human error. In exercising their judgment, our employees may not always be able to assign an accurate credit rating to a customer or credit risk or to effectively identify the risks relating to the business, industry or region where a customer operates, which may result in a higher credit risk exposure for us than indicated by our risk rating system. In addition, we have been trying to refine our credit policies and guidelines to address potential risks associated with particular industries or types of customers, such as affiliated entities and group customers. However, we may not be able to timely detect these risks before related losses occur, or due to limited resources or tools available to us, our employees may not be able to effectively implement them, which may increase our credit risk. As a result, our failure to effectively implement, consistently follow or continuously refine our credit risk management system may result in a higher risk exposure for us, which could materially and adversely affect our results of operations and financial position.

In assessing customers’ creditworthiness, we rely largely on the credit information available from our own internal databases, the Mexican credit bureaus and other sources. Due to limitations in the availability of information and the developing information infrastructure in Mexico, our assessment of credit risk associated with a particular customer may not be based on complete, accurate or reliable information. We cannot assure you that our credit scoring systems collect complete or accurate information reflecting the actual behavior of customers or that their credit risk can be assessed correctly. Without complete, accurate and reliable information, we have to rely on other publicly available resources and our internal resources, which may not be effective. As a result, our ability to effectively manage our credit risk and subsequently our impairment losses and allowance for impairment losses may be materially adversely affected.

The credit card industry is highly competitive and entails significant risks, including the possibility of over-indebtedness of customers.

The credit card industry in Mexico is dominated by institutions that may possess greater financial resources and broader coverage in this market than we do. There is no assurance that we will be able to effectively compete for and retain customers in this competitive segment. Moreover, our credit card business is subject to a number of risks and uncertainties, including the possibility of over-indebtedness of our customers, their economic condition and level of employment and income. Part of our current growth strategy is to increase volume in the credit card portfolio, at the same or a slightly faster rate than the market, which may increase our exposure to risk in our loan portfolio, which could have a material adverse effect on us.

Furthermore, credit card products are characterized by higher consumer default than other consumer credit products, and defaults are highly correlated with macroeconomic indicators that are beyond our control, such as the recent COVID-19 pandemic. If Mexican economic growth slows or declines or if we fail to effectively analyze the creditworthiness of our customers, we may be faced with unexpected losses that could have a material adverse effect on us, including our financial condition and results from operations.

We may be unable to effectively control the level of non-performing or low credit quality loans in our loan portfolios and our loan loss reserves may be insufficient to cover actual loan losses.

Non-performing or low credit quality loans can negatively impact our results of operations. We cannot assure you that we will be able to effectively collect impaired loans or control and reduce the level of the impaired loans in our loan portfolio. In particular, the amount of our reported non-performing loans may increase in the future as a result of growth in our loan portfolio or factors beyond our control, such as the impact of a global financial crisis and macroeconomic trends and political events affecting Mexico or events such as the COVID-19 pandemic affecting certain industries to which we lend including, in the case of COVID-19, transportation, export and import, tourism, hotels, restaurants, oil and gas and automotive industries.

As of March 31, 2020, December 31, 2019 and December 31, 2018, the aggregate outstanding principal amount and accrued interest of loans to our 15 largest clients (including loans to a single commercial group or to the Mexican government) represented 18.0%, 17.6% and 19.7%, respectively, of our total loan portfolio (on an unconsolidated basis). If the financial well-being of any of these clients were to be negatively impacted by political, economic or industry-related developments or any other factor, it could lead to an increase in our non-performing or low credit quality loans.

On March 25, 2020, in order to mitigate the economic impact of the COVID-19 pandemic, the CNBV announced certain special temporary measures applicable to banking institutions, including, among others, the total or partial deferral of principal and/or interest payments by debtors of mortgages, credit cards, automobile, personal, payroll, and SME loans that were in good standing as of February 28, 2020, for up to four months (with the possibility to extend them for two additional months). Even though, as established by the CNBV, we are not required to create loan-loss provisions for these deferrals, such temporary measures and any other measures to be taken by the Mexican federal government with respect to the COVID-19 pandemic, may adversely impact our business and financial condition. See “Recent Developments – Measures Adopted by the Mexican Government in Connection with the COVID-19.

In addition, our loan loss reserves, even with the provision to be created in the second quarter of 2020, may not be adequate to cover an increase in the amount of non-performing loans or any future deterioration in the overall credit quality of our total loan portfolio. Our loan loss reserves, which are calculated in accordance with CNBV regulations and under internal models in the case of credit card and enterprises portfolios, are based on our current assessment of, and expectations concerning, various factors affecting us, including the quality of our loan portfolio. These factors include, among others, our borrowers’ financial condition, repayment abilities and repayment intentions, the realizable value of any collateral, the prospects for guarantor support, government macroeconomic policies, interest rates and the legal and regulatory environment. As a result, there is no precise method for predicting loan and credit losses, and we cannot assure you that our loan loss reserves are or will be sufficient to cover actual losses.

If our assessment of, and expectations concerning, the above-mentioned factors differ from actual developments; if the quality of our total loan portfolio deteriorates, for any reason, including an increase in lending to individuals and SMEs, an increase in our credit card portfolio and our introduction of new products; or if future actual losses exceed our estimates of incurred losses, we may be required to increase our provisions and allowance for loan losses, which

may adversely affect us. If we are unable to control or reduce the level of our non-performing or low credit quality loans, or to adequately reserve such loans, our financial position and results of operations could be materially and adversely affected.

We have experienced asset quality problems, including with respect to collateral, and have reported relatively large loan loss provisions.

The asset quality of our loan portfolio, including with respect to collateral, has been negatively affected by the unfavorable financial and economic conditions prevailing in Mexico following the global financial crisis that commenced in 2008. Mexican regulatory authorities and the banking system responded to this situation in several ways, including making revisions to Mexican Banking GAAP, including allowing for the reclassification of certain “available for sale securities” to “held to maturity securities” and broadening the class of securities available for repurchase. Other regulatory responses have included imposing more stringent loan loss reserve requirements and capitalization standards, as well as adopting a number of programs designed to provide relief to Mexican borrowers in connection with the granting and restructuring of outstanding loans. Such reserve requirements could have a direct adverse impact on our financial results. Unfavorable financial and economic conditions in Mexico and these regulatory initiatives have caused the Mexican banking sector to experience asset quality problems and to record relatively large loan loss provisions. See “*Selected Statistical Information—Non-Performing Loan Portfolio*.” We also believe that recoveries from those non-performing loans as a percentage of the non-performing loan portfolio are likely to decline over time as a consequence of the aging of such non-performing loan portfolio, as well as the decreased value of the collateral supporting these loans.

Moreover, in Mexico, foreclosure procedures are generally subject to delays and procedural uncertainties and administrative requirements that may result in lower levels of recovery on collateral compared to its value. In addition, other factors such as defects in the perfection of our security interests, fraudulent transfers by borrowers, attachments by other creditors obtaining priority over collateral or a reduction in the value or liquidity of the collateral may impair our ability to recover on our collateral. Accordingly, there can be no assurance that we will be able to realize the full value of our collateral.

Lower recovery rates, asset quality deterioration, decreased value of collateral and lower levels of recovery on collateral compared to its value could have a material and adverse effect on our business, financial condition and results of operations.

The rules applicable to loan loss provisions have been modified throughout time.

In an effort to conform its regulations to the recommendations issued by the Basel Committee on Banking Supervision (the “Basel Committee”), since 2009, the Mexican government has implemented new rules regarding the methodology that Mexican banks must use to classify loans and to determine loan loss provisions. The new regulatory framework shifted away from an accrued losses methodology to an expected losses methodology. This new methodology has been implemented in phases, as follows:

- in 2009, for credit card loans;
- in 2011, for consumer, mortgage and government loans;
- in 2013, for commercial loans;
- in 2014, for loans to financial institutions;
- In 2015, for revolving consumer loan portfolio;
- In 2017, for term loans and mortgages, as well as to accounting for loan losses and write-offs; and
- In 2018, for reserves and capital related to our credit card loan portfolio.

Additionally, in 2015, the CNBV adjusted the rating methodology for non-revolving consumer and mortgage loan portfolios, which remains based on expected losses and incorporates new factors based on recent information on the

industry's performance. In addition to taking into consideration the borrower's experience with the financial institution granting the loan, the most significant change introduced by the new methodology is that it considers information provided by credit information companies about the credit behavior of the borrower with other financial institutions. The new methodology for revolving consumer loan portfolios became effective on June 1, 2017.

In January 2018, the CNBV approved Banorte's adoption of an advanced internal rating-based model to estimate the provisions and capital requirements for credit risk of revolving consumer loans. This new methodology is calibrated with the borrower's historic credit relationship with Banorte and other institutions.

In addition, in the first quarter of 2019, the CNBV approved Banorte's adoption of a basic internal model for commercial loans to estimate the provisions and capital requirements for corporations (other than states, municipalities and financial entities), and individuals (sole proprietorships), both with annual sales equal to or higher than 14 million UDIs.

The CNBV has completed a project to update the accounting framework applicable to credit institutions, which aims to converge with the latest changes in international financial reporting standards regarding the classification and measurement of financial instruments, update the current revenue recognition standard, the leasing standard, as well as the adoption of a new Mexican standard relating to the determination of fair value and its disclosure. These new standards will become effective on January 1, 2022.

In the future, the CNBV could modify the accounting rules applicable to loan loss allowances, and further modify the methodology to measure credit risk or the requirements for loans loss provisions of other portfolios. Any such modifications could require us to increase our allowance for loan losses and, therefore, adversely affect our results of operations and financial position.

The retail banking market is exposed to macroeconomic shocks that may negatively impact household income, and a downturn in the economy could result in increased loan losses.

One of our main strategies is to grow our retail loan portfolio. The recoverability of our existing retail loan portfolio, our ability to increase our loans outstanding and, in general, our results of operations and financial condition, may become increasingly vulnerable to macroeconomic shocks (such as the outbreak of COVID-19) that could negatively impact the household income of our retail customers and result in increased loan losses, which in turn could have a material adverse effect on us. The Mexican economy has historically experienced cycles of growth followed by slowdowns; for example, although Mexican GDP has grown since 2010, it suffered a mild contraction of the GDP of 0.1% in 2019, and an additional contraction of 2.2% in the first quarter of 2020. We can provide no assurance that previously observed GDP growth rates will continue.

Furthermore, because the penetration of bank lending products in the Mexican retail sector historically has been low, there is little basis on which to evaluate how the retail sector will perform in the event of an economic crisis, such as a recession or a significant devaluation, among others. Consequently, our historical loan loss experience may not be indicative of the performance of our loan portfolio in the future.

We maintain lower levels of capital or reserves in connection with our loans to Mexican federal, state and municipal governments.

The Mexican Capitalization Requirements and the rules governing the creation of reserves for loan losses applicable to credit institutions generally require significantly lower capitalization levels or reserves (if any) in connection with loans made to Mexican federal, state or municipal governments (together, the "Government Loans"). As of March 31, 2020, our Government Loans amounted to Ps.161,281 million, or 20.8% of our total gross loan portfolio. Although as of March 31, 2020, we had only Ps.35 million in Government Loans categorized as non-performing loans, an additional deterioration in the credit quality of our Government Loans could result in an adverse impact on our financial position and results of operations. The magnitude of this impact would be a function of the size of our exposures to the relevant government entities, the extent of the deterioration in their internal credit ratings assigned by our risk management area according to the methodology approved by the CNBV and the guarantees of these loans, among other factors.

Some of our loans to Mexican states and municipalities may be renegotiated.

The Mexican government and commercial banks, including us, have from time to time agreed to modify the terms of Government Loans. Such modifications have included maturity extensions, amendments to collateral received, reductions in interest rates and the inclusion of prepayment features and/or options. As of March, 2020, Ps.20,941 million of these loans, or 18.5% of our total state and municipal government loan portfolio, have been renegotiated. There can be no assurance that these or other Government Loans will not be similarly renegotiated in the future in a way that could reduce our margins in this line of business, which could adversely affect our results of operations.

We can provide no assurance that in the event that borrowers in our state and municipal government segment or our federal government segment implement any plan to reduce their cost of funding, the loans that we have granted to such borrowers will not be renegotiated on terms favorable to us or early repaid. Any such renegotiation or early repayment could adversely affect our business, financial condition and results of operations.

Many of our loans to Mexican states and municipalities are secured by cash flows from the Mexican federal government.

Most of our loans to Mexican states and municipalities are secured by such entities' right to receive their corresponding allocation of *participaciones federales*. Any changes to Mexican laws and regulations regarding the use of *participaciones federales* as source of payment for these type of loans or defects in the perfection of such collateral, may require amendments to our credit facilities and may impact the credit risk of such facilities or the manner in which we conduct business with Mexican states and municipal governments, which in turn could affect our results of operations and financial position.

Furthermore, as *participaciones federales* are subject to the conditions of the Mexican economy and the federal government's tax collections, we cannot give any assurances that the *participaciones federales* will remain at their current funding level or that they will be sufficient for the timely performance of Government Loans. If *participaciones federales* are reduced as a result of changes to Mexican laws and regulations or for any other reason, our results of operations and financial condition could be adversely affected.

Defects in the perfection of our security interests or fraudulent transfers by borrowers may impair our ability to recover on our collateral. Accordingly, there can be no assurance that we will be able to realize the full value of our collateral, or timely realize the full value of our collateral, in connection with financings made to Mexican state and municipal governments. If we are not able to realize the full value of our collateral, our results of operations and financial condition could be adversely affected.

The future of government sector lending in Mexico is uncertain.

Our business is subject to a continuously evolving regulatory regime of financial service laws, regulations, administrative actions and policies in each Mexican state in which we operate. In particular, due to certain high profile restructurings of Mexican state and municipal debt, in April 2016, the Mexican Congress approved certain amendments related to government sector lending. As a result, state and municipal governments are now subject to the Law of Financial Discipline for States and Municipalities (*Ley de Disciplina Financiera de las Entidades Federativas y los Municipios*), which seeks to organize and align budgetary and financial instruments of the states, municipalities and their agencies, as to ensure sustainable management of local public finances. This law establishes general principles of financial discipline, including, among others, rules on the incurrence of indebtedness and a registry for such indebtedness applicable to states and municipalities. Although we expect the measures will help to achieve healthier public finances and transparent investment of government debt, the implementation of these provisions will be gradual and the full benefits of the new standards may take between one to six years to materialize; therefore, we cannot predict the impact they will have on our business.

Additionally, although state and municipal public debt is regulated by state law in Mexico, there are certain provisions and limitations set forth in the Mexican Federal Constitution and other federal laws (including in the Law of Financial Discipline for States and Municipalities), especially in connection with the use of *participaciones federales* as a source of payment or as a public funding investment. In the past, there have been inconsistencies between state and federal law with respect to these uses of *participaciones federales*, which have been addressed by the Mexican Supreme Court. Some of these judgments have had an adverse effect on the manner in which Government Loans have been granted. We cannot ensure that future judicial interpretations or resolutions, or new

policies implemented by the Mexican government (which stepped into office on December 1, 2018), will not have an adverse effect on our Government Loan portfolio and our results of operations.

Our borrowers that are Mexican federal, state or municipal governments or agencies may claim privileges under Mexican law, and our ability to sue and recover may be limited.

In Mexico, foreclosure procedures may be subject to delays and administrative requirements that may result in lower levels of recovery on collateral compared to its value. Article 9 of the Fiscal Coordination Law (*Ley de Coordinación Fiscal*) provides that *participaciones federales* used by states or municipalities may not be subject to attachment or liens, may not be assigned or subject to retention or withholding, except that they may be used to satisfy payment obligations of such states and municipalities, provided they have the authorization of the state's congress and are registered with the SHCP in the Registry of Obligations and Loans of the States (*Registro de Obligaciones y Empréstitos de Entidades Federativas*).

In addition, Article 4 of the Mexican Federal Code for Civil Procedure (*Código Federal de Procedimiento Civiles*) does not allow attachment prior to judgment or attachment in and of execution upon a judgment by a Mexican court upon any of the assets of the federal, state or municipal governments. As a result, the ability to enforce judgment against such governments or agencies, upon the occurrence of a default, may be limited, and this could materially affect our business, financial condition and results of operation. Furthermore, other factors such as defects in the perfection of our security interests, fraudulent transfers by borrowers or a reduction in the value or liquidity of the collateral may impair our ability to recover on our collateral. Accordingly, we can give no assurance that we will be able to realize the full value of our collateral or realize it in a timely manner. Furthermore, many secured creditors may compete for collateral granted by state or municipal governments, as *participaciones federales* are available, on a pro rata basis, to secured creditors. As a result, lower recovery rates, asset quality deterioration and decreased value of collateral could have a material and adverse effect on our results of operations and financial position.

Liquidity and funding risks are inherent to our business.

Liquidity risk is the risk that we either do not have available sufficient financial resources to meet our obligations as they fall due or can secure them only at excessive cost. This risk can be heightened by a number of company-specific factors, including over-reliance on a particular source of funding, changes in credit ratings or market-wide phenomena such as market dislocation. While we have liquidity management processes designed to mitigate and control these risks, unforeseen systemic market factors in particular make it difficult to completely eliminate these risks. Adverse and continued constraints in our liquidity, including interbank lending, has affected and may materially and adversely affect the cost of funding our business, and extreme liquidity constraints may affect our current operations and our ability to fulfill regulatory liquidity requirements, as well as limit growth possibilities. Disruption and volatility in the global financial markets could also have a material adverse effect on our ability to access capital and liquidity on financial terms acceptable to us.

In the past many Mexican banks have suffered severe liquidity problems as a result of a financial crisis in Mexico, particularly in connection with refinancing short- and medium-term U.S. dollar liabilities in the international capital markets. No assurance can be given that liquidity problems will not affect the Mexican banking system again or that liquidity constraints will not affect us in the future. While we expect to be able to pay or refinance our projected liabilities, no assurance can be given that we will be able to repay such liabilities or refinance such liabilities on favorable terms.

We rely, and will continue to rely, primarily on customer deposits to fund lending activities. The ongoing availability of this type of funding is sensitive to a variety of factors outside our control, such as general economic conditions and the confidence of customer depositors in the economy, in general, and the financial services industry in particular, the availability and extent of deposit guarantees, and competition between banks for deposits. Any of these factors could significantly increase the amount of customer deposit withdrawals in a short period of time, thereby reducing our ability to access customer deposit funding on appropriate terms, or at all, in the future. If these circumstances were to arise, this could have a material adverse effect on our operating results, financial condition and prospects.

We anticipate that customers in Mexico will continue in the near future to demand short-term deposits (particularly demand deposits and short-term time deposits) and loans and that we will maintain our reliance on the use of deposits as a source of funding. The short-term nature of this funding source could cause liquidity problems

for us in the future if deposits are not made in the volumes we expect or are not renewed. As of March 31, 2020, 57.1% of our local and foreign currency deposits had remaining maturities of one year or less or were payable on demand. In the past, a substantial portion of such customer deposits have been rolled over upon maturity or maintained with us (in the case of deposits payable on demand) and, as a result, such deposits have over time been a stable source of funding. No assurance can be given, however, that customers will continue to roll over or maintain their deposits with us. If a substantial number of our customers fail to roll over their deposits upon maturity or withdraw their deposits, our liquidity position could be adversely affected, and we may be required to seek funding from more expensive sources, affecting our financial condition and results of operations.

We are exposed to volatility in Peso exchange rates and interest rates in Mexico.

We are exposed to currency risk any time we hold an open position in a currency other than Pesos and to interest rate risk when we have an interest rate re-pricing gap or carry interest-earning securities having fixed real or nominal interest rates. Peso exchange rates and interest rates in Mexico have been subject to significant fluctuations in recent years. Because of the historical volatility in Peso exchange rates and interest rates in Mexico, the risks associated with such positions may be greater than in certain other countries. Exchange rates and interest rates have experienced considerable volatility in recent years.

As of March 31, 2020, the expected shortfall associated with our financial instruments sensitive to interest rates was U.S.\$3.49 million (Ps.81.9 million). Although we follow various risk management procedures in connection with our trading and treasury activities, there can be no assurance that we will not experience losses with respect to these positions in the future, any of which could have a material adverse effect on our results of operations and financial position. See “*Selected Statistical Information—Interest Rate Sensitivity of Assets and Liabilities*” and “*Risk Management*.” In addition, our foreign currency liabilities are subject to regulation by the Mexican Central Bank, which imposes liquidity requirements in matching currencies, depending upon the maturities of such liabilities.

Depreciation of the Peso may have an adverse effect on us by, for example, increasing in Peso terms the amount of our foreign currency-denominated liabilities and the rate of default among our borrowers or affecting our results of operations when measured in U.S. dollar terms. It may also result, as in the past, in the implementation of exchange controls that may impact our ability to convert Pesos into U.S. dollars or to transfer currencies outside of Mexico, which may have a negative impact on our ability to pay our U.S. dollar-denominated liabilities and on our financial condition.

As of December 31, 2018, the Peso had appreciated 0.06%, to Ps.19.6512 per U.S. dollar as compared to the exchange rate of Ps.19.6629 per U.S. dollar as of December 31, 2017. As of December 31, 2019 the Peso had appreciated 4.00%, to Ps.18.8642 per U.S. dollar as compared to the exchange rate of Ps.19.6512 per U.S. dollar as of December 31, 2018. As of March 31, 2020 the Peso had depreciated 24.5%, to Ps.23.4847 per U.S. dollar as compared to the exchange rate of Ps.18.8642 per U.S. dollar as of December 31, 2019. As of July 3, 2020 the Peso has appreciated to Ps.22.4147 per U.S. dollar. The Peso continues to be affected by uncertainty and volatility in the global markets. The Mexican government has implemented a series of measures to limit the volatility of the Peso. However, we cannot assure you that such measures will be effective or maintained or how such measures will impact the Mexican economy.

In recent years, the overnight interbank rate in Mexico has been relatively stable, with historical closings at 7.25%, 8.25%, and 7.25% in 2019, 2018 and 2017, respectively; however, as a consequence of the COVID-19 pandemic and other macroeconomic factors, the Mexican Central Bank has reduced the overnight interbank rate several times in 2020, to 5.50% as of May 14, 2020. International financial volatility and the external environment have had a negative impact over the Mexican economy. Furthermore, geopolitical and economic uncertainty have affected macroeconomic variables, such as the exchange rate between U.S. dollars and Pesos.

There can be no assurance that such interest rates will increase in the future. A sustained increase in interest rates will also raise our funding costs and may reduce our loan demand, especially among consumers. Rising interest rates may therefore require us to re-balance our asset portfolio and our liabilities in order to minimize the risk of potential mismatches and maintain our profitability. In addition, rising interest rate levels may adversely affect the Mexican economy and the financial position and repayment ability of our corporate and retail borrowers, including holders of our credit cards, which, in turn, may lead to a deterioration in our asset quality.

In addition, the Mexican economy has suffered balance of payment deficits and shortages in foreign exchange

reserves in the past. While the Mexican government, for more than seventeen years, has not restricted the ability of Mexican and foreign individuals or entities to convert Pesos to U.S. dollars, we cannot assure you that the Mexican government will not institute restrictive exchange control policies in the future. To the extent that any such restrictive exchange control policies were to be instituted in the future in the event of shortages of foreign currency, our ability to transfer or convert Pesos into U.S. dollars and other currencies to service our foreign currency obligations, including the Notes, would be adversely affected and foreign currency may not be available without substantial additional cost.

Severe devaluation or depreciation of the Peso may also result in government intervention, as has occurred in other countries, or disruption of international foreign exchange markets. While the Mexican government does not currently restrict, and for many years has not restricted, the right or ability of Mexican or foreign persons or entities to convert Pesos into U.S. dollars or to transfer other currencies outside of Mexico, the Mexican government has taken such measures in the past and could institute restrictive exchange control policies in the future. Accordingly, fluctuations in the value of the Peso against the U.S. dollar could have a material adverse effect on us and impair our ability to make payments under the Notes.

We are subject to market and operational risks associated with derivative transactions, as well as structuring risks and the risk that documentation will not incorporate accurately the terms and conditions of derivative transactions.

We enter into financial derivative transactions primarily for hedging purposes and, to a lesser extent, on behalf of our customers. Accordingly, we are subject to market and operational risks associated with these transactions, including basis risk (the risk of loss associated with variations in the spread between the asset yield and the funding and/or hedge cost) and credit or default risk (the risk of insolvency or other inability of the counterparty to a particular transaction to perform its obligations thereunder).

Mexican courts have limited experience in dealing with issues related to derivative transactions, as most disputes have typically been resolved through negotiations among Mexican financial institutions. As a result, the outcomes of disputes regarding derivatives reaching the Mexican judicial system are not fully predictable. Derivative transactions are usually documented under ISDA master agreements or similar agreements that differ from agreements typically used in the Mexican market, which further increases the unpredictability of their interpretation by Mexican courts. Given that for certain of our financial derivative transactions the derivative market is not yet as developed in Mexico as in other jurisdictions, there are added structuring risks and the risk that our documentation will not incorporate accurately the terms and conditions of such derivative transactions.

Our ability to adequately monitor, analyze and report derivative transactions continues to depend, to a great extent, on our IT systems and our ability to hire and retain qualified personnel, which further increases the risks associated with these transactions and could have a material adverse effect on us.

We are subject to consumer laws that may limit the activities of Mexican banks.

The Mexican National Commission for the Protection and Defense of Financial Service Users (*Comisión Nacional para la Protección y Defensa de los Usuarios de Servicios Financieros*) (the “CONDUSEF”) has broad powers to regulate our activities and activities of other Mexican banks, and is entitled to:

- order amendments to our standard form commercial banking documentation (such as loan and account agreements), if CONDUSEF deems that provisions included in such agreements are detrimental to users;
- order the attachment of our assets for the benefit of our customers; and
- initiate class actions for the benefit of groups of customers.

CONDUSEF has broad and discretionary authority to take this and other similar actions, including the imposition of laws and the publication of information, such as imposing fines that may be detrimental to our business and reputation. Actions taken by CONDUSEF against us, whether on an isolated or recurrent basis, may have a material impact on us.

We may need additional capital in the future, and may not be able to obtain such capital on acceptable terms, or at all.

In order to grow, remain competitive, enter into new businesses and meet regulatory capital adequacy requirements, we may require additional capital in the future. Moreover, we may need to raise additional capital in the event of large losses in connection with any of our activities that result in a reduction of our shareholders' equity. Our ability to obtain additional capital in the future is subject to a variety of uncertainties, including:

- our future financial position, results of operations and cash flows;
- any necessary government regulatory or corporate approvals;
- public health and economic consequences in Mexico and abroad of the COVID-19 pandemic;
- general market conditions for capital-raising activities by commercial banks and other financial institutions;
- the trading value of our equity or debt securities in the secondary market;
- any reduction in our credit rating or the credit rating of our subsidiaries; and
- social, economic, political and other conditions in Mexico and elsewhere.

We may not be able to obtain needed capital in a timely manner or on acceptable terms or at all.

Downgrades in our credit ratings or those of any of our subsidiaries would increase our cost of borrowing and negatively impact our ability to raise new funds, attract deposits or renew maturing debt.

Our credit ratings are an important component of our liquidity profile. Among other factors, our credit ratings are based on the financial strength, credit quality and concentrations in our loan portfolio, the level and volatility of our earnings, our capital adequacy and leverage, the liquidity of our balance sheet, the availability of a significant base of core retail and commercial deposits, and our ability to access a broad array of wholesale funding sources. Our lenders and counterparties in financial derivative transactions are sensitive to the risk of a ratings downgrade. Changes in our credit ratings would increase the cost of raising funds in the capital markets or of borrowing funds or could restrict our participation in certain activities. In addition, our ability to roll over maturing debt may be more difficult and expensive. There can be no assurance that rating agencies will maintain our current ratings or outlook.

On March 26, 2020, S&P downgraded Mexico's long-term foreign currency and local currency ratings to "BBB" (from BBB+) and to "BBB+" (from A+), respectively. The downgrade reflected the expected economic impact of the combined shocks of COVID-19 in Mexico and in the U.S. and lower global oil prices. As a result of Mexico's weakening economic resilience, S&P took various rating action on financial institutions. Banorte's rating was lowered to BBB (from "BBB+") on global scales and our Junior Subordinated Securities to BB- from BB.

Fitch Ratings downgraded Mexico's sovereign debt on April 15, 2020, reflecting an assessment of the overall financial capacity of the government of Mexico to pay its obligations and its ability to meet its financial commitments as they become due, from BBB to BBB- citing increased risk due to PEMEX's deteriorating credit profile and weakness in the macroeconomic outlook due to, among other things, trade tensions. In addition, Moody's downgraded Mexico's rating on April 17, 2020, from A3 to Baa1, maintaining the negative outlook. On the same date, Fitch Ratings also revised the outlook of Mexico's state oil company, PEMEX, from stable to negative, citing insufficient investment to restore declining production. These downgrades could adversely affect the Mexican economy and, consequently, our ratings as well as our business, financial condition, operating results and prospects.

On April 21, 2020, Fitch Ratings announced it conducted a portfolio review of Mexican banks with international scale ratings following the downgrade of the country's sovereign rating, lowering Banorte's rating to BBB- from BBB. According to Fitch Ratings, the ratings primarily reflect our risk appetite, which results in higher-than-peers exposure to government-related businesses. Although Fitch believes we have a good financial profile to face the challenges of the operating environment, our financial metrics could weaken relative to previous performance, which is reflected in

the rating downgrade and negative outlook. We have been resilient over the past years to a deteriorating operating environment, with a growing franchise, high profitability, sound impairment ratios as well as what we believe is a good funding and liquidity profile; however, if the operating environment continues to worsen, our ratings could face larger downside potential relative to peers due to our more concentrated business mix.

While the ultimate economic and financial market implications of the COVID-19 pandemic are unclear, Fitch Ratings considers the already deteriorated and challenging operating environment to be clearly skewed to the downside, which has driven the agency's adjustment on the operating environment mid-point score to BB+ from BBB with a negative outlook. Fitch Ratings' assessment of the operating environment has a direct influence on bank ratings, and for many banks this is a high influence rating factor. Fitch Ratings expects deteriorating operating conditions from the COVID-19 outbreak to pressure asset quality and weigh on earnings due to lower loan growth, decreasing interest rates and higher credit costs over the medium term.

On April 22, 2020, Moody's downgraded to Baa1, from A3, our long-term global local and foreign currency deposit, issuer and debt ratings. In the same rating action, Moody's affirmed our Aaa.mx/MX-1 long- and short-term Mexican National Scale ratings. The outlook of Banorte remains negative according to Moody's. The reasons for these actions were (1) Mexico's medium-term economic growth prospects have materially weakened, (2) the continued deterioration in PEMEX's (Ba2 negative) financial and operational standing is eroding the sovereign's fiscal strength, and (3) weakened policy making and institutional capacity. The rating actions reflect the high inter-linkages between Mexican banks' ratings and those of the sovereign as a result of holdings of government bonds for liquidity purposes or lending to entities such as state-owned enterprises or regional and local governments that benefit from cash flows from revenues of the federal government. Moreover, the global spread of the COVID-19 is resulting in simultaneous supply and demand shocks. Moody's expects these shocks to materially slow global economic activity, particularly in the first half of this year. In Mexico, according to Moody's, the COVID-19 outbreak will mire an already weak economy into a recession, and as such Moody's forecasts a significant GDP contraction this year followed by a weak recovery, all of which are likely to have a material impact on our operations and financial condition.

Our ability to compete successfully in the marketplace for deposits depends on various factors, including our financial stability as reflected by our credit ratings. A downgrade in our credit ratings may adversely affect perception of our financial stability and our ability to raise deposits or obtain other funding, which could significantly affect our business, financial conditions and results of operations.

We are exposed to risks faced by other financial institutions.

We routinely transact with counterparties in the financial services industry, including broker-dealers, commercial banks, investment banks, mutual funds, hedge funds and other institutional clients. Defaults by, and even rumors or questions about the solvency of, certain financial institutions and the financial services industry generally have led to market-wide liquidity problems and could lead to losses or defaults by other institutions. Many of the routine transactions we enter into expose us to significant credit risk in the event of default by one of our significant counterparties. Concerns relating to the financial health of a number of European governments and the European sovereign debt crisis have recently intensified, contributing to volatility of the capital and credit markets, and the risk of contagion throughout the European financial system (in which the parent companies of some of our most important competitors operate) and beyond the Eurozone remains, as a significant number of financial institutions throughout Europe have substantial exposures to sovereign debt issued by nations which are under considerable financial pressure. These liquidity concerns have had, and may continue to have, an adverse effect on interbank financial transactions in general. Should any of these nations default on their debt, or experience a significant widening of credit spreads, major financial institutions and banking systems throughout Europe could be destabilized. A default by a significant financial counterparty, or liquidity problems in the financial services industry generally, could have a material adverse effect on our business, financial position and results of operation.

We are subject to significant competition from other banks, financial institutions and fintech companies in providing financial services.

We face strong competition in all aspects of our business, including loan origination and growing our deposits base. The competition in loan origination comes principally from other Mexican and foreign banks, mortgage banking companies, consumer finance companies, insurance companies, other institutional lenders and purchasers of loans and recently fintech companies. We anticipate that we will encounter greater competition as we continue expanding our

operations in Mexico. A number of institutions with which we compete have significantly greater assets and capital, name recognition and other resources. Certain of our competitors, such as multiple purpose financial companies (*sociedades financieras de objeto múltiple*) (“*Sofomes*”), are not financial institutions and, therefore, are not subject to the supervision of regulatory authorities or to the extensive Mexican banking regulations to which we are subject, including the requirement to maintain certain levels of capital and reserves for loan losses. In addition, Mexico is the country with the second most fintech companies in the region. The largest segment addressed by fintech companies in Mexico is payments and remittances, accounting for 22% of total Mexican fintech companies, while companies dedicated to lending activities make up the second largest segment. With the recent growth of fintech companies in the Mexican financial services sector, we are facing a different and more challenging competitive environment. Due to their legacy-free infrastructure and flexibility, fintech companies are gaining a “first mover” advantage over traditional banks to enter the market with new and innovative solutions for Mexican businesses and consumers. Low capital requirements, developing regulatory framework, and low administrative expenses applicable to fintech companies help foster the development of the Mexican fintech ecosystem. As a result, certain of our competitors may have advantages in conducting certain businesses and providing loans and other financial services. Moreover, competition is likely to increase as a result of the entrance of new participants into the financial services sector. The SHCP has granted a number of banking licenses for the establishment and operation of several new banking institutions and is likely to continue granting banking licenses to new participants.

In addition, legal and regulatory reforms in the Mexican banking industry have increased competition among banks and other financial institutions. Various reforms to the Mexican Banking Law allow for the incorporation of limited purpose banks (*bancos de nicho*), which can only engage in those activities expressly authorized by the CNBV and set forth in their bylaws, and are subject to lesser regulatory requirements (including lower capital requirements) depending on such authorized activities. Therefore, we could experience higher competition in certain sectors of our business should the CNBV grant many limited-purpose banking licenses. We believe that the Mexican government’s commitments to adopt accelerated regulatory reforms in, and the liberalization of, the Mexican financial industry have resulted in increased competition among financial institutions in Mexico. As the reform to the financial sector continues, foreign financial institutions, many with greater resources than us, have entered and may continue to enter the Mexican market either by themselves or in partnership with existing Mexican financial institutions and compete with us. There can be no assurance that we will be able to compete successfully with such domestic or foreign financial institutions or that increased competition will not have a material adverse effect on our financial position or operating results.

An increase in competition or a more aggressive competition strategy by our competitors may force us to decrease the rates at which we lend money or to pay higher interest rates to our creditors and bank depositors, which would increase our interest expenses and reduce our net interest income and, consequently, adversely impact our financial position or operating results.

In addition, if our customer service levels were perceived by the market to be materially below those of our competitor financial institutions, we could lose existing and potential business. If we are not successful in retaining and strengthening customer relationships, we may lose market share, incur losses on some or all of our activities or fail to attract new deposits or retain existing deposits, which could have a material adverse effect on us.

Our ability to maintain our competitive position depends, in part, on the success of new products and services we offer our clients and our ability to continue offering products and services from third parties.

The success of our operations and our profitability depends, in part, on the success of new products and services we offer our clients and our ability to continue offering products and services from third parties. However, we cannot guarantee that our new products and services will be responsive to client demands or successful once they are offered to our clients, or that they will be successful in the future or that we will have the information systems, personnel or innovative capacity sufficient to offer our clients the products and services they demand. In addition, our clients’ needs or desires may change over time, and such changes may render our products and services obsolete, outdated or unattractive and we may not be able to develop new products that meet our clients’ changing needs. If we cannot respond in a timely fashion to the changing needs of our clients, we may lose clients, which could in turn materially and adversely affect our business, financial position and results of operation.

As we expand the range of our products and services, some of which may be at an early stage of development in the Mexican market, we will be exposed to new and potentially increasingly complex risks and development expenses, with respect to which our experience and the experience of our partners may not be helpful. Our employees and our

risk management systems may not be adequate to handle such risks. In addition, the cost of developing products that are not launched is likely to affect our results of operations. Any or all of these factors, individually or collectively, could have a material adverse effect on our business, financial position and results of operation.

Our increasing focus on individuals and small and medium-sized businesses could lead to higher levels of non-performing loans and subsequent charge-offs.

Approximately 38.1% of the value of our total gross loan portfolio as of March 31, 2020 consisted of exposure to individuals, while SMEs comprised approximately 4.6% of the value of the total gross loan portfolio as of March 31, 2020. As part of our business strategy, we are seeking to further increase lending and other services to individuals and SMEs, which are more likely to be adversely affected by downturns in the Mexican economy (such as the recent downturn resulting from the COVID-19 pandemic) than large corporations and high-income individuals who have greater resources. Consequently, we may experience higher levels of non-performing loans, which could result in higher provisions for loan loss reserves, which in turn would negatively affect us.

For the three-month period ended March 31, 2020, non-performing loans were Ps.12,826 million and total charge-offs against our allowance for loan losses were Ps.3,867 million. Non-performing loans related to individuals and SMEs represented 47.5% and 19.3%, respectively, of our total non-performing loans for the three-month period ended March 31, 2020, and 43.3% and 15.8% respectively, for the three-month period ended March 31, 2019. Charge-offs related to individual and SME loans represented 89.7% and 7.3%, respectively, of our total charge-offs for the three-month period ended March 31, 2020, and 90.4% and 8.4%, respectively, for the three-month period ended March 31, 2019.

For the year ended December 31, 2019, non-performing loans were Ps.12,392 million and total charge-offs against our allowance for loan losses were Ps.15,692 million. Non-performing loans related to individuals and SMEs represented 50.4% and 18.5%, respectively, of our total non-performing loans for the year ended December 31, 2019, and 45.1% and 15.3%, respectively, for the year ended December 31, 2018. Charge-offs related to individual and SME loans represented 86.7% and 6.8%, respectively, of our total charge-offs for the year ended December 31, 2019, and 91.0% and 5.9%, respectively, for the year ended December 31, 2018.

For the year ended December 31, 2018, non-performing loans were Ps.12,839 million and total charge-offs against our allowance for loan losses were Ps.15,635 million. Non-performing loans related to individuals and SMEs represented 45.1% and 15.3%, respectively, of our total non-performing loans for the year ended December 31, 2018, and 46.4% and 15.5%, respectively, for the year ended December 31, 2017. Charge-offs related to individual and SME loans represented 91.0% and 5.9%, respectively, of our total charge-offs for the year ended December 31, 2018, and 89.3% and 8.7%, respectively, for the year ended December 31, 2017.

There can be no assurance that our levels of non-performing loans and subsequent charge-offs will not be materially higher in the future and affect our financial condition and results of operations.

We are subject to substantial regulation and changes to these regulations may further limit and adversely affect us.

As a financial institution, we are subject to extensive laws and regulations regarding our organization, operations, lending and funding activities, capitalization, transactions with related parties, and taxation and other matters, including regulation by the Mexican Central Bank, the CNBV and the SHCP. These laws and regulations impose numerous requirements on us, including the maintenance of minimum credit, market and operating-risk capital levels and allowance for impairment losses, and otherwise regulate prohibited activities. The regulations also place limitations on the fees, commissions and interest rates we charge, our business practices and practices relating to risk-profile and sales of securities, money laundering, derivatives, rates charged, application of required accounting regulations and tax obligations. Statutes, regulations and policies to which we are subject, in particular those relating to the banking sector and financial institutions, may be changed at any time, and the interpretation and the application of those laws and regulations by regulators is also subject to change. Many of the applicable laws and regulations have changed extensively in recent years, with a negative impact on our financial condition.

Moreover, there may be future changes in the legal or regulatory system or in the interpretation and enforcement of the laws and regulations. In addition, the volume, granularity, frequency and scale of regulatory and other reporting requirements necessitate a clear data strategy to enable consistent data aggregation, reporting and management.

Inadequate management information systems or processes, including those relating to risk data aggregation and risk reporting, could lead to a failure to meet regulatory reporting requirements or other internal or external information demands, and we may face supervisory measures as a result.

One of the main aspects of the changes in recent years in the Mexican Banking Law approved by Congress consists of the authority granted to the SHCP to conduct evaluations of Mexican banks. Negative or deficient results of evaluations may result in corrective measures being ordered, including a requirement that the bank present a plan to correct such deficiencies. The most recent evaluation was conducted in 2018 and we received a positive evaluation, no corrective measures were ordered. In the event that we receive a negative or deficient evaluation in the future, it is uncertain what corrective measures may be ordered by the SHCP and whether the imposition of such measures may have a material adverse effect on our business.

In June 2014, the Mexican Supreme Court of Justice decided that federal judges have discretion to determine whether or not an interest rate agreed in a promissory note is evidently excessive, violating an individual's human rights, and consequently establishing a reduced rate. The elements the judge should take into account to determine if a rate is evidently excessive are:

- the type of relationship between the parties;
- the qualification of the persons intervening in the subscription of the note and if the activity of the creditor is regulated;
- the purpose of the credit;
- the amount of the loan;
- the term of the loan;
- the existence of guaranties for the payment of the loan;
- the interest rates applied by financial institutions in transactions similar to the one under analysis, as a mere reference;
- the variation of the national inflation index during the term of the loan;
- market conditions; and
- other issues that may be considered relevant by the judge.

The mandatory and partly discretionary application of such criteria in the lawsuits affecting our portfolio could have a material adverse effect on the interest rates we charge and on our operating results.

Changes in regulations may also cause us to face increased compliance costs and limitations on our ability to pursue certain business opportunities and provide certain products and services. As some of the banking laws and regulations have been recently adopted, such as the regulations implementing Basel III in Mexico (described below), the manner in which those laws and related regulations are applied to the operations of financial institutions is still evolving. No assurance can be given generally that laws or regulations will be adopted, enforced or interpreted in a manner that will not have a material adverse effect on our business and results of operations.

We are subject to capital adequacy requirements. Any failure by us to maintain this ratio will result in administrative actions or sanctions which may affect our ability to fulfill our obligations, including losing our banking license.

In December 2010, the Basel Committee reached an agreement on comprehensive changes to the capital adequacy framework, known as Basel III. A revised version of Basel III was published in June 2011. The Basel III framework includes heightened capital standards reflecting increases in both the quality and quantity of the regulatory capital base and enhancements to the risk coverage of the capital framework. Basel III also requires institutions to maintain

a capital conservation buffer above the minimum Capital Ratios in order to avoid certain capital distribution constraints. The capital conservation buffer, to be comprised of common equity Tier 1 Capital, would result in an effective Tier 1 Capital requirement of 6% of risk-weighted assets and other risks. In addition, Basel III directs national regulators to require certain institutions to maintain a Countercyclical Capital Supplement during periods of excessive credit growth. The Basel III capital standards are intended to be implemented at the national level subject to transitional arrangements, with the principal requirements being phased in from January 2013 to January 2019 and the remaining requirements fully effective in 2022. The CNBV issued amendments to the Mexican Capitalization Requirements, which became effective on January 1, 2013 and implemented Basel III in all material respects.

As a result of these amendments, in May 2016, as a bank of systemic importance, we were required by CNBV to constitute a Systemically Important Bank Capital Supplement of 0.90% with Tier 1 Capital. Also, an initial Countercyclical Capital Supplement of 0.001% was imposed. These Capital Supplements were required to be implemented by us over a four-year period, to be constituted in four equal parts in December of each year, from December 31, 2016 through December 31, 2019. Given our strong capital base, our Capital Ratios as of March 31, 2020 are well above such Capital Supplement requirements.

In addition to the changes to the capital adequacy framework described above, the Basel Committee also published its global quantitative liquidity framework, comprising the LCR and Net Stable Funding Ratio (“NSFR”) metrics, with the objectives of (1) promoting the short-term resilience of banks’ liquidity risk profiles by ensuring they have sufficient high-quality liquid assets to survive a significant stress scenario; and (2) promoting resilience over a longer term by creating incentives for banks to fund their activities with more stable sources of funding on an ongoing basis. The LCR was subsequently revised by the Basel Committee in January 2013, which included an amended definition of high-quality liquid assets and a revised timetable for the phase-in of the standard from 2015 to 2019, as well as some technical changes to some of the stress scenario assumptions. The final framework to be established in Mexico could differ from Basel III in certain respects. The LCR was implemented in December 2015. In October 2014, the Basel Committee published the final NSFR standard, which established a standard for banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities. The first effective date of the NSFR under the Basel Committee standard was January 1, 2018. A proposed disclosure standard related to the NSFR was published in December 2014. During 2015, the CNBV and the Mexican Central Bank modified general regulatory dispositions related to operational risk, counterparty risk, market risk, and credit risk.

At the beginning of 2018, the Mexican Central Bank proposed amendments to the Circular 3/2012, which regulates capital instruments issued by Mexican banks and opened a public consultation period from May 4, 2018 to May 31, 2018. On November 14, 2018 the final amendments were published in the Official Gazette, including, among others, changes such as the requirement to submit a transfer pricing study justifying interest rates applicable to capital instruments and *de minimis* non-related party placement requirements, when the offering did not qualify as a public offering.

The Basel Committee could adopt a new accord regarding minimum capitalization requirements that sets conditions that are more restrictive for Tier 1 Capital or that raises the minimum capital ratios even higher. Changes in laws and regulations issued by the CNBV in connection with the minimum capitalization requirements in compliance with international banking standards may affect our financial condition and results of operations and the treatment of the Notes as part of our Tier 1 Capital.

The effective management of our capital position is important to our ability to operate our business, to continue to grow organically and to pursue our business strategy. However, as these changes to the regulatory capital framework and other changes are implemented, or as future changes are considered or adopted that limit our ability to manage our balance sheet and capital resources effectively or to access funding on commercially acceptable terms, we may experience a material adverse effect on our financial condition and regulatory capital position. In addition, the implementation and maintenance of enhanced liquidity risk management systems may result in significant costs, and more stringent requirements to hold liquid assets may materially affect our lending business as more funds may be required to acquire or maintain a liquidity buffer, thereby reducing future profitability.

Furthermore, we cannot predict the terms that will be included in implementing regulations in connection with requirements to be satisfied in respect of lending activities to certain sectors of the economy. However, if the SHCP determines, after an evaluation, that we have not complied with applicable requirements, we may be forced to lend to certain sectors of the economy or to certain persons that may not meet our credit quality standards, that we may not

know or that are not acceptable credit risks, which in turn may impact our financial condition and results of operations and the quality of our assets. Moreover, if we were to fail any evaluation, publicity surrounding such failure may impact our reputation, which in turn may adversely impact our ability to conduct business in Mexico and our financial condition and results of operations.

Any legislative or regulatory actions and any required changes to our business operations resulting from such legislation and regulations could result in significant loss of revenue, limit our ability to pursue business opportunities in which we might otherwise consider engaging, affect the value of assets that we hold, require us to increase our prices and therefore reduce demand for our products, impose additional costs on us or otherwise adversely affect our businesses. Accordingly, there can be no assurance that future changes in regulations or in their interpretation or application will not adversely affect us.

We are subject to regulatory inspections, examinations, inquiries and audits that could result in intervention, sanctions and other penalties by our regulators and supervisors.

We are subject to comprehensive regulation and supervision by U.S. and Mexican regulatory authorities. The Mexican regulatory authorities include the Mexican Central Bank, the CNBV, the IPAB and the SHCP. See “*The Mexican Financial System*.” These regulatory authorities have broad powers to adopt regulations and other requirements that affect all aspects of our capitalization, organization and operations, including changes to capital adequacy and reserve requirements, compliance with rules relating to secrecy, the imposition of anti-money laundering measures and the authority to regulate the terms of products, including the interest rates we charge and the fees we collect in exchange for services. Moreover, Mexican and U.S. financial regulatory authorities possess significant powers to enforce applicable regulatory requirements, including the imposition of fines, requiring that new capital be contributed, inhibiting us from paying dividends to shareholders or paying bonuses to employees, or the revocation of licenses to operate our business (including our banking or broker-dealer licenses).

Furthermore, in the event we encounter significant financial problems or become insolvent or in danger of becoming insolvent, Mexican banking authorities would have the power to take over our management and operations. See “*Supervision and Regulation*.”

As noted above, our business and operations are subject to increasingly significant rules and regulations that are required to conduct banking and financial services business. These apply to our business operations, affect our financial returns, include reserve and reporting requirements, and set forth conduct of business regulations.

The regulators seek to maintain the safety and soundness of Mexican financial institutions with the aim of strengthening the protection of customers and the financial system. The continuing supervision of financial institutions is conducted through a variety of regulatory tools, reports, visits to firms and regular meetings with management to discuss issues such as performance, risk management and strategy. In general, regulators in Mexico have a more outcome-focused approach that involves more proactive enforcement and more punitive penalties for infringement, including intervening in institutions and restricting dividends or bonuses to employees. As a result, we face significant high levels of supervisory scrutiny (resulting in increasing internal compliance costs and supervision fees) and in the event of a breach of our regulatory obligations we may face significant regulatory fines.

Some of the regulators focus primarily on consumer protection, including a focus on the design and operation of products, the behavior of customers and the operation of markets. Applicable regulations may prevent institutions such as ours from providing products to customers until changes are made to address the regulators’ views on potential detriment to consumers. Regulations require us to be in compliance across all aspects of our business, including the training, authorization and supervision of personnel, systems, processes and documentation. If we fail to comply with the relevant regulations, we may face adverse impacts on our business from sanctions, fines or other actions imposed by the regulatory authorities, including the revocation of our authorization and the intervention in our operations.

Furthermore, customers of financial services institutions, including our customers, may seek redress if they have suffered loss as a result of an offered product, or through incorrect application of the terms and conditions of a particular product.

Given the inherent unpredictability of litigation and judgments by the relevant authorities, it is possible that an adverse outcome in some matters could harm our reputation or have a material adverse effect on our operating results, financial condition and prospects arising from any penalties imposed or compensation awarded, together with the

costs of defending such an action, thereby reducing our profitability.

Furthermore, pursuant to Mexican case law (*jurisprudencia*), which is binding to tribunals in the first circuit (*tribunales colegiados en el primer circuito*) only in respect of criminal matters in which a banking institution acts as auxiliary authority to immobilize or seize bank accounts, a Mexican banking institution may be deemed as responsible authority (*autoridad responsable*) for purposes of an amparo suit (*juicio de amparo*), which may imply that certain actions taken by a Mexican banking institution may be suspended or revoked by a court in an amparo suit, among other potential results. Even if, pursuant to Mexican law and the aforementioned case law, a Mexican banking institution is only deemed as responsible authority in an amparo suit when (i) such institution acts in a manner equivalent to a governmental authority, (ii) affects rights of individuals, and (iii) its functions are determined by law, such case law allows each court to interpret and decide subjective elements in connection with the determination of a bank as a responsible authority under an amparo suit. The characterization of a Mexican banking institution, under certain circumstances, as responsible authority may subject such institutions to the provisions of the Mexican *Ley de Amparo*, which effects and consequences are still unknown, and may increase the regulatory charges applicable to, and affect the activities of the Bank. Recent non-binding Mexican judicial criteria (*tesis aisladas*) have set forth that, if a banking institution is acting in its ordinary course of business, it cannot be deemed as a responsible authority under the Mexican *Ley de Amparo*.

We may be subject to future Mexican government restrictions on interest rates, fees and commissions or changes in allowance for loan loss requirements.

A portion of our revenues and operating cash flow is generated by the interest rates, fees and commissions that we charge to our customers, and any limitations or requests for additional information relating to interest rates, fees and commissions that we charge may have a material adverse effect on us. In Mexico, the Law for the Protection and Defense of Financial Services Users (*Ley de Protección y Defensa al Usuario de Servicios Financieros*) does not impose any specific limit on the interest rate that a bank may charge, subject to certain exceptions. However, under the Law for the Transparency and Ordering of Financial Services (*Ley para la Transparencia y Ordenamiento de los Servicios Financieros*), the Mexican Central Bank has broad authority to determine that reasonable competitive conditions do not exist and to issue temporary regulations that relate to interest rates, fees and commissions. In addition, the Mexican Central Bank has broad authority to issue regulations in respect of credit and debit cards, checks, fund transfers and other means of payment, as a means to ensure competition, free access, no discrimination and protection of the interest of users.

After informal discussions led by the Senate's majority party leader to limit fees and commissions charged by banks, as of the date of this offering memorandum, the Mexican Congress and Mexican regulators (including the Mexican Central Bank) have not yet formally proposed any specific legislation to limit the interest rates we may charge. Some banks have reacted by lowering or eliminating some of their fees. We cannot predict what impact the issuance of any such regulations may have on our business and results of operations, although it is likely to require amendments to the way in which we operate and may adversely impact our financial results.

Our banking license may be revoked by the CNBV.

Under the Mexican Banking Law, the CNBV may revoke our banking license upon the occurrence of certain events, including:

- our failure to comply with any minimum corrective measures ordered by the CNBV;
- our failure to comply with the minimum Capital Ratios required under the Mexican Banking Law and the Mexican Capitalization Requirements;
- our failure to pay certain of our debts or to comply with our obligations with one or more participants in clearing systems or with our depositors; or
- our failure to comply with restrictions on certain types of transactions prohibited by the Mexican Banking Law.

If the CNBV were to revoke our banking license, our business, results of operations and financial condition would

be materially and adversely affected. See “*Supervision and Regulation.*”

Allowances for loan losses in Mexico differ from those applicable to banks in the United States and certain other countries and are subject to change from time to time.

Except for Government Loans and loans to certain Mexican development banks guaranteed by the federal government and the Mexican Central Bank, we are required to classify each loan or type of loan according to an assessment of risk based on criteria set forth by Mexican banking regulations, and to establish corresponding reserves. Mexican banking regulations relating to loan classification and determination of allowance for loan losses are generally different than those applicable to banks in other countries, including the United States. The criteria to establish reserves include both qualitative and quantitative factors and involve certain discretionary determinations.

We may be required or deem it necessary to increase our allowances for loan losses in the future, as a result of changes in CNBV rules or for other reasons. Moreover, the CNBV could further change accounting regulations for determination of allowance for loan losses or the methodology to measure credit risk of government institutions, which could require a substantial increase in our allowances, and could result in an adverse effect to our business, financial condition and results of operations.

Future mergers or acquisitions of financial institutions could disrupt our operations.

GFNorte acquired Bancentro in 1996, Banpaís in 1997, Bancrecer in December 2001, INB in 2006, UniTeller in 2006, Motran in 2007, IXE in 2011 and GFInter in 2018. The combination of two independent businesses is typically a complex and costly time-consuming process. We faced difficulties and delays in the integration of the banking operations of certain of these entities that affected our performance by diverting our management’s attention and human resources. We could face similar problems if we engage in similar transactions in the future. In addition, future acquisitions may require us to operate in markets that are new to us and may subject us to regulatory arrangements in other countries with which we have not had prior experience.

Such transactions and the possibility of a new merger, acquisition or other business combination involving us is likely to entail risks, including diversion of management attention and of human resources, unknown or unforeseen liabilities relating to the counterparty, difficulty in integrating and managing new or combined operations, labor unrest and loss of key personnel.

We depend on our retention of certain key personnel and on our ability to hire additional key personnel and maintain good labor relations.

We depend on our executive officers and key employees. In particular, our senior management has significant experience in the banking, financial services and pension fund management businesses, and the loss of any of our executive officers, key employees or senior managers could negatively affect our ability to execute our business strategy.

We depend on our continuing ability to identify, hire, train and retain other qualified sales, marketing and managerial personnel. Competition for such qualified personnel is intense and we may be unable to attract, integrate or retain qualified personnel at levels of experience or compensation that are necessary to sustain or expand our operations. Our businesses could be materially and adversely affected if we cannot attract these necessary personnel.

In addition, as of March 31, 2020, approximately 35.9% of our employees were unionized, and we could incur higher ongoing labor costs and disruptions in our operations in the event of a strike or other work stoppage.

We are subject to litigation and other legal, administrative and regulatory proceedings.

We are regularly party to litigation and other legal proceedings relating to claims resulting from our operations in the normal course of business. See “*Business—Litigation and Regulatory Proceedings.*” Litigation is subject to inherent uncertainties, and unfavorable rulings may occur. Furthermore, the current regulatory environment, which has resulted in an increased supervisory focus on enforcement, combined with uncertainty about the evolution of the regulatory regime, may lead to material compliance costs and subject us to regulatory enforcement actions, fines and penalties. See Note 35 to our Audited Consolidated Financial Statements and Note 25 to our Unaudited Condensed Consolidated Interim Financial Statements.

We cannot assure you that these or other legal, administrative and regulatory proceedings will not materially and adversely affect our ability to conduct our business in the manner that we expect or otherwise adversely affect our results of operations and financial position should an unfavorable ruling occur.

Our business relies heavily on data collection, processing and storage systems in order for our internal control systems and other operating systems to function properly.

Our business is dependent on our ability to timely collect and process a large volume of financial and other information across numerous and diverse markets and products at our various locations or branches, at a time when transaction processes have become increasingly complex. The proper functioning of our internal control, accounting and data collection and processing systems is critical to our business. A partial or complete failure of any of these systems could materially and adversely affect our decision making processes and the functioning of our risk management and internal control systems, as well as our timely response to changing market conditions. If we cannot maintain an effective data collection and management system, our business operations, financial position and results of operations could be materially and adversely affected.

Furthermore, we depend on information systems to operate our website, provide information to customers, process transactions, respond to customer inquiries on a timely basis and maintain cost-efficient operations. We may experience operational problems with our information systems as a result of system failures, viruses, computer “hackers” or other causes. Any material disruption or slowdown of our systems could cause information, including data related to customer requests, to be lost or to be delivered to our clients with delays or errors, which could reduce demand for our services and products or result in loss of customers, and could materially and adversely affect our financial position and results of operations.

If we fail to adequately protect personal information, our business, financial condition and operating results could be adversely affected.

A wide variety of state, national, and international laws and regulations apply to the collection, use, retention, protection, disclosure, transfer and other processing of personal data. These data protection and privacy-related laws and regulations are evolving and may result in increasing requirements and public scrutiny and escalating levels of enforcement and potential sanctions for violations. In July 2010, the Mexican government enacted the Federal Law for Protection of Personal Data Held by Private Persons (*Ley Federal de Protección de Datos Personales en Posesión de los Particulares*), which requires us to ensure the confidentiality of information received from clients. Although we have modified our processes, procedures and systems as required to implement this law, including procedures to supervise our activities thereunder, we can provide no assurances as to how this legislation will be interpreted and how strictly it will be enforced by Mexican authorities. An unfavorable interpretation and enforcement of this legislation could have a material adverse effect on us, including increasing our operating costs and subjecting us to fines and penalties in the event of violations of the provisions of such law.

We depend on our ability to effectively improve or upgrade our IT infrastructure and management information systems in a timely manner.

Our ability to remain competitive in the markets in which we operate depends in part on our ability to upgrade our IT infrastructure on a timely and cost-effective basis, through continuous investment. Our opening of new offices and branches requires us to improve our IT infrastructure and to maintain and upgrade our software and hardware systems and back-office operations.

Additionally, any failure or interruption in the improvement, development and expansion of our information systems could result in a delay in our ability to respond to the demands of our customers, our ability to manage risk, or defects in our service. This could adversely affect our customers or our reputation for reliability.

Any failure to effectively improve or upgrade our IT infrastructure and management information systems in a timely manner and our ability to achieve the expected results from our alliance with IBM’s outsourced services could materially and adversely affect our competitiveness, financial position and results of operations, and result in losses for our customers, resulting in liabilities for us.

We are subject to the risk of cybersecurity incidents and attacks that could result in a loss of customer data and other sensitive information, financial theft and regulatory penalties.

Cybersecurity incidents against us, our business partners, customers, vendors, or other third parties could result in a loss of customer data and other sensitive information, as well as financial theft. In addition, cyber-attacks could give rise to the disablement of our IT systems, or those of our third party vendors, used to service our business operations and customers. As attempted attacks continue to evolve in scope and sophistication, we may incur significant costs in our attempt to modify or enhance our protective measures against such attacks, or to investigate or remediate any vulnerability or resulting breach, or in communicating cybersecurity incidents to our customers. Furthermore, remote working resulting from the COVID-19 pandemic has increased our cybersecurity risks, given the greater use of computer networks outside the corporate environment. If we fail to effectively manage our cybersecurity risk, e.g., by failing to update our systems and processes in response to new threats, this could hamper our reputation and adversely affect our operating results, financial condition and prospects through the payment of customer compensation, loss of customers, regulatory penalties and fines and/or through the loss of assets.

We have been and continue to be subject to a range of cyber incidents, such as denial of service attacks, intrusion attempts through email malware attachments, ATM hacks, credit card and debit card fraud, attacks via third-party platforms we utilize and phishing. For example, in March 2015, we detected that a third party had gained unauthorized access to certain customer records, although no sensitive information was compromised. Also, on April 26, 2018, we became aware that an unauthorized third party had interfered with the platform we use to connect to the SPEI interbank banking system (*Sistema de Pagos Electrónicos Interbancarios*, the “SPEI”), an electronic funds transfer system owned and operated by the Mexican Central Bank. The unauthorized third party used our connection as well as other banks’ connections to the SPEI to originate phantom payment orders to accounts at other banks. On the same date, we reported the suspicious transactions to the Mexican Central Bank and we were disconnected from the SPEI to prevent further fraud. The contingency procedures we were required to use thereafter resulted in slower processing times and difficulties in the settlement of payment transfers for some of our clients for a period of approximately fifteen days. We identified that over 500 fraudulent operations were carried out. Other Mexican banks and brokerage firms were also subject to similar attacks. While we have implemented several mitigation and preventive measures to reinforce our cybersecurity and to comply with the Mexican Central Bank’s regulatory security requirements and we were authorized to reconnect to the SPEI in October 2018, the forensic analysis consultant we retained to investigate the incident was unable to determine the root cause of the intrusion. Many of the operating expenses and losses incurred by us in connection with this incident were covered by our insurance policies.

We cannot assure that cybersecurity incidents and attacks will not cause a material adverse effect in the future.

Our Financial Statements have been prepared and are presented in accordance with Mexican Banking GAAP, which is significantly different from U.S. GAAP.

Our Financial Statements included in this offering memorandum have been prepared and are presented in accordance with Mexican Banking GAAP. Significant differences exist between Mexican Banking GAAP and U.S. GAAP which are material to our Financial Statements and other financial information included in this offering memorandum. See “*Annex A – Significant Differences Between Mexican Banking GAAP and U.S. GAAP.*” We have made no attempt to identify or quantify the impact of those differences in this offering memorandum. In making an investment decision, you must rely upon your own examination of us, the terms of this offering and the financial information included in this offering memorandum. You should consult your own professional advisors for an understanding of the differences between Mexican Banking GAAP and U.S. GAAP and how those differences might affect the financial information included in this offering memorandum.

We may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis, which could expose us to liability and harm our business.

We are required to comply with applicable anti-money laundering and anti-terrorism laws and other regulations in the jurisdictions in which we operate. These laws and regulations have become more strict and require us, among other things, to adopt and enforce “know your customer” policies and procedures and to report suspicious and large transactions to the applicable regulatory authorities. These laws and regulations have become increasingly complex and detailed, require improved systems and sophisticated monitoring and compliance personnel and have become the subject of enhanced government supervision. Recent rules have been adopted in Mexico restricting the ability of Mexican banks to receive currencies in physical form, in exchange for foreign exchange and other similar transactions.

See “*Supervision and Regulation—Money Laundering Regulations.*”

While we have adopted policies and procedures aimed at detecting and preventing the use of our banking network for money laundering activities and by terrorists and terrorist-related organizations and individuals generally, such policies and procedures have in some cases only been adopted recently and may not completely eliminate instances where we may be used by other parties to engage in money laundering and other illegal or improper activities. To the extent we fail to fully comply with applicable laws and regulations, the relevant government agencies to which we report have the power and authority to impose fines and other penalties on us, including the revocation of our license. In addition, our business and reputation could suffer if our infrastructure is used for money laundering or illegal or improper purposes and some of our operations could be suspended by regulatory authorities. Any of these situations could have a materially adverse effect on our business, financial position or results of operations.

In addition, while we review our relevant counterparties’ internal policies and procedures with respect to such matters, we, to a large degree, rely upon our relevant counterparties to maintain and properly apply their own appropriate anti-money laundering procedures. Such measures, procedures and compliance may not be completely effective in preventing third parties from using our (and our relevant counterparties’) operations as a conduit for money laundering (including illegal cash operations) without our (and our relevant counterparties’) knowledge. If we are associated with, or even accused of being associated with, or become a party to, money laundering, then our reputation could suffer and/or we could become subject to fines, sanctions and/or legal enforcement (including being added to any “blacklists” that would prohibit certain parties from engaging in transactions with us), any one of which could have a material adverse effect on our reputation, business, financial condition or results of operations.

We are subject to actions taken by the Mexican Antitrust Commission in respect of the Mexican financial sector or our business.

On January 16, 2014, the Mexican Antitrust Commission formally began an investigation regarding the Mexican financial sector. As part of the financial reform that became effective as of January 2014, the Mexican Antitrust Commission was instructed by the Mexican Congress to investigate competition in the Mexican financial sector. On July 9, 2014, the Mexican Antitrust Commission published the full investigation work paper and its official report pursuant to which the plenary of the Mexican Antitrust Commission reported the background, considerations and general concepts of the Mexican financial sector used for the investigation, and issued 36 recommendations for the improvement of competition such industry. Although such recommendations are not legally binding, the Mexican Antitrust Commission has authority to begin, at any time, a specific investigation for alleged antitrust practices by any financial institution, including us, which could have a material adverse effect on our reputation, business, financial condition or results of operations. As of the date of this offering memorandum, no such investigations have commenced.

We are subject to the Mexican Federal Anticorruption Law in Public Contracting, the U.S. Foreign Corrupt Practices Act and similar worldwide anti-bribery laws.

In July 2016, as part of the historic constitutional reform which created the National Anticorruption System (*Sistema Nacional Anticorrupción*) (“SNA”), the Mexican Congress approved a group of laws that comprises the legal framework that will ensure the implementation of the public strategies and policies for fighting corruption and impunity. The objective of this reform is to achieve full coordination of efforts from the federal, state and municipal governments, and the government of Mexico City, in order to prevent, investigate and punish administrative violations and corrupt practices by public officers, companies and individuals.

For the operation of the SNA, the Mexican Congress approved the General Law on the National Anticorruption System (*Ley General del Sistema Nacional Anticorrupción*), the Federal Anticorruption Law on Public Contracts (*Ley Federal Anticorrupción en Contrataciones Públicas*), the General Law on Administrative Accountability (*Ley General de Responsabilidades Administrativas*) and the Organic Law of the Federal Tribunal of the Administrative Justice (*Ley Orgánica del Tribunal Federal de Justicia Administrativa*). In addition, it approved the Law on Auditing and Accountability of the Federation (*Ley de Fiscalización y Rendición de Cuentas de la Federación*), and amendments on internal controls of the federal executive branch to the Organic Law of the Federal Public Administration (*Ley Orgánica de la Administración Pública Federal*), to the Fiscal Coordination Law (*Ley de Coordinación Fiscal*) and to the General Law for Governmental Accounting (*Ley General de Contabilidad Gubernamental*).

There can be no assurance that our internal control policies and procedures will protect us from reckless or criminal acts committed by our employees or agents. Violations of these laws, or allegations of such violations, could disrupt our business and could have a material adverse effect on our reputation, business, financial condition or results of operations.

We may be required to make significant contributions to the IPAB.

Under Mexican law, banks are required to make monthly contributions to support the operations of the IPAB, in an amount equal to one-twelfth of 0.4% (the annual rate) multiplied by the average of certain liabilities minus the average of certain assets. The IPAB was created in January 1999 to manage the bank savings protection system and regulate the financial support granted to banks in Mexico. Mexican authorities impose regular assessments on banking institutions covered by the IPAB for funding.

We contributed Ps.3,297 million, Ps.3,149 million and Ps.2,634 million to the IPAB during 2019, 2018 and 2017, respectively. In the event that the IPAB's reserves are insufficient to manage the bank savings protection system and provide the necessary financial support granted to troubled banking institutions, the IPAB maintains the discretionary right to require extraordinary contributions to participants in the system. Any such requirement can be a result of a multitude of circumstances, cannot be predicted and could adversely affect our business, financial condition or results of operations.

Depending upon the value and the nature of our assets and the amount and nature of our income over time, we could be classified as a passive foreign investment company for U.S. federal income tax purposes.

The Bank will be classified as a passive foreign investment company ("PFIC") in any taxable year if either: (a) 50% or more of the fair market value of our gross assets (determined on the basis of a quarterly average) for the taxable year produce passive income or are held for the production of passive income or (b) 75% or more of our gross income for the taxable year is passive income. The application of the PFIC rules is subject to uncertainty in several respects. If we are a PFIC for any taxable year during which a U.S. Holder (as defined under "Taxation—Certain United States Federal Income Tax Considerations") held our Notes, the U.S. Holder might be subject to increased U.S. federal income tax liability and to additional reporting obligations. We do not intend to provide the information necessary for the U.S. Holder to make a qualified electing fund election with respect to our Notes. U.S. Holders should consult their own independent tax advisors regarding the application of the PFIC rules to an investment in the Notes. See "Taxation—United States Federal Income Tax Considerations—PFIC Rules."

While not entirely clear, payments under the Notes may be subject to withholding tax pursuant to the U.S. Foreign Account Tax Compliance Act.

Pursuant to certain provisions of the Code, commonly known as FATCA, a "foreign financial institution" may be required to withhold on certain payments it makes ("foreign passthru payments") to persons that fail to meet certain certification, reporting, or related requirements. The Bank is a foreign financial institution for these purposes. A number of jurisdictions (including Mexico and the Cayman Islands) have entered into, or have agreed in substance to, intergovernmental agreements with the United States to implement FATCA ("IGAs"), which modify the way in which FATCA applies in their jurisdictions. A foreign financial institution in an IGA jurisdiction would generally not be required to withhold under FATCA or an IGA from payments that it makes. Certain aspects of the application of the FATCA provisions and IGAs to instruments such as the Notes, including whether withholding on "foreign passthru payments" would ever be required pursuant to FATCA or an IGA on instruments such as the Notes, are uncertain. Even if withholding were required or relevant for the Bank pursuant to FATCA or an IGA with respect to payments on instruments such as the Notes, such withholding would not apply before the date that is two years after the date of the publication of final Treasury Regulations defining the term "foreign passthru payments." Holders should consult their own tax advisors regarding how these rules might apply to their investment in the Notes. In the event any withholding would be required pursuant to FATCA or an IGA with respect to payments on the Notes, neither the Bank nor any other paying agent will be required to pay additional amounts as a result of the withholding.

Risks Relating to Mexico

We are subject to economic and political developments in Mexico that could affect Mexican economic policy and our business.

We are a Mexican bank and most of our operations and assets are located in Mexico. As a result, our business, financial condition and results of operations may be affected by the general condition of the Mexican economy, changes in Mexico's GDP, per capita disposable income, unemployment rates, the devaluation of the Peso as compared to the U.S. dollar, price instability, inflation, changes in oil prices, interest rates, regulation, taxation, social instability, acts of terrorism, disease outbreaks, such as the COVID-19, and other political, social and economic developments in or affecting Mexico over which we have no control. Decreases in the growth rate of the Mexican economy, periods of negative growth or reductions in disposable income may result in lower demand for our services and products. The Mexican government cut spending in response to a downward trend in international crude oil prices, and it may further cut spending in the future. These cuts could adversely affect the Mexican economy and, consequently, our business, financial condition, operating results and prospects.

Our revenues are subject to risk of loss from unfavorable political and diplomatic developments, social instability, and changes in governmental policies, including expropriation, nationalization, international ownership legislation, interest-rate caps and tax policies. As a result, the actions of the Mexican government concerning the economy and regulating certain industries, including the banking sector, could have a significant effect on Mexican private sector entities, including us, and on market conditions, prices and returns on Mexican securities, including our securities.

The Mexican Congress has approved reforms in recent years, including constitutional amendments that have liberalized certain areas of the economy, including the financial sector. It is expected that these reforms will boost Mexico's economic growth in the medium and long term. However, that could not be the case. As of the date of this offering memorandum, the new government has not assigned any new project. We cannot predict exactly if there will be changes in Mexico's economic and governmental policy that positively or negatively affect our business, financial position and results of operations.

Political events in Mexico may significantly affect Mexican economic policy and, consequently, our operations and financial condition. Presidential and federal congressional elections in Mexico were held on July 1, 2018, which resulted in a change in administration and the ruling party. Andrés Manuel López Obrador, the leader of the political party known as *Movimiento Regeneración Nacional (Morena)*, was elected President of Mexico and the coalition known as *Juntos Haremos Historia*, conformed by *Morena*, *Partido del Trabajo* and *Partido Encuentro Social*, obtained the majority in both chambers of the Mexican Congress (*Congreso de la Unión de los Estados Unidos Mexicanos*) and in 17 of the 32 state-level Congresses that exist. The elected members of the Mexican Congress took office on September 1, 2018 and Andrés Manuel López Obrador took over the Mexican presidency on December 1, 2018. The President's term will expire on September 30, 2024. We cannot provide any assurances that political developments in Mexico will not have an adverse effect on the Mexican economy or the banking industry and, in turn, in our business, results of operations and financial condition.

Informal discussions led by the Senate's majority party leader to limit certain fees and commissions charged by banks took place during the first 100 days of the new administration, causing high uncertainty over the final outcome of these discussions. In addition, during his campaign, Andrés Manuel López Obrador proposed, among other things, his desire to modify and/or terminate certain structural reforms. As of the date of this offering memorandum, a new education reform was approved by Congress and ratified by the legislative authorities of 22 states. In addition, the administration canceled the New Mexico City Airport (*Nuevo Aeropuerto Internacional de la Ciudad de México*) project, and has announced the kickoff of the main infrastructure projects that were promised during campaign (including a new refinery at Dos Bocas, the "Mayan train", and the construction of a new airport in Santa Lucía). In March, 2020, the Mexican government also carried out a popular consultation (or referendum) with respect to the construction and development of a brewing facility by Constellations Brand in Baja California, Mexico. Based on the results, the government decided to cancel the project.

Several investors and credit rating agencies are still cautious about the new administration's policies, which could contribute to a decrease in the Mexican economy's resilience in the event of a global economic downturn. As a result of the last election Andrés Manuel López Obrador and the *Juntos Haremos Historia* coalition have majority in the Congress of the Union and in the state-level Congresses, enough to implement significant reforms without the approval of the rest of the other Mexican political parties, including amendments to the Mexican Constitution. Such

concentration of power and any instability in Mexican politics or economy as a result of the above can have a negative impact on our business, financial position or operating results. The extent of such impact cannot be accurately predicted.

On June 5, 2019, Fitch Ratings downgraded Mexico's sovereign debt, which reflects an assessment of the overall financial capacity of the government of Mexico to pay its obligations and its ability to meet its financial commitments as they become due, from BBB+ to BBB citing increased risk due to PEMEX's deteriorating credit profile and weakness in the macroeconomic outlook due to, among other things, trade tensions. In addition, Moody's changed its outlook on Mexico's A3 rating from stable to negative. The same day, Fitch Ratings downgraded Mexico's state oil company, PEMEX, from BBB- to BB+, citing insufficient investment to restore declining production. On March 26, 2020, S&P downgraded its credit rating for Mexico's sovereign debt from BBB+ to BBB (negative outlook). Moreover, on April 3, 2020, Fitch Ratings downgraded PEMEX from BB+ to BB, citing the continued deterioration of its stand-alone credit profile amid the downturn in the global oil and gas industry, Fitch Ratings' lower oil price assumptions and the weakening credit linkage between Mexico and PEMEX and, on April 15, 2020, Fitch Ratings revised its rating of Mexico's sovereign debt from BBB to BBB- (stable outlook). Finally, on April 17, 2020, Moody's downgraded its ratings of PEMEX's senior unsecured notes, as well as its ratings of PEMEX's guarantee, from Baa3 to Ba2 and, simultaneously, Moody's withdrew PEMEX's Baa3 issuer rating and assigned a Ba2 corporate family rating. Moody's also lowered PEMEX's Baseline Credit Assessment (BCA), which reflects its standalone credit strength, to caa2 from caa1. These rating actions were triggered by PEMEX's aggregated liquidity and business risk. Simultaneously, on April 17, 2020, Moody's downgraded the credit ratings for Mexico's sovereign debt from A3 to Baa1 and maintained the negative outlook. We cannot assure you that the rating agencies will not announce additional downgrades of Mexico and/or PEMEX in the future. These downgrades could adversely affect the Mexican economy and, consequently, our business, financial condition, operating results and prospects.

Furthermore, the COVID-19 pandemic has and may continue to cause disruption to economic activity, which may intensify the slowdown of the Mexican economy. See *"Risk Factors – Risks Relating to Our Business – Our operations and results have been impacted by the COVID-19 pandemic, which we expect will have a continued and likely material adverse effect on our business, results of operations and financial condition."*

We may be subject to adverse economic conditions in Mexico.

Most of our operations are dependent upon the performance of the Mexican economy, mainly on matters such as the Peso-U.S. dollar exchange rate, price volatility and inflation, interest rates, regulation, taxation, social instability and other political, social and economic developments in or affecting Mexico, over which we have no control. In the past, Mexico has experienced both prolonged periods of weak economic conditions and deteriorations in economic conditions that have had a negative impact on us. We cannot assume that such conditions will not return or that such conditions will not have a material adverse effect on our business, financial condition or results of operation.

During 2012, GDP in Mexico grew 3.6% and inflation reached 4.1% on average. In 2013, GDP grew 1.4% and inflation was 3.8% on average. In 2014, GDP grew 2.8% and inflation reached 4.0% on average. In 2015, GDP grew 3.3% and inflation was 2.7% on average. In 2016, GDP grew 2.9% and inflation was 2.8% on average. In 2017, GDP grew 2.0% and inflation was 6.0% on average. In 2018, GDP grew 2.0% and inflation was 4.9% on average. During 2019, GDP contracted by 0.1% and inflation was 3.6% on average. During the first three months of 2020, GDP contracted by 2.2% and annualized inflation was 3.4% on average.

Mexico also has, and is expected to continue to have, high real and nominal interest rates relative to the U.S but rate differential may shrink. The interest rates on 28-day Mexican government treasury securities (*Certificados de la Tesorería de la Federación*) ("Cetes"), averaged 2.98%, 4.17%, 6.69%, 7.62%, 7.85% and 6.98% for the years ended December 31, 2015, 2016, 2017, 2018 and, 2019 and the for the three-month period ended March 31, 2020, respectively.

A recession could affect our operations to the extent that we are unable to reduce our costs and expenses in response to falling demand. Similarly, our loan portfolio could deteriorate as a result of higher delinquency rates. These factors could result in a decrease in our loan portfolio, revenues and net income.

Ongoing disputes and volatility in the global financial market may adversely affect our business, financial condition and results of operations.

The global financial markets continue to be uncertain and it is hard to predict for how long the effects of the global financial stress of recent years will persist and what impact it will have on the global economy. Our future results may be impacted by the uncertainty caused by an economic downturn, volatility or deterioration in the debt and equity capital markets, inflation, deflation or other adverse economic conditions that may negatively affect us or parties with whom we do business resulting in a reduction in our customers' spending and increased risk of non-payment or inability to perform obligations owed to us. Since 2014, this risk has been exacerbated due to several factors, including, the drop of oil prices, the slowdown of Chinese economy, the strength of the U.S. dollar compared to foreign currencies, geopolitical tensions and, more recently, the COVID-19 outbreak and the implementation of protective measures across the world, resulting in a global wave of risk aversion.

More recently, certain measures on trade taken by the U.S., which have resulted in retaliatory measures from other countries, the *Brexit*, U.S. monetary policy normalization along with other geopolitical and economic factors have contributed to increase the volatility and uncertainty in several financial markets. Any interruption to the expansion of the developed economies, the impact of said factors in emerging economies or a new economic and/or financial crisis, or a combination of the above, could affect the Mexican economy, and, consequently, materially adversely affect our business.

In addition, the normalization of monetary policy in the U.S. has caused an increase in the volatility of the Peso/U.S. dollar exchange rate. The relative strength of the U.S. dollar against other currencies, including the Peso, could impact manufacturing's contribution to growth, thus affecting economic activity in Mexico.

The uncertainty of local and international policies adopted by several countries, including the United States, as well as the worsening of other economic and political conditions worldwide could have the following effects:

- an economic downturn or insufficient recovery of the economy generally and the financial markets and any adverse social or political developments for any reason, including illnesses or epidemics, including the COVID-19 pandemic, which may adversely impact our business, financial condition and results of operations;
- increased regulation of the financial industry, which may increase our costs of capital and limit our ability to pursue business opportunities;
- the inability to estimate losses inherent in credit exposure or to make difficult, subjective and complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of our customers to pay their leases and loans;
- economic downturn or insufficient recovery of the economy generally and the financial markets, which may impact our business, financial condition and results of operations; and
- the imposition of tariffs on Mexican imports by the United States or any other country.

The persistence or deterioration and volatility of the global economy and the financial markets could adversely affect us, including our ability to raise capital and liquidity on favorable terms or at all. The absence of sources of financing through the capital markets or an excessive increase in the cost of such financing may have the effect of increasing our cost of capital and force us to increase the rates we charge our customers. Any such increase in the cost of financing could have a material adverse effect on our margins. In addition, our financial results are exposed to market risks, including interest rate and exchange rate fluctuations, which can have a material adverse effect on our financial condition and results of operations. In total, the volatility of the global financial markets, both as stemming from inherent risks and as stemming from disputes and retaliation, may adversely affect our business, financial condition and results of operations and financial condition.

Developments in other countries, particularly the United States, could materially affect the Mexican economy and, in turn, our business, financial condition and results of operations.

The Mexican economy continues to be influenced by the U.S. economy, and therefore, the deterioration of the

United States' economy, the termination of the North American Free Trade Agreement ("NAFTA") or the USMCA or other related events may impact the economy of Mexico. Economic conditions in Mexico have become increasingly correlated to economic conditions in the United States as a result of the NAFTA, which has induced higher economic activity between the two countries and increased the remittance of funds from Mexican immigrants working in the United States to Mexican residents. On an annual basis, as of 2019, close to 80% of Mexico's total exports are purchased by the United States, the single country with the highest share of trade with Mexico.

As a result of talks to renegotiate NAFTA, on November 30, 2018, the United States, Canada, and Mexico signed the USMCA. On June 19, 2019, the Mexican senate ratified the USMCA, and, consequently, Mexico became the first country to ratify the USMCA trade agreement. On January 29, 2020, President Donald Trump signed the USMCA into U.S. law, following approval from both houses of the U.S. Congress. On March 13, 2020 Canada ratified the USMCA. The USMCA entered into force on July 1, 2020. Due to its recent entry into force, it is currently unclear what the results of the USMCA and its implementation will be. The new terms of the USMCA could have an impact on Mexico's economy generally and job creation in Mexico, which could significantly adversely affect our business, financial performance and results of operations.

Likewise, any action taken by the current U.S. or Mexico administrations, including changes to the USMCA and/or other U.S. government policies that may be adopted by the U.S. administration, could have a negative impact on the Mexican economy, such as reductions in the levels of remittances, reduced commercial activity or bilateral trade or declining foreign direct investment in Mexico. In addition, increased or perceptions of increased economic protectionism in the United States and other countries could potentially lead to lower levels of trade and investment and economic growth, which could have a similarly negative impact on the Mexican economy. These economic and political consequences could adversely affect our business, operating results and financial condition.

The current U.S. governmental policies towards Mexico have created instability, uncertainty and may adversely affect the Mexican economy. For example, President Donald Trump has instituted import tariffs and enforced measures intended to control illegal immigration from Mexico, which have created friction between the U.S. and Mexican governments and may reduce economic activity between these countries. In June of 2019, the Trump administration announced plans to impose an escalating series of tariffs on Mexico unless the Mexican government enacted certain policy changes. While the Mexican and U.S. governments were able to reach an agreement, we cannot assure you that we will not be materially adversely affected by such tariffs, or any other policy developments or disputes in the U.S. or elsewhere, in the future.

Moreover, there is uncertainty around the implications of a U.S. tax reform for the fiscal deficit and national debt. However, there can be no assurance as to what the U.S. administration will do or the impact of these measures or any others adopted by the U.S. administration. We cannot assure that any of these events or developments will not materially and adversely affect the Mexican economy and, in turn, our business, financial condition and results of operations in the future.

Additionally, economic conditions in Mexico may also be affected by political developments in the United States, such as the presidential election taking place in November 2020. We cannot assure you that any developments in the U.S. or elsewhere will not materially and adversely affect us in the future.

The Mexican government has exercised, and continues to exercise, significant influence over the Mexican economy, including controlling inflation.

The Mexican government frequently intervenes in the Mexican economy and occasionally makes significant changes in policies and regulations. The Mexican government's actions to control inflation and other policies and regulations historically have involved, among other measures, increases in interest rates, changes in tax policies, price controls, currency fluctuations, taxation on investment flows, capital controls and limits on imports. We and the market price of our securities may be adversely affected by changes in policies or regulations involving, among others:

- interest rates;
- exchange rates and controls and restrictions on the movement of capital in or out of Mexico;
- reserve requirements;

- capital requirements;
- funding and lending limits;
- fees and commissions charged;
- inflation;
- liquidity of the domestic capital and lending markets; and
- tax and regulatory policies.

Mexico has experienced high rates of inflation in the past and has therefore implemented monetary policies that have resulted in high nominal interest rates. The Mexican government's measures to fight inflation, principally through the Mexican Central Bank, have had and may in the future have significant effects on the Mexican economy and our business. Tight monetary policies with high interest rates and high compulsory deposit requirements may have restricted and may continue to restrict Mexico's growth and the availability of credit, reduced our loan volumes and increased our loan loss provisions. Conversely, more lenient government and the Mexican Central Bank policies and interest rate decreases may trigger increases in inflation, and, consequently, growth volatility and the need for sudden and significant interest rate increases, which could negatively affect our interest rate spreads.

Although the Mexican government has implemented what we believe to be sound economic policies over the past few years, uncertainty over whether the administration of Andrés Manuel López Obrador will implement changes in policy or regulation in the future may contribute further to economic uncertainty in Mexico and to heightened volatility in the Mexican securities markets and in the securities issued abroad by Mexican issuers. These uncertainties and other developments in the Mexican economy may adversely affect us and the market value of our securities.

Changes in taxes and other fiscal assessments may adversely affect us.

The Mexican government regularly enacts reforms to the tax and other assessment regimes to which we and our customers are subject. Such reforms include changes in the rate of assessments and, occasionally, enactment of temporary taxes, the proceeds of which are earmarked for designated governmental purposes. The effects of these changes and any other changes that result from enactment of additional tax reforms have not been, and cannot be, quantified and there can be no assurance that these reforms will not, once implemented, have an adverse effect on us. Furthermore, such changes may produce uncertainty in the financial system, increasing the cost of borrowing and contributing to the increase in our non-performing credit portfolio.

Exposure to Mexican federal government debt could have a material adverse effect on us.

Like many other Mexican banks, we invest in debt securities of the Mexican government. As of March 31, 2020, approximately 12.05% of our total assets, and 83.48% of our investment portfolio (excluding investment in equity securities), was comprised of debt securities issued by the Mexican government (including those issued by the Mexican Central Bank). Any failure by the Mexican government to make timely payments under the terms of these securities, or a significant decrease in their market value, will have a material adverse effect on us.

Violence in Mexico has adversely impacted, and may continue to adversely impact, the Mexican economy.

Mexico has experienced violence relating to illegal drug trafficking, particularly in Mexico's northern states near the U.S. border. This violence has had an adverse impact on the economic activity in Mexico generally. Also, social instability in Mexico or adverse social or political developments in or affecting Mexico could adversely affect us, our ability to conduct our business and offer our services, and our ability to obtain financing. We cannot assure you that the levels of violent crime in Mexico, over which we have no control, will not increase or decrease and will have no further adverse effects on Mexico's economy or on our business, financial position and results of operation.

Developments in other countries may affect the market value for our securities and adversely affect our ability to raise additional financing.

The market value of securities of Mexican companies is, to varying degrees, influenced by economic and securities market conditions in other emerging market countries. Although economic conditions are different in each country, investors' reaction to developments in one country can have effects on the securities of issuers in other countries, including Mexico, as adverse economic conditions in other emerging market countries may cause an entire region or class of investments to be disfavored by international investors. This could lead to capital flight and, as a consequence, a decrease in the amount of foreign investment in Mexico. We cannot assure you that events elsewhere, especially in emerging markets, will not adversely affect the market value of our securities and in turn adversely affect our ability to raise additional financing.

Risks not contemplated in our insurance policies may affect our results of operation.

We maintain insurance in amounts that we believe to be adequate to cover risks related to our operations including, among others, general banking liability insurance for our business, general professional liability for services we provide, general directors and officers liability for our directors and executives and general liability against fraudulent activity. However, it is possible that the terms and conditions of the insurance policies we have will not cover a specific event or incident or that our insurance will cover only part of the losses that we may incur. If any uninsured events occur with respect to a significant portion of our operations, such lack of coverage could have a material adverse effect on our financial conditions and results from operations. Additionally, if we are unable to renew our insurance policies from time to time or losses or other liabilities occur that are not covered by insurance or that exceed our insurance limits, we could be subject to significant unexpected additional costs which could adversely affect our business.

Risks Relating to the Notes

The Notes have no scheduled maturity and no fixed redemption date and you do not have the right to cause the Notes to be redeemed or otherwise accelerate the repayment of the principal amount of the Notes except in very limited circumstances.

The Notes are perpetual securities and have no fixed maturity date or fixed redemption date and holders and beneficial owners of the Notes may not require any redemption of their Notes at any time. Although under certain circumstances as described under “Description of the Notes—Redemption” the Bank may redeem the Notes, the Bank is under no obligation to do so and you have no right to call for their redemption. Therefore, you have no ability to cash in your investment except under limited circumstances.

There is no right of acceleration in the case of any non-payment of principal of, or interest on, the Notes or in the case of a failure by us to perform any other covenant under the Notes or under the Indenture. Accordingly, we are not required to make any repayment of the principal amount of Notes at any time or under any circumstances other than in connection with certain events involving insolvency (*resolución*) or liquidation of the Bank. In connection with such a liquidation, you may receive some of any resulting liquidation proceeds, depending upon the outcome of the proceedings, but only following payment in full of all creditors that are senior to the holders of the Notes.

Interest payments on the Notes will be due and payable in the Bank's sole and absolute discretion and the Bank may (and in certain circumstances must) cancel interest payments, in whole or in part, at any time. Canceled interest shall not be due and shall not accumulate or be payable at any time thereafter and you shall have no rights thereto.

Interest on the Notes will be due and payable only at the Bank's sole discretion and the Bank shall have absolute discretion at all times and for any reason to cancel any interest payment in whole or in part that would otherwise be payable on any Interest Payment Date. Interest will only be due and payable on an Interest Payment Date to the extent it is not canceled in accordance with the terms of the Notes, including as a result of a mandatory cancellation as required under applicable law. Therefore, there can be no assurances that you will receive interest payments in respect of the Notes.

If the Bank elects to cancel any scheduled interest payment or any such interest payment is mandatorily canceled, such interest payment shall not be or become due and shall not accumulate or be payable at any time thereafter and

you shall have no rights thereto or claim against it with respect to such interest amount or be able to accelerate the principal of the Notes as a result of such interest cancellation. If the Bank does not make an interest payment on the relevant Interest Payment Date (or if it elects to make a payment of a portion of, but not all of such interest payment) such non-payment shall evidence the exercise of the Bank's discretion to cancel such interest payment, or the portion of such interest payment not paid. Furthermore, no cancellation of interest in accordance with the terms of the Indenture or the Notes shall constitute a default in payment or otherwise under the terms of the Notes. If practicable, the Bank will provide notice of any cancellation of interest (in whole or in part) to you through DTC (or, if you hold the Notes in definitive form, directly to the address shown in the register for the Notes) and to the Trustee directly on or prior to the relevant Interest Payment Date. However, failure to provide such notice will not have any impact on the effectiveness of, or otherwise invalidate, any such cancellation of interest, or give you any rights as a result of such failure.

Following cancellation of any interest payment, and until it makes a scheduled interest payment in full, the Indenture will restrict our ability to (i) declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of our capital stock; or (ii) make any payment of premium, principal or interest on or repay, repurchase or redeem any other of our Subordinated Non-Preferred Indebtedness. However, our ability to make payments with respect to securities that rank senior to our Subordinated Non-Preferred Indebtedness will not be in any way limited or restricted. We may therefore cancel (in whole or in part) any interest payment on the Notes at our discretion and may without restriction use funds that could have been applied to make such canceled payments to meet our obligations under securities that rank senior to our Subordinated Non-Preferred Indebtedness as they become due or to meet our other obligations as they become due, regardless of their nature.

In addition to the Bank's right to cancel, in whole or in part, interest payments at any time, the terms of the Notes also restrict the Bank from making interest payments on the Notes in certain circumstances, in which case such interest shall be canceled. Interest that is canceled shall not be due and shall not accumulate or be payable at any time thereafter and you shall have no right to such interest.

In addition to its right to cancel, in whole or in part, interest payments at any time as described above and, subject to the extent permitted in the following paragraphs in respect of partial interest payments, we shall not make an interest payment on the Notes on any Interest Payment Date if an Interest Cancellation Event takes place, and such interest payment shall therefore be automatically canceled and thus shall not be due and payable on such Interest Payment Date. Any Interest Cancellation Event is at the Bank's absolute discretion. Currently, the minimum Capital Ratios to be classified as Class I (and, as a result, not Class II or below), including the Capital Conservation Buffer, are (i) 10.5% in respect of Total Net Capital (*capital neto*), (ii) 8.5% in the case of Tier 1 Capital (*capital básico*) and (iii) 7.0% in the case of Fundamental Capital (*capital básico fundamental*), plus in each case, any other applicable Capital Supplement (currently, a Systemically Important Bank Capital Supplement for grade II D-SIBs of 0.90% and any Countercyclical Capital Supplement applicable to the Bank).

Although we may, at our sole discretion, elect to make a partial interest payment on the Notes on any Interest Payment Date, we may only do so to the extent that such partial interest payment may be made without breaching the restrictions in the preceding paragraphs. In addition, we may elect to make a full or partial interest payment with respect to any security ranking senior to the Notes without making an interest payment on any or all of the Notes on any Interest Payment Date.

We will be responsible for determining compliance with this restriction, and neither the Trustee nor any other agent will be required to monitor such compliance or to perform any calculations in connection therewith.

Any interest canceled on any relevant Interest Payment Date shall not be due and shall not accumulate or be payable at any time thereafter, and you shall have no rights thereto or to receive any additional interest, penalty or compensation as a result of such cancellation. Furthermore, no cancellation of interest in accordance with the terms of the Indenture or the Notes as described above shall constitute a default in payment or otherwise under the terms of the Notes. If practicable, we will provide notice of any cancellation of interest (in whole or in part) to you through DTC (or, if you hold the Notes in definitive form, directly to the address shown in the register for the Notes) and to the Trustee directly on or prior to the relevant Interest Payment Date. However, failure to provide such notice will not have any impact on the effectiveness of, or otherwise invalidate, any such cancellation of interest, or give you any rights as a result of such failure.

The Notes may be written down to zero, causing holders of the Notes to irrevocably waive their rights to claim

or receive repayment of the principal amount of the Notes.

If our Fundamental Capital equals or falls below 5.125%, or other events described in “*Description of the Notes—Trigger Event and Write-Down—Write-Down*,” as applicable, as Trigger Events occur, interest on the Notes will cease to accrue, any accrued interest will be canceled and the outstanding principal amount of the Notes will be written down in an aggregate amount as described in this offering memorandum without the possibility of any future write-up or reinstatement of principal. The holders of the Notes will automatically be deemed to have irrevocably waived their right to claim or receive repayment of the written down principal amount of the Notes then outstanding, and any unpaid interest and any additional amounts with respect thereto. Holders would not receive any of our shares or the shares of our affiliates or be entitled to any other form of compensation in the event of a Write-Down. As a result, holders would lose all or a portion, as the case may be, of their investment in the Notes and will have no right to repayment by us of the written down amount. See “*Description of the Notes—Trigger Event and Write-Down—Write-Down*.” If a Trigger Event occurs, it is expected that a Write-Down would take place before the determination of the treatment of our remaining indebtedness or other securities without similar write-down features. Our other indebtedness without similar write-down features, including indebtedness that is initially subordinated to the Notes, may remain outstanding after a Write-Down of the Notes.

The circumstances surrounding or triggering a Write-Down are unpredictable and may be caused by factors not fully within our control.

The occurrence of a Trigger Event resulting in a Write-Down is inherently unpredictable and may depend on a number of factors, any of which may be outside of our control. The determination as to whether a Trigger Event has occurred will partially depend on the calculation of our Fundamental Capital and whether such ratio equals or has fallen below 5.125%. Fluctuations in our Fundamental Capital may be caused by changes to Mexican Capitalization Requirements and applicable accounting rules, or by changes to regulatory adjustments which modify the regulatory capital impact of accounting rules, among other external factors.

In addition, any disclosure that our Capital Ratios are moving towards the level which would cause the occurrence of a Trigger Event may have an adverse effect on the market price and liquidity of the Notes.

The Notes are novel and complex financial instruments that involve a high degree of risk and may not be a suitable investment for all investors.

The Notes are novel and complex financial instruments that involve a high degree of risk. As a result, an investment in the Notes will involve risks that are not common and are incremental to those applicable in respect of debt securities. Each potential investor of the Notes must determine the suitability (either alone or with the help of a financial adviser) of that investment in light of its own circumstances. In particular, each potential investor should:

- have sufficient knowledge and experience to make a meaningful evaluation of the Notes, the merits and risks of investing in the Notes and the information contained in this offering memorandum;
- have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the Notes and the impact such investment will have on its overall investment portfolio and expected income;
- have sufficient financial resources and liquidity to bear all of the risks of an investment in the Notes, including where the currency for principal or interest payments, i.e., U.S. dollars, is different from the currency in which such potential investor’s financial activities are principally denominated and the possibility that the entire principal amount of the Notes be paid in a different currency and could be lost;
- understand thoroughly the terms of the Notes, such as the provisions governing the Write-Down (including, in particular, the calculation of the Fundamental Capital Ratio, as well as under what circumstances a Trigger Event will occur), and be familiar with the behavior of any relevant indices and financial markets; and
- be able to evaluate possible scenarios for economic, banking industry, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

Sophisticated investors generally do not purchase complex financial instruments that bear a high degree of risk as stand-alone investments. They purchase such financial instruments as a way to enhance yield with an understood, measured, appropriate addition of risk to their overall portfolios. A potential investor should not invest in the Notes unless it has the knowledge and expertise (either alone or with a financial advisor) to evaluate how the Notes will perform under changing conditions, the resulting effects on the likelihood of a Write-Down and the value of the Notes, and the impact this investment will have on the potential investor's overall investment portfolio. Prior to making an investment decision, potential investors should consider carefully, in light of their own financial circumstances and investment objectives, all the information contained in this offering memorandum.

The Notes may be traded with accrued interest, but under certain circumstances described above, such interest may be canceled and not paid on the relevant Interest Payment Date.

The Notes may trade, and/or the prices for the Notes may appear, on the SGX-ST and in other trading systems with accrued interest. If this occurs, purchasers of Notes in the secondary market will pay a price that reflects such accrued interest upon purchase of the Notes. However, if a payment of interest on any Interest Payment Date is canceled (in whole or in part) as described herein and thus is not due and payable, purchasers of such Notes will not be entitled to that interest payment (or if the Bank elects to make a payment of a portion, but not all, of such interest payment, the portion of such interest payment not paid) on the relevant Interest Payment Date. This may affect the value of your investment in the Notes.

The interest rate on the Notes will be reset on each Reset Determination Date, which may affect the market value of the Notes.

From and including the Issue Date to (but excluding) the First Call Date, interest will accrue on the then Current Principal Amount of the Notes at an initial fixed rate equal to 8.375% per annum. From and including each Reset Date, including the First Call Date, to (but excluding) the next succeeding Reset Date, interest will accrue on the then Current Principal Amount of the Notes at a fixed rate per annum equal to the sum of the then-prevailing Treasury Yield on the relevant Reset Determination Date and 776.0 basis points. This reset rate following each Reset Date, could be less than the initial interest rate and/or the interest rate that applies immediately prior to such reset date, which could affect the amount of any interest payments under the Notes and, by extension, could affect the market value of the Notes.

Also, after the First Call Date, the Notes will be subject to redemption on each Interest Payment Date, which may have an effect on the market value of the Notes.

The Notes do not contain events of default and if the Bank does not satisfy its obligations under the Notes, whether due to a Write-Down or otherwise, your remedies will be limited.

The terms of the Notes do not provide for any events of default. You may not at any time demand repayment or redemption of your Notes, although in certain events involving our insolvency (*resolución*) or liquidation you may have a claim. There is no right of acceleration in the case of non-payment of principal or interest on the Notes or of the Bank's failure to perform any of its obligations under or in respect of the Notes.

The sole remedy in the event of any non-payment of principal under the Notes subject to certain conditions as described under "*Description of the Notes—Enforcement Events and Remedies*" is that the Trustee, on your behalf, may, at its discretion, or shall at the direction of the holders of 25% or more of the aggregate principal amount of the outstanding Notes, subject to any applicable laws, institute proceedings for the Bank's liquidation.

Prior to the occurrence of certain events involving the insolvency (*resolución*) or liquidation of the Bank, the Notes will remain subject to one or more Write-Downs upon a Trigger Event, which does not constitute an Enforcement Event under the Indenture. The Bank is entitled to cancel any interest payment as described under "*Description of the Notes—Interest Cancellation*," and such cancellation (in whole or in part) will not constitute an Enforcement Event.

The remedies under the Notes are more limited than those typically available to the Bank's unsubordinated creditors. For further detail regarding the limited remedies of the Trustee and the holders of the Notes, see "*Description of the Notes—Enforcement Events and Remedies*."

Changes in law may adversely affect your rights under the Notes or may adversely affect the Bank's business, financial performance and capital plans.

Changes in law after the date hereof may affect your rights as a holder of Notes as well as the market value of the Notes. Regulators may, from time to time, propose or consider amendments to laws or legislation and rule making which may affect the Bank's business, your rights as a holder of the Notes and the market value of the Notes. Such changes in law may include changes in statutory, tax and regulatory regimes during the life of the Notes, or changes that could have a significant impact on the future legal entity structure, management of the Bank, and use of capital and requirements for loss-absorbing capacity of the Bank, which may have an adverse effect on an investment in the Notes.

Such legislative and regulatory uncertainty could also affect your ability to accurately value the Notes and therefore affect the trading price of the Notes given the extent and impact on the Notes that one or more regulatory or legislative changes could have on the Notes.

The Notes will be unsecured, subordinated and non-preferred and rank junior in right of payment and in liquidation to all of our present or future senior indebtedness and subordinated preferred indebtedness.

The Notes constitute our subordinated non-preferred indebtedness (*obligaciones subordinadas no preferentes*), will be subordinated and junior in right of payment and in liquidation to all of our present and future senior indebtedness and subordinated preferred indebtedness, and will rank *pari passu* without preference among themselves with all our other present or future subordinated non-preferred indebtedness, senior only to all classes of present and future capital stock of the Bank.

By reason of the subordination of the Notes, in the case of certain events involving bankruptcy, liquidation or dissolution, although the Notes would become immediately due and payable at their principal amount together with any unpaid and not canceled interest thereon, our assets would be available to pay such amounts only after all of our senior indebtedness and subordinated preferred indebtedness have been paid in full. As of March 31, 2020, we had, on a consolidated basis, an aggregate of Ps.8,508 million (U.S.\$362 million) of subordinated preferred indebtedness outstanding, and an aggregate of Ps.49,590 million (U.S.\$2,112 million) of subordinated non-preferred indebtedness outstanding. The Indenture will not limit our ability to incur additional senior indebtedness, subordinated preferred indebtedness and subordinated non-preferred indebtedness from time to time. See "*Description of the Notes — Subordination.*"

DTC may decide to suspend all clearance and settlement of transfers of the Notes by holders of such Notes after its receipt of a Write-Down Notice that causes the principal amount of the Notes to be reduced to zero, and any transfer of the Notes that is scheduled to settle after such suspension is expected to be rejected by DTC and will not be settled within DTC.

DTC may decide to suspend all clearance and settlement of transfers of the Notes by holders after its receipt of a Write-Down Notice that causes the principal amount of the Notes to be reduced to zero. We have agreed to provide a Write-Down Notice (as defined in "*Description of the Notes*") to holders and to the Trustee via the applicable clearing system on the business day after the occurrence of the Trigger Event. However, the records of DTC will not be immediately updated to reflect the Trigger Event, and a period of time, which may exceed several days, may be required before the clearance and settlement of transfers of the Notes through DTC are suspended. Due to such delay, it is possible that transfers that are initiated prior to such suspension and scheduled to settle on a date after DTC commences such suspension fail to settle through DTC even though such transfers were initiated prior to the Trigger Event that caused the principal amount of the Notes to be reduced to zero. In such circumstances, transferors of such Notes would not receive any consideration through DTC in respect of such intended transfer because DTC will not settle such transfer after commencement of such suspension. Similarly, it is possible that transfers that are initiated prior to such suspension and scheduled to settle on a date before DTC commences such suspension will be settled through DTC even though such transfers were initiated after the Trigger Event that caused the principal amount of the Notes to be reduced to zero. In such circumstances, transferees of the Notes may be required to pay consideration through DTC even though, upon the occurrence of such Trigger Event, no amounts under the Notes will thereafter become due, and such transferees will have no rights whatsoever under the Indenture or the Notes to take any action or enforce any rights or instruct the Trustee to take any action or enforce any rights whatsoever against us, regardless of whether they have received actual or constructive notice of such fact. The settlement of the Notes following a Trigger Event will be subject to procedures of DTC that are in place at such time.

The Notes are subject to redemption in the event of specified changes affecting the treatment of the Notes under the Mexican Capitalization Requirements or changes affecting the tax treatment of the Notes.

Upon the occurrence and continuation of certain specified changes affecting the tax treatment of the Notes or treatment of the Notes as capital securities under the Mexican Capitalization Requirements, as described under “Description of the Notes—Redemption—Withholding Tax Redemption,” and “Description of the Notes—Redemption—Special Event Redemption,” we will have the option, but not the obligation, under the Indenture of the Notes to redeem the Notes at any time in whole (but not in part) subject to any regulatory requirements.

The rating of the Notes may be lowered or withdrawn depending on various factors, including the rating agencies’ assessments of our financial strength and Mexican sovereign risk.

The rating of the Notes addresses the likelihood of payment of principal at their maturity. The rating also addresses the timely payment of interest on each payment date. The rating of the Notes is not a recommendation to purchase, hold or sell the Notes, and the rating does not comment on market price or suitability for a particular investor. We cannot assure you that the rating of the Notes will remain for any given period of time or that the rating will not be lowered or withdrawn. An assigned rating may be raised or lowered depending, among other things, on the respective rating agency’s assessment of our financial strength, as well as its assessment of Mexican sovereign risk generally.

Our Capital Ratios are affected by business decisions made by us and our shareholders and, in making such decisions, these interests may not be aligned with those of the holders of the Notes offered hereby.

The Notes being offered hereby have terms that are affected by the extent to which we are in compliance with Mexican Capitalization Requirements. See “*Description of the Notes.*” Our Capital Ratios could be affected by a number of factors, including business decisions taken by us in coordination with our controlling shareholder, GFNorte. In this regard, our business strategy and operations may depend on the decisions of GFNorte relating to its overall business, including its operations carried on by us, as well as the overall management of our consolidated capital position. We have no obligation to consider the interests of the holders of the Notes offered hereby (or any other series of our indebtedness that may be outstanding) in connection with overall strategic decisions of GFNorte, including in respect of capital management, regardless of whether they result in the occurrence of a Trigger Event. In addition, holders will not have any claim against us relating to decisions that affect the business and operations of GFNorte, including its capital position, regardless of whether they result in the occurrence of any event that causes a suspension or cancellation of amounts due in respect of the Notes offered hereby. In addition, notwithstanding the applicability of any one or more of the conditions set out above that would result in amounts due in respect of the Notes not being paid or being paid only in part, there will be no restriction on our paying dividends on our ordinary shares or making pecuniary or other distributions to the holders of our ordinary shares, including our controlling shareholder, GFNorte, assuming that we are in compliance with Mexican Capitalization Requirements. Such decisions could cause holders of the Notes offered hereby to lose all or part of the value of their investment in the Notes.

There is no existing market for the Notes and one may not develop in the future; thus it may be difficult to resell your Notes.

Application will be made to have the Notes listed on the SGX-ST, although no assurance can be given that such listing will be accomplished. Even if the Notes are listed on this exchange we may delist the Notes. The Notes constitute a separate and new issue of securities with no established trading market. In addition, in the event there are changes in the listing requirements, we may conclude that continued listing on the SGX-ST is unduly burdensome. See “*General Information.*”

No assurance can be given as to:

- the liquidity of any markets that may develop for the Notes;
- whether an active public market for the Notes will develop;
- your ability to sell your Notes (or beneficial interests therein); or
- the price at which you will be able to sell your Notes, as the case may be.

We have not and will not register the Notes with the RNV maintained by the CNBV and therefore we may not publicly offer the Notes or sell the Notes, nor can they be the subject of brokerage activities in Mexico, except that we may offer the Notes in Mexico to investors that qualify as institutional or accredited investors (*inversionistas institucionales* or *inversionistas calificados*) pursuant to the private placement exemption set forth in Article 8 of the Mexican Securities Market Law (*Ley del Mercado de Valores*) and regulations thereunder. In addition, the Notes have not been registered under the Securities Act and will be subject to transfer restrictions. See “*Transfer Restrictions.*” Future trading prices of the Notes will depend on many factors including, among other things, prevailing interest rates, our operating results, and the market for similar securities. The initial purchasers may make a market in the Notes, but they are not obligated to do so, and any such market-making activity may be terminated at any time without notice to you. In addition, such market-making activity will be subject to the limits of the Securities Act. If an active public trading market for the Notes does not develop, the market price and liquidity of the Notes may be adversely affected. See “*Plan of Distribution.*” In addition, trading or resale of the Notes (or beneficial interests therein) may be negatively affected by other factors described in this offering memorandum arising from this transaction or the market for securities of Mexican issuers generally.

Holders of Notes may find it difficult to enforce civil liabilities against us or our directors, officers and controlling persons.

We are organized under the laws of Mexico. Most of our directors, officers and controlling persons reside outside of the United States. In addition, all or a substantial portion of our assets and their assets are located outside of the United States. As a result, it may be difficult for holders of Notes to effect service of process within the United States on such persons or to enforce judgments against them, including in any action based on civil liabilities under the U.S. federal securities laws. Based on the opinion of our Mexican internal counsel, there is doubt as to the enforceability against such persons in Mexico, whether in original actions or in actions to enforce judgments of U.S. courts, of liabilities based solely on the U.S. federal securities laws.

Mexican law does not require us to pay our foreign-currency judgments in a currency other than Pesos.

Although our obligations to pay U.S. dollars outside Mexico are valid, under Article 8 of the Mexican Monetary Law (*Ley Monetaria de los Estados Unidos Mexicanos*), if proceedings are brought in Mexico, whether pursuant to an initial action or as an action to enforce a judgment, seeking to enforce in Mexico our obligations under the Notes, we would not be required to discharge such obligations in Mexico in a currency other than Mexican currency. Pursuant to such Article 8, an obligation that is payable in Mexico in a currency other than Mexican currency, may be satisfied in Mexican currency at the rate of exchange in effect on the date and in the place payment occurs. Such rate currently is determined by the Mexican Central Bank every business banking day in Mexico and published the following business banking day in the Official Gazette. It is unclear, however, whether the applicable rate of exchange applied by the Mexican court to determine the Mexican Judgment Currency is the rate prevailing at the time when the judgment is rendered or when the judgment is paid. Provisions that purport to limit our liability to discharge our obligations as described above, or to give any party an additional course of action seeking indemnity or compensation for possible deficiencies arising or resulting from variations in rates of exchange, may not be enforceable in Mexico.

If we were declared insolvent by the CNBV, we would be liquidated in a court procedure and the holders of the Notes may find it difficult to collect payment on the Notes.

Under the Mexican Banking Law, if the CNBV declares us insolvent, our authorization to organize and operate as a bank will be revoked and a resolution (*resolución*) and liquidation procedure before a Federal Mexican court will commence, in which by statute the IPAB will be appointed as the receiver (*liquidador judicial*). We would be in liquidation as of the date following the notification by CNBV of the revocation of the authorization to operate as a bank and our payment obligations denominated in foreign currency, including the Notes:

- would be converted to Pesos at the exchange rate prevailing at the time such revocation is deemed effective, other than secured debt,
- would cease accruing interest to the extent such debt is not secured,
- would be paid at the time claims of creditors are satisfied, and
- would not be adjusted to consider any depreciation of the Peso against the U.S. dollar occurring after the liquidation procedure begins.

In addition, in the event of our liquidation, Mexican law provides preferential treatment for certain claims, such as those relating to labor, taxes and secured creditors.

USE OF PROCEEDS

Our net proceeds from the issuance of the Notes are estimated to be approximately U.S.\$488 million, after deducting the initial purchasers' discounts and commissions and estimated offering expenses. We expect to use the net proceeds from the offering of the Notes for general corporate purposes.

EXCHANGE RATES AND CURRENCY

Mexico has had a free market for foreign exchanges since 1994, allowing the Peso to float freely against the U.S. dollar and other foreign currencies. Exchange rate policy is determined by the Exchange Rate Commission (*Comisión de Cambios*), which is formed by officers from the SHCP and the Mexican Central Bank. The Mexican Central Bank is in charge of managing international reserves through rule-based operations (1996-2001 and 2003-onwards) and/or discretionary interventions (last intervention was on February 19, 2016) to promote a clean float and prevent excess accumulation or reduction of Mexico's international reserves. Furthermore, the Mexican Central Bank intervenes directly in the foreign exchange market only to reduce excessive short-term volatility. Since late 2003, the Mexican Central Bank has been conducting auctions of U.S. dollars in an attempt to reduce the levels of its foreign reserves. The Mexican Central Bank conducts open market operations on a regular basis to determine the size of Mexico's monetary base. The Mexican Central Bank may increase or decrease the reserve of funds that financial institutions are required to maintain. Changes in Mexico's monetary base have an impact on the Peso exchange rate. If the reserve requirement is increased, financial institutions will be required to allocate more funds to their reserves, which will reduce the amount of funds available for operations. This causes the amount of available funds in the market to decrease and the cost, or interest rate, to obtain funds to increase. The opposite happens if the reserve requirements are reduced. This mechanism, known as "*corto*" or "*largo*," as the case may be, or more formally "the daily settlement balance target," represents a device used by the Mexican Central Bank to adjust the level of interest and foreign exchange rates.

There can be no assurance that the Mexican government will maintain its current policies with respect to the Peso or that the Peso will not depreciate or appreciate significantly in the future.

The following table sets forth, for the periods indicated, the period-end, average, high and low, the Mexican Central Bank Exchange Rate expressed in Pesos per U.S. dollar. The Mexican Central Bank Exchange Rate is currently determined by the Mexican Central Bank every business day in Mexico based on an average of wholesale foreign exchange market quotes and published the following business banking day in the Official Gazette and on the Mexican Central Bank's website (www.banxico.org.mx). The rates shown below are in nominal Pesos that have not been restated in constant currency units. No representation is made that the Peso amounts referred to in this offering memorandum could have been or could be converted into U.S. dollars at any particular rate or at all. Unless otherwise indicated, U.S. dollar amounts that have been translated from Pesos have been so translated at an exchange rate of Ps.23.4847 to U.S.\$1.00, the Mexican Central Bank Exchange Rate determined by the Mexican Central Bank on March 31, 2020, and published on the Official Gazette on April 1, 2020.

Year Ended December 31,	Mexican Central Bank Exchange Rate ⁽¹⁾			
	Period-End	Average ⁽²⁾	High	Low
2015	17.2487	15.8810	17.3776	14.5559
2016	20.6194	18.6886	21.0511	17.1767
2017	19.6629	18.8098	21.9076	17.4937
2018	19.6512	19.2331	20.7160	17.9787
2019	18.8642	19.2796	20.0696	18.8642
Month				
January 2020	18.9082	18.8040	18.9407	18.6725
February 2020	19.7760	18.8443	19.7760	18.5712
March 2020	23.4847	22.3784	25.1185	19.2837
April 2020	23.9283	24.2658	24.8583	23.5645
May 2020	22.1718	23.4230	24.3812	22.1718
June 2020	23.0893	22.2990	23.1325	21.5837
July 2020 (through July 3)	22.4147	22.5817	22.8078	22.4147

(1) Source: Mexican Central Bank.

(2) Average of end-of-month rates for 2015, 2016, 2017, 2018 and 2019. Average of daily rates for each complete or partial month of 2020.

CAPITALIZATION

The following table sets forth our total capitalization as of March 31, 2020, as follows:

- on an actual basis; and
- as adjusted to reflect the issuance of the Notes offered hereby and the application of the net proceeds of this offering as described herein under “Use of Proceeds.”

This table should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Use of Proceeds” our Financial Statements appearing elsewhere in this offering memorandum.

	Actual		As Adjusted for this Offering ⁽²⁾	
	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)
Long-Term Debt:				
Bank and other loans.....	179	4,197	179	4,197
Senior debt issued.....	1,505	35,355	1,505	35,355
Subordinated debentures:				
Preferred subordinated debentures.....	362	8,509	362	8,509
Non-preferred subordinated debentures.....	2,112	49,590	2,112	49,590
Accrued interest.....	14	324	14	324
Total subordinated debentures.....	2,488	58,423	2,488	58,423
Notes offered hereby.....	-	-	488	11,465
Total long-term debt.....	4,172	97,975	4,660	109,440
Stockholders’ Equity:				
Paid-in capital ⁽³⁾	899	21,130	899	21,130
Other capital.....	3,940	92,530	3,940	92,530
Minority interest.....	-	3	-	3
Total stockholders’ equity.....	4,839	113,663	4,839	113,663
Total Capitalization⁽⁴⁾.....	9,011	211,638	9,499	223,103

(1) Solely for the convenience of the reader, Peso amounts as of March 31, 2020 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “Exchange Rates and Currency.”

(2) The “As Adjusted for this Offering” column reflects the issuance of the Notes in an aggregate principal amount of U.S.\$500,000,000, less the initial purchasers’ discounts and commissions and estimated offering expenses.

(3) As of March 31, 2020, our capital stock consisted of 144,197,415,428 Series O Shares, par value Ps.0.10 per share, which were issued, outstanding and fully paid. Of these shares, 141,691,146,957 (98.26% of our capital stock) are held by GFNorte.

(4) Total capitalization is the sum of total long-term debt and total stockholders’ equity. For a discussion of our Capital Ratio, see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Risk—Based Capital.”

Except as disclosed in this offering memorandum, there has been no material change in our total capitalization since March 31, 2020.

SELECTED CONSOLIDATED FINANCIAL INFORMATION

The selected consolidated financial information presented in this section is derived from our accounting records or from our Financial Statements and relates only to us and our consolidated subsidiaries. This information should be read in conjunction with “Presentation of Financial and Other Information,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our Financial Statements and the notes thereto included elsewhere in this offering memorandum.

Our Financial Statements have been prepared in accordance with Mexican Banking GAAP, which differs in certain important respects from U.S. GAAP. For a summary of the differences between Mexican Banking GAAP and U.S. GAAP, see “Annex A – Significant Differences Between Mexican Banking GAAP and U.S. GAAP.”

Summary Statement of Income Data:	For the three-month period ended March 31,			For the Year ended December 31,			
	2020	2020	2019	2019	2019	2018	2017
	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)		(U.S.\$ millions) ⁽¹⁾		(Ps. millions)	
Interest income.....	1,276	29,978	32,643	5,417	127,208	117,979	95,710
Interest expense.....	(531)	(12,462)	(15,712)	(2,496)	(58,621)	(53,466)	(40,062)
Net interest income.....	745	17,516	16,931	2,921	68,587	64,513	55,648
Allowance for loan losses.....	(181)	(4,262)	(3,700)	(643)	(15,104)	(15,635)	(14,983)
Net interest income after allowance for loan losses.....	564	13,254	13,231	2,278	53,483	48,878	40,665
Commission and fee income.....	246	5,782	5,303	975	22,906	21,379	18,436
Commission and fee expense.....	(91)	(2,135)	(1,951)	(363)	(8,516)	(7,849)	(6,142)
Intermediation revenues.....	45	1,048	934	194	4,560	3,799	2,101
Other operating income.....	1	31	1,820	112	2,624	2,869	2,365
Non-interest expense.....	(414)	(9,718)	(9,341)	(1,622)	(38,095)	(35,079)	(31,750)
	(213)	(4,992)	(3,235)	(704)	(16,521)	(14,881)	(14,990)
Operating income.....	351	8,262	9,996	1,574	36,962	33,997	25,675
Equity in earnings of unconsolidated subsidiaries and associated companies.....	1	29	14	5	128	161	62
Income before income tax.....	352	8,291	10,010	1,579	37,090	34,158	25,737
Current income tax.....	(110)	(2,576)	(2,176)	(342)	(8,021)	(8,565)	(6,781)
Deferred income tax (expense) benefit.....	20	465	(472)	(67)	(1,576)	(759)	(706)
Discontinued operations.....	-	-	-	-	-	-	89
Net income.....	262	6,180	7,362	1,170	27,493	24,834	18,339

- (1) Solely for the convenience of the reader, Peso amounts for the three-month period ended March 31, 2020 and for the year ended December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “Exchange Rates and Currency.”

	As of March 31,		As of December 31,			
	2020	2020	2019	2019	2018	2017
Balance Sheet Data:						
	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)	(U.S.\$ millions) ⁽¹⁾		(Ps. millions)	
Assets:						
Cash and cash equivalents.....	3,776	88,668	2,652	62,282	75,233	76,063
Margin securities	413	9,701	252	5,926	1,458	1,986
Investment in securities						
Trading securities	3,405	79,968	3,201	75,169	92,418	122,065
Securities available for sale	6,686	157,021	6,499	152,630	147,986	152,910
Securities held to maturity.....	839	19,711	834	19,593	8,492	6,834
	10,930	256,700	10,534	247,392	248,896	281,809
Debtor balances under repurchase and resale agreements.....	82	1,930	86	2,016	405	5
Derivatives financial instruments.....						
For trading purposes	2,084	48,940	949	22,295	28,083	25,511
For hedging purposes.....	55	1,291	7	162	156	205
	2,139	50,231	956	22,457	28,239	25,716
Valuation adjustments for assets hedging.....	3	66	3	69	84	99
Performing loan portfolio						
Commercial loans						
Business loans.....	12,281	288,409	11,345	266,442	275,979	210,431
Financial institutions' loans.....	1,022	24,011	877	20,595	21,088	22,875
Government loans.....	6,866	161,246	7,245	170,155	192,234	132,816
Consumer loans.....	4,948	116,200	4,949	116,228	111,237	101,995
Mortgage loans	7,376	173,226	7,242	170,086	155,797	135,405
Total performing loan portfolio.....	32,493	763,092	31,658	743,506	756,335	603,552
Past-due loan portfolio						
Commercial loans						
Business loans.....	285	6,700	262	6,147	7,044	6,540
Financial Institutions loans.....	-	4	-	4	-	-
Government loans.....	1	35	-			
Consumer loans.....	171	4,018	182	4,268	4,331	4,329
Mortgage loans	88	2,069	84	1,973	1,464	1,323
Total past-due loan portfolio.....	545	12,826	528	12,392	12,839	12,192
Loan portfolio.....	33,038	775,918	32,186	755,898	769,174	615,714
(Less) allowance for loan losses	(764)	(17,932)	(727)	(17,083)	(18,264)	(15,551)
Loan portfolio, net.....	32,274	757,986	31,459	738,815	750,910	600,163
Acquired collection rights.....	54	1,261	58	1,359	2,001	1,925
Total loan portfolio, net.....	32,328	759,247	31,517	740,174	752,911	602,088
Receivables generated by						
securitizations.....	7	161	6	139	61	141
Other accounts receivable, net.....	3,545	83,264	1,252	29,410	36,082	37,492
Foreclosed assets, net.....	35	818	37	860	738	752
Property, furniture and equipment, net.....	646	15,167	642	15,088	13,547	13,474
Permanent stock investments.....	20	468	18	418	342	150
Long Term Assets Available for Sale	-	-	-	-	-	-
Deferred taxes, net.....	185	4,352	47	1,104	4,839	3,517
Other assets.....	974	22,874	946	22,201	17,657	13,131
Total Assets.....	55,083	1,293,647	48,948	1,149,536	1,180,492	1,056,423
Liabilities:						
Deposits						
Demand deposits.....	19,240	451,842	18,542	435,453	412,118	394,995
Time deposits						
General public	11,734	275,566	11,143	261,705	277,576	245,288
Money market	1,145	26,894	772	18,122	55,552	3,679
Time deposits.....	94	2,213	89	2,085	1,891	1,657
Senior debt issued	1,505	35,355	1,146	26,907	12,098	3,003
	33,718	791,870	31,692	744,272	759,235	648,622

	As of March 31,		As of December 31,			
	2020	2020	2019	2019	2018	2017
Balance Sheet Data:						
	(U.S.\$ millions) ⁽¹⁾	(Ps. millions)	(U.S.\$ millions) ⁽¹⁾		(Ps. millions)	
Interbank and other loans						
Demand loans.....	213	5,000	21	500	-	-
Short-term loans.....	355	8,332	395	9,276	13,523	8,441
Long-term loans	179	4,197	207	4,854	22,199	6,797
	<u>747</u>	<u>17,529</u>	<u>623</u>	<u>14,630</u>	<u>35,722</u>	<u>15,238</u>
Creditor balances under repurchase and resale agreements	<u>7,481</u>	<u>175,685</u>	<u>6,927</u>	<u>162,684</u>	<u>163,507</u>	<u>190,363</u>
Collateral sold or pledged						
Repurchase or resale agreements (creditor balance)	1	16	4	105	2	3
Derivatives financial instruments						
For trading purposes	2,153	50,574	884	20,752	23,605	24,608
For hedging purposes.....	447	10,487	180	4,221	10,963	12,401
	<u>2,600</u>	<u>61,061</u>	<u>1,064</u>	<u>24,973</u>	<u>34,568</u>	<u>37,009</u>
Other account payables						
Income tax.....	102	2,402	64	1,513	1,696	1,940
Employee profit sharing.....	27	639	22	508	485	405
Creditors from settlements of transactions.....	1,277	29,983	400	9,397	4,402	15,871
Creditors from cash collateral.....	312	7,331	106	2,493	14,319	11,083
Sundry creditors and other payables ..	1,482	34,824	1,118	26,265	24,059	16,897
	<u>3,200</u>	<u>75,179</u>	<u>1,710</u>	<u>40,176</u>	<u>44,961</u>	<u>46,196</u>
Subordinated debentures.....	<u>2,488</u>	<u>58,423</u>	<u>2,046</u>	<u>48,050</u>	<u>33,560</u>	<u>32,445</u>
Deferred credits and advanced collections.....	<u>9</u>	<u>221</u>	<u>16</u>	<u>386</u>	<u>535</u>	<u>485</u>
Total liabilities	<u>50,244</u>	<u>1,179,984</u>	<u>44,082</u>	<u>1,035,276</u>	<u>1,072,090</u>	<u>970,361</u>
Stockholders' equity						
Paid-in capital						
Common stock.....	800	18,794	800	18,794	18,794	18,105
Additional paid-in capital.....	99	2,336	90	2,123	1,184	648
	<u>899</u>	<u>21,130</u>	<u>890</u>	<u>20,917</u>	<u>19,978</u>	<u>18,753</u>
Other capital						
Capital reserves.....	738	17,330	738	17,330	14,847	13,013
Retained earnings from prior years....	3,304	77,595	2,167	50,883	53,133	38,959
Result from valuation of securities available for sale	(120)	(2,824)	80	1,885	(1,994)	4
Result from valuation of instruments for cash flow hedging	(169)	(3,965)	(97)	(2,287)	(3,430)	(3,653)
Cumulative foreign currency translation adjustment	8	177	(1)	(34)	1,659	1,590
Remeasurements defined benefits for employees.....	(84)	(1,963)	(82)	(1,930)	(628)	(943)
Net income	<u>262</u>	<u>6,180</u>	<u>1,171</u>	<u>27,493</u>	<u>24,834</u>	<u>18,339</u>
	<u>3,940</u>	<u>92,530</u>	<u>3,976</u>	<u>93,340</u>	<u>88,421</u>	<u>67,309</u>
Noncontrolling interest.....	<u>-</u>	<u>3</u>	<u>-</u>	<u>3</u>	<u>3</u>	<u>-</u>
Total stockholders' equity	<u>4,839</u>	<u>113,663</u>	<u>4,866</u>	<u>114,260</u>	<u>108,402</u>	<u>86,062</u>
Total liabilities and stockholders' equity.....	<u>55,083</u>	<u>1,293,647</u>	<u>48,948</u>	<u>1,149,536</u>	<u>1,180,492</u>	<u>1,056,423</u>

(1) Solely for the convenience of the reader, Peso amounts as of March 31, 2020 and as of December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See "Exchange Rates and Currency."

	As of or for the three-month period ended March 31,		As of or for the year ended December 31,			
	2020	2020	2019	2019	2018	2017
	(U.S.\$ millions, except percentages) ⁽¹⁾	(Ps. millions, except percentages)	(U.S.\$ millions, except percentages) ⁽¹⁾	(Ps. millions, except percentages)		
Profitability and Efficiency:						
Return on average total assets ⁽²⁾	2.0%	2.0%	2.4%	2.4%	2.3%	1.8%
Return on average equity ⁽³⁾	21.7%	21.7%	24.2%	24.2%	25.7%	20.3%
Net interest margin ⁽⁴⁾	6.3%	6.3%	6.4%	6.4%	6.3%	5.8%
Efficiency ratio ⁽⁵⁾	43.7%	43.7%	42.3%	42.3%	41.4%	43.8%
Credit Quality Data:						
Total performing loans	32,493	763,092	31,658	743,506	756,335	603,522
Total non-performing loans	545	12,826	528	12,392	12,839	12,192
Total loans	33,038	775,918	32,186	755,898	769,174	615,714
Loans graded “C,” “D” and “E” ⁽⁶⁾	1,834	43,079	1,644	38,616	48,067	31,080
Allowance for loan losses	764	17,932	727	17,083	18,264	15,551
Credit Quality Ratios:						
Allowance for loan losses as a percentage of total loans	2.3%	2.3%	2.3%	2.3%	2.4%	2.5%
Allowance for loan losses as a percentage of total non- performing loans ⁽⁷⁾	139.8%	139.8%	137.9%	137.9%	142.3%	127.6%
Allowance for loan losses as a percentage of loans graded “C,” “D” and “E” ⁽⁶⁾	41.6%	41.6%	44.2%	44.2%	38.0%	50.0%
Total non-performing loans as a percentage of total loans	1.7%	1.7%	1.6%	1.6%	1.7%	2.0%
Net non-performing loans (total non-performing loans less allowance for loan losses) as a percentage of net total loans (total performing loans plus net non-performing loans)	(0.7%)	(0.7%)	(0.6%)	(0.6%)	(0.7%)	(0.6%)
Net non-performing loans (total non-performing loans less allowance for loan losses) as a percentage of stockholders’ equity	(4.5%)	(4.5%)	(4.1%)	(4.1%)	(5.0%)	(3.9%)
Loans graded “C,” “D” and “E” as a percentage of total loans ⁽⁶⁾	5.6%	5.6%	5.1%	5.1%	6.2%	5.0%

- (1) Solely for the convenience of the reader, Peso amounts as of and for the three-month period ended March 31, 2020 and as of and for the year ended December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “*Exchange Rates and Currency*.”
- (2) Net income for the year divided by the average of the last five quarters of total assets, based on end-of-period balances (excluding minority interest). For the three-month period ended March 31, 2020, net income is determined on an annualized basis and is divided by the last two quarters of total assets based on end-of-period balances, in this case, March 31, 2020 and December 31, 2019.
- (3) Net income for the year divided by the average of the last five quarters of stockholders’ equity, based on end-of-period balances (excluding minority interest). For the three-month period ended March 31, 2020, net income is determined on an annualized basis and is divided by the last two quarters of total assets based on end-of-period balances, in this case, March 31, 2020 and December 31, 2019.
- (4) Net interest income divided by the average of the last five quarters of total interest-earning assets, based on end-of-period balances (excluding minority interest). For the three-month period ended March 31, 2020, net income is determined on an annualized basis.
- (5) Efficiency ratio is equal to non-interest expense divided by the aggregate of net interest income and non-interest income (commissions and fees, intermediation revenues and other operating income). For this purpose, net interest income is calculated before allowance for loan losses.
- (6) Refers to our loan portfolio classified pursuant to the General Rules Applicable to Mexican Banks. Under applicable regulations, such classification is determined by reference to our loan portfolio at the end of the preceding quarter. See “*Selected Statistical Information—Grading of Loan Portfolio*.”
- (7) Corresponds to end-of-year balance, which is different from guidelines prescribed by the CNBV regarding calculation of required additional reserves. See “*Selected Statistical Information—Allowance for Loan Losses*.”

Capital Ratios

The table below presents our risk-weighted assets and Capital Ratios for the periods indicated.

	As of March 31,		As of December 31,			
	2020	2020	2019	2019	2018	2017
	(U.S. millions, except for percentages) ⁽¹⁾	(Ps. millions, except for percentages)	(U.S.\$ millions, except for percentages) ⁽¹⁾	(Ps. millions, except for percentages)		
Capital:						
Fundamental Capital (CET1)	4,292	100,805	4,340	101,927	94,970	75,220
Additional Tier 1 Capital	2,000	46,969	1,607	37,728	18,865	20,103
Tier 2 Capital	391	9,194	374	8,783	14,472	13,286
Total Net Capital	6,684	156,968	6,321	148,438	128,307	108,609
Risk-Weighted Assets:						
Credit risk	27,687	650,213	26,696	626,953	627,479	507,721
Market risk	4,749	111,536	4,614	108,359	66,119	72,848
Operational risk	2,805	65,882	2,760	64,812	53,865	46,406
Total Risk-Weighted Assets	35,241	827,630	34,070	800,125	747,464	626,976
Capital Ratios (credit, market and operational risk):						
Fundamental Capital (CET1) to risk-weighted assets	12.18%	12.18%	12.74%	12.74%	12.71 %	12.00%
Tier 1 Capital to risk-weighted assets	17.86%	17.86 %	17.45%	17.45%	15.23%	15.20%
Tier 2 Capital to risk-weighted assets	1.11%	1.11%	1.10%	1.10%	1.94%	2.12%
Total Net Capital to Total Risk-Weighted Assets	18.97%	18.97 %	18.55%	18.55%	17.17%	17.32%

- (1) Solely for the convenience of the reader, Peso amounts as of March 31, 2020 and as of December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “Exchange Rates and Currency.”

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with our Financial Statements, together with the notes thereto, included elsewhere in this offering memorandum. Our Financial Statements have been prepared in accordance with Mexican Banking GAAP, which differs in certain significant respects from MFRS and U.S. GAAP. See "Annex A - Significant Differences Between Mexican Banking GAAP and U.S. GAAP" for a discussion of significant differences between Mexican Banking GAAP and U.S. GAAP. No reconciliation of any of our Financial Statements to U.S. GAAP has been performed. Any such reconciliation would likely result in material quantitative differences. See "Presentation of Financial and Other Information" and "Risk Factors—Risks Relating to Our Business—Our Financial Statements have been prepared and are presented in accordance with Mexican Banking GAAP, which is significantly different from U.S. GAAP."

Principal Factors Affecting Our Financial Condition and Results of Operations

A substantial portion of our operations are located in Mexico. Consequently, our results of operations and our financial condition are strongly affected by the general economic environment and political conditions existing in Mexico.

Mexican Economic Environment

In 2017, the Mexican economy grew 2.0%, on an annualized basis, driven by a strong performance of the services sector, along with a pickup in manufacturing activity. Inflation remained under control despite the depreciation of the Peso against the U.S. dollar at the beginning of the year and the impact of the liberalization of energy prices.

In 2018, the Mexican economy grew at an average of 2.0% with the economy expanding at 0.2%, on a quarter-to-quarter basis for the fourth quarter according to data released by INEGI (*Instituto Nacional de Estadística y Geografía*), slightly below 0.8% expansion, on a quarter-to-quarter basis, registered in the previous quarter. Economic activity was primarily driven by a strong services sector, along with the recovery of the manufacturing activity that supported the industrial production, particularly as uncertainty about the trade with the U.S. was following the agreement on trade reached in late August 2018.

In 2019, the Mexican economy contracted at an average of 0.1% with the economy contracting by 0.3%, on a quarter-to-quarter basis for the fourth quarter according to data released by INEGI (*Instituto Nacional de Estadística y Geografía*), which was slightly weaker than the 0.2% contraction, on a quarter-to-quarter basis, registered in the previous quarter. Economic activity was primarily affected by temporary shocks that took place at the beginning of the year, namely, problems with fuel distribution, strikes in the northern part of the country and teachers' strikes in Michoacán. We expect these shocks to have a transitory impact on economic activity in 2020.

In the first quarter of 2020, the Mexican economy contracted at an average of 2.2% with the economy contracting by 1.25% on a quarter-to-quarter basis versus the fourth quarter, according to data released by INEGI (*Instituto Nacional de Estadística y Geografía*). Economic activity was primarily affected by the outbreak of COVID-19 pandemic and the sharp decline and volatility in oil prices, including those triggered by crude oil price disagreement between Russia and Saudi Arabia. The World Bank has estimated that Mexico's GDP could contract by as much as 7.5% in 2020 and forecasts by several analysts and financial institutions estimate a more pronounced contraction.

In April 2020, the countries members of the OPEC+ alliance, including Mexico, agreed to significantly reduce output, with the aim of lifting crude oil prices from 20-year lows. The reduction in the amount of crude oil may have an adverse effect on the revenues of the Mexican government economy and, in turn, on Mexico. Beginning on May 1, 2020, OPEC+ cut production by 9.7 million barrels per day. On June 6, OPEC+ agreed to a one-month extension of its record crude oil-production cuts and adopted a stricter approach to ensuring members don't pump more than they pled. This deal is expected to underpin the oil market's recovery. The reduction in the amount of crude oil may have an adverse effect on the revenues of the Mexican government economy and, in turn, on Mexico.

On March 13, 2020 Canada ratified the USMCA, which entered into force on July 1, 2020. The new terms of the USMCA could have an impact on Mexico's economy generally and job creation in Mexico.

On March 26, 2020, S&P downgraded Mexico's long-term foreign currency and local currency ratings to "BBB" (from BBB+) and to "BBB+" (from A+), respectively. The downgrade reflected the expected economic impact of the combined shocks of COVID-19 in Mexico and in the U.S. and lower global oil prices. As a result of Mexico's weakening economic resilience, S&P took various rating action on financial institutions. Banorte's rating was lowered to BBB (from "BBB+") on global scales and our Junior Subordinated Securities to BB- from BB.

Fitch Ratings downgraded Mexico's sovereign debt on April 15, 2020, reflecting an assessment of the overall financial capacity of the government of Mexico to pay its obligations and its ability to meet its financial commitments as they become due, from BBB to BBB- citing increased risk due to PEMEX's deteriorating credit profile and weakness in the macroeconomic outlook due to, among other things, trade tensions. In addition, Moody's downgraded Mexico's rating on April 17, 2020, from A3 to Baa1, maintaining the negative outlook. On the same date, Fitch Ratings also revised the outlook of Mexico's state oil company, PEMEX, from stable to negative, citing insufficient investment to restore declining production. These downgrades could adversely affect the Mexican economy and, consequently, our ratings as well as our business, financial condition, operating results and prospects.

On April 21, 2020, Fitch Ratings announced it conducted a portfolio review of Mexican banks with international scale ratings following the downgrade of the country's sovereign rating, lowering Banorte's rating to BBB- from BBB. According to Fitch Ratings, the ratings primarily reflect our risk appetite, which results in higher-than-peers exposure to government-related businesses. Although Fitch believes we have a good financial profile to face the challenges of the operating environment, our financial metrics could weaken relative to previous performance, which is reflected in the rating downgrade and negative outlook. We have been resilient over the past years to a deteriorating operating environment, with a growing franchise, high profitability, sound impairment ratios as well as what we believe is a good funding and liquidity profile; however, if the operating environment continues to worsen, our ratings could face larger downside potential relative to peers due to our more concentrated business mix. While the ultimate economic and financial market implications of the COVID-19 pandemic are unclear, Fitch Ratings considers the already deteriorated and challenging operating environment to be clearly skewed to the downside, which has driven the agency's adjustment on the operating environment mid-point score to BB+ from BBB with a negative outlook. Fitch Ratings' assessment of the operating environment has a direct influence on bank ratings, and for many banks this is a high influence rating factor. Fitch Ratings expects deteriorating operating conditions from the COVID-19 outbreak to pressure asset quality and weigh on earnings due to lower loan growth, decreasing interest rates and higher credit costs over the medium term.

On April 22, 2020, Moody's downgraded to Baa1, from A3, our long-term global local and foreign currency deposit, issuer and debt ratings. In the same rating action, Moody's affirmed our Aaa.mx/MX-1 long- and short-term Mexican National Scale ratings. The outlook of Banorte remains negative according to Moody's. The reasons for these actions were (1) Mexico's medium-term economic growth prospects have materially weakened, (2) the continued deterioration in PEMEX's (Ba2 negative) financial and operational standing is eroding the sovereign's fiscal strength, and (3) weakened policy making and institutional capacity. The rating actions reflect the high inter-linkages between Mexican banks' ratings and those of the sovereign as a result of holdings of government bonds for liquidity purposes or lending to entities such as state-owned enterprises or regional and local governments that benefit from cash flows from revenues of the federal government. Moreover, the global spread of the COVID-19 is resulting in simultaneous supply and demand shocks. Moody's expects these shocks to materially slow global economic activity, particularly in the first half of this year. In Mexico, according to Moody's, the COVID-19 outbreak will mire an already weak economy into a recession, and as such Moody's forecasts a significant GDP contraction this year followed by a weak recovery, all of which are likely to have a material impact on our operations and financial condition.

COVID-19 Pandemic

Since December 2019, the COVID-19 has spread throughout the world. On March 11, 2020, COVID-19 was categorized as a pandemic by the World Health Organization. On March 30, 2020, the Mexican Federal Government declared a health emergency as a result of the COVID-19 pandemic, announcing the implementation of several protective measures, including the suspension of any and all non-essential activities and a voluntary shelter in place.

order. These measures, as well as other measures implemented across the world, including border closures and travel restrictions, have led to a suspension or a material decrease of a significant number of commercial activities, including international flights, operation of hotels, restaurants, retail stores and other establishments, disruption of supply chains worldwide and falls in production and demand, among others, causing unprecedented commercial disruption in a number of jurisdictions, including Mexico.

In Mexico, several industries and sectors to which we have exposure have been particularly impacted by the COVID-19 pandemic and related economic disruption, including, but not limited to, transportation, tourism, and restaurants, oil and gas and automotive industries. As of March 31, 2020, approximately 15.9% of our total loan portfolio was comprised of loans to borrowers in these sectors.

On March 25, 2020, in order to mitigate the economic impact of the COVID-19 pandemic, the CNBV announced certain special temporary accounting criteria applicable to banks, including (i) the total or partial deferral of principal and/or interest payments by debtors of mortgages, credit cards, automobile, personal, payroll, and SME loans that were in good standing as of February 28, 2020, for up to four months (with the possibility to extend them for two additional months), and (ii) to freeze the balances of existing loans that were in good standing as of February 28, 2020, without interest charges; in each case, without considering such loans to be non-performing, and therefore, without requiring banks to create loan-loss provisions.

While the impact of the COVID-19 has been significant in general, the disruptions caused by the COVID-19 had no impact on our financial performance for the period ended December 31, 2019, and our results for the first quarter of 2020 were not significantly affected by the pandemic, given that, among other reasons, (i) most of the public-health restrictions in Mexico were implemented after the second week of March 2020, (ii) we were able to maintain adequate levels of funding and deposits, and (iii) the measures implemented by the CNBV on March 25, 2020 have enabled us to maintain adequate levels of non-performing loans.

However, given the uncertainty around the extent and timing of the future spread of COVID-19, the potential imposition of additional protective measures or the relaxation of existing measures, it is not possible to predict the effect that this pandemic will have on our operations, as well as on those of our clients, counterparties and other stakeholders.

Furthermore, the Mexican government's shelter in place order and other related measures, in the context of a weakened economy, lower interest rates and a weaker exchange rate, have affected us both directly and indirectly, through an impact on our customers, counterparties, employees and other stakeholders, and these measures may adversely affect us in the future by, among other things, decreasing lending volumes, decreasing fee-generating transactions, reducing margins on lending, putting pressure on our capitalization ratios, increasing our delinquency rates and past due loan ratios and requiring additional allowances for impairment of loans.

In response to the pandemic, some of our clients have drawn on credit lines and we anticipate that more of our clients could do so. While our liquidity position remains strong, we expect these draws to lead to a reduction in our liquidity ratio. Substantial draws in the future could again reduce our liquidity ratios and our overall liquidity.

We had to temporarily close some of our branches in Mexico as a result of the COVID-19 pandemic. As of June 15, 2020, we had closed 15% of our branches. While we still have branches open as of the date of this offering memorandum, we may generally provide only a limited number of services through them. In addition, a significant number of our personnel are working remotely, disrupting our normal operations. Remote work has increased cybersecurity risks given greater use of computer networks outside the corporate environment. Moreover, the spread of COVID-19 could also negatively impact the business and operations of third-party service providers who perform critical services for us.

The COVID-19 pandemic has had a negative impact on various commercial and economic activities in Mexico and abroad, which have caused an economic recession in Mexico. Despite the various measures and programs that we have implemented to mitigate the progression of liquidity risk to default risk, the depth of the economic recession in Mexico is expected to cause a systemic risk and a future deterioration in the credit quality of our clients. Such potential deterioration is not currently considered by the rating and reserving methodologies we are authorized to use to generate reserves for credit risks. Therefore, in order to proactively reflect this potential deterioration in our financial

statements, at the end of June 2020, we created Ps.3,000 million in additional reserves, in excess of those required by our rating and reserving methodologies, that will impact our second quarter results. This amount covers our estimated additional reserves impact for 2020 and a significant portion of 2021. Additionally, with the idea to prepare the Bank's balance sheet to absorb the new past due loan portfolio estimated from the pandemic, we also charged an impairment on non-COVID-19 past due loans for a total of Ps.4,618 million, of which only Ps.1,868 million affected our June 2020 statement of income given that the remaining Ps.2,750 million were previously reserved. As a result, the aggregate impact of these measures in our second quarter statement of income was Ps. 4,868 million. We may create additional reserves in the future, in response to the economic recession caused by the pandemic. See "Risk Factors—Risks Relating to Our Business—Our results of operations have been, and may continue to be, adversely affected by U.S. and international financial market and economic conditions."

Effects of Changes in Interest Rates

Interest rate fluctuations in Mexico have a significant effect on our interest income, interest expense and trading income. Changes in market interest rates may lead to temporary repricing gaps between our interest-earning assets and our interest-bearing liabilities. Upward or downward adjustments of the interest rates on our assets and liabilities generally occur approximately every 28 days. The repricing generally limits the effects of net exposures that regularly occur upon movements in interest rates. See "Selected Statistical Information—Interest Rate Sensitivity of Assets and Liabilities." In addition, sustained high interest rate environments have historically discouraged customers from borrowing and have resulted in increased delinquencies in outstanding loans and in a deterioration of asset quality.

The table below shows the annual interest rate paid in connection with primary offerings of *Cetes*, which are Mexican government Peso-denominated treasury bills, with 28-day maturities.

Average Monthly CETES Rate



Source: Mexican Central Bank

During the year ended December 31, 2017, the Mexican Central Bank increased interest rates by 150 basis points to 7.25%. Interest rates on 28-day and 91-day *Cetes* averaged 6.69% and 6.88%, respectively, in the year ended December 31, 2017.

During the year ended December 31, 2018, the Mexican Central Bank increased interest rates by 100 basis points to 8.25%. Interest rates on 28-day and 91-day *Cetes* averaged 7.62% and 7.83%, respectively, in the year ended December 31, 2018, as compared with average rates on 28-day and 91-day *Cetes* of 6.69% and 6.88%, respectively, in the year ended December 31, 2017.

During the year ended December 31, 2019, the Mexican Central Bank maintained interest rates at 7.25%. Interest rates on 28-day and 91-day *Cetes* averaged 7.85% and 7.94%, respectively, in the year ended December 31, 2019, as

compared with average rates on 28-day and 91-day *Cetes* of 7.38% and 7.53%, respectively, in the year ended December 31, 2018.

During the three-month period ended March 31, 2020, the Mexican Central Bank decreased interest rates by 75 basis points to 6.50% (which was reduced again to 5.5% on May 14, 2020 and to 5.0% on June 25, 2020). Interest rates on 28-day and 91-day *Cetes* averaged 6.98% and 6.99%, respectively, in the first three months of 2020, as compared with average rates on 28-day and 91-day *Cetes* of 7.97% and 8.15%, respectively, in the first three months of 2019. For further detail, see “*Risk Management—Market Risk.*”

Trends Affecting our Financial Condition and Results of Operations

The Mexican financial services sector is likely to remain competitive with a large number of financial services providers and alternative distribution channels. Additionally, further consolidation in the sector (through mergers, acquisitions or alliances) is likely to occur as other major banks look to increase their market share, combine with complementary businesses or strengthen their balance sheets. In addition, regulatory changes will take place in the future that we expect will increase the overall level of regulation in the sector.

The following are the most important trends, uncertainties and events that we believe are reasonably likely to have a material adverse effect on us or that would cause the disclosed financial information not to be indicative of our future operating results or our financial condition:

- an economic downturn or insufficient recovery of the economy generally and the financial markets, as a result from the COVID-19 pandemic, which could result in reduced demand for financial products and services, a sharp deterioration in the valuation of financial assets and investments, increased volatility in the financial markets, exchange rate volatility and an increase in loan defaults;
- uncertainties relating to economic growth expectations, interest rate cycles in Mexico, the new government policies and continued instability and volatility in the financial markets, and the impact they may have over the yield curve and exchange rates;
- the resulting effect of the global economic slowdown and fluctuations in local interest and exchange rates;
- changes in the credit quality of our loan portfolio as a result of inorganic or organic growth and weakness in certain sectors of the Mexican economy, such as the home building sector;
- increases in our cost of funding that could adversely affect our net interest margin as a consequence of timing differences in the repricing of our assets and liabilities;
- increased competition that may lead to tightening of our margins;
- inflationary pressures that may lead to increases in interest rates and decreases in growth;
- acquisitions or restructurings of businesses that do not perform in accordance with our expectations or that subject us to previously unknown risks; and
- increased regulation, government intervention and new laws prompted by the global financial crisis which could change our industry and require us to modify our businesses or operations.

The COVID-19 pandemic is expected to lead to sharp declines in the Mexican and global GDP in 2020, increases in unemployment levels, a sharp deterioration in the valuation of financial assets and investments, increased volatility in the financial markets, including with respect to the value and trading of our debt securities, exchange rate volatility, an increase in loan defaults by both companies and individuals and increases in public debt due to actions taken by governmental authorities in response to the pandemic.

If our clients default on their payment obligations at the end of the grace period provided by the release program implemented by us in connection with the measures announced by the CNBV on March 25, 2020, or otherwise fail to timely comply with their obligations under our outstanding loans, this will result in higher levels of non-performing loans, leading to the recognition of additional allowances for impairment losses. Furthermore, defaults by our clients that are not covered by payment deferral measures enacted by the CNBV would also lead to increased recognition of allowances for impairment losses. While we have not recognized significant impairment losses since the beginning of the COVID-19 pandemic, the impact on our allowance for impairment losses is currently uncertain, as it is highly dependent on the duration of the COVID-19 pandemic and the extent and length of the ensuing economic downturn.

Future developments with respect to COVID-19 are highly uncertain and new information may emerge concerning the severity of the COVID-19 pandemic and the actions taken to contain it. Furthermore, there are no indications the Mexican government will be implementing extraordinary loan programs, tax relief or other forms of relief or assistance for private sector entities such as us. If the pandemic continues and further government programs are not initiated, or the ones in place are not effective, this could have a material adverse effect on us.

The extent to which the COVID-19 pandemic impacts our results will depend on its duration and the level of continued disruption to Mexican, regional and global economic activity. Even though both the Mexican federal government and several states in Mexico have announced programs to progressively reopen their economies starting in June 2020, it is impossible to predict with certainty the duration of the pandemic or the restrictions and preventive measures implemented by the government. In addition, customer habits, even following the pandemic and the termination of the governmental restrictions described above, may have been altered, which may have a material adverse effect on our business. There can also be no assurance that the adverse impact of the COVID-19 pandemic will not lead to a tightening of liquidity conditions or funding uncertainty.

Recognition of the effects of inflation in financial information

We recognize inflation in our Financial Statements pursuant to MFRS B-10 “Effects of Inflation,” which considers two types of economic environments: a) inflationary, when the accumulated inflation of the three previous years is equal to or higher than 26%, in which case the effects of inflation must be acknowledged; and b) non-inflationary, when in the same period inflation is less than 26%, in which case the effects of inflation should not be recorded in the financial statements.

The cumulative Mexican inflation over the three years prior to 2019 and 2018 was 15.71% and 12.60%, respectively. Therefore, the Mexican economy is considered as non-inflationary. Therefore, pursuant to the provisions of MFRS B-10 described above, the Mexican economy was considered as non-inflationary during these periods. However, assets, liabilities and stockholders’ equity as of December 31, 2019 and 2018 include the restatement effects recorded up through December 31, 2007.

The Mexican inflation rates for the years ended on December 31, 2019, 2018 and 2017 were 2.83%, 4.83% and 6.77%, respectively, and the annualized inflation rate for the three-month period ended March 31, 2020 was 3.25%.

Changes in accounting policies

On November 4, 2019, the Mexican Board for Research and Development of Financial Reporting Standards published a resolution in relation to the Mexican Financial Reporting Standards (“NIF”) to amend the Fourth Transitory Article of the “Resolution that modifies the general provisions applicable to credit institutions,” as published in the Official Gazette of the Federation on December 15, 2018. The effective date of new accounting rules was postponed from January 1, 2019 to the reporting period beginning on January 1, 2022.

The Commission expects to publish the final version of criterion A-2, “Application of Particular Rules,” currently under review, which includes some clarifications in the application of these NIFs. The main accounting standards that have been considered as part of this project are as follows:

- NIF B-17, “Determination of Fair Value”.

- NIF C-2, "Investment in financial instruments".
- NIF C-3, "Accounts receivable".
- NIF C-9, "Provisions, contingencies and commitments".
- NIF C-10, "Derivative financial instruments and hedging relationships".
- NIF C-16, "Impairment of financial instruments receivable".
- NIF C-19, "Financial instruments payable".
- NIF C-20, "Financial instruments receivable principal and interest".
- NIF D-1, "Revenue from contracts with customers".
- NIF D-2, "Costs for contracts with customers".
- NIF D-5, "Leases".
- NIF B-5 "Financial information by segments".
- NIF B-12 "Compensation of financial assets and financial liabilities".
- NIF C-2 "Investment in financial instruments".
- NIF C-10 "Derivative and hedging financial instruments".
- NIF C-13 "Related parties".
- NIF C-14 "Transfer and derecognition of financial assets".
- NIF C-22 "Cryptocurrencies"
- NIF B-11 "Long-lived assets held for sale and discontinued operations"

The final version of criterion A-2 may further differ from U.S. GAAP requirements.

Changes in the accounting criteria B-6 Loan portfolio

In the resolution published on December 27, 2017, amendments to Criterion B-6 were included, which require the following concepts to be recorded by decreasing the line item "Provisions for loan losses" instead of recording them within "other operating income (expenses)":

- excess of loan losses, and
- recoveries of loans write-off.

These amendments became effective beginning on January 1, 2019, with the option for credit institutions to early adopt them as of the day following their publication. Therefore, we decided to early adopt them in February 13, 2018.

As of December 31, 2018, we recognized Ps.502 million and Ps.1,853 million related to surplus credit reserves and recoveries of write-off loans, respectively, in the "allowance for loan losses" category, which, up to December 2017, were recorded under the caption "Other income (expenses) of the operation."

As of December 31, 2019, we recognized Ps.1,199 million and Ps.2,008 million related to surplus credit reserves and recoveries of write-off loans, respectively, in the “Allowance for loan losses” category, which, up to December 2018, were recorded in the caption of “Other income (expenses) of the operation.”

As of March 31, 2020, we recognized Ps.185 million and Ps.565 million related to surplus credit reserves and recoveries of write-off loans, respectively, in the “Allowance for loan losses” category.

Effects of the Merger of Banco Interacciones into the Bank

On July 13, 2018, the merger of GFInter into our parent company, GFNorte, became effective. Subsequently, on the same date, Banco Interacciones, the banking subsidiary of GFInter, merged into the Bank. As a result of the Interacciones Merger, we consolidated our position as the fourth largest bank in Mexico in terms of total assets, performing loans and core deposits, according to information published by the CNBV, and we strengthened our government lending business.

As a result of the Interacciones Merger, our Financial Statements for any period from and after July 13, 2018 are not fully comparable to prior periods, including other financial information as of and for the year ended on December 31, 2019 and the three-month period ended on March 31, 2020 contained in this offering memorandum.

Critical Accounting Policies

We have identified certain critical accounting policies on which our financial position and results of operations are dependent. These critical accounting policies generally involve complex quantitative analyses or are based on subjective judgments or decisions. In the opinion of management, our critical accounting policies under Mexican Banking GAAP are those described further below. Our management uses certain assumptions and estimates based on historical experience and other factors that are considered to be relevant for the preparation of our audited consolidated financial statements and are applied consistently to our condensed interim financial statements. These assumptions and estimates are continuously reviewed by our management. We recognize amendments to our accounting estimates in the period in which the amendment is introduced and subsequent periods if the amendment affects both current and subsequent periods. Actual results may differ from these assumptions and estimates. For a complete description of our significant accounting policies, see Note 4 to our Audited Consolidated Financial Statements.

Fair Value of Financial Instruments

Financial instruments, including securities and derivatives, included in our portfolio are recorded at fair value. Our management uses assumptions and estimates in the determination of the fair value of these financial instruments. Fair values are based on listed market prices, where possible. If listed market prices are not available or if the liquidation of our positions would reasonably be expected to impact market prices, fair value is determined based on other relevant factors, including dealer price quotations and price quotations for similar instruments traded in different markets, including markets located in different geographic areas. Although, we believe these assumptions to be appropriate, limitations to obtain daily prices may occur, which could affect the determination of the fair value of financial instruments and the results of the period in which the related changes in fair value occur. Fair values for certain derivative contracts are derived from pricing models that consider current market and contractual prices for the underlying financial instruments or commodities, as well as time value and yield curve or volatility factors underlying the positions.

Allowance for Loan Losses

We classify our loan portfolio according to the rules issued by the SHCP and by the methodology established by the CNBV. Such regulations establish the general methodology for grading our loan portfolio and estimating the loan loss allowance for each type of loan.

In the case of consumer mortgage and commercial loans, we apply the General Rules Applicable to Mexican Banks for rating the loan portfolio as issued by the CNBV and published in the Official Gazette on June 24, 2013.

On June 24, 2013, the CNBV issued changes to the General Rules Applicable to Mexican Banks regarding commercial loan ratings. 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 rules 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 CNBV.

The commercial loan portfolio grading procedure requires that credit institutions apply the established methodology based on quarterly information for the periods ending in March, June, September and December of each year whereas also recording in their financial statements the allowances determined at the end of each month. Furthermore, during the months following each quarter, financial institutions may apply to the respective loan the grading methodology used at the close of the immediately preceding quarter, based on the outstanding balance of such loan in effect on the last day of the aforementioned months. The allowances for loan losses that have exceeded the amount required to grade the loan will be canceled against the period's results on the following quarterly grading date. Additionally, recoveries on the previously written-off loan portfolios are recorded in the period's results.

On March 25, 2020, in order to mitigate the economic impact of the COVID-19 pandemic, the CNBV announced certain special temporary accounting criteria applicable to banks, including (i) the total or partial deferral of principal and/or interest payments by debtors of mortgages, credit cards, automobile, personal, payroll, and SME loans that were in good standing as of February 28, 2020, for up to four months (with the possibility to extend them for two additional months), and (ii) to freeze the balances of existing loans that were in good standing as of February 28, 2020, without interest charges; in each case, without considering such loans to be non-performing, and therefore, without requiring banks to create allowances for loan-losses. For a complete description and application of the temporary accounting criteria, see Notes 2 and 27 to our Unaudited Condensed Consolidated Interim Financial Statements.

General description of rules established by the CNBV

The rules for grading consumer, mortgage and commercial loans (other than loans for investment projects having their own source of payment) provided that the loan losses allowance for such loans should be determined based on an estimate of the loan's expected loss over the next twelve-month period. The grading methodology requires that the estimation of such loss takes into consideration the probability of a default, the loss given default and the exposure at default. The result of multiplying these three factors is the estimated expected loan loss that is the same as the amount of the reserves needed in order to cover the loan loss.

The probability of default, the loss given default and the exposure at default are determined by type of loan considering the following:

- *Probability of Default:*
 - For non-revolving consumer loans, the probability of default is determined based on the number of days past due, the payments made on outstanding balances, the loan to asset value ratio, the type of consumer loan and the term to maturity, among others.
 - For revolving consumer loans, the probability of default is determined based on the current situation and historical behavior of the borrower regarding the number of past due payments, number of days past due, the payments made on outstanding balances, as well as the percentage of utilization of the authorized line of credit.
 - For mortgage loans, the probability of default is determined based on the number of days past due, highest number of past due payments over the last four periods, the borrower's willingness to pay and the loan to asset value ratio.
 - For commercial loans, the probability of default is determined based on the type of borrower, the borrower's historical payment behavior, payment history with Infonavit, rating agencies'

evaluation, financial risk, socioeconomic risk, financial soundness, country and industry risk, market positioning, transparency, standards and corporate governance.

- **Loss Given Default**

- For consumer loans (non-revolving and revolving), the loss given default is determined based on the number of past due payments.
- For mortgage loans, the loss given default is determined based on the outstanding balance of the mortgage loan, unemployment insurance and the state where the loan was granted.
- For commercial loans, the loss given default is determined based on the value of the financial and non-financial collateral securing the loan, as well as guarantees granted by the borrower.

- **Exposure at Default**

- For non-revolving consumer loans, the exposure at default is determined based on the outstanding loan balance as of the grading date.
- For revolving consumer loans, the exposure at default is determined based on the current percentage of utilization of the authorized line of credit line, which is used to estimate how much such utilization would increase in the event of a default.
- For mortgage loans, the exposure at default is determined based on the outstanding loan balance as of the grading date.
- For commercial loans, the exposure at default **(i)** in the case of uncommitted lines of credit, it is determined based on the outstanding loan balance as of the grading date and **(ii)** in the case of committed lines of credit, it is determined based on the current percentage of utilization of the authorized line of credit, which is used to estimate how much such utilization would increase in the event of a default.

The regulatory loan classification and grading rules establish the following categories corresponding to levels of risk based on allowance percentage: Grade “A” loans, representing minimal risk of non-payment; grade “B” loans, representing low risk loans; grade “C” loans, representing loans with moderated risk; grade “D” loans, representing high risk loan; grade “E” loans, representing non-collectible loans.

Risk Levels	% of Allowance for Loan Loss Reserves			
	Consumer Loans		Mortgage Loans	Commercial Loans
	Non Revolving	Revolving		
A-1	0 to 2.0	0 to 3.0	0 to 0.50	0 to 0.9
A-2	2.01 to 3.0	3.01 to 5.0	0.501 to 0.75	0.901 to 1.5
B-1	3.01 to 4.0	5.01 to 6.5	0.751 to 1.0	1.501 to 2.0
B-2	4.01 to 5.0	6.51 to 8.0	1.001 to 1.50	2.001 to 2.50
B-3	5.01 to 6.0	8.01 to 10.0	1.501 to 2.0	2.501 to 5.0
C-1	6.01 to 8.0	10.01 to 15.0	2.001 to 5.0	5.001 to 10.0
C-2	8.01 to 15.0	15.01 to 35.0	5.001 to 10.0	10.001 to 15.5
D	15.01 to 35.0	35.01 to 75.0	10.001 to 40.0	15.501 to 45.0
E	35.01 to 100.0	> 75.01	40.001 to 100.0	> 45.0

Employee Retirement Obligations

Our employee retirement obligations include employee pension plans, seniority premium benefits and severance indemnities and medical reserves at the end of the work relationship. The determination of our obligations and expenses is dependent on our selection of certain assumptions to determine the best estimate for our retirement

obligations. These assumptions include demographic factors, discount rates and expected increases in compensation and life expectancy, among others. Although we believe these assumptions to be appropriate, a change in such assumptions could affect the value of the employee retirement liability and the results of the period in which it occurs. We evaluate our assumptions at least annually. Those assumptions are described in Notes 4 and 2 to our Audited Consolidated Financial Statements and include the expected return on plan assets, discount rate and rate of increase in compensation costs. Our assumptions depend on Mexico's economic circumstances.

In accordance with the provisions of MFRS D-3, "Employee Benefits," actual results that differ from our assumptions (actuarial gains or losses) are accumulated and amortized over future periods and, therefore, generally affect our recognized expenses and recorded obligations in these future periods. While we believe that our assumptions are appropriate, significant differences in our actual experience or significant changes in our assumptions may substantially affect our employee retirement obligations and our future expenses.

Property, Plant and Equipment

Property, furniture and equipment are recorded at acquisition cost. The acquisition balance of such property, furniture and equipment up to December 31, 2007 is restated using factors derived from the UDI value up to such date. Depreciation is calculated using the straight-line method based on the useful lives of the assets as estimated by internal and external independent appraisers. Useful lives are reviewed at least once a year and are based on the current conditions of the assets and the estimate of the period during which they will continue to generate economic benefits to us. If there are changes in the estimate of useful lives, the carrying amount of assets is affected prospectively, as well as the amortization or depreciation expense, as applicable.

Deferred Income Tax Assets

We calculate our deferred income tax 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 balance of deferred tax assets is determined based on our projections of recoverability through the generation of future net income for tax purposes. These projections are based on our management's judgments and estimates of future transactions to conclude on the likelihood of recoverability of deferred tax assets.

Results of Operations for the Three-month Period Ended March 31, 2020 Compared to the Three-month Period Ended March 31, 2019

Net Interest Income

Our net interest income was Ps.17,516 million for the three-month period ended March 31, 2020 compared to Ps.16,931 million for the corresponding period in 2019, an increase of Ps.585 million, or 3.5%. This increase resulted from a 20.7% decrease of our interest expense, despite an 8.2% decrease of our total interest income, which were caused by the decrease in market rates and a decline in loan origination. During the three-month period ended March 31, 2020, the rate on 28-day Mexican benchmark interbank money market rate (*Tasa de Interés Interbancaria de Equilibrio*) ("TIIE") averaged 7.3%, 130 basis points lower than 8.6% average rate for the corresponding period in 2019, which had a positive impact on our NIM.

In terms of margins, our average interest rate earned on interest-earning assets was 10.1% in the three-month period ended March 31, 2020, and our average interest rate paid on interest-bearing liabilities was 5.8%, resulting in a yield spread of 4.3%. Our average interest rate earned on interest-earning assets was 10.4% for the three-month period ended March 31, 2019, and our average interest rate paid on interest-bearing liabilities was 6.7%, resulting in a yield spread of 3.8%.

The following table sets forth the components of our net interest income for the periods indicated:

	For the three-month period ended March 31,	
	2020	2019
	<i>(Ps. millions)</i>	
Interest Income:		
Interest on loans.....	21,909	22,469
Fees on loans ⁽¹⁾	358	324
Interest on cash and cash equivalents and securities.....	4,709	5,602
Income on hedging operations.....	1,240	1,502
Interest on repurchase operations ⁽²⁾	1,730	2,717
UDI valuation ⁽⁵⁾	32	18
Foreign exchange valuation ⁽⁴⁾	-	13
Total interest income.....	29,978	32,643
Interest Expense:		
Interest on deposits and funding.....	6,456	7,906
Interest on repurchase operations ⁽³⁾	4,591	6,329
Expense on hedging operations.....	994	1,198
UDI valuation ⁽⁵⁾	-	-
Foreign exchange valuation ⁽⁴⁾	130	-
Fees paid ⁽⁶⁾	291	279
Total interest expense.....	12,462	15,712
Monetary (loss) gain, net.....	-	-
Net interest income.....	17,516	16,931

- (1) Fees on loans represent fees generated in connection with the issuance, renewal, draw-down or prepayment of a loan that is recorded as interest income in accordance with Mexican Banking GAAP.
- (2) Interest income on repurchase operations represents interest income on securities purchased pursuant to our agreements to resell in accordance with Mexican Banking GAAP.
- (3) Interest expense on repurchase operations represents interest expense on securities sold under agreements to repurchase in accordance with Mexican Banking GAAP.
- (4) Foreign exchange valuation represents the net changes in the foreign exchange valuation that are recorded as interest income or interest expense depending on the net effect in accordance with Mexican Banking GAAP.
- (5) UDI valuation represents part of the effect from changes in the inflation rate on UDI-denominated liabilities that are recorded in interest expense and UDI-denominated assets that are recorded in interest income, as the case may be, in accordance with Mexican Banking GAAP.
- (6) Fees paid represent fees incurred in connection with our withdrawal, renewal and drawing down of loans that are recorded as interest expense in accordance with Mexican Banking GAAP.

Interest Income

Our interest income was Ps.29,978 million for the three-month period ended March 31, 2020 compared to Ps.32,643 million for the corresponding period in 2019, a decrease of Ps.2,665 million, or 8.2%. Our average interest rate earned on interest-earning assets decreased by 34 basis points from 10.4% during the three-month period ended March 31, 2019 to 10.1% during the corresponding period in 2020. Our average balance of interest-earning assets decreased by 5.1% from Ps.1,256,039 million during the three-month period ended March 31, 2019 to Ps.1,192,087 million during the corresponding period in 2020. The average balance of our interest-earning assets decreased primarily as a result of a decline of repurchase agreement operations of 34.2%, from Ps.150,292 million during the three-month period ended March 31, 2019 to Ps.98,944 million during the three-month period ended March 31, 2020, in addition to a 28.3% decrease of hedging operations from Ps.44,438 million during the three-month period ended March 31, 2019 to Ps.31,851 million during the three-month period ended March 31, 2020.

Our interest on loans was Ps.21,909 million (or 73.1% of our interest income) for the three-month period ended March 31, 2020 compared to Ps.22,469 million (or 68.8% of interest income) for the corresponding period in 2019, a decrease of Ps.560 million, or 2.5%. This decrease was primarily the result of a 0.15% decrease in the average balance of our loans, mostly in our consumer portfolio, and the decrease in interest rates that the Mexican Central Bank carried out during 2019 and the first quarter of 2020. Our fees on loans were Ps.358 million (or 1.2% of our interest income) for the three-month period ended March 31, 2020 compared to Ps.324 million (or 1.0% of interest income) for the corresponding period in 2019, an increase of Ps.34 million, or 10.5%. This increase was primarily the result of higher loan business volumes linked to an increase in commission fees detailed as follows: Ps.12 million on business loans,

Ps.2 million on government loans, Ps. 2 million on payroll loans, Ps.6 million on car loans, and Ps.13 million on housing mortgage loans.

Our interest income from cash and cash equivalents and securities was Ps.4,709 million (or 15.7% of our interest income) for the three-month period ended March 31, 2020 compared to Ps.5,602 million (or 17.2% of our interest income) for the corresponding period in 2019, a decrease of Ps.893 million, or 15.9%. Despite this decrease, there was a marginal increase in the average balance of our cash and cash equivalents and securities of 0.7% in the three-month period ended March 31, 2020 as compared to the three-month period ended March 31, 2019.

Our interest income from hedging operations was Ps.1,240 million (or 4.1% of our interest income) for the three-month period ended March 31, 2020 compared to Ps.1,502 million (or 4.6% of our interest income) for the corresponding period in 2019, a decrease of Ps.262 million, or 17.4%. This change was due to a decrease of interest income on interest rate swaps hedging floating rate deposits due to a decrease in the TIIE and a 28.3% decrease in the average balance of our hedging operations in the three-month period ended March 31, 2020 as compared to the three-month period ended March 31, 2019.

Our interest income from repurchase operations was Ps.1,730 million (or 5.8% of our interest income) for the three-month period ended March 31, 2020 compared to Ps.2,717 million (or 8.3% of our interest income) for the corresponding period in 2019, a decrease of Ps.987 million, or 36.3%. This change was mainly due to a 34.2% decrease in the average balance on repurchase operations as well as lower market interest rates, primarily the overnight interbank interest rate (*tasa de fondeo interbancario*), which resulted in lower Cetes rates during the three-month period ended March 31, 2020 as compared to the three-month period ended March 31, 2019.

Interest Expense

Our interest expense was Ps.12,462 million for the three-month period ended March 31, 2020 compared to Ps.15,712 million for the corresponding period in 2019, a decrease of Ps.3,250 million, or 20.7%. This decrease was mainly due to a Ps.1,450 million decrease in interest on deposits and funding and a decrease of Ps.1,738 million of interests in repurchase operations, which was due to the impact of higher market interest rates. Our average interest rate paid on interest-bearing liabilities decreased by 97 basis points from 6.7% for the corresponding period in 2019 to 5.8% for the three-month period ended March 31, 2020 and our average balance of these liabilities decreased by 7.5% from Ps.923,787 million for the corresponding period in 2019 to Ps.854,309 million for the three-month period ended March 31, 2020. The decrease in our average rate paid on interest-bearing liabilities was primarily due to lower market interest rates (overnight interbank interest rate (*tasa de fondeo interbancario*)). The rate on 28-day Cetes averaged 6.98% for the three-month period ended March 31, 2020, compared to 7.97% for the corresponding period in 2019.

Our interest payments on deposits and funding was Ps.6,456 million (or 51.8% of our interest expense) for the three-month period ended March 31, 2020 compared to Ps.7,906 million (or 50.3% of our interest expense) for the corresponding period in 2019, a decrease of Ps.1,450 million, or 18.34%. This decrease is explained by lower market interest rates and a marginal decrease of 0.06% in our average total deposits and funding, mainly due to a 6.9% decrease in our time deposits.

Our interest expense from repurchase operations was Ps.4,591 million (or 36.8% of interest expense) for the three-month period ended March 31, 2020 compared to Ps.6,329 million (or 40.3% of interest expense) for the corresponding period in 2019, a decrease of Ps.1,738 million, or 27.5%. This decrease was the result of lower market interest rates (primarily the overnight interbank interest rate (*tasa de fondeo interbancario*), which resulted in lower Cetes rates during the three-month period ended March 31, 2020 as compared to the corresponding period in 2019), and a 16.9% lower average balance of repurchase operations in the three-month period ended March 31, 2020 as compared to the corresponding period in 2019.

Allowance for Loan Losses

Our allowance for loan losses charged against earnings was Ps.4,262 million for the three-month period ended March 31, 2020 compared to Ps.3,700 million for the corresponding period in 2019, an increase of Ps.562 million, or 15.2%. This increase is mainly due to a non-recurrent loan loss allowance related to a specific client in the Corporate Banking segment.

Our allowance for loan losses as a percentage of non-performing loans increased to 139.8% as of March 31, 2020 from 136.1% as of March 31, 2019. The increase in the ratio of our allowance for loan losses to non-performing loans reflects a 2.0% decrease in non-performing loans. The cost of risk (calculated as loan losses divided by average total loans) was 2.2% for March 31, 2020 compared to 1.9% for three-month period ended March 31, 2019.

Net Interest Income after Allowance for Loan Losses

As a result of the factors discussed above, our net interest income after allowance for loan losses was Ps.13,254 million for the three-month period ended March 31, 2020 compared to Ps.13,231 million for the corresponding period in 2019, an increase of Ps.23 million, or 0.17%.

Commission and Fee Income

Our total commission and fee income was Ps.5,782 million for the three-month period ended March 31, 2020 compared to Ps.5,303 million for the corresponding period in 2019, an increase of Ps.479 million, or 9.0%, primarily due to an increase in core banking services, such as electronic banking and fee income on loan disposals.

The following table shows the breakdown of our commissions and fees for the periods indicated:

	For the three-month period ended March 31,	
	2020	2019
	<i>(Ps. millions)</i>	
Commissions and Fees:		
Fund transfers.....	403	370
Account management.....	598	623
Fiduciary	118	104
Credit card.....	1,216	1,185
Income from real estate loan portfolios acquired and other investment projects	2	1
Electronic banking services.....	2,336	2,128
Other commissions and fees.....	1,109	892
Total commissions and fees income	5,782	5,303

Commission and Fee Expense

Our total commission and fee expense was Ps.2,135 million for the three-month period ended March 31, 2020 compared to Ps.1,951 million for the corresponding period in 2019, an increase of Ps.184 million, or 9.4%, primarily due to an increase in POS activity (in terms of number of transactions and volumes transacted), which caused an increase on fees paid for interbank transactions resulting in higher commissions paid for origination dynamics of consumer loans.

Intermediation Revenues

Our intermediation revenues were Ps.1,048 million in the three-month period ended March 31, 2020 compared to Ps.934 million for the corresponding period in 2019, an increase of Ps.114 million, or 12.2%, due to higher hedging derivative operations with our clients and higher intermediation volumes, reflecting the overall market volatility.

Our foreign exchange gains were Ps.358 million in the three-month period ended March 31, 2020 compared to Ps.97 million for the corresponding period in 2019, an increase of Ps.261 million, or 269%, due primarily to higher volumes on foreign exchange intermediation with our clients and volatility in exchange rates.

Our realized gains on securities intermediation increased to Ps.2,047 million for the three-month period ended March 31, 2020 compared to Ps.248 million for the corresponding period in 2019, an increase of Ps.1,799 million, or 725%, which was attributable mainly to higher intermediation volumes. We recorded unrealized losses on securities of Ps.1,357 million in the three-month period ended March 31, 2020 compared to positive unrealized gains on securities of Ps.589 million for the corresponding period in 2019, which was attributable principally to a decrease in intermediation revenues on securities and mark-to-market gains, reflecting market volatility linked to economic and political events.

Other Operating Income

Our other operating income was Ps.31 million for the three-month period ended March 31, 2020 compared to Ps.1,820 million for the corresponding period in 2019, a decrease of Ps.1,789 million, or 98.3%, mainly due to the extraordinary income of Ps.1,661 million from the foreign exchange conversion effect of Banorte USA as part of the profit derived from its liquidation in the first quarter of 2019.

Non-interest expense

Our non-interest expense was Ps.9,718 million for the three-month period ended March 31, 2020 compared to Ps.9,341 million for the corresponding period in 2019, an increase of Ps.377 million, or 4%. This increase was the result mainly of the following expenses:

- a Ps.10 million decrease in our salaries and employee benefits;
- a Ps.164 million increase in our administrative and promotional expenses;
- a Ps.267 million increase in our leases, depreciation and amortization;
- an Ps.11 million decrease, or 1.3%, in our contributions to the IPAB on deposits; and
- a Ps.33 million decrease in our other factors, mainly due to taxes and other income taxes.

The efficiency ratio, defined as non-interest expense divided by the aggregate of net interest income and non-interest income in the three-month period ended March 31, 2020 was 43.7%, compared to 40.5% for the corresponding period in 2019.

Operating Income

As a result of the factors discussed above, our operating income was Ps.8,262 million for the three-month period ended March 31, 2020 compared to Ps.9,996 million for the corresponding period in 2019, a decrease of Ps.1,734 million, or 17.3%.

Equity in Earnings of Unconsolidated Subsidiaries and Associated Companies

Our equity in earnings of unconsolidated subsidiaries and associated companies was Ps.29 million in the three-month period ended March 31, 2020 compared to Ps.14 million for the corresponding period in 2019, an increase of Ps.15 million, or 107.1%. This increase was primarily due to an allowance for losses and expenses related to data security generated in 2019 in one of our subsidiaries.

Income Taxes

Our current income tax expense was Ps.2,576 million for the three-month period ended March 31, 2020 compared to Ps.2,176 million for the corresponding period in 2019, an increase of Ps.400 million, or 18.3%. The greater income tax expense is a result of higher accumulated taxable income in certain transactions.

We recorded a deferred income tax benefit of Ps.465 million in the three-month period ended March 31, 2020, compared to a Ps.472 million deferred income tax expense for the corresponding period in 2019, mainly as a result of expenses made for profitable business due to the temporary differences between accounting and fiscal assets and liabilities according to NIF D-4. This resulted in projects to be capitalized, global preventive reserves and advanced payments.

The net decrease in our income tax expense was Ps.537 million in the three-month period ended March 31, 2020 compared to the corresponding period in 2019.

Net Income

Our net income was Ps.6,180 million for the three-month period ended March 31, 2020 compared to Ps.7,362 million for the corresponding period in 2019, a decrease of Ps.1,182 million, or 16%, due to the results of our operations discussed above.

Results of Operations for the year Ended December 31, 2019 compared to the year ended December 31, 2018

Net Interest Income

Our net interest income was Ps.68,587 million for the year ended December 31, 2019 compared to Ps.64,513 million for the year ended December 31, 2018, an increase of Ps.4,074 million, or 6.3%. During the year ended December 31, 2019, the rate on 28-day TIIE averaged 8.3%, 32 basis points higher than 8.0% average rate for the year ended December 31, 2018, which had a positive impact on our NIM. This increase resulted in a 7.8% increase of our total interest income and a 10.9% increase of our interest income from loans.

In terms of margins, our average interest rate earned on interest-earning assets was 10.5% in the year ended December 31, 2019 and our average interest rate paid on interest-bearing liabilities was 6.7%, resulting in a yield spread of 3.8%. Our average interest rate earned on interest-earning assets was 10.4% for the year ended December 31, 2018 and our average interest rate paid on interest-bearing liabilities was 6.5%, resulting in a yield spread of 3.9%.

The following table sets forth the components of our net interest income for the periods indicated:

	For the year ended December 31,	
	2019	2018
	(Ps. millions)	
Interest Income:		
Interest on loans.....	89,532	80,758
Fees on loans ⁽¹⁾	1,405	1,282
Interest on cash and cash equivalents and securities	20,877	22,974
Income on hedging operations.....	5,561	6,668
Interest on repurchase operations ⁽²⁾	9,725	6,141
UDI valuation ⁽³⁾	77	80
Foreign exchange valuation ⁽⁴⁾	30	77
Total interest income.....	127,208	117,979
Interest Expense:		
Interest on deposits and funding.....	30,066	25,616
Interest on repurchase operations ⁽³⁾	22,736	21,214
Expense on hedging operations.....	4,663	5,591
UDI valuation ⁽³⁾	-	-
Foreign exchange valuation ⁽⁴⁾	-	-

	For the year ended December 31,	
	2019	2018
	(Ps. millions)	
Fees paid ⁽⁶⁾	1,156	1,044
Total interest expense	58,621	53,466
Net interest income	68,587	64,513

- (1) Fees on loans represent fees generated in connection with the issuance, renewal, draw-down or prepayment of a loan that is recorded as interest income in accordance with Mexican Banking GAAP.
- (2) Interest income on repurchase operations represents interest income on securities purchased pursuant to our agreements to resell in accordance with Mexican Banking GAAP.
- (3) Interest expense on repurchase operations represents interest expense on securities sold under agreements to repurchase in accordance with Mexican Banking GAAP.
- (4) Foreign exchange valuation represents the net changes in the foreign exchange valuation that are recorded as interest income or interest expense depending on the net effect in accordance with Mexican Banking GAAP.
- (5) UDI valuation represents part of the effect from changes in the inflation rate on UDI-denominated liabilities that are recorded in interest expense and UDI-denominated assets that are recorded in interest income, as the case may be, in accordance with Mexican Banking GAAP.
- (6) Fees paid represent fees incurred in connection with our withdrawal, renewal and drawing down of loans that are recorded as interest expense in accordance with Mexican Banking GAAP.

Interest Income

Our interest income was Ps.127,208 million for the year ended December 31, 2019, compared to Ps.117,979 million for the year ended December 31, 2018, an increase of Ps.9,229 million, or 7.8%. 96% of this increase was due to a growth of Ps.8,898 million in interest on loans, which, in turn, resulted from an annual increase of 9.4% in the average loans portfolio.

Our average interest rate earned on interest-earning assets increased by 10 basis points from 10.4% during the year ended December 31, 2018 to 10.5% during the year ended December 31, 2019. Our average balance of interest-earning assets increased by 6.8% from Ps.1,129,801 million during the year ended December 31, 2018 to Ps.1,206,427 million during the year ended December 31, 2019. The average balance of our interest-earning assets increased primarily as a result of an increase of our loan portfolio of 9.4% from Ps.685,404 million during the year ended December 31, 2018 to Ps.750,147 million during the year ended December 31, 2019, in addition to a 2.7% increase on other interest-earning assets which include cash, cash equivalents and securities, hedging operations, and repurchase operations from Ps.444,397 million during the year ended December 31, 2018 to Ps.456,280 million during the year ended December 31, 2019.

Our interest on loans was Ps.89,532 million (or 70.4% of our interest income) for the year ended December 31, 2019 compared to Ps.80,758 million (or 68.5% of our interest income) for the year ended December 31, 2018, an increase of Ps.8,774 million, or 10.9%. This increase was the result of a 9.4% increase in the average loans portfolio and an increase in overnight interest rates that the Mexican Central Bank carried out during the year ended December 31, 2019. Our fees on loans were Ps.1,405 million (or 1.1% of our interest income) for the year ended December 31, 2019 compared to Ps.1,282 million (or 1.1% of our interest income) for the year ended December 31, 2018, an increase of Ps.123 million, or 9.6%.

Our interest income from cash and cash equivalents and securities was Ps.20,984 million (or 16.5% of our interest income) for the year ended December 31, 2019 compared to Ps.23,130 million (or 19.6% of our interest income) for the year ended December 31, 2018, a decrease of Ps.2,146 million, or 9.3%. This decrease was primarily due to an 11.3% reduction in the average balance of our cash and cash equivalents and securities in the year ended December 31, 2019 as compared to the year ended December 31, 2018.

Our interest income from hedging operations was Ps.5,561 million (or 4.4% of our interest income) for the year ended December 31, 2019 compared to Ps.6,668 million (or 5.7% of our interest income) for the year ended December 31, 2018, a decrease of Ps.1,107 million, or 16.6%. This change was due to a decrease of interest income on interest rate swaps hedging floating rate deposits due to an increase in the TIIE and a 14.1% decrease in the average balance

of our hedging operations in the year ended December 31, 2019 as compared to the year ended December 31, 2018.

Our interest income from repurchase operations was Ps.9,725 million (or 7.6% of our interest income) for the year ended December 31, 2019 compared to Ps.6,141 million (or 5.2% of our interest income) for the year ended December 31, 2018, an increase of Ps.3,584 million, or 58.4%. This change was mainly due to a 62.9% increase in the average balance on repurchase operations as well as a higher market interest rates primarily the overnight interbank interest rate (*tasa de fondeo interbancario*), which resulted in higher Cetes rates during the year ended December 31, 2019 as compared to the year ended December 31, 2018.

Interest Expense

Our interest expense was Ps.58,621 million for the year ended December 31, 2019 compared to Ps.53,466 million for the year ended December 31, 2018, an increase of Ps.5,155 million, or 9.6%. This increase was mainly due to a Ps.4,450 million increase in interest on deposits and funding and an increase of Ps.1,522 million of interests in repurchase operations, which was due to the impact of higher market interest rates.

Our average interest rate paid on interest-bearing liabilities increased by 18 basis points from 6.5% for the year ended December 31, 2018 to 6.7% for the year ended December 31, 2019 and our average balance of these liabilities increased by 6.7% from Ps.822,424 million for the year ended December 31, 2018 to Ps.877,359 million for the year ended December 31, 2019. The increase in our average rate paid on interest-bearing liabilities was primarily due to higher market interest rates. The 28-day *Cetes* rate averaged 7.6% for the year ended December 31, 2018 as compared to 7.9% for the year ended December 31, 2019.

Our interest payments on deposits and funding were Ps.30,066 million (or 51.3% of our interest expense) for the year ended December 31, 2019 compared to Ps.25,616 million (or 47.9% of our interest expense) for the year ended December 31, 2018, an increase of Ps.4,450 million, or 17.4%. This increase is explained by higher market interest rates and an increase of 8.3% in our average total deposits and funding, mainly due to an 11.9% increase in our time deposits.

Our interest expense from repurchase operations was Ps.22,736 million (or 38.8% of interest expense) for the year ended December 31, 2019 compared to Ps.21,214 million (or 39.7% of interest expense) for the year ended December 31, 2018, an increase of Ps.1,522 million, or 7.2%. This increase was the result of higher market interest rates and an average balance of repurchase operations increase of 6.2% year to year.

Allowance for Loan Losses

Our allowance for loan losses charged against earnings was Ps.15,104 million for 2019 compared to Ps.15,635 million for the year ended December 31, 2018, a decrease of Ps.531 million, or 3.4%. This decrease reflects an exceptional loan loss allowance of Ps.619 million in March 2018 as well as the decreases of 1.7% and 3.5% in the performing loan and non-performing loan portfolios, respectively.

The cost of risk (calculated as loan losses divided by average total loans) was 2.0% for 2019 compared to 2.3% for 2018, a decrease of 13.0%.

Net Interest Income after Allowance for Loan Losses

As a result of the factors discussed above, our net interest income after allowance for loan losses was Ps.53,483 million for 2019 compared to Ps.48,878 million for 2018, an increase of Ps.4,605 million, or 9.4%.

Commission and Fee Income

Our total commission and fee income was Ps.22,906 million for 2019 compared to Ps.21,379 million for 2018, an increase of Ps.1,527 million, or 7.1%, primarily due to an increase in core banking services, such as electronic banking services, as well as growth in services related to credit card loans.

The following table shows the breakdown of our commissions and fees for 2019 and 2018:

	For the year ended December 31,	
	2019	2018
	(Ps. millions)	
Commissions and Fees:		
Fund transfers.....	1,648	1,648
Account management	2,439	2,601
Fiduciary	483	496
Credit card.....	5,054	4,586
Income from real estate loan portfolios acquired and other investment projects	8	45
Electronic banking services.....	9,432	8,268
Other commissions and fees.....	3,842	3,735
Total commissions and fees income.....	22,906	21,379

Commission and Fee Expense

Our total commission and fee expense was Ps.8,516 million for the year ended December 31, 2019 compared to Ps.7,849 million for the year ended December 31, 2018 an increase of Ps.667 million, or 8.5%, due to an increase in POS activity (in terms of number of transactions and volumes transacted), which caused an increase on fees paid for interbank transactions resulting in higher commissions paid for origination dynamics of consumer loans.

Intermediation Revenues

Our intermediation revenues were Ps.4,560 million in the year ended December 31, 2019 compared to Ps.3,799 million in the year ended December 31, 2018 an increase of Ps.761 million, or 20.0%, due to higher securities trading volumes and revenues, partially offset by a decrease in foreign exchange gains.

Our foreign exchange gains were Ps.1,115 million in the year ended December 31, 2019 compared to Ps.1,994 million in the year ended December 31, 2018, a decrease of Ps.879 million, or 44.1%, due primarily to lower volumes of foreign exchange trades with our clients and higher volatility of exchange rates.

Our realized gains on securities intermediation increased to Ps.4,079 million for the year ended December 31, 2019 compared to a loss of Ps.101 million for the year ended December 31, 2018, an increase of Ps.4,180 million which was attributable principally to higher securities trading volumes. We recorded a loss in unrealized gains on securities of Ps.634 million for the year ended December 31, 2019 compared to a gain of Ps.1,906 million for the year ended December 31, 2018, which was attributable principally to a decrease in trading revenues on securities and valuation gains, reflecting the market volatility linked to economic and political events.

Other Operating Income

Our other operating income was Ps.2,624 million for the year ended December 31, 2019 compared to Ps.2,869 million for the year ended December 31, 2018, a decrease of Ps.245 million, mainly due to the difference between non-recurrent income of Ps.2,410 million related to sell-and-lease-back transactions in 2018 as compared to the extraordinary income of Ps.1,661 million from recognition of the foreign exchange conversion effect of Banorte USA as part of the profit derived from its liquidation in 2019.

Non-interest expense

Our non-interest expense was Ps.38,095 million for the year ended December 31, 2019 compared to Ps.35,079 million for the year ended December 31, 2018, an increase of Ps.3,016 million, or 8.6%. This increase was the result of the following increases in expenses:

- a Ps.850 million increase in our salaries and employee benefits;

- a Ps.1,355 million increase in our leases, depreciation and amortization;
- a Ps.670 million increase in our administrative and promotional expenses;
- a Ps.148 million increase, or 4.7%, in our contributions to the IPAB on deposits growth; and
- a Ps.7 million decrease in our other factors, mainly due to professional fees.

The efficiency ratio, defined as non-interest expense divided by the aggregate of net interest income and non-interest income in the year ended December 31, 2019 was 42.3%, compared to 41.4% for the year ended December 31, 2018.

Operating Income

As a result of the factors discussed above, our operating income was Ps.36,962 million for the year ended December 31, 2019 compared to Ps.33,997 million for the year ended December 31, 2018, an increase of Ps.2,965 million, or 8.7%.

Equity in Earnings of Unconsolidated Subsidiaries and Associated Companies

Our equity in earnings of unconsolidated subsidiaries and associated companies was Ps.128 million in the year ended December 31, 2019 compared to Ps.161 million for the year ended December 31, 2018, a decrease of Ps.33 million, or 20.5%. This decrease was primarily due to lower profits registered by the associated companies.

Income Taxes

Our current income tax expense was Ps.8,021 million for the year ended December 31, 2019, compared to Ps.8,565 million for the year ended December 31, 2018, a decrease of Ps.544 million, or 6.4%. The lower income tax expense is a result of lower accumulated taxable income in certain transactions and recognition of tax losses.

We recorded a deferred income tax expense of Ps.1,576 million in the year ended December 31, 2019, compared to a Ps.759 million deferred income tax benefit in the year ended December 31, 2018, derived primarily from the valuation effect on securities, tax losses pending amortization and projects to be capitalized.

The net increase in our income tax expense was Ps.273 million in the year ended December 31, 2019, compared to the year ended December 31, 2018.

Net Income

Our net income was Ps.27,493 million for the year ended December 31, 2019 (representing a market share of 16.8%, according to the CNBV), compared to Ps.24,834 million for the year ended December 31, 2018, an increase of Ps.2,659 million, or 10.7%, due to the results of our operations discussed above.

Results of Operations for Year Ended December 31, 2018 Compared to the Year Ended December 31, 2017

Net Interest Income

Our net interest income was Ps.64,513 million for 2018 compared to Ps.55,648 million for 2017, an increase of Ps.8,865 million, or 16%. During 2018, the rate on the TIIE averaged 8.00%, 94 basis points higher than 7.06% average rate for 2017, which had a positive impact on our NIM. This increase resulted in a 23.3% increase in our total interest income and a 21.8% growth in our interest income from loans and a growth of 26.7% in our net interest income from cash, cash equivalents and securities, from hedging operations, and from repurchase operations.

In terms of margins, our average interest rate earned on interest-earning assets was 10.4% in 2018 and our average interest rate paid on interest-bearing liabilities was 6.5%, resulting in a yield spread of 3.9%. Our average interest rate

earned on interest-earning assets was 9.8% for 2017 and our average interest rate paid on interest-bearing liabilities was 5.5%, resulting in a yield spread of 4.3%.

The following table sets forth the components of our net interest income for the periods indicated:

	For the years ended December 31,	
	2018	2017
	(Ps. millions)	
Interest Income:		
Interest on loans.....	80,758	66,296
Fees on loans ⁽¹⁾	1,282	1,169
Interest on cash and cash equivalents and securities.....	22,974	20,889
Income on hedging operations.....	6,668	5,073
Interest on repurchase operations ⁽²⁾	6,141	2,283
UDI valuation ⁽⁵⁾	80	-
Foreign exchange valuation ⁽⁴⁾	77	-
Total interest income.....	117,979	95,710
Interest Expense:		
Interest on deposits and funding.....	25,616	17,407
Interest on repurchase operations ⁽³⁾	21,214	17,039
Expense on hedging operations.....	5,591	4,668
UDI valuation ⁽⁵⁾	-	149
Foreign exchange valuation ⁽⁴⁾	-	112
Fees paid ⁽⁶⁾	1,044	687
Total interest expense.....	53,466	40,062
Net interest income.....	64,513	55,648

- (1) Fees on loans represent fees generated in connection with the issuance, renewal, draw-down or prepayment of a loan that is recorded as interest income in accordance with Mexican Banking GAAP.
- (2) Interest income on repurchase operations represents interest income on securities purchased pursuant to our agreements to resell in accordance with Mexican Banking GAAP.
- (3) Interest expense on repurchase operations represents interest expense on securities sold under agreements to repurchase in accordance with Mexican Banking GAAP.
- (4) Foreign exchange valuation represents the net changes in the foreign exchange valuation that are recorded as interest income or interest expense depending on the net effect in accordance with Mexican Banking GAAP.
- (5) UDI valuation represents part of the effect from changes in the inflation rate on UDI-denominated liabilities that are recorded in interest expense and UDI-denominated assets that are recorded in interest income, as the case may be, in accordance with Mexican Banking GAAP.
- (6) Fees paid represent fees incurred in connection with our withdrawal, renewal and drawing down of loans that are recorded as interest expense in accordance with Mexican Banking GAAP.

Interest Income

Our interest income was Ps.117,979 million for 2018, compared to Ps.95,710 million for 2017, an increase of Ps.22,269 million, or 23.3%. There was a 60 basis point increase in the average interest rate earned on interest-earning assets from 9.8% during 2017 to 10.4% during 2018. There was a 15.9% increase in the average balance of interest-earning assets from Ps.974,864 million during 2017 to Ps.1,129,801 million during 2018. The average balance of interest-earning assets increased primarily as a result of an increase in the average balance of our loans of Ps.97,300, or 16.5%, and an increase in the average balance of repurchase agreements of Ps.43,018, or 124.5%.

Our interest on loans was Ps.80,758 million (or 68.5% of our interest income) for 2018 compared to Ps.66,296 million (or 69.3% of interest income) for 2017, an increase of Ps.14,462 million, or 21.8%. This increase was primarily the result of 24.9% increase in the loans portfolio, mostly consumer and government, and the increase in the TIIE carried out during 2018. Our fees on loans were Ps.1,282 million (or 1.1% of our interest income) for 2018 compared to Ps.1,169 million (or 1.2% of interest income) for 2017, an increase of Ps.113 million, or 9.7%. This change was mainly the result of 24.9% increase in the loans portfolio.

Our interest income from cash and cash equivalents and securities was Ps.22,974 million (or 19.5% of our interest income) for 2018 compared to Ps.20,889 million (or 21.8% of our interest income) for 2017, an increase of Ps.2,085 million, or 10%. This increase was primarily due to higher market interest rates primarily the TIIE.

Our interest income from hedging operations was Ps.6,668 million (or 5.7% of our interest income) for 2018 compared to Ps.5,073 million (or 5.3% of our interest income) for 2017, an increase of Ps.1,595 million, or 31.4%. This change was due to an increase of interest income on interest rate swaps hedging floating rate liabilities due to an increase on the TIIE and a 57.3% increase in the average balance of our hedging operations in 2018 as compared to 2017.

Our interest income from repurchase operations was Ps.6,141 million (or 5.2% of our interest income) for 2018 compared to Ps.2,283 million (or 2.4% of our interest income) for 2017, an increase of Ps.3,858 million, or 169%. This change was mainly due to an increase of 124.5% on our average balance of repurchase operations and higher market interest rates.

Interest Expense

Our interest expense was Ps.53,466 million for 2018 compared to Ps.40,062 million in 2017, an increase of Ps.13,404 million, or 33.5%. This increase was mainly due to an increase of Ps.8,209 million in interest on deposits and funding and an increase of Ps.4,175 million of interests on repurchase operations, which was due to the impact of higher market interest rates.

Our average interest rate paid on interest-bearing liabilities increased by 100 basis points from 5.5% for 2017 to 6.5% for 2018 and our average balance of these liabilities increased by 13% from Ps.724,948 million for 2017 to Ps.822,424 million for 2018. The increase in our average rate paid on interest-bearing liabilities was primarily due to an increase of 28-day *Cetes* rate averaged 7.6% for 2018 as compared to 6.7% for 2017.

Our interest payments on deposits and funding were Ps.25,616 million (or 47.9% of our interest expense) for 2018 compared to Ps.17,407 million (or 43.5% of our interest expense) for 2017, an increase of Ps.8,209 million, or 47.2%. This increase is explained by the result of higher market interest rates, however, our average total deposits and funding increased 14.8%, mainly due to a 28.8% increase in our time deposits.

Our interest expense from repurchase operations was Ps.21,214 million (or 39.7% of interest expense) for 2018 compared to Ps.17,039 million (or 42.5% of interest expense) for 2017, an increase of Ps.4,175 million, or 24.5%. This increase was the result of higher market interest rates, however, our average repurchase operations increased 7.7% year to year.

Allowance for Loan Losses

Our allowance for loan losses charged against earnings was Ps.15,635 million for 2018, compared to Ps.14,983 million for 2017, an increase of Ps.652 million, or 4.4%. This increase was primarily due to higher reserve requirements on consumer loans.

Our allowance for loan losses as a percentage of non-performing loans increased to 142.3% as of December 31, 2018 from 127.6% as of December 31, 2017. The increase in the ratio of our allowance for loan losses to non-performing loans reflects an increase in the reserve requirement mainly for government loans.

Net Interest Income after Allowance for Loan Losses

As a result of the factors discussed above, our net interest income after allowance for loan losses was Ps.48,878 million for 2018 compared to Ps.40,665 million for 2017, an increase of Ps.6,114 million, or 14%.

Commission and Fee Income

Our total commission and fee income was Ps.21,379 million for 2018 compared to Ps.18,436 million 2017, an

increase of Ps.2,943 million, or 16%, primarily due to an increase in core banking services, such as electronic banking services and fund transfers, as well as growth in services related to credit card loans.

The following table shows the breakdown of our commissions and fees for years ended December 31, 2018 and 2017:

	For the year ended December 31,	
	2018	2017
	(Ps. millions)	
Commissions and Fees:		
Fund transfers.....	1,648	1,503
Account management.....	2,601	2,596
Fiduciary.....	496	420
Credit card.....	4,586	4,177
Income from real estate loan portfolios acquired and other investment projects	45	36
Electronic banking services.....	8,268	6,903
Other commissions and fees.....	3,735	2,801
Total commissions and fees income	21,379	18,436

Commission and Fee Expense

Our total commission and fee expense was Ps.7,849 million for 2018 compared to Ps.6,142 million for 2017, an increase of Ps.1,707 million, or 28%, due to an increase in POS activity (in terms of number of transactions and volumes transacted), which caused an increase on fees paid for interbank transactions resulting in higher commissions paid for origination dynamics of consumer loans.

Intermediation Revenues

Our intermediation revenues were Ps.3,799 million in 2018 compared to Ps.2,101 million in 2017, an increase of Ps.1,698 million, or 81%, due to higher securities trading volumes and revenues, and an increase of foreign exchange gains.

Our foreign exchange gains were Ps.1,994 million in 2018 compared to Ps.1,600 million in 2017, an increase of Ps.394 million, or 24.6%, due primarily to higher volumes on foreign exchange trades with our clients.

Our realized gains on securities intermediation decreased to a Ps.101 million loss for 2018 compared to Ps.487 million gain for 2017, a decrease of Ps.588 million, or 120.7%, which was attributable principally to lower securities trading volumes. We recorded unrealized gains on securities of Ps.1,906 in 2018 compared to unrealized gains on securities of Ps.14 in 2017, which was attributable principally to a decrease in intermediation revenues on securities and mark-to-market gains, reflecting market volatility linked to economic and political events.

Other Operating Income

Our other operating income was Ps.2,869 million for 2018 compared to Ps.2,365 million for 2017, an increase of Ps.504 million, mainly due to an extraordinary income from the sale of real estate and leaseback of the Bank's property.

Non-interest expense

Our non-interest expense was Ps.35,079 million for 2018 compared to Ps.31,750 million for 2017, an increase of Ps.3,329 million, or 11%. This increase was the result of the following increases in expenses:

- a Ps.1,504 million increase in our salaries and employee benefits;
- a Ps.380 million increase in our administrative and marketing expenses;

- a Ps.603 million increase in our leases, depreciation and amortization; and
- a Ps.515 million increase, or 19.6%, in our contributions to the IPAB on deposits growth; and
- a Ps.572 million decrease in our other factors, mainly due to taxes and other than income taxes and increase in professional fees.

The efficiency ratio, defined as non-interest expense divided by the aggregate of net interest income and non-interest income in 2018 was 41.4%, compared to 43.8% for 2017.

Operating Income

As a result of the factors discussed above, our operating income was Ps.33,997 million for 2018 compared to Ps.25,675 million for 2017, an increase of Ps.8,322 million, or 32%.

Equity in Earnings of Unconsolidated Subsidiaries and Associated Companies

Our equity in earnings of unconsolidated subsidiaries and associated companies was Ps.161 million in 2018 compared to Ps.62 million for 2017, an increase of Ps.99 million, or 160%. This increase was primarily due to higher profits registered by the associated companies.

Income Taxes

Our current income tax expense was Ps.8,565 million for 2018 compared to Ps.6,781 million for 2017, an increase of Ps.1,784 million, or 26%. This increase was mainly due to a higher operating profit.

We recorded a deferred income tax expense of Ps.759 million in 2018, compared to a Ps.706 million deferred income tax benefit in 2017, derived primarily from the valuation effect on securities, tax losses pending amortization and projects to be capitalized.

The net increase in our income tax expense was Ps.1,837 million in 2018 compared to 2017.

Net Income

Our net income was Ps.24,834 million for 2018 compared to Ps.18,339 million for 2017, an increase of Ps.6,495 million, or 35%, due to the results of our operations discussed above.

Financial Position

The following discussion compares our consolidated financial position at March 31, 2020 and December 31, 2019, 2018 and 2017.

Assets

We had total assets of Ps.1,293,647 million as of March 31, 2020, compared to Ps.1,149,536 million as of December 31, 2019, an increase of Ps.144,111 million, or 12.5%. This increase was mainly the result of an increase of Ps.27,774 million in our derivatives operations, an increase of Ps.26,386 in our cash and cash equivalents and an increase of Ps.20,020 in our loan portfolio.

We had total assets of Ps.1,149,536 million as of December 31, 2019, compared to Ps.1,180,492 million as of December 31, 2018, a decrease of Ps.30,956 million, or 2.6%. This decrease was mainly the result of a decrease of Ps.12,951 million in our cash and cash equivalents and a decrease of Ps.13,276 million in our loan portfolio.

We had total assets of Ps.1,180,492 million as of December 31, 2018, compared to Ps.1,056,423 million as of December 31, 2017, an increase of Ps.124,069 million, or 11.7%. This increase was mainly the result of an increase

of Ps.152,813 million in our total performing loans. This variation was mainly due to the effects of the Interacciones Merger (see “—Effects of the Merger of Banco Interacciones into the Bank”).

Performing Loan Portfolio

As of March 31, 2020, total performing loans were Ps.763,092 million compared to Ps.743,506 million as of December 31, 2019, an increase of Ps.19,586 million, or 2.6%. This variation was mainly due to an increase in our business and mortgage loan portfolios. Total performing loans represented 59.0% of total assets as of March 31, 2020, compared to 64.7% of total assets as of December 31, 2019. As of March 31, 2020, performing business loans represented 37.8% of total performing loans, performing loans to financial institutions represented 3.1%, performing mortgage loans represented 22.7%, performing government loans represented 21.1% and performing consumer loans represented 15.2%.

As of December 31, 2019, total performing loans were Ps.743,506 million compared to Ps.756,335 million as of December 31, 2018, a decrease of Ps.12,829 million, or 1.7%. This variation was mainly due to a decrease in our business and government loan portfolios. Total performing loans represented 64.7% of total assets as of December 31, 2019, compared to 64.1% of total assets as of December 31, 2018. As of December 31, 2019, performing business loans represented 35.8% of total performing loans, loans to financial institutions represented 2.8%, performing mortgage loans represented 22.9%, performing government loans represented 22.9% and performing consumer loans represented 15.6%.

We had total performing loans of Ps.756,335 million as of December 31, 2018, compared to Ps.603,522 million as of December 31, 2017, an increase of Ps.152,813 million, or 25.3%. This variation was mainly due to the effects of the Interacciones Merger (see “—Effects of the Merger of Banco Interacciones into the Bank”). Total performing loans represented 64.1% of total assets as of December 31, 2018. As of December 31, 2018, performing business loans represented 36.5% of total performing loans, loans to financial institutions represented 2.8%, performing mortgage loans represented 20.6%, performing government loans represented 25.4% and performing consumer loans represented 14.7%.

The net interest margin of our loan portfolio was 8.1% as of March 31, 2020 compared to 7.9% as of December 31, 2019, an increase of 2.6%.

The net interest margin of our loan portfolio was 7.9% as of December 31, 2019 compared to 8.1% as of December 31, 2018, a decrease of 2.5%.

Non-Performing Loan Portfolio

We had total non-performing loans of Ps.12,826 million as of March 31, 2020 compared to Ps.12,392 million as of December 31, 2019, an increase of Ps.434 million, or 3.4%. This increase was primarily due to an increase in our business past due loans. Total non-performing loans represented 1.0% of total assets as of March 31, 2020, compared to 1.1% of total assets as of December 31, 2019. As of March 31, 2020, non-performing business loans represented 52.2% of total non-performing loans, non-performing financial institution loans represented 0.03%, non-performing mortgage loans represented 16.1% and non-performing consumer loans represented 31.3% of total non-performing loans.

We had total non-performing loans of Ps.12,392 million as of December 31, 2019 compared to Ps.12,839 million as of December 31, 2018, a decrease of Ps.447 million, or 3.5%. Business loans represented Ps.897 million, mortgage loans represented Ps.509 million, consumer loans represented Ps.63 million and financial institutions loans represented Ps.4 million of the total variation for the period. Total non-performing loans represented 1.1% of total assets as of December 31, 2019, compared to 1.1% of total assets as of December 31, 2018. As of December 31, 2019, non-performing business loans represented 49.6%, non-performing mortgage loans represented 15.9% and non-performing consumer loans represented 34.4% of total non-performing loans.

We had total non-performing loans of Ps.12,839 million as of December 31, 2018 compared to Ps.12,192 million as of December 31, 2017, an increase of Ps.647 million, or 5.3%. As of December 31, 2018, non-performing business

loans represented 54.9% of total non-performing loans, non-performing consumer loans represented 33.7% and non-performing mortgage loans represented 11.4%.

Deferred Taxes and Employee Profit Sharing Assets

Our deferred taxes are a net asset comprised of temporary differences to be used as income tax deductions in future years. These temporary differences mainly derive from the loan loss reserves that could be tax deducted at the time a loan is written-off, according with the rules issued by the CNBV.

We had net deferred tax and employee profit sharing assets of Ps.4,352 million as of March 31, 2020, compared to Ps.1,104 million as of December 31, 2019, an increase of Ps.3,247 million, or 294.2% derived primarily from the valuation effect on securities, surplus of loan loss reserves and non-deductible provisions, and a project to be capitalized, consisting of investments for technological development and improvement of the different components that support the Bank's operations and banking products, which are capitalized in accordance with MFRS.

We had net deferred tax and employee profit sharing assets of Ps.1,104 million as of December 31, 2019, compared to Ps.4,839 million as of December 31, 2018 a decrease of Ps.3,735 million, or 77%, derived primarily from the valuation effect on securities, surplus of loan loss reserves and non-deductible provisions and project to be capitalized.

We had net deferred tax and employee profit sharing assets of Ps.4,839 million as of December 31, 2018 compared to Ps.3,517 million as of December 31, 2017, an increase of Ps.1,322 million, or 38%. This increase was derived primarily from the valuation effect on securities, a surplus of loan loss reserves and projects to be capitalized.

Liabilities

We had total liabilities of Ps.1,179,984 million as of March 31, 2020 compared to Ps.1,035,276 million as of December 31, 2019, an increase of Ps.144,708 million, or 13.9%. This variation was mainly due to an increase of Ps.47,598 million in our deposits, an increase of Ps.10,373 million in our subordinated debentures and an increase of Ps.36,088 million in our derivative operations.

We had total liabilities of Ps.1,035,276 million as of December 31, 2019 compared to Ps.1,072,090 million as of December 31, 2018, a decrease of Ps.36,814 million, or 3.4%. This variation was mainly due to a decrease of Ps.14,963 million in our deposits and a decrease of Ps.21,092 million in our interbank and other loans.

We had total liabilities of Ps.1,072,090 million as of December 31, 2018 compared to Ps.970,361 million as of December 31, 2017, an increase of Ps.101,729 million, or 10.5%, mainly as a result of a higher increase in total deposits of Ps.110,613 million during the period, of which Ps.84,161 were time and money market deposits.

Deposits

We had total deposits of Ps.791,870 million as of March 31, 2020 (representing a market share of 12.4%, according to the CNBV) compared to Ps.744,272 million as of December 31, 2019, an increase of Ps.47,598 million, or 6.4%. As of March 31, 2020, demand deposits, which bear interest at lower rates, represented 57.1% of total deposits, while general public time deposits represented 34.8% of total deposits.

We had total deposits of Ps.744,272 million as of December 31, 2019 (representing a market share of 13.2%, according to the CNBV) compared to Ps.759,235 million as of December 31, 2018, a decrease of Ps.14,963 million, or 2.0%. As of December 31, 2019, demand deposits, which bear interest at lower rates, represented 58.5% of total deposits, while general public time deposits represented 35.2% of total deposits.

We had total deposits of Ps.759,235 million as of December 31, 2018 compared to Ps.648,622 million as of December 31, 2017, an increase of Ps.110,613 million, or 17.1%, that was driven by good performance in time and money market deposits throughout the year, as a result of clients shifting towards interest bearing instruments, given the high rate cycle in Mexico. As of December 31, 2018, demand deposits represented 54.3% of total deposits and

general public time deposits represented 36.6%. As of December 31, 2017, demand deposits represented 60.9% of total deposits and general public time deposits represented 37.8%.

Total deposits represented 67.1%, 71.9%, 70.8%, and 66.8% of total liabilities as of March 31, 2020, December 31, 2019, December 31, 2018 and December 31, 2017, respectively.

Interbank and Other Loans

We had interbank and other loans of Ps.17,529 million as of March 31, 2020, compared to Ps.14,630 million as of December 31, 2019 an increase of Ps.2,899 million, or 19.8%. Interbank and other loans represented 1.5% of total liabilities as of March 31, 2020 compared to 1.4% as of December 31, 2019.

We had interbank and other loans of Ps.14,630 million as of December 31, 2019, compared to Ps.35,722 million as of December 31, 2018, a decrease of Ps.21,092 million, or 59.0%. Interbank and other loans represented 1.4% of total liabilities as of December 31, 2019 compared to 3.3% as of December 31, 2018.

We had interbank and other loans of Ps.35,722 million as of December 31, 2018 compared to Ps.15,238 million as of December 31, 2017, an increase of Ps.20,484 million or 134.4%. This variation was mainly due to the effects of the Interacciones Merger (see “—*Effects of the Merger of Banco Interacciones into the Bank*”). Interbank and other loans represented 3.3% of total liabilities as of December 31, 2018 compared to 1.6% as of December 31, 2017.

Subordinated Debt Instruments

We had outstanding non-convertible subordinated debt instruments of Ps.58,423 million as of March 31, 2020 compared to Ps.48,050 million as of December 31, 2019. This increase was mainly due to a depreciation of the peso against the dollar partially offset by the redemption of Ps.1,000 million of fixed rate subordinated non-preferred non-convertible debentures in March 2020.

We had outstanding non-convertible subordinated debt instruments of Ps.48,050 million as of December 31, 2019 compared to Ps.33,560 million as of December 2018. This increase was mainly due to the issuance of U.S.\$1,100 million Subordinated Non-Preferred Non-Cumulative Tier 1 Capital Notes in June 2019, partially offset by (i) the repurchase of U.S.\$206 million of subordinated preferred capital notes pursuant to a tender offer in October 2019, and (ii) the repurchase of Ps.1,085 million of fixed rate subordinated preferred non-convertible debentures, pursuant to a tender offer in December 2019.

We had outstanding non-convertible subordinated debt instruments of Ps.33,560 million as of December 31, 2018 compared to Ps.32,445 million as of December 31, 2017. This variation was mainly due to the issuance of U.S.\$900 million Subordinated Non-Preferred Non-Cumulative Tier 1 Capital Notes in July 2017.

Subordinated debt instruments represented 5.0%, 4.6%, 3.1% and 3.3% of total liabilities as of March 31, 2020, December 31, 2019, December 31, 2018 and December 31, 2017, respectively.

The table below summarizes our Tier 1 and Tier 2 U.S. dollar-denominated subordinated non-convertible debt instruments outstanding as of March 31, 2020, and their contribution to our regulatory capital:

As of March 31, 2020						
Series	Type	Principal	Interest rate	Issuance date	Call date	Effect on capital ⁽¹⁾
BANOC36	Tier 2	U.S.\$294,000,000	5.750%	Oct. 4, 2016	Oct. 4, 2026	0.83%
BANOD19	Tier 1	U.S.\$350,000,000	6.875%	July 6, 2017	July 6, 2022	0.99%
BANOE91	Tier 1	U.S.\$550,000,000	7.625%	July 6, 2017	Jan. 10, 2028	1.56%
BANOA64	Tier 1	U.S.\$600,000,000	6.750%	June 27, 2019	Sept. 27, 2024	1.70%
BANOB48	Tier 1	U.S.\$500,000,000	7.500%	June 27, 2019	June 27, 2029	1.42%
Total		U.S.\$2,294,000,000	7.01%⁽²⁾			6.51%

- (1) Outstanding Tier 1 and Tier 2 U.S. dollar denominated subordinated non-convertible debt instruments as of March 31, 2020 considering the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00, divided by risk weighted assets.
- (2) Average weighted rate of our outstanding Tier 1 and Tier 2 U.S. dollar denominated subordinated non-convertible debt instruments outstanding as of March 31, 2020.

Stockholders' Equity

Our stockholders' equity was Ps.113,663 million as of March 31, 2020 compared to Ps. 114,260 million as of December 31, 2019, a decrease of Ps.597 million, or 0.5% due to the increase in our accumulated net income for the three-month period ended March 31, 2020 by Ps.6,180 million, which was partially offset by a decrease generated by the valuation of available for sale securities by Ps.4,709 million, as well as a decrease in the result from valuation of cash flow hedging instruments by Ps.1,678 million.

Our stockholders' equity was Ps.114,260 million as of December 31, 2019 compared to Ps.108,402 million as of December 31, 2018, an increase of Ps.5,858 million, or 5.4%.

Our stockholders' equity was Ps.108,402 million as of December 31, 2018 compared to Ps.86,062 million as of December 31, 2017, an increase of Ps.22,340 million, or 26.0%.

Liquidity

The purpose of our liquidity management function is to ensure that we have funds available to meet our financial obligations. These obligations arise from withdrawals of deposits, repayments at maturity of short-term notes, extensions of loans or other forms of credit and working capital needs. One significant element of the liquidity management function is maintaining our compliance with the Mexican Central Bank's liquidity regulations. See *"Supervision and Regulation—Liquidity Requirements for Foreign Currency-Denominated Liabilities."*

We have various sources of liquidity. Short-term and marketable investments, such as government securities and deposits with the Mexican Central Bank and prime banks, are our most liquid income-generating assets. Deposits, including demand deposits, savings deposits and time deposits, are our largest source of liquidity. Our liquid assets also include deposits in foreign banks. These deposits in foreign banks are denominated principally in U.S. dollars.

Mexican Central Bank regulations require Mexican banks to comply with certain reserve requirements with respect to non-Peso-denominated liabilities. Reserves on non-Peso-denominated deposits continue to be required. See *"Supervision and Regulation—Liquidity Requirements for Foreign Currency-Denominated Liabilities."* As of March 31, 2020 and December 31, 2019, 2018 and 2017, we were in compliance with all reserve requirements and liquidity coefficients.

Our management expects that cash flows from operations and other sources of liquidity will be sufficient to meet our liquidity requirements over the next 12 months,

Foreign Currency Position

Mexican Central Bank regulations require that a bank maintain open positions in foreign currencies no higher than a specified level with respect to its total Tier 1 Capital. See “*Supervision and Regulation—Liquidity Requirements for Foreign Currency-Denominated Liabilities*.” As of March 31, 2020, the limit established for us by the Mexican Central Bank for maturity-adjusted net foreign currency-denominated liabilities was U.S.\$13,548 million (Ps.318,166 million). As of such date, our maturity-adjusted net foreign currency-denominated liabilities were U.S.\$3,647 million (Ps.85,649 million). For a discussion of the components of Tier 1 Capital, see “*Supervision and Regulation—Capitalization*.”

As of March 31, 2020 and for the years ended December 31, 2019, 2018 and 2017, we were in compliance with regulatory requirements relating to the ratio of dollar-denominated liabilities to total liabilities.

As part of our asset liability management strategy, we closely monitor our exposure to foreign currency risk, with a view to minimizing the effect of exchange rate movements on our earnings. As of March 31, 2020, our foreign currency-denominated assets totaled U.S.\$9,450 million (Ps.221,927 million), representing 17.3% of our total assets. At that date, our foreign currency-denominated liabilities amounted to U.S.\$9,922 million (Ps.233,020 million), representing 19.8% of our total liabilities. See “*Selected Statistical Information—Interest-Bearing Deposits with Other Banks*.”

Funding

Our principal sources of funding are customer deposits, which are concentrated in non-interest-bearing checking accounts, short-term notes with interest due at maturity and interest-bearing demand and time deposits. Customer deposits are our least expensive source of funding. Our customer deposits increased to Ps.729,621 million (or 61.8% of total liabilities) as of March 31, 2020 from Ps.699,243 million (or 67.5% of total liabilities) as of December 31, 2019, an increase of Ps.30,378 million, or 4.3%. This increase was primarily due to an increase of Ps.16,389 million in our demand deposits that was driven by good performance of several internal campaigns to strength our funding and an increase of Ps.13,861 million in our general public time deposits. Our annual cost of funds as of March 31, 2020 was 50.0% of *Cetes* compared to 49.8% as of December 31, 2019.

Long-term debt is another source of funds for us. Long-term debt is issued to match long-term loans and investments and reduce liquidity risk. As of March 31, 2020, we had Ps.4,197 million principal amount of long-term debt outstanding with maturities over one year. We had Ps.4,854 million and Ps.22,199 million principal amount of long-term debt outstanding with maturities over one year as of December 31, 2019 and 2018, respectively.

Our current funding strategy seeks to reduce funding costs by taking advantage of our extensive branch network and customer base to attract banking deposits. Although we monitor developments in public demand for long-term loans and opportunities to borrow long-term funds on favorable terms, we anticipate that customers in Mexico will continue in the near future to demand short-term deposits (particularly demand deposits and short-term time deposits) and loans, and we intend to maintain our emphasis on the use of banking deposits.

UDI-denominated deposits from the Mexican government provide the funding for our off-balance sheet UDI Trusts. In return, we have purchased from the Mexican government *Cetes Especiales*, which have an interest rate based on the *Cetes* rate and maturities and principal amounts that mirror the maturities and the principal amount of the loans in the UDI Trusts (the “*Cetes Especiales*” or “*Special Cetes*”). These *Special Cetes* pay interest in cash only as the loans in the UDI Trusts mature. The Mexican government’s UDI-denominated deposits have a fixed real interest rate which varies depending on the type of loan in the UDI Trusts.

Our foreign currency-denominated assets, substantially all of which are dollar-denominated, are funded from a number of sources. These sources include deposits of the same currency obtained mainly through deposits of customers, medium and large Mexican companies, primarily in the export sector, interbank deposits and fixed rate notes. In the case of foreign trade transactions, we use trade financing facilities including from Mexican development banks and foreign export-import banks. Foreign currency funding rates are generally based on LIBOR. Our position in foreign currency as of March 31, 2020 amounted to U.S.\$9,450 million in assets (or 17.3% of total assets) and

U.S.\$9,922 million in liabilities (or 19.8% of total liabilities). Our position in foreign currency as of December 31, 2019 amounted to U.S.\$8,238 million in assets (or 13.6% of total assets) and U.S.\$8,277 million in liabilities (or 15.1% of total liabilities). Our position in foreign currency as of December 31, 2018 amounted to U.S.\$7,914 million in assets (or 13% of total assets) and U.S.\$8,325 million in liabilities (or 15% of total liabilities).

Capital Expenditures

We budget internally for capital expenditures in U.S. dollars. We invested (in nominal terms) U.S.\$14.3 million, U.S.\$378 million, U.S.\$322 million and U.S.\$304 million in technology (including telecommunications, computer hardware and software, systems development, ATMs and POSs) for the three-month period ended March 31, 2020 and in the fiscal years 2019, 2018 and 2017, respectively. In addition, we estimate that in the remaining quarters of 2020 we will invest U.S.\$445 million as part of our branch expansion program and approximately U.S.\$345 million in technology (including telecommunications, computer hardware and software, systems development, ATMs and POSs), out of which we will invest approximately U.S.\$21 million as part of our cybersecurity program.

We expect that capital expenditures for the remaining quarters of 2020 will be funded with cash generated from future operations and other sources of liquidity. We can give no assurance, however, that the capital expenditures will be made in the amounts currently expected or be funded with cash generated from our future operations.

Risk-Based Capital

The Mexican Capitalization Requirements take into account credit risk, operational risk and market risk. See “*Supervision and Regulation—Capitalization.*” As of March 31, 2020, we were in compliance with all applicable capital adequacy regulations. On a general basis, in order for a Mexican bank not to be required to defer or cancel interest payments and defer principal payments of subordinated debt and not to be subject to certain other corrective measures, it needs to comply with the following minimum Capital Ratios required by the Mexican Capitalization Requirements: **(a)** 10.5% in the case of Total Net Capital, **(b)** 8.5% in the case of Tier 1 Capital, or **(c)** 7.0% in the case of Fundamental Capital, plus, in each case, any applicable Capital Supplement required under the Mexican Capitalization Requirements.

The table below presents our risk-weighted assets and Capital Ratios as of March 31, 2020 and as of December 31, 2019, 2018 and 2017, determined, as required by regulations.

	As of March 31,		As of December 31,			
	2020	2020	2019	2019	2018	2017
	(U.S. millions, except for percentages) (1)	(Ps. millions, except for percentages)	(U.S. millions, except for percentages) (1)	(Ps. millions, except for percentages)		
Capital:						
Fundamental Capital (CET1).....	4,292	100,805	4,340	101,927	94,970	75,220
Additional Tier 1 Capital.....	2,000	46,969	1,607	37,728	18,865	20,103
Tier 2 Capital.....	391	9,194	374	8,783	14,472	13,286
Total Net Capital.....	6,684	156,968	6,321	148,438	128,307	108,609
Risk-Weighted Assets:						
Credit risk.....	27,687	650,213	26,696	626,953	627,479	507,721
Market risk.....	4,749	111,536	4,614	108,359	66,119	72,848
Operational risk.....	2,805	65,882	2,760	64,812	53,865	46,406
Total Risk-Weighted Assets.....	35,241	827,630	34,070	800,125	747,464	626,976
Capital Ratios (credit, market and operational risk):						
Fundamental Capital (CET 1) to risk-weighted assets	12.18%	12.18%	12.74%	12.74%	12.71%	12.00%
Tier 1 Capital to risk-weighted assets.....	17.86%	17.86%	17.45%	17.45%	15.23%	15.20%
Tier 2 Capital to risk-weighted assets.....	1.11%	1.11%	1.10%	1.10%	1.94%	2.12%
Total Net Capital to Total Risk-Weighted Assets..	18.97%	18.97%	18.55%	18.55%	17.17%	17.32%

(1) Solely for the convenience of the reader, Peso amounts as of March 31, 2020 and as of December 31, 2019 have been translated into U.S. dollars at the Mexican Central Bank Exchange Rate on March 31, 2020 of Ps.23.4847 per U.S.\$1.00. See “*Exchange Rates and Currency.*”

SELECTED STATISTICAL INFORMATION

The following selected statistical information is provided with respect to Banorte and its consolidated subsidiaries only. Selected statistical information for Banorte is as of and for the three-month period ended March 31, 2020 and as of and for the years ended December 31, 2019, 2018 and 2017.

Assets and liabilities have been classified by currency of denomination (Pesos or foreign currency), rather than by domicile of customer or other criteria, because substantially all of our transactions are effected in Mexico or on behalf of Mexican residents in Pesos or foreign currency. The U.S. dollar is the main foreign currency used in our transactions, although Euros are also used. For purposes of this section, all foreign currency assets and liabilities have been converted into U.S. dollars and then converted into Pesos at an exchange rate of Ps.23.4847 to U.S.\$1.00, the Mexican Central Bank Exchange Rate on March 31, 2020.

The following information should be read in conjunction with our Financial Statements and the notes thereto included elsewhere in this offering memorandum, as well as “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Presentation of Financial and Other Information.” The following information is presented solely for the convenience of the reader for analytical purposes and, for certain items, differs from and is not comparable to the presentation in our Financial Statements.

Unless otherwise indicated, balance sheet and statement of income items in the following tables are presented in millions of Pesos as of March 31, 2020. Because Mexican tax law does not currently provide income tax exemptions for any investment securities, we do not hold any income tax-exempt securities and no tax-equivalence adjustments are considered necessary.

Certain amounts and percentages included in this offering memorandum have been subject to rounding adjustments; accordingly, figures shown for the same category presented in different tables may vary slightly and figures shown as totals in certain tables may not be an arithmetic aggregation of the figures preceding them.

Average Balance Sheet and Interest Rate Data

Peso-Denominated Average Balances and Interest Income

Average balances for Peso-denominated assets and liabilities have been calculated in the following manner: for each month, an average of the daily Peso balances and the interest income (expense) was determined. The average balance for each year presented below is the average of the monthly balances so determined. Interest income (expense) for each year is the total of the income (expense) for the months so determined.

Foreign Currency-Denominated and UDI-Denominated Average Balances and Interest Income

Average balances and interest income (expense) for foreign currency-denominated and UDI-denominated assets and liabilities have been translated into Pesos and calculated in the following manner: for each month, an average of the daily foreign currency or UDI balances and the total interest income (expense) was determined. In addition, the average balances and the total interest income (expense) were translated into Pesos using the applicable month-end exchange rate published in the Official Gazette. The average balance for each year presented below is the average of the monthly balances so determined. Interest income (expense) for each year is the total of the income (expense) for the months so determined.

Average Interest Rate

The average annual rates earned on interest-earning assets and the average annual rate paid on interest-bearing liabilities are nominal rates.

Average Assets and Interest Rates

The table below presents the average balance of assets, interest income and average annual interest rate for the periods indicated:

	For the three-month period ended March 31,			For the year ended December 31,								
	2020			2019			2018			2017		
	Average Balance	Interest Income	Average Interest Rate	Average Balance	Interest Income	Average Interest Rate	Average Balance	Interest Income	Average Interest Rate	Average Balance	Interest Income	Average Interest Rate
<i>(Ps. millions, except percentages)</i>												
Deposits in banks:												
Pesos	39,863	734	7.4%	41,858	3,969	9.5%	41,893	3,989	9.5%	31,953	2,445	7.7%
Foreign currency	(5,016)	-	0.0%	(6,401)	1	0.0%	-	-	0.0%	2,112	19	0.9%
Sub-total.....	34,847	734	8.4%	35,457	3,970	11.2%	41,893	3,989	9.5%	34,065	2,464	7.2%
Investment securities ^{(1) (3)} :												
Pesos	182,541	3,259	7.1%	176,956	14,109	8.0%	210,267	16,261	7.7%	235,949	16,708	7.2%
UDIs	4,180	107	10.2%	2,908	242	8.3%	5,558	403	7.3%	4,110	362	8.8%
Foreign currency	75,407	598	3.2%	69,818	2,506	3.6%	63,587	2,310	3.6%	47,176	1,347	2.9%
Sub-total.....	262,128	3,964	6.0%	249,682	16,857	6.8%	279,412	18,974	6.8%	287,235	18,417	6.4%
Loans ⁽²⁾ :												
Pesos	685,030	21,496	12.6%	681,284	87,815	12.9%	627,383	79,448	12.7%	548,020	65,728	12.0%
UDIs	5,087	9	0.7%	6,686	46	0.7%	5,034	36	0.7%	270	3	1.1%
Foreign currency	69,718	763	4.4%	62,177	3,077	4.9%	52,987	2,556	4.8%	39,814	1,734	4.4%
Sub-total.....	759,835	22,268	11.7%	750,147	90,938	12.1%	685,404	82,040	12.0%	588,104	67,465	11.5%
Repurchase Agreements:												
Pesos	98,944	1,730	7.0%	126,331	9,725	7.7%	77,560	6,141	7.9%	34,542	2,283	6.6%
Trading Derivatives:												
Pesos	-	-	0.0%	-	-	0.0%	2,402	-	0.0%	4,094	-	0.0%
Foreign Currency	4,482	-	0.0%	8,560	-	0.0%	946	-	0.0%	-	-	0.0%
Sub-total.....	4,482	-	0.0%	8,560	-	0.0%	3,348	-	0.0%	4,094	-	11.2%
Hedging Derivatives:												
Pesos	31,851	1,240	15.6%	36,250	5,561	15.3%	42,184	6,668	15.8%	26,823	5,073	18.9%
Foreign Currency	-	-	0.0%	-	-	0.0%	-	-	0.0%	-	-	0.0%
Sub-total.....	31,851	1,240	15.6%	36,250	5,561	15.3%	42,184	6,668	15.8%	26,823	5,073	18.9%
Foreign exchange valuation: ..	-	32	0.0%	-	108	0.0%	-	157	0.0%	-	-	0.0%
Dividend from equity instruments:	-	10	0.0%	-	49	0.0%	-	11	0.0%	-	8	0.0%
Total interest-earning assets:												
Pesos	1,038,229	28,501	11.0%	1,062,679	121,336	11.4%	1,001,689	112,675	11.2%	881,381	92,245	10.5%
UDIs	9,267	116	5.0%	9,594	288	3.0%	10,592	439	4.1%	4,380	365	8.3%
Foreign currency	144,591	1,361	3.8%	134,154	5,584	4.2%	117,520	4,866	4.1%	89,102	3,100	3.5%
Sub-total.....	1,192,087	29,978	10.1%	1,206,427	127,208	10.5%	1,129,801	117,980	10.4%	974,863	95,710	9.8%
Permanent stock investments:												
Pesos	352			377			229			558		
Foreign Currency	1			1			1			1		
Sub-total.....	353			378			230			559		

	For the three-month period ended March 31,			For the year ended December 31,								
	2020			2019			2018			2017		
	Average Balance	Interest Income	Average Interest Rate	Average Balance	Interest Income	Average Interest Rate	Average Balance	Interest Income	Average Interest Rate	Average Balance	Interest Income	Average Interest Rate
<i>(Ps. millions, except percentages)</i>												
Cash and due from banks:												
Pesos	22,407			22,528			20,933			18,067		
UDI	-			-			-			-		
Foreign currency	15,812			21,184			27,786			23,735		
Sub-total.....	38,219			43,712			48,719			41,802		
Securitizations (<i>Constancias</i>):												
Pesos	136			114			150			159		
Allowances for loan losses:												
Pesos	(15,794)			(16,569)			(15,917)			(14,368)		
UDIs	(25)			(39)			(39)			(4)		
Foreign currency	(1,287)			(960)			(876)			(283)		
Sub-total.....	(17,106)			(17,568)			(16,832)			(14,655)		
Property, furniture and equipment, net:												
Pesos	14,995			13,993			14,047			12,405		
Foreign Currency	176			136			132			92		
Sub-total.....	15,171			14,129			14,179			12,497		
Other non-interest-earning assets												
Pesos	61,907			62,258			46,571			43,676		
UDIs	194			134			229			106		
Foreign currency	19,797			14,957			16,179			14,181		
Sub-total.....	81,898			77,349			62,997			57,963		
Total assets:												
Pesos	1,122,232	28,501	10.2%	1,145,380	121,336	10.6%	1,067,702	112,675	10.6%	941,878	92,245	9.8%
UDIs	9,436	116	4.9%	9,689	288	3.0%	10,782	439	4.1%	4,482	365	8.1%
Foreign currency	179,090	1,361	3.0%	169,472	5,584	3.3%	160,760	4,866	3.0%	126,828	3,100	2.4%
Total	1,310,758	29,978	9.1%	1,324,541	127,208	9.6%	1,239,244	117,980	9.5%	1,073,188	95,710	8.9%

- (1) Does not include equity investments in subsidiaries and affiliates. Includes securities purchased under agreements to resell and derivatives financial instruments.
- (2) Interest income includes fees on loans of Ps.1,169 million in 2017, Ps.1,282 million in 2018, Ps.1,405 million in 2019 and Ps.358 million for the three-month period ended March 31, 2020.
- (3) UDI Trusts' deposits are payable to the Mexican federal government and deducted from *Cetes Especiales* (investment securities) for balance sheet purposes.

Average Liabilities, Stockholders' Equity and Interest Rates

The table below presents the average balance of liabilities and stockholders' equity, interest expense and average annual interest rate for the periods indicated:

	For the three-month period ended March 31,			For the year ended December 31,								
	2020		Average	2019			2018			2017		
	Average Balance	Interest Expense	Interest Rate	Average Balance	Interest Expense	Average Interest Rate	Average Balance	Interest Expense	Average Interest Rate	Average Balance	Interest Expense	Average Interest Rate
<i>(Ps. millions, except percentages)</i>												
Demand deposits:												
Pesos.....	112,063	1,180	4.2%	98,418	4,067	4.1%	106,671	3,735	3.5%	132,281	2,290	1.7%
Foreign currency.....	21,254	11	0.2%	19,236	41	0.2%	18,923	37	0.2%	17,384	9	0.1%
Sub-total.....	133,317	1,191	3.6%	117,654	4,108	3.5%	125,594	3,772	3.0%	149,665	2,299	1.5%
Time deposits:												
Peso.....	311,414	4,598	5.9%	323,744	22,426	6.9%	288,701	18,375	6.4%	226,060	12,570	5.6%
UDL.....	2,403	-	0.0%	2,326	116	5.0%	1,678	83	4.9%	-	-	0.0%
Foreign currency.....	25,655	54	0.8%	22,675	255	1.1%	21,272	235	1.1%	15,855	134	0.8%
Sub-total.....	339,472	4,652	5.5%	348,745	22,797	6.5%	311,651	18,693	6.0%	241,915	12,704	5.3%
Bank loans:												
Pesos.....	4,220	102	9.7%	2,439	250	10.3%	2,902	241	8.3%	1,700	118	6.9%
Foreign currency.....	189	-	0.0%	9,579	3	0.0%	6,419	3	0.0%	1,425	4	0.3%
Sub-total.....	4,409	102	9.3%	12,018	253	2.1%	9,321	244	2.6%	3,125	122	3.9%
Loans from Mexican development banks:												
Pesos.....	12,206	239	7.8%	13,867	1,455	10.5%	13,643	1,596	11.7%	10,015	1,061	10.6%
Foreign currency.....	1,091	7	2.6%	2,304	389	16.9%	4,089	301	7.4%	3,868	142	3.70%
Sub-total.....	13,297	246	7.4%	16,171	1,844	11.4%	17,732	1,897	10.7%	13,883	1,203	8.70%
Outstanding subordinated debentures:												
Pesos.....	453	24	21.2%	640	116	18.1%	131	52	39.7%	1,336	136	10.2%
UDIs.....	1,816	23	5.1%	2,806	140	5.0%	2,746	138	5.0%	2,615	132	5.0%
Foreign currency.....	50,239	219	1.7%	39,661	808	2.0%	29,452	820	2.8%	20,022	812	4.1%
Sub-total.....	52,508	266	2.0%	43,107	1,064	2.5%	32,329	1,010	3.1%	23,973	1,080	4.5%
Securities sold under agreements to repurchase:												
Pesos.....	252,827	4,591	7.3%	283,355	22,736	8.0%	271,315	21,102	7.8%	252,174	16,946	6.7%
Foreign currency.....	18,548	-	0.0%	7,892	-	0.0%	2,890	112	3.9%	2,520	93	3.7%
Sub-total.....	271,375	4,591	6.8%	291,247	22,736	7.8%	274,205	21,214	7.7%	254,694	17,039	6.7%
Trading Derivatives:												
Pesos.....	513	-	0.0%	4,781	-	0.0%	-	-	0.0%	-	-	0.0%
Foreign currency.....	-	-	0.0%	-	-	0.0%	-	-	0.0%	3,168	-	0.0%
Sub-total.....	513	-	0.0%	4,781	-	0.0%	-	-	0.0%	3,168	-	0.0%
Hedging Derivatives:												
Pesos.....	16,668	994	23.8%	10,311	4,663	45.2%	12,451	4,230	34%	10,317	3,775	36.6%
Foreign currency.....	22,730	-	0.0%	33,325	-	0.0%	39,141	1,362	3.5%	24,208	893	3.7%
Sub-total.....	39,418	994	10.1%	43,636	4,664	10.7%	51,592	5,591	10.8%	34,525	4,668	13.5%
Foreign exchange valuation:												
Pesos.....	-	129	-	-	-	-	-	-	-	-	260	0.0%
Cost for new credits:												

	For the three-month period ended March 31,			For the year ended December 31,								
	2020			2019			2018			2017		
	Average Balance	Interest Expense	Average Interest Rate	Average Balance	Interest Expense	Average Interest Rate	Average Balance	Interest Expense	Average Interest Rate	Average Balance	Interest Expense	Average Interest Rate
	<i>(Ps. millions, except percentages)</i>											
Pesos.....	-	291	0.0%	-	1,156	0.0%	-	1,044	0.0%	-	687	0.0%
Total interest-bearing liabilities:												
Pesos.....	710,384	12,148	6.8%	737,555	56,869	7.7%	695,814	50,375	7.2%	633,883	37,844	6.0%
UDIs	4,219	23	2.2%	5,132	256	5.0%	4,424	221	5.0%	2,615	132	5.0%
Foreign currency	139,706	291	0.8%	134,672	1,496	1.1%	122,186	2,870	2.3%	88,450	2,087	2.4%
Sub-total.....	854,309	12,462	5.8%	877,359	58,621	6.7%	822,424	53,466	6.5%	724,948	40,062	5.5%
Non-interest-bearing liabilities:												
Pesos.....	298,702			289,598			274,055			216,470		
UDIs	270			138			234			33		
Foreign currency	40,072			40,306			44,705			37,440		
Sub-total.....	339,044			330,042			318,994			253,943		
Stockholders' equity:												
Pesos.....	115,771			115,503			96,296			92,591		
UDIs	-			-			6			70		
Foreign currency	1,634			1,637			1,524			1,640		
Sub-total.....	117,405			117,140			97,826			94,301		
Total liabilities and stockholders' equity:												
Pesos.....	1,124,857	12,148	4.3%	1,142,656	56,869	5.0%	1,066,165	50,375	4.7%	942,944	37,844	4.0%
UDIs	4,489	23	2.0%	5,270	256	4.9%	4,664	221	4.7%	2,718	132	4.9%
Foreign currency	181,412	291	0.6%	176,615	1,498	0.8%	168,415	2,870	1.7%	127,530	2,087	1.6%
Total.....	1,310,758	12,462	3.8%	1,324,541	58,623	4.4%	1,239,244	53,466	4.3%	1,073,192	40,063	3.7%

Changes in Interest Income and Expense—Volume and Rate Analysis

The following tables allocate, by currency of denomination, changes in interest income and interest expense between changes in volume and changes in rates for the three-month period ended March 31, 2020 compared to the corresponding period in 2019, for the year ended December 31, 2019 compared to the year ended December 31, 2018, for 2018 compared to 2017 and for 2017 compared to 2016. Volume and rate variances have been calculated based on movements in average balances over the period and changes in interest rates on average interest-earning assets and average interest bearing liabilities. The variances caused by changes in both volume and rate have been allocated to volume.

Interest-Earning Assets

	Three-month period ended March 31, 2020/2019			Years Ended December 31, 2019/2018			Years Ended December 31, 2018/2017			Years Ended December 31, 2017/2016		
	Increase/(Decrease) due to Changes in Interest			Increase/(Decrease) due to Changes in Interest			Increase/(Decrease) due to Changes in Interest			Increase/(Decrease) due to Changes in Interest		
	Volume	Rate	Net Change	Volume	Rate	Net Change	Volume	Rate	Net Change	Volume	Rate	Net Change
	<i>(Ps. millions)</i>											
Deposits in banks:												
Pesos	(100)	(289)	(389)	(3)	(17)	(20)	761	783	1,544	(219)	1,158	939
Foreign currency	-	-	-	-	1	1	(19)	-	(19)	(169)	(49)	(218)
Sub-total	(100)	(289)	(389)	(3)	(16)	(19)	742	783	1,525	(388)	1,109	721
Investment securities:												
Pesos	(84)	(534)	(618)	(2,576)	424	(2,152)	(1,819)	1,372	(447)	230	6,034	6,264
UDIs	-	107	107	(192)	31	(161)	128	(87)	41	202	27	229
Foreign currency	91	(87)	4	226	(30)	196	469	494	963	243	210	453
Sub-total	7	(514)	(507)	(2,542)	425	(2,117)	(1,222)	1,779	557	675	6,271	6,946
Loans ⁽¹⁾ :												
Pesos	(211)	(267)	(478)	6,826	1,541	8,367	9,519	4,201	13,720	6,155	8,804	14,959
UDIs	(3)	-	(3)	12	(2)	10	53	(20)	33	1	(2)	(1)
Foreign currency	95	(137)	(42)	443	78	521	574	248	822	62	155	217
Sub-total	(119)	(404)	(523)	7,281	1,617	8,898	10,146	4,429	14,575	6,218	8,957	15,175
Repurchase operations:												
Pesos	(929)	(59)	(988)	3,862	(278)	3,584	2,843	1,015	3,858	(8)	874	866
Hedging Derivatives:												
Pesos	(426)	163	(263)	(938)	(168)	(1,106)	2,905	(1,311)	1,594	771	2,184	2,955
Foreign currency	-	-	-	-	-	-	-	-	-	(206)	-	(206)
Sub-total	(426)	163	(263)	(938)	(168)	(1,106)	2,905	(1,311)	1,594	565	2,184	2,749
Foreign exchange valuation:												
Pesos	-	2	2	-	(49)	(49)	-	157	157	-	(155)	(155)
UDI Trusts' fiduciary liabilities:												
Pesos	-	-	-	-	38	38	-	3	3	-	1	1
Subtotal	-	-	-	-	38	38	-	3	3	-	1	1
Total interest-earning assets:												
Pesos	(1,750)	(984)	(2,734)	7,171	1,491	8,662	14,209	6,220	20,429	6,929	18,900	25,829
UDIs	(3)	107	104	(180)	29	(151)	181	(107)	74	203	25	228
Foreign currency	186	(224)	(38)	669	49	718	1,024	742	1,766	(70)	316	246
Total	(1,567)	(1,101)	(2,668)	7,660	1,569	9,229	15,414	6,855	22,269	7,062	19,241	26,303

(1) Interest income includes fees on loans of Ps.1,169 million in 2017, Ps.1,282 million in 2018, Ps.1,405 million for 2019 and Ps.358 million for the three-month period ended March 31, 2020.

Interest-Bearing Liabilities

	March 31, 2020/2019			2019/2018			2018/2017			2017/2016		
		Interest			Interest	Increase/(Decrease) due to Changes in				Interest		
	Volume	Rate	Net Change	Volume	Rate	Net Change	Volume	Interest	Net Change	Volume	Interest	Net Change
						(Ps. millions)						
Demand deposits:												
Pesos	221	13	234	(289)	621	332	(443)	1,888	1,445	(58)	887	829
Foreign currency	1	-	1	1	3	4	1	27	28	1	-	1
Sub-total.....	222	13	235	(288.)	624	336	(442)	1,915	1,473	(57)	887	830
Time deposits:												
Pesos	(547)	(871)	(1,418)	2,230	1,821	4,051	3,483	2,322	5,805	1,325	4,929	6,254
UDIs	-	-	-	32	1	33	-	83	83	-	-	-
Foreign currency	15	(12)	3	15	5	20	46	55	101	(11)	93	82
Sub-total.....	(532)	(883)	(1,415)	2,277.00	1,827	4,104	3,529	2,460	5,989	1,314	5,022	6,336
Bank loans:												
Pesos	63	(1)	62	(38.)	47	9	83	40	123	20	59	79
Foreign currency	(1)	0	(1)	1	(1)	-	14	(15)	(1)	(15)	(22)	(37)
Sub-total.....	62	(1)	61	(37)	46	9	97	25	122	5	37	42
Loans from Mexican development banks:												
Pesos	(87)	(97)	(184)	26	(167)	(141)	384	151	535	56	578	634
Foreign currency	(106)	(43)	(149)	(131)	219	88	8	151	159	(2)	45	43
Sub-total.....	(193)	(140)	(333)	(105)	52	(53)	392	302	694	54	623	677
Outstanding subordinated debentures:												
Pesos	(9)	5	(4)	202	(138)	64	(123)	39	(84)	(416)	63	(353)
UDIs	(13)	1	(12)	3	(1)	2	7	(1)	6	7	2	9
Foreign currency	141	(123)	18	284	(296)	(12)	382	(374)	8	897	(693)	204
Sub-total.....	119	(117)	2	489	(435)	54	266	(336)	(70)	488	(628)	(140)
Securities sold under agreements to repurchase:												
Pesos	(1,383)	(354)	(1,737)	936	698	1,634	1,286	2,870	4,156	163	6,348	6,511
Foreign currency	-	-	-	194	(306)	(112)	14	5	19	-	93	93
Sub-total.....	(1,383)	(354)	(1,737)	1,130	392	1,522	1,300	2,875	4,175	163	6,441	6,604
Hedging derivatives:												
Pesos	141	(345)	(204)	(727)	1,160	433	783	(329)	454	1,217	200	1,417
Foreign currency	-	-	-	(202)	(1,160)	(1,362)	551	(82)	469	46	618	664
Sub-total.....	141	(345)	(204)	(929)	-	(929)	1,334	(411)	923	1,263	818	2,081
Foreign exchange valuation:												
Pesos	-	(129)	(129)	-	-	-	-	(260)	(260)	-	186	186
Cost for Credits:												
Pesos	-	11	11	-	112	112	-	357	357	-	202	202
Total interest-bearing liabilities:												
Pesos	(1,601)	(1,780)	(3,369)	2,340	4,154	6,494	5,453	7,078	12,531	2,307	13,452	15,759
UDIs	(13)	1	(12)	35	-	35	7	82	89	7	2	9
Foreign currency	50	(178)	(128)	162	(1,536)	(1,374)	1,016	(233)	783	916	134	1,050
Total.....	(1,564)	(1,945)	(3,509)	2,537	2,618	5,155	6,476	6,927	13,403	3,230	13,588	16,818

Interest-Earning Assets—Yield and Yield Spread

The following table sets forth, by currency of denomination, the levels of our average interest earning assets and net interest income, and gross and net yield and yield spread obtained, for each of the periods indicated. In addition, because loan fees are a component of pricing, a table including loan fees (other than fees on credit card cash disbursements and merchant fees on credit card purchases) in net interest income has been included.

	For the three-month period ended March 31,	For the year ended December 31,		
	2020	2019	2018	2017
	(Ps. millions, except percentages)			
Total average earning assets:				
Pesos.....	1,038,229	1,062,679	1,001,689	881,381
UDIs.....	9,267	9,594	10,592	4,380
Foreign currency.....	144,591	134,154	117,520	89,102
Total.....	1,192,087	1,206,427	1,129,801	947,863
Historical not including loan fees:				
Net interest income:				
Pesos.....	16,353	64,467	61,019	53,233
UDIs.....	93	32	218	233
Foreign currency.....	1,070	4,088	1,996	1,013
Total.....	17,516	68,587	62,233	54,479
Gross yield ⁽¹⁾ :				
Pesos.....	11.0%	11.4%	11.1%	10.3%
UDIs.....	5.0%	3.0%	4.1%	8.3%
Foreign currency.....	3.8%	4.2%	4.1%	3.5%
Weighted-average rate.....	10.1%	10.5%	10.3%	9.7%
Net yield ⁽²⁾ :				
Pesos.....	6.3%	6.1%	6.1%	6.0%
UDIs.....	4.0%	0.3%	2.1%	5.3%
Foreign currency.....	3.0%	3.0%	1.7%	1.1%
Weighted-average rate.....	5.9%	5.7%	5.6%	5.6%
Yield spread ⁽³⁾ :				
Pesos.....	4.1%	3.7%	3.9%	4.4%
UDIs.....	2.8%	(2.0%)	(0.9%)	3.3%
Foreign currency.....	2.9%	3.1%	1.8%	1.1%
Weighted-average rate.....	4.2%	3.9%	3.8%	4.2%

(1) Gross yield represents interest income divided by average earning assets.

(2) Net yield represents the total of net interest income divided by average earning assets, based on beginning and end-of-year balances

(3) Yield spread represents the difference between gross yield on average interest-earning assets and average cost of interest-bearing liabilities, based on beginning and end-of-year balances

Return on Average Total Assets and Average Stockholders' Equity

The following table presents certain selected financial data and ratios for Banorte for the periods indicated:

	For the three-month period ended March 31,	For the year ended December 31,		
	2020	2019	2018	2017
	(Ps. millions, except percentages)			
Net income	6,180	27,493	24,834	18,339
Average total assets	1,310,758	1,324,541	1,239,244	1,073,188
Average stockholders' equity	117,405	117,140	97,826	94,301
Return on average assets ⁽¹⁾⁽³⁾	2.0%	2.4%	2.3%	1.8%
Return on average equity ⁽²⁾⁽³⁾	21.7%	24.2%	25.7%	20.3%
Average stockholders' equity as a percentage of average total assets	9.0%	8.8%	7.9%	8.8%
Dividend Payout Ratio		81.5%	0.0%	127.5%

- (1) Net income for the year divided by the average of the last five quarters of total assets, based on end-of-period balances (excluding minority interests).
- (2) Net income for the year divided by the average of the last five quarters of stockholders' equity, based on end-of-period balances (excluding minority interests).
- (3) For the three-month period ended March 31, 2020, net income is determined on an annualized basis and is divided by the last two quarters of total assets for ROAA or by the last two quarters of stockholder's equity for ROAE based on end-of-period balances, in this case, March 31, 2020 and December 31, 2019.

Interest Rate Sensitivity of Assets and Liabilities

Interest Rates

Mexican Central Bank regulations mandate that Mexican banks base their floating interest rates on commercial and mortgage loans on a single reference rate published by official or market-driven sources and that the agreements for such loans specify the factor used to determine the interest rate and the minimum and maximum spread over the reference rate. Currently, we generally base the floating interest rate on all of our new Peso-denominated loans on the TIIE.

In accordance with the Mexican Central Bank regulations, our policy with respect to non-Peso lending activities, mainly in U.S. dollars, is to price such loans generally on the basis of LIBOR or a fixed rate. Spreads over LIBOR are determined in accordance with our marginal cost of funding in currencies other than Pesos. Under Mexican Central Bank regulations, a portion of our non-Peso liabilities must be invested in certain dollar-denominated, low-risk, highly liquid instruments and deposits. See “*Supervision and Regulation—Liquidity Requirements for Foreign Currency-Denominated Liabilities*.” Our cost associated with funding the reserve is also included in determining the cost to customers of non-Peso-denominated loans.

Interest Rate Sensitivity

A key component of our asset and liability policy is the management of interest rate sensitivity. Interest rate sensitivity is the relationship between market interest rates and net interest income due to the repricing characteristics of assets and liabilities. For any given period, the pricing structure is matched when an equal amount of assets and liabilities reprice. Any excess of assets or liabilities over these matched items results in a repricing gap or net exposure. A negative repricing gap denotes liability sensitivity and normally means that a decline in interest rates would have a positive effect on net interest income, while an increase in interest rates would have a negative effect on net interest income.

The following table reflects our interest-earning assets and interest-bearing liabilities as of March 31, 2020. Fixed-rate instruments were classified in this table according to their final maturity and other instruments according to their time of repricing.

As of March 31, 2020						
	0-30 Days	31-90 Days	91-180 Days	181-365 Days	Non-Rate Sensitive or Over One Year	Total
	(Ps. millions, except percentages)					
Assets⁽¹⁾:						
Variable-rate loans.....	416,252	11,334	565	44	1,506	429,701
Fixed-rate loans.....	10,474	13,338	15,795	30,322	263,461	333,391
Total performing loans.....	426,726	24,672	16,360	30,366	264,968	763,092
Securities and investments.....	44,754	3,663	413	1,577	206,359	256,766
Repurchase agreements and derivative financial instruments.....	19,819	256	478	990	30,617	52,161
Total interest-earning assets.....	491,299	28,591	17,251	32,933	501,944	1,072,019
Cash, property and other non-interest-earning assets.....					226,734	226,734
Non-performing loans.....					12,826	12,826
Less: Allowance for loan losses.....					(17,932)	(17,932)
Total assets.....	491,299	28,591	17,251	32,933	723,572	1,293,647
Liabilities And Stockholders' Equity⁽¹⁾:						
Demand deposits.....	97,297	3,210	13,666	28,081	310,404	451,842
Time deposits.....	246,478	61,177	4,995	3,444	23,119	339,213
Total deposits.....	343,775	64,387	18,660	31,525	333,522	791,870
Short-term debt.....	10,829	66	212	268	1,957	13,332
Long-term debt.....					4,197	4,197
Securities and derivative financial instruments.....	218,044	2,118	825	5,714	11,165	237,866
Subordinated debentures.....				2,818	55,605	58,423
Other liabilities.....					74,300	74,300
Stockholders' equity.....					113,659	113,663
Total liabilities and stockholders' equity.....	572,648	66,571	19,697	40,325	594,406	1,293,647
Interest rate sensitivity gap.....	(81,415)	(37,979)	(2,446)	(7,392)	129,166	(66)
Cumulative interest rate sensitivity gap.....	(81,415)	(119,395)	(121,840)	(129,232)	(66)	(132)
Cumulative gap as percentage of total interest-earning assets.....	-	-	-	-	-	-

(1) Based on the lesser of the number of days to reprice and the remaining days to maturity of the corresponding asset or liability.

As of March 31, 2020, interest-earning assets totaled Ps.1,071,953 million. Of these assets, 45.8% repriced periodically every 30 days or less. Such assets included 86.9% of performing loans and 9.1% of securities and investments. Of our total performing loan portfolio, 56.3% was comprised of variable-rate loans and 43.7% was comprised of fixed-rate loans.

Of our liabilities as of March 31, 2020, 67.1% consisted of deposits, totaling Ps.791,870 million, of which 43.4% reprice every 30 days or less. The remaining 32.9% of our liabilities amounting to Ps.388,114 million consisted of Ps.17,529 million of funds from bank borrowings, Ps.58,423 million of subordinated debentures, Ps.237,866 million of financial instruments repurchase operations, and Ps.74,300 million of other liabilities. Of such Ps.1,179,984 million of liabilities, 48.5% reprice every 30 days or less.

Interest-Bearing Deposits with Other Banks

Mexican Central Bank regulations require banks to maintain a minimum liquidity coefficient of foreign currency liabilities. See “*Supervision and Regulation—Liquidity Requirements for Foreign Currency-Denominated Liabilities.*” A substantial majority of our short-term deposits with international banks are denominated in U.S. dollars.

Mexican Central Bank regulations require that a bank maintain balanced positions in foreign currencies no higher than a specified level with respect to its Tier 1 Capital. As of December 31, 2019, the limit established for us by the Mexican Central Bank for maturity-adjusted net foreign currency-denominated liabilities was U.S.\$13,308million (Ps.251,049 million). As of December 31, 2019, our maturity-adjusted net foreign currency liabilities totaled

U.S.\$2,569 million (Ps.48,462 million). As of March 31, 2020, the limit established for us by the Mexican Central Bank for maturity-adjusted net foreign currency-denominated liabilities was U.S.\$13,548 million (Ps.318,166 million). As of March 31, 2020, our maturity-adjusted net foreign currency liabilities totaled U.S.\$3,647 million (Ps.85,649 million).

Securities

We held securities in the amount of Ps.256,700 million as of March 31, 2020, representing 19.8% of our total assets.

The following table presents our portfolio of securities as of the dates indicated, including those subject to repurchase agreements:

	As of March 31, 2020	As of December 31, 201920182017		
		(Ps. millions, except percentages)		
Peso-Denominated:				
Mexican government securities:				
Cetes	618	817	3,458	2,995
Cetes Especiales ⁽¹⁾	573	568	545	523
Bonds	153,686	144,236	136,543	157,937
Total Mexican government securities	154,877	145,621	140,546	161,455
Bank bonds and certificates	22,495	23,582	39,885	48,350
Other fixed income securities	4,419	4,844	4,920	4,078
Equity securities (GFNorte, Banorte Stock Plan).....	561	103	93	201
Total Peso-denominated	182,352	174,150	185,444	214,084
Foreign Currency-Denominated:				
Government securities:				
Mexican government securities issued abroad	63,628	56,810	48,821	46,268
Total government securities	63,628	56,810	48,821	46,268
Eurobonds PEMEX	9,535	12,244	10,562	13,063
U.S. commercial paper	1,919	-	-	-
US Agencies	-	1,537	4,020	-
Other fixed income securities	71	-	48	8,694
Equity securities (Visa & MC).....	-	66	-	168
Total foreign currency-denominated	75,153	70,657	63,452	68,192
Sub-total securities	257,505	244,807	248,896	282,277
Assigned Securities Pending Settlement	(805)	2,585	-	(467)
Total Securities	256,700	247,392	248,896	281,809

(1) Cetes Especiales in the above table are shown net of UDI Trusts' deposits.

Securities—Maturities and Average Yields

The following table analyzes, as of March 31, 2020, remaining maturities and weighted-average yields of our securities that have a specific date of maturity:

	From 1 to 89 days		From 90 to 179 days		From 6 to 12 months		From 1 to 2 years		From 2 to 3 years		From 3 to 4 years		From 4 to 5 years		More than 5 years		Total
	Amnt	Yield	Amnt	Yield	Amnt	Yield	Amnt	Yield	Amnt	Yield	Amnt	Yield	Amnt	Yield	Amnt	Yield	Balance
	<i>(Ps. millions, except percentages)</i>																
PESO-DENOMINATED:																	
Cetes	420,272,008	6.4%	197,943,048	6.3%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	618,215,057
Cetes Especiales	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	169,964,235	3.7%	402,683,455	3.7%	572,647,692
Bonds	1,196,325,395	6.6%	5,871,893,164	6.5%	8,025,791,421	5.7%	9,990,610,279	6.6%	33,325,884,155	6.7%	43,143,971,018	6.7%	22,682,676,636	6.7%	29,449,220,645	6.8%	153,686,372,716
Total Mexican government securities	1,616,597,403	6.5%	6,069,836,213	6.5%	8,025,791,422	5.7%	9,990,610,280	6.6%	33,325,884,156	6.6%	43,143,971,019	6.7%	22,852,640,872	6.7%	29,851,904,101	6.7%	154,877,235,464
Bank bonds and certificates	683,489,231	6.7%	611,242,068	6.7%	2,570,682,349	7.1%	1,118,094,776	7.1%	6,087,191,382	7.0%	1,952,778,152	6.4%	1,546,098,834	8.2%	7,925,364,431	7.0%	22,494,941,227
Other fixed-income securities	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-
Total Peso-denominated	2,300,086,634	6.6%	6,681,078,281	6.5%	10,596,473,772	6.0%	11,108,705,056	6.7%	39,413,075,538	6.7%	45,096,749,171	6.6%	24,398,739,706	6.8%	37,777,268,532	6.8%	177,372,176,691
FOREIGN CURRENCY-DENOMINATED:																	
Mexican government securities issued abroad	-	0.0%	-	0.0%	-	0.0%	1,301,413,597	1.6%	226,675,818	10.4%	-	0.0%	3,042,261,149	2.9%	59,057,790,081	3.8%	63,628,140,647
U.S. Treasury securities	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-
Eurobonds	-	0.0%	-	0.0%	197,966,741	1.1%	-	0.0%	449,436,730	10.4%	2,148,891,148	11.5%	3,553,383,315	8.9%	3,185,737,310	9.2%	9,535,415,246
PEMEX	-	0.0%	-	0.0%	337,712,033	1.7%	923,729,797	2.0%	657,249,002	1.6%	-	0.0%	-	0.0%	-	0.0%	1,918,690,834
U.S. commercial paper	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-
Agencies	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-
Other fixed-income securities	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-	0.0%	-
Total foreign currency denominated	-	0.0%	-	0.0%	535,678,775	1.5%	2,225,143,395	1.8%	1,333,361,551	6.3%	2,148,891,148	11.5%	6,595,644,465	6.1%	62,243,527,392	4.1%	75,082,246,727
Total securities (excluding equity securities)	2,300,086,634	6.6%	6,681,078,281	6.5%	11,132,152,547	5.8%	13,333,848,451	5.9%	40,746,437,090	6.7%	47,245,640,320	6.9%	30,994,384,171	6.6%	100,020,795,925	5.1%	252,454,423,418
UDJ Trusts' deposits																	-
Equity Securities (GFNorte, Banorte Stock Plan)																	631,962,792
Managed Fund Stocks																	4,381,986,884
Assigned Securities Pending Settlement																	(805,023,128)
Consolidated securities balance																	256,663,349,966

Bank Loans and Securities Sold Under Repurchase Agreements

The following table sets forth our borrowings and securities sold under repurchase agreements for the periods indicated:

	As of and for the three-month period ended March 31,		As of and for the year ended December 31,					
	2020		2019		2018		2017	
	Amount	Rate	Amount	Rate	Amount	Rate	Amount	Rate
	<i>(Ps. millions, except percentages)</i>							
Bank loans:								
At end of period.....	17,529	6.6%	14,630	8.4%	35,722	4.5%	15,238	5.3%
Daily average indebtedness during period..	17,511	7.1%	26,914	5.4%	26,591	5.9%	16,226	5.1%
Maximum month-end balance.....	21,080	7.8%	38,331	9.1%	40,888	7.4%	19,148	6.4%
Securities sold under repurchase agreements:								
At end of period.....	175,685	7.0%	162,684	9.0%	163,507	10.4%	190,363	5.9%
Daily average indebtedness during period..	178,065	7.1%	161,745	9.6%	189,073	7.7%	215,980	5.4%
Maximum month-end balance.....	179,433	8.2%	185,188	11.0%	253,053	10.4%	231,559	5.9%
Total at end of period	193,214	7.0%	177,315	8.9%	199,229	9.3%	205,601	5.8%
Daily average indebtedness during period..	195,576	7.1%	188,659	9.0%	215,664	7.5%	232,206	5.4%
Maximum month-end balance.....	200,513	8.2%	223,519	10.7%	293,941	10.0%	253,707	6.0%

Deposits

The following table presents the components of our deposit base for the dates indicated:

	As of March 31,	As of December 31,		
	2020	2019	2018	2017
	<i>(Ps. millions)</i>			
Interest-bearing demand deposits:				
Peso-denominated.....	144,799	122,727	93,609	143,392
Non-Peso-denominated.....	21,239	19,516	18,952	15,690
Sub-total.....	166,038	142,243	112,561	159,082
Non-interest-bearing demand deposits:				
Peso-denominated.....	258,075	270,033	270,118	202,118
Non-Peso-denominated.....	29,942	25,262	31,331	35,452
Sub-total.....	288,017	295,295	301,448	237,570
Time deposits:				
Peso-denominated.....	303,208	279,645	322,121	229,647
Non-Peso-denominated.....	34,606	27,089	23,104	22,323
Sub-total.....	337,815	306,734	345,226	251,970
Total.....	791,870	744,272	759,235	648,622

Loan Portfolio

Total loan amounts set forth in this section include the total principal amount of our performing and non-performing loans outstanding at the date presented, which include rediscounted loans and loans in the UDI Trusts. The terms “total loans” and “total loan portfolio” include total performing loans plus total non-performing loans. The terms “net total loans” and “net total loan portfolio” refer to net total performing loans plus net non-performing loans. See “*Presentation of Financial and Other Information—Terms Relating to Our Loan Portfolio.*”

Total balance of our loan portfolio as of March 31, 2020 amounted to Ps.775,918 million, an increase of Ps.20,020 million, or 2.6%, from the balance as of December 31, 2019. This variation was mainly due to an increase in our business and mortgage loan portfolios. As of March 31, 2020, performing business loans represented 37.8% of total performing loans, performing loans to financial institutions represented 3.1%, performing mortgage loans represented 22.7%, performing government loans represented 21.1% and performing consumer loans represented 15.2%. As of December 31, 2019, our loan portfolio amounted to Ps.755,898 million, a decrease of Ps.13,276 million, or 1.7%, from the balance as of December 31, 2018. This variation was mainly due to a decrease in our business and government loan portfolios. As of December 31, 2019, performing business loans represented 36% of total performing loans, loans to financial institutions represented 3%, performing mortgage loans represented 23%, performing government loans represented 23% and performing consumer loans represented 16%.

As of December 31, 2018, our loan portfolio amounted to Ps.769,174 million, an increase of Ps.153,460 million, or 24.9% compared to December 31, 2017. This variation was mainly due to the effects of the Interacciones Merger (see “*Effects of the Merger of Banco Interacciones into the Bank*”) and also to the increase in our housing mortgage loans by Ps.20,534 million.

Loans by Type and by Borrower

The following table analyzes our loan portfolio by loan type. Total loans reflect the sum of the performing loan portfolio and the non-performing loan portfolio. For a breakdown of non-performing loans by loan type, see “*Non-Performing Loan Portfolio*” below.

	As of March 31, 2020	As of December 31, (Ps. millions)		
		2019	2018	2017
Performing and Non-Performing Loans				
Commercial and Corporate loans:				
Government loans	161,246	170,155	192,234	132,816
Loans granted to financial institutions	24,011	20,595	21,088	22,875
Commercial loans:				
Collateralized or guaranteed	198,275	190,076	193,036	155,861
Unsecured	90,134	76,366	82,943	54,570
Sub-total	288,409	266,442	275,979	210,431
Total commercial and corporate loans.....	473,666	457,192	489,301	366,122
Consumer loans:				
Mortgage.....	173,226	170,086	155,797	135,405
Credit cards.....	38,707	39,700	36,657	33,906
Other consumer credit	77,493	76,528	74,580	68,089
Total consumer loans.....	289,426	286,314	267,034	237,400
Total performing loans	763,092	743,506	756,335	603,522
Total non-performing loans.....	12,826	12,392	12,839	12,192
Total loans⁽¹⁾.....	775,918	755,898	769,174	615,714

(1) The loan amounts set out in the above table include accrued interest.

Commercial Loans

Total performing commercial loans as of March 31, 2020 amounted to Ps.473,666 million, which increased by Ps.16,474 million, or 3.6%, from the amount recorded on December 31, 2019. This variation was mainly due to an increase in our commercial, corporate and SME loan portfolios.

Total performing commercial loans totaled Ps.457,192 million as of December 31, 2019, which decreased by Ps.32,108 million, or 6.6%, from the amount recorded on December 31, 2018. This variation was mainly due to a decrease in our business and government loan portfolios.

Total performing commercial loans totaled Ps.489,300 million as of December 31, 2018, reflecting an increase of Ps.123,178 million, or 33.6%, compared to December 31, 2017. This increase was mainly due to the effects of the Interacciones Merger (see “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Effects of the Merger of Banco Interacciones into the Bank*”).

As of March 31, 2020 and as of December 31, 2019, 2018 and 2017 the aggregate outstanding principal amount and accrued interest of loans to our 15 largest clients (including loans to a single corporate group or to the Mexican government) represented 18.0%, 17.6%, 19.7% and 18.2%, respectively, of total government, commercial and corporate loans. Of these 15 largest clients, as of March 31, 2020, 14 were classified as “A” and one as “B”, under the CNBV’s regulatory loan classification guidelines.

As of March 31, 2020, 26.7% of our commercial loan portfolio was unsecured. Unsecured commercial loans, consisting primarily of short-term working capital loans (with terms of 30 to 90 days), are common in Mexico. The credit analysis and administration of these loans are the same as for secured loans. If we establish an unsecured line of credit, it is because we believe the borrower is a creditworthy customer, and the fact that it is an unsecured loan is taken into consideration during the approval process.

Consumer Loans

Our performing consumer loans, including mortgage, credit card and other consumer loans, increased 17.9% in 2017, increased 12.5% in 2018, increased 7.2% in 2019 and increased 1.1% during the three-month period ended March 31, 2020.

Our performing credit card portfolio increased 19.2% in 2017, increased 8.1% in 2018, increased 8.3% in 2019 and decreased 2.5% during the three-month period ended March 31, 2020. Like other Mexican banks, we reflect in our interest rates for credit cards the greater risk associated with such loans. Other types of loans, such as mortgage and automobile loans, are generally less risky because borrowers are less able to increase their borrowings without prior approval and must generally provide some form of collateral.

Our performing automobile and other consumer loans increased 9.5% from December 31, 2017 to December 31, 2018, increased 2.6% from December 31, 2018 to December 31, 2019 and increased 1.3% from December 31, 2019 to March 31, 2020.

As of March 31, 2020, our mortgage portfolio consisted of 168,111 residential loans, with an aggregate principal amount outstanding of Ps.175,295 million. These loans were originally granted in Pesos or UDIs. The Peso-denominated loans were funded by us and carry market interest rates, but the monthly payment is fixed or variable. The UDI-denominated loans were funded by us and the Mexican government, and the monthly payment is fixed, but the outstanding balance in Pesos increases monthly in proportion to the variation of the NCPI.

Loans by Currency

Foreign currency-denominated loans amounted to Ps.84,362 million on March 31, 2020, reflecting an increase of 30% from December 31, 2019. The increase in foreign currency-denominated loans from December 31, 2019 to March 31, 2020 was partly due to the increase in the demand for loans in foreign currency and the depreciation of the Mexican peso.

Foreign currency-denominated loans amounted to Ps.65,117 million on December 31, 2019, reflecting an increase of 1.9% from December 31, 2018. The increase in foreign currency-denominated loans from December 31, 2018 to December 31, 2019 was partly due to the increase in the demand for loans in foreign currency that offset the decrease of the exchange rate. Foreign currency-denominated loans amounted to Ps.63,910 million on December 31, 2018, reflecting an increase of 28% from December 31, 2017. The increase in foreign currency denominated loans from

December 31, 2017 to December 31, 2018 was partly due to the effects of the Interacciones Merger (see—“Management’s Discussion and Analysis of Financial Condition and Results of Operations—Effects of the Merger of Banco Interacciones into the Bank”) and the result of reflecting the exchange rate volatility linked to economic and political events.

The following table presents our Peso and foreign currency-denominated loan portfolio at the dates indicated. Foreign currency-denominated loans that were not denominated in U.S. dollars were converted into U.S. dollars and then expressed in Pesos, at the Mexican Central Bank Exchange Rate.

	As of March 31,		2019		As of December 31,		2018		2017	
	Loan Amount	% of Portfolio ⁽²⁾	Loan Amount	% of Portfolio ⁽²⁾	Loan Amount	% of Portfolio ⁽²⁾	Loan Amount	% of Portfolio ⁽²⁾	Loan Amount	% of Portfolio ⁽²⁾
	<i>(Ps. millions, except percentages)</i>									
Peso-denominated loans.....	688,846	88.8%	684,332	90.5%	698,328	90.8%	566,538	92.0%		
UDI denominated loans.....	2,710	0.3%	6,449	0.9%	6,936	0.9%	3,183	0.5%		
Foreign currency-denominated loans.....	84,362	10.9%	65,117	8.6%	63,910	8.3%	45,993	7.5%		
Total loans⁽¹⁾.....	775,918	100.0%	755,898	100.0%	769,174	100.0%	615,714	100.0%		

(1) The loan amounts set out in the above table include accrued interest.

(2) Percentage of portfolio equals the relevant loan amount by currency divided by the sum of total loans.

Loans to the Public and Private Sectors

As of March 31, 2020, our loans to the public sector amounted to Ps.161,281 million, accounting for 20.8% of our total loan portfolio. The percentage of our loan portfolio comprised of public sector loans decreased from 25.0% as of December 31, 2018 to 22.5% as of December 31, 2019. This decrease was mainly due to a process of improvement in the profitability of that portfolio. The percentage of our loan portfolio comprised of public sector loans increased from 21.6% as of December 31, 2017 to 25.0% as of December 31, 2018. This increase was mainly due to the effect of the Interacciones Merger (see “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Effects of the Merger of Banco Interacciones into the Bank”) and new financing opportunities for our clients in the government sector, and decreased to 22.5% as of December 31, 2019. See “Risk Factors—Risks Relating to Our Business—We maintain lower levels of capital or reserves in connection with our loans to Mexican federal, state and municipal governments” and “Risk Factor—Risks Relating to Our Business—Some of our loans to Mexican states and municipalities may be restructured.”

Loans to individuals consisted of loans for business activities, mortgage loans, credit card loans and automobile and other consumer loans. Our loans to individuals totaled Ps.302,813 million as of March 31, 2020, reflecting an increase of 1.0% from Ps.299,758 million as of December 31, 2019. For December 31, 2019, our loans to individuals totaled Ps.299,758 million, which increased by 6.7% from Ps.281,067 million as of December 31, 2018, which increased by 11.7% from December 31, 2017. The following table sets forth an analysis of the composition of our total loan portfolio at the dates indicated with respect to loans to both the public and private sectors:

	As of March 31,		2019		As of December 31,		2018		2017	
	Loan Amount	% of Portfolio ⁽³⁾	Loan Amount	% of Portfolio ⁽³⁾	Loan Amount	% of Portfolio ⁽³⁾	Loan Amount	% of Portfolio ⁽³⁾	Loan Amount	% of Portfolio ⁽³⁾
	<i>(Ps. millions, except percentages)</i>									
Public sector ⁽¹⁾	161,281	20.8%	170,155	22.5%	192,234	25.0%	132,816	21.6%		
Private sector:										
Businesses.....	311,823	40.2%	285,985	37.8%	295,875	38.5%	231,336	37.6%		
Individuals ⁽²⁾	302,813	39.0%	299,758	39.7%	281,067	36.5%	251,561	40.9%		
Total private sector loans.....	614,637	79.2%	585,743	77.5%	576,942	75%	482,898	78.4%		
Total loans.....	775,918	100.0%	755,898	100.0%	769,174	100.0%	615,714	100.0%		

(1) Includes loans supported by the full faith and credit of the Mexican government.

(2) Includes loans to individuals for business activities as well as mortgage, credit card and other consumer loans.

(3) Percentage of portfolio equals the relevant loan amount divided by the sum of total loans.

Loans by Economic Activity

During the last few years, we have focused our lending activities towards those sectors of the Mexican economy which we believe, within the context of our overall risk management policies, have the greatest potential for growth. In addition, we have attempted to reduce our risk by diversifying our loan portfolio among a greater number of customers and within a larger geographic area in Mexico.

By December 31, 2018, the total balance of our mortgage loan portfolio increased by Ps.20,534 million, or 15.0% of our total portfolio, mainly due to higher levels of mortgage loans. As of December 31, 2019, our mortgage loan portfolio totaled Ps.172,059 million, representing an increase of Ps.14,797 million, or 9.4%, from the mortgage loan balance as of December 31, 2018. This increase was mainly the result of a major focus in our business strategy of sales through different channels (branches, agencies and third party sellers). Mortgage loans represented 22.8%, 20.4% and 22.2%, respectively, of our total loan portfolio as of December 31, 2019, 2018 and 2017, respectively.

As of December 31, 2019, our government loans decreased by Ps.22,079 million, or 11.5%, construction and real estate development loans decreased by Ps.10,879 million, or 24.6% and our mortgage loans increased by Ps.14,797 million, or 9.4%.

During the three-month period ended March 31, 2020, our government loans decreased by Ps.8,874 million, or 5.2%, construction and real estate development loans increased by Ps.602 million, or 1.8% and our mortgage loans increased by Ps.3,236 million, or 1.9% from the loan balance as of December 31, 2019. The following table sets forth an analysis of our loan portfolio's composition at the dates indicated according to the borrower's principal economic activity:

	As of March 31, 2020		As of December 31,							
	Loan Amount	% of Portfolio ⁽⁵⁾	Loan Amount	% of Portfolio ⁽⁵⁾	Loan Amount	% of Portfolio ⁽⁵⁾	Loan Amount	% of Portfolio ⁽⁵⁾	Loan Amount	% of Portfolio ⁽⁵⁾
<i>(Ps. millions, except percentages)</i>										
Economic Activity⁽¹⁾:										
Mortgages	175,295	22.6%	172,059	22.8%	157,262	20.4%	136,728	22.2%		
Social and community services ⁽²⁾ ..	31,531	4.1%	30,065	4.0%	28,326	3.7%	12,418	2.0%		
Manufacturing	41,975	5.4%	37,137	4.9%	41,037	5.3%	33,173	5.4%		
Construction and real estate development	34,009	4.4%	33,407	4.4%	44,287	5.8%	35,403	5.7%		
Commercial activities ⁽³⁾	76,485	9.9%	69,369	9.2%	70,526	9.2%	65,005	10.6%		
Credit card	41,090	5.3%	41,987	5.6%	38,808	5.1%	36,093	5.9%		
Financial services ⁽⁴⁾	68,712	8.9%	60,012	7.9%	63,311	8.2%	55,992	9.1%		
Energy and utilities	11,612	1.5%	11,833	1.6%	9,794	1.3%	6,606	1.1%		
Agriculture, forestry and livestock	8,830	1.1%	9,163	1.2%	8,965	1.2%	8,247	1.3%		
Mining	5,821	0.8%	5,119	0.7%	2,405	0.3%	2,803	0.5%		
Transportation and communication ..	40,089	5.2%	37,052	4.9%	35,438	4.6%	20,199	3.3%		
Government	161,281	20.8%	170,155	22.5%	192,234	25%	132,816	21.6%		
INB commercial portfolio	-	0.0%	-	0.0%	-	0.0%	-	0.0%		
Other consumer loans	79,127	10.2%	78,509	10.4%	76,760	10.0%	70,231	11.4%		
ADE	-	0.0%	-	0.0%	-	0.0%	-	0.0%		
Fid. FCICK16-1	61	0.0%	31	0.0%	22	0.0%	-	0.0%		
Total loan portfolio	775,918	100.0%	755,898	100.0%	769,174	100.0%	615,714	100.0%		

(1) The loan amounts set out in the above table include accrued interest and non-performing loans.

(2) Includes certain loans to the public sector and to educational and cultural institutions.

(3) Includes loans for commercial activities not directly related to manufacturing.

(4) Includes credit extended to financial institutions and unincorporated businesses except for credit exposures connected to leasing and factoring.

(5) Percentage of portfolio equals the relevant loan amount by economic activity divided by the sum of total loans.

Our loan portfolio is characterized by seasonal variations in loan demand and in outstanding loan balances. For example, heavy demand for agricultural financing drives increases in outstanding loan balances from May through July of each year. In addition, the Mexican economy has historically experienced large increases in economic activity during the second half of the year, resulting in significant demand for working capital and inventory financing during the period from September through November and for consumer loan balances from November through January.

Maturity Composition of the Loan Portfolio

The following table sets forth an analysis with reference to time remaining to maturity of our loan portfolio, as of March 31, 2020 and as of December 31, 2019, 2018 and 2017:

	As of March 31,		As of December 31,					
	2020		2019		2018		2017	
	Loan Amount	% of Portfolio⁽³⁾	Loan Amount	% of Portfolio⁽³⁾	Loan Amount	% of Portfolio⁽³⁾	Loan Amount	% of Portfolio⁽³⁾
	<i>(Ps. millions, except percentages)</i>							
Due within 1 year ⁽¹⁾	182,411	23.5%	178,495	23.6%	136,081	17.7%	144,222	23.4%
Between 1 and 5 years ⁽¹⁾	258,144	33.3%	260,095	34.4%	193,902	25.2%	206,278	33.5%
Over 5 years ⁽¹⁾	322,538	41.6%	304,917	40.3%	426,352	55.4%	253,022	41.1%
Sub-total loans.....	763,092	98.3%	743,506	98.4%	756,335	98.3%	603,522	98.0%
Non-performing loans.....	12,826	1.7%	12,392	1.6%	12,839	1.7%	12,192	2.0%
ADE.....	-	0.0%	-	0.0%	-	0.0%	-	0.0%
Total loan portfolio⁽²⁾.....	775,918	100.0%	755,898	100.0%	769,174	100.0%	615,714	100.0%

(1) These loans may be prepaid.

(2) Maturity composition is based on the period remaining to the maturity of the loans.

(3) Percentage of portfolio equals the relevant loan amount by currency divided by the sum of total loans.

From December 31, 2017 to December 31, 2018, the balance of the loans due within one year decreased by Ps.8,141 million, or 5.6%. From December 31, 2018 to December 31, 2019, such loans increased by Ps.42,414 million, or 31.2%. From December 31, 2019 to March 31, 2020, such loans increased by Ps.3,916 million, or 2.2%.

For the three-month period ended March 31, 2020 and for the years ended December 31, 2019, 2018 and 2017, our loans with a maturity of over five years increased as a percentage of total loans. These trends are the result of increases in our mortgage loan portfolio with maturities of fifteen years.

Interest Rate Sensitivity of Outstanding Loans

Every 28 days the interest rates of the majority of our Peso-denominated loans have rates that are determined by reference to a marginal variable rate. Following the establishment of the TIIE on March 20, 1995, we began pricing loans based on the TIIE.

The following table presents the interest rate sensitivity of our outstanding loan portfolio at the dates indicated:

	As of March 31,	As of December 31,		
	2020	2019	2018	2017
	<i>(Ps. millions)</i>			
Fixed-rate.....	333,391	331,840	317,321	244,328
Variable rate.....	429,701	411,666	439,014	359,194
Total loan portfolio.....	763,092	743,506	756,335	603,522
Non-performing loans.....	12,826	12,392	12,839	12,192
Allowances for loan losses.....	(17,932)	(17,083)	(18,264)	(15,551)
Net total loan portfolio⁽¹⁾.....	757,986	738,815	750,910	600,163

(1) The loan amounts set out in the above table include accrued interest.

Non-Performing Loan Portfolio

In assessing the performance of our loan portfolio, we have reviewed both the outstanding amount of our non-performing loan portfolio, as well as the classification of loans using the loan grading system set forth under the General Rules Applicable to Mexican Banks. In accordance with the practice of most Mexican banks, we have traditionally monitored the performance of our loan portfolio by reference to our *cartera vencida*, or non-performing loan portfolio.

Pursuant to Mexican Banking GAAP, we recognize the entire principal amount and accrued but unpaid interest of a loan as “non-performing” in accordance with the following criteria:

- in the case of loans where the principal and interest is payable in a single installment, 30 days after a payment becomes due;
- in the case of loans where the principal is payable in a single installment with periodic interest payments, 90 days after an interest payment is missed or 30 days after a principal payment is missed;
- in the case of loans where the principal and interest are payable in periodic installments, 90 days after a payment is missed;
- in the case of revolving loans, 60 days after a missed payment;
- in the case of mortgage loans, 90 days after a missed payment;
- in the case of credit card loans, after two consecutive payments are missed; and
- in the case of checking accounts, when an overdraft occurs.

In addition, unpaid balances of loans are considered “non-performing” when a borrower has declared bankruptcy. Restructured loans are considered “non-performing” until we have received payment for three consecutive monthly periods, or one installment payment in cases where the installment period is greater than 60 days. Loans with an extended maturity date in which the borrower has not paid the accrued interest and at least 25% of the original principal amount when due will be considered “non-performing” so long as there is no evidence of sustained payment.

Accrued interest recorded as non-performing interest and included in income becomes part of our total classifiable credit portfolio and is subject to the loan loss reserve requirements of the credit portfolio grading system, as described under “—Grading of Loan Portfolio.” The amount of the loan loss allowance for possible credit risk is based upon the grade assigned to the underlying loan.

The non-performing loan portfolio may include credits that our management views as involving different risk levels and that are accordingly graded for regulatory purposes in categories ranging from “A” to “E.” See “—Grading of Loan Portfolio.”

As of March 31, 2020, the total amount of non-performing loans was Ps.12,826 million, which represented 1.7% of total loans. Of this amount, Ps.418 million, or 3.3%, of the total amount of non-performing loans represented non-performing interest. The total amount of non-performing loans increased by Ps.434 million, or 3.4%, during the three-month period ended March 31, 2020, out of which business loans represented Ps.589 million, which was offset by a decrease in consumer loans for Ps.154 million. As of December 31, 2019, the total amount of non-performing loans was Ps.12,392 million, which represented 1.6% of total loans. Of this amount, Ps.414 million, or 3.3%, of the total amount of non-performing loans represented non-performing interest. The total amount of non-performing loans decreased by Ps.447 million, or 3.5%, during the year ended December 31, 2019, out of which business loans represented Ps.894 million and consumer loans represented Ps.446 million.

As of December 31, 2018, the total amount of non-performing loans was Ps.12,839, or 1.7% of total loans. Of this amount, Ps.385 million, or 3.0%, of the total amount of non-performing loans represented non-performing interest.

As of December 31, 2017, the total amount of non-performing loans was Ps.12,192, or 2.0% of total loans. Of this amount, Ps.332 million, or 2.7%, of the total amount of non-performing loans represented non-performing interest.

The following table sets forth an analysis of our non-performing loans (including non-performing interest) by type of loan at the dates indicated:

	As of March 31, 2020	As of December 31, 2019 2018 2017 (Ps. millions)		
Non-Performing Loans				
Commercial, Corporate and Government loans:				
Collateralized or guaranteed.....	2,107	1,954	2,857	4,482
Unsecured.....	4,632	4,197	4,187	2,058
Total commercial, corporate and government loans.....	6,740	6,151	7,044	6,540
Consumer loans:				
Residential Mortgage.....	2,069	1,973	1,464	1,323
Credit card.....	2,384	2,287	2,151	2,188
Other consumer credit.....	1,634	1,981	2,180	2,141
Total consumer loans.....	6,087	6,241	5,795	5,652
Total non-performing loans.....	12,826	12,392	12,839	12,192
Allowance for loan losses	(17,932)	(17,083)	(18,264)	(15,551)
Total non-performing portfolio net of allowance for loan losses	(5,106)	(4,691)	(5,425)	(3,359)

Grading of Loan Portfolio

We classify our loan portfolio according to the rules issued by the CNBV and by the methodology established by the CNBV. Such regulations establish the general methodology for grading our loan portfolio and estimating the loan loss allowance for each type of loan.

The commercial loan portfolio grading procedure requires that credit institutions apply the established methodology based on quarterly information for the periods ending in March, June, September and December of each year whereas also recording in their financial statements the allowances determined at the end of each month. Furthermore, during the months following each quarter, financial institutions may apply to the respective loan the grading methodology used at the close of the immediately preceding quarter, based on the outstanding balance of such loan in effect on the last day of the aforementioned months. The allowances for loan losses that have exceeded the amount required to grade the loan will be canceled against the period's results on the date of the following quarterly grading, additionally, recoveries on the previously written-off loan portfolios are recorded in the period's results.

General description of rules established by the CNBV

The rules for grading consumer, mortgage and commercial loans (other than loans for investment projects having their own source of payment) provided that the loan losses allowance for such loans should be determined based on an estimate of the loan's expected loss over the next twelve-month period. The grading methodology requires that the estimation of such loss takes into consideration the probability of a default, the loss given default and the exposure at default. The result of multiplying these three factors is the estimated expected loan loss that is the same as the amount of the reserves needed in order to cover the loan loss.

The probability of default, the loss given default and the exposure at default are determined by type of loan considering the following:

- Probability of Default:
 - For non-revolving consumer loans, the probability of default is determined based on the number of days past due, the payments made on outstanding balances, the loan to asset value ratio, the type of consumer loan and the term to maturity, among others.

- For revolving consumer loans, the probability of default is determined based on the current situation and historical behavior of the borrower regarding the number of past due payments, number of days past due, the payments made on outstanding balances, as well as the percentage of utilization of the authorized line of credit.
- For mortgage loans, the probability of default is determined based on the number of days past due, highest number of past due payments over the last four periods, the borrower's willingness to pay and the loan to asset value ratio.
- For commercial loans, the probability of default is determined based on the type of borrower, the borrower's historical payment behavior, payment history with Infonavit, rating agencies' evaluation, financial risk, social-economical risk, financial soundness, country and industry risk, market positioning, transparency, standards and corporate governance.
- **Loss Given Default**
 - For consumer loans (non-revolving and revolving), the loss given default is determined based on the number of past due payments.
 - For mortgage loans, the loss given default is determined based on the outstanding balance of the mortgage loan, unemployment insurance and the state where the loan was granted.
 - For commercial loans, the loss given default is determined based on the value of the financial and non-financial collateral securing the loan, as well as guarantees granted by the borrower.
- **Exposure at Default**
 - For non-revolving consumer loans, the exposure at default is determined based on the outstanding loan balance as of the grading date.
 - For revolving consumer loans, the exposure at default is determined based on the current percentage of utilization of the authorized line of credit line, which is used to estimate how much such utilization would increase in the event of a default.
 - For mortgage loans, the exposure at default is determined based on the outstanding loan balance as of the grading date.
 - For commercial loans, the exposure at default **(i)** in the case of uncommitted lines of credit, it is determined based on the outstanding loan balance as of the grading date and **(ii)** in the case of committed lines of credit, it is determined based on the current percentage of utilization of the authorized line of credit, which is used to estimate how much such utilization would increase in the event of a default.

The regulatory loan classification and grading rules establish the following categories corresponding to levels of risk based on allowance percentage: Grade "A" loans, representing minimal risk of non-payment; grade "B" loans, representing low risk loans; grade "C" loans, representing loans with moderated risk; grade "D" loans, representing high risk loan; grade "E" loans, representing non-collectible loans.

Risk Levels	% of Allowance for Loan Loss Reserves			
	Consumer Loans		Mortgage Loans	Commercial Loans
	Non Revolving	Revolving		
A-1	0 to 2.0	0 to 3.0	0 to 0.50	0 to 0.9
A-2	2.01 to 3.0	3.01 to 5.0	0.501 to 0.75	0.901 to 1.5
B-1	3.01 to 4.0	5.01 to 6.5	0.751 to 1.0	1.501 to 2.0
B-2	4.01 to 5.0	6.51 to 8.0	1.001 to 1.50	2.001 to 2.50
B-3	5.01 to 6.0	8.01 to 10.0	1.501 to 2.0	2.501 to 5.0
C-1	6.01 to 8.0	10.01 to 15.0	2.001 to 5.0	5.001 to 10.0
C-2	8.01 to 15.0	15.01 to 35.0	5.001 to 10.0	10.001 to 15.5

D	15.01 to 35.0	35.01 to 75.0	10.001 to 40.0	15.501 to 45.0
E	35.01 to 100.0	> 75.01	40.001 to 100.0	> 45.0

As of December 31, 2018 and December 31, 2019, the aggregate outstanding principal amount of our 15 largest loans (including loan exposures to a single corporate group or to an agency of the Mexican government) represented 19.7% and 17.6%, respectively, of our total loans. The largest single loan exposure at December 31, 2019 and March 31, 2020 (excluding the Mexican government and our affiliates) accounted for 4.9% and 5.8% of our stockholders' equity, respectively.

The following table analyzes the grading of our commercial loan portfolio at the dates indicated. In accordance with the CNBV rules, loans are graded based on their outstanding balance at the end of the reported update. This table excludes loans to the Mexican federal government and the Mexican Central Bank or to any party that is guaranteed by these institutions, but includes accrued interest, non-performing interest and our off-balance sheet commitments (such as guarantees and letters of credit).

	As of March 31,		As of December 31,					
	2020		2019		2018		2017	
	Amount	%	Amount	%	Amount	%	Amount	%
Total graded loans:								
A.....	685,953	86.4%	664,201	86.0%	679,561	85.3%	546,862	85.8%
B.....	64,451	8.1%	69,510	9.0%	69,463	8.7%	59,368	9.3%
C.....	21,759	2.7%	18,130	2.3%	29,360	3.7%	14,262	2.2%
D.....	14,885	1.9%	14,140	1.8%	12,959	1.6%	10,480	1.6%
E.....	6,435	0.8%	6,346	0.8%	5,748	0.7%	6,338	1.0%
Total graded loans ⁽¹⁾	793,483	100.0%	772,327	100.0%	797,091	100.0%	637,310	100.0%
Allowance grading of our loans:								
Additional allowances derived from grading:								
Commercial loans.....	6,685	37.3%	5,729	33.5%	7,791	42.7%	5,089	32.7%
Mortgage loans.....	1,154	6.4%	1,129	6.6%	958	5.2%	934	6.0%
Credit card.....	4,597	25.6%	4,436	26.0%	4,588	25.1%	4,777	30.7%
Other consumer loans.....	5,056	28.2%	5,070	29.7%	4,321	23.6%	4,560	29.3%
Non-performing interest.....	212	1.2%	206	1.2%	174	1.0%	149	1.0%
Excess over minimum regulatory requirements...	228	1.3%	513	3.0%	432	2.4%	43	0.3%
Total allowance for loan losses.....	17,932	100.0%	17,083	100.0%	18,264	100.0%	15,551	100.0%
Total loans graded C, D or E.....	43,079		38,616		48,067		31,081	
Allowances as a percentage of:								
Graded loans.....		2.3%		2.2%		2.3%		2.4%
Total loans plus interest ⁽²⁾		2.3%		2.3%		2.4%		2.5%
Total non-performing amounts.....		139.8%		137.9%		142.3%		127.6%
Total loans graded C, D or E.....		41.6%		44.2%		38.0%		50.0%
Total non-performing amounts as a percentage of total loans plus interest ⁽²⁾		1.7%		1.6%		1.7%		2.0%
Total net non-performing loans (non-performing amounts less allowance) as percentage of net total loans plus interest.....		(0.7%)		(0.6%)		(0.7%)		(0.6%)
Total loans graded C, D or E as a percentage of total loans.....		5.6%		5.1%		6.2%		5.0%

(1) Total graded loans include our surety bonds and stand-by letters of credit, which are not included in the balance sheet.

(2) Interest includes non-performing and outstanding interest.

Allowance for Loan Losses

We provide for possible loan losses in accordance with the Loan Classification and Rating Rules as required by the CNBV and currently we are in compliance with the allowance for losses required to be set aside by such rules. The grading of loans determines the amount of the allowance for loan losses required to be set aside, which is determined based on the percent of the outstanding balance of such loans depending on their type of portfolio: between 0.0% and 0.99% for Grade "A" loans, between 1% and 19.99% for Grade "B" loans, between 20% and 59.99% for Grade "C" loans, between 60% and 89.99% for Grade "D" loans and between 90% and 100% for Grade "E" loans. Mexican government and the Mexican Central Bank loans or loans to a third party guaranteed by these institutions are not subject to the grading system and are effectively deemed to be Grade "A" loans for loan loss allowance.

purposes. See “Risk Factors—Risks Relating to Our Business—We maintain lower levels of capital or reserves in connection with our loans to Mexican federal, state and municipal governments.” The loan loss reserves are held in a separate account on our balance sheet and all write-offs of uncollectible loans are charged against this reserve. Mexican banks are required to obtain authorization from their boards of directors in order to write off loans. In addition, Mexican banks are required to inform the CNBV after such write-offs have been recorded.

During the three-month period ended March 31, 2020, we recorded net provisions from liberation of reserves charged against earnings totaling Ps.4,827 million. For the year ended December 31, 2019, we recorded net provisions from liberation of reserves charged against earnings totaling Ps.17,112 million. Consequently, our allowance for loan losses amounted to Ps.17,083 of non-performing loans as of December 31, 2019, compared to Ps.18,264 as of December 31, 2018.

Analysis of Allowance for Loan Losses

The following table analyzes our allowance for loan losses and movements in loan charge-offs and recoveries for the periods indicated, as well as changes to income and period-end allowances for loan losses:

	For the three-month period ended March 31,	For the year ended December 31,		
	2020	2019	2018	2017
		(Ps. millions)		
Balance at beginning of year.....	17,083	18,264	15,551	13,941
Increase:				
Allowances charged to income.....	4,827	17,112	17,454	14,628
Appreciation of foreign currency items and UDIs.....	298	-	54	-
Recognized against retained earnings from prior years.....	-	-	1,508	1,015
Other	-	-	72	-
Sub-total.....	5,125	17,112	19,088	15,643
Decrease:				
Benefits and reductions granted to UDI loan programs	2	7	7	9
Losses and write-offs.....	4,274	18,250	16,368	13,691
Valuation of foreign currencies and UDIs.....	-	36	-	12
Other	-	-	-	321
Sub-total.....	4,276	18,293	16,375	14,033
Balance at year end	17,932	17,083	18,264	15,551

Allocation of Allowance for Loan Losses by Category

	As of March 31,		As of December 31,					
	2020		2019		2018		2017	
	<u>Allowance</u>	<u>%</u>	<u>Allowance</u>	<u>%</u>	<u>Allowance</u>	<u>%</u>	<u>Allowance</u>	<u>%</u>
	(Ps. millions, except percentages)							
Commercial, financial and agricultural ..	6,685	37.3%	5,729	33.5%	7,791	42.7%	5,089	32.7%
Residential mortgages	1,154	6.4%	1,129	6.6%	958	5.2%	933	6.0%
Credit card.....	4,597	25.6%	4,436	26.0%	4,588	25.1%	4,777	30.7%
Other consumer loans.....	5,056	28.2%	5,070	29.7%	4,321	23.6%	4,560	29.3%
Non-performing interest.....	212	1.2%	206	1.2%	174	1.0%	149	1.0%
Excess over minimum regulatory requirements.....	228	1.3%	513	3.0%	432	2.4%	43	0.3%
Total.....	17,932	100.0%	17,083	100.0%	18,264	100.0%	15,551	100.0%

Rules for the UDI Trusts require a minimum level of loan loss allowance based upon the Loan Classification and Rating Rules in the case of commercial loans, and in the case of mortgage loans the greater of the minimum required by the Loan Classification and Rating Rules or the percentage required under methodologies approved by the CNBV. This loan loss allowance forms part of the loan loss allowances shown in our Financial Statements included elsewhere in this offering memorandum.

Foreclosed Real Estate and Other Assets

As of March 31, 2020, the book value of real estate and non-real estate assets on which we foreclosed totaled Ps.2,925 million and Ps.6.1 million, respectively, a 3.7% and 22.8% decrease, respectively, from December 31, 2019.

As of December 31, 2019, the book value of real estate and non-real estate assets on which we foreclosed totaled Ps.3,040 million and Ps.8 million, respectively, a 4.4% and a 14.3% increase, respectively, from December 31, 2018.

Under the CNBV regulations, Mexican banks that are awarded title to foreclosed property in a judicial auction are required to account for such property at the lesser of the amount set in the auction and the appraised value. Real estate assets we received in a negotiated settlement with the borrower are required to be recorded at the lower of the appraised value of the property and the amount of the loan recorded in such settlement. Pursuant to CNBV rules, the loss in the value of foreclosed assets is recognized on the basis of the amount of time that has elapsed following the foreclosure proceedings or settlement.

The following table analyzes as of March 31, 2020 the ranges of elapsed times and the applicable provision for losses in connection with foreclosed real estate and other assets:

Other Foreclosed Assets	
Time Elapsed Since Foreclosure or Settlement (months)	% of Loss Reserve
up to 6.....	0.0%
6 to 12.....	10.0%
12 to 18.....	20.0%
18 to 24.....	45.0%
24 to 30.....	60.0%
More than 30.....	100.0%

Foreclosed Real Estate Assets	
Time Elapsed Since Foreclosure or Settlement (months)	% of Loss Reserve
up to 12.....	0.0%
12 to 24.....	10.0%
24 to 30.....	15.0%
30 to 36.....	25.0%
36 to 42.....	30.0%
42 to 48.....	35.0%
48 to 54.....	40.0%
54 to 60.....	50.0%
More than 60.....	100.0%

We have a special division that administers foreclosed real estate and manages all activities related to the administration, marketing and sale of properties.

The following table sets forth, by type of property, the book value of foreclosed real estate and non-real estate assets at the periods indicated. The book value does not include the assets foreclosed from credits sold to the Banking Fund for Savings Protection (*Fondo Bancario de Protección al Ahorro*) (“FOBAPROA”) and the IPAB.

	<u>As of March 31,</u>	<u>As of December 31,</u>		
	<u>2020</u>	<u>2019</u>	<u>2018</u>	<u>2017</u>
		<i>(Ps. millions)</i>		
Real estate:				
Rural land	582	666	663	604
Urban land	925	927	926	685
Single-family houses	853	847	802	857
Condominiums	47	47	74	81
Industrial plants	183	183	121	119
Commercial buildings	74	77	42	92
Other	261	293	284	85
Sub-total	2,925	3,040	2,913	2,523
Non-real estate	6	8	7	3
Provisions for losses	(2,113)	(2,188)	(2,182)	(1,774)
Total	818	860	738	752

Restructuring of Loans

The deteriorating economic situation in Mexico subsequent to the December 1994 devaluation of the Peso and the increase in the portfolio of non-performing loans led Mexican banks, including us, to implement restructuring programs in most of their business divisions. In addition, the Mexican government adopted a number of debtor relief programs to facilitate this process. Restructured loans remain classified as “non-performing” until at least three payments on such loans have been made or until one payment on such loans has been made where the installment period is greater than 60 days. Restructured loans under Mexican government support programs are classified as performing loans as long as the debtor remains current on such loans.

When we restructure a loan, we reclassify current accrued interest, past-due principal and past-due interest as current principal. If the restructuring results in a sufficient improvement in the quality of a loan, we may also maintain a smaller allowance for loan loss with respect to such loan and use the excess allowance to reduce the amount of additional provisions on other loans.

Workout and Credit Recovery

Our workout unit handles debt recovery from borrowers with non-performing loans. The workout unit focuses on consumer loan recovery, mortgage collections and commercial loan recovery.

Consumer Loan Recovery

As of March 31, 2020, the consumer loan recovery unit managed 54 non-performing loan accounts involving Ps.6.7 million. As of December 31, 2019, this unit settled 2,224,487 non-performing loan accounts amounting to more than Ps.7,376 million. As of December 31, 2018, this unit managed 2,354,246 accounts involving Ps.7,842 million. Commencing in 2004, we adopted a policy to write-off non-performing consumer loans that are six months or more past due and non-performing mortgage loans that are nine months or more past due.

Mortgage Collections

As of March 31, 2020, 52,937 mortgage loans were settled in the aggregate amount of Ps.1,251 million. For the year ended December 31, 2019, the unit settled 220,325 cases and represented an aggregate amount of Ps.5,382 million. For the year ended December 31, 2018, the unit settled 224,373 cases and represented an aggregate amount of Ps.4,594 million.

Commercial Loan Recovery

The commercial loan recovery unit focuses on recovering non-performing loans in excess of Ps.1 million which have missed payments. For the year ended December 31, 2019, this unit has settled 30,558 loans representing total value of Ps.3,797 million. As of March 31, 2020, this unit is negotiating 8,481 loans totaling Ps.1,101 million.

For the year ended December 31, 2018 this unit settled 28,897 cases representing a total value of Ps.2,898 million.

In the event that the credit recovery unit is unable to reach an agreement with a borrower in respect of non-performing loan amounts and the borrower fails to propose terms for an alternative restructuring agreement satisfactory to us, the unit submits the loan to our litigation department for the initiation of legal action to recover the amount outstanding on the loan. Foreclosure proceedings on collateral in Mexico can take a long time. The procedure requires the filing of a written petition with the competent court requesting the court's authorization to complete the foreclosure. This petition and the approval process is generally subject to significant delays and accordingly, the value of the collateral may be negatively affected. Loans with respect to which recovery has been unsuccessful despite the implementation of workout procedures and litigation are charged off.

BUSINESS

Overview

We are a multiple purpose bank (*institución de banca múltiple*) incorporated as a limited liability corporation (*sociedad anónima*) in accordance with the laws of Mexico and licensed by the SHCP to operate as a commercial bank. We are the largest bank in Mexico in terms of total assets, deposits and stockholders' equity, that is not controlled by or affiliated to a non-Mexican financial institution. As of March 31, 2020, we ranked second among all Mexican banks in terms of loan portfolio and fourth in core deposits (a combination of demand deposits and time deposits), according to information published by the CNBV. With more than 120 years of operation as a financial entity in the Mexican banking sector, we have developed an extensive experience and in-depth knowledge of the Mexican market, providing a full range of banking services to over 11.3 million customers in Mexico as of March 31, 2020.

We are the banking subsidiary of GFNorte, the fourth largest financial services holding company in Mexico in terms of total assets as of March 31, 2020, according to the latest information published by the CNBV. Through us and its other subsidiaries, GFNorte provides financial and related services primarily in Mexico, including banking products; annuities and insurance products; retirement savings funds; mutual funds; leasing and factoring; warehousing; and a wide array of broker-dealer services, including securities trading, offering and underwriting. We are GFNorte's most significant subsidiary, representing approximately 74.8% of GFNorte's total assets and 57.5% of its total stockholders' equity, as of March 31, 2020.

As of March 31, 2020, we had total assets of Ps.1,293.6 billion (representing a market share of 11.3% according to CNBV), total liabilities of Ps.1,179.9 billion (including total deposits of Ps.791.8 billion) and stockholders' equity of Ps.113.6 billion. In the three-month period ending March 31, 2020, we generated net income of Ps.6,180 million, and had a ROAE of 21.7% and a ROAA of 2.0%. In 2019, we generated net income of Ps.27,493 million, and had a ROAE of 24.2% and a ROAA of 2.4%. In 2018, we had a ROAE of 25.7% and a ROAA of 2.3%. For an explanation regarding the calculation of ROAE and ROAA, see footnotes (2) and (3) to the table on page 2 below.

Our Capital Ratios were 18.97% for Total Net Capital, 17.86% for Tier 1 Capital and 12.18% for Core Equity Tier 1 Capital as of March 31, 2020, exceeding the minimum Capital Ratios that we are required to comply under Mexican banking regulations, and applicable to us, of 11.40%, 9.40% and 7.90%, respectively. These Capital Ratios are inclusive of the Systemically Important Bank Capital Supplement. Given our status as a bank of systemic importance in Mexico, we were required by the CNBV to constitute a Systemically Important Bank Capital Supplement of 0.90% over a four-year period, to be constituted in four equal parts in December of each year, on a cumulative basis, commencing in December 2016; accordingly, all portions of this supplement are now in place, which amount to 0.90%.

Over the years, we have successfully expanded our banking operations through strategic mergers and acquisitions, as well as consistent organic growth. This expansion has allowed us to increase our market share, especially in loans and deposits, as well as expand our geographic coverage and enhance the diversity and quality of our customer base. We have created a multi-channel network to provide a wide range of commercial and retail banking services, consisting of a network of 1,178 branches, 9,090 ATMs (57% of which are located outside of our branches) and 168,478 POSs in each case, as of March 31, 2020. Our branch network extends throughout Mexico, with a particular focus on the areas with the highest concentration of economic activity, including the Northeast of Mexico and Mexico City. We process approximately 273 million banking transactions per month, as of March 31, 2020. We had 24,099 employees as of March 31, 2020.

History and Ownership

We were founded in 1899 as Banco Mercantil de Monterrey, with a strong regional presence in Northeast Mexico, particularly in the metropolitan area of Monterrey, Nuevo León, one of the country's most important industrial centers.

Together with other Mexican commercial banks, Banco Mercantil de Monterrey was nationalized by the Mexican government in 1982. In 1986, Banco Mercantil de Monterrey merged with Banco Regional del Norte, another financial institution with headquarters in Monterrey, and became Banco Mercantil del Norte, *Sociedad Nacional de Crédito*. In 1987, under a Mexican government privatization initiative, the government sold approximately 34% of our capital stock to the Mexican public. In 1990, the Mexican Constitution was amended to allow the total privatization of Mexican commercial banks, and the government enacted the Mexican Banking Law, which provided for private ownership of Mexican commercial banks. The privatization of Mexican commercial banks began in 1991.

GFNorte, our parent company, was incorporated in 1992 under the name “Grupo Financiero AFIN, S.A. de C.V.” as part of the privatization process of the Mexican banking system. In 1993 our shareholders acquired AFIN through a stock-for-stock exchange. As a result of this exchange, we became a subsidiary of AFIN and AFIN changed its name to “Grupo Financiero Banorte, S.A. de C.V.”

The 1995 Mexican Peso crisis and the entrance of foreign institutions in Mexico prompted a consolidation of the Mexican banking system which resulted in the absorption of many smaller Mexican banks into larger institutions. In September 1997, we acquired Bancentro, increasing our market share in the Central and Western regions of Mexico and adding 195 branches. In August 1997, GFNorte acquired 81% of the shares of Banpaís, and in January 2000, we merged with Banpaís consolidating the banking activities of GFNorte under Banorte and enabling further expansion of our client base, geographical position and national coverage through the addition of 161 branches. In December 2001, GFNorte acquired Bancreer and in September 2002 we merged with and into Bancreer. The surviving entity was renamed “Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.”

In 2006, we expanded our operations into the United States, through the acquisition of INB, a regional bank based in Texas with primary presence in the Rio Grande Valley and headquartered in McAllen, Texas. We sold our equity interest in INB in March 2017. Also in 2006, we acquired UniTeller, a New Jersey-based remittances company, and in 2007 we acquired Motran, a money transfer company based in California.

In 2011, GFNorte merged with IXE in a stock-for-stock transaction. IXE conducted its business through its own subsidiaries, the largest one being Ixe Banco, a commercial bank in Mexico focusing on middle- and upper-income customers. In 2012, GFNorte expanded its pension fund manager joint venture, first through a merger with Afore XXI, and later in 2013, with the acquisition of Afore Bancomer, resulting in the largest pension fund manager in Mexico. On April 15, 2013 and May 7, 2013, IXE Banco and Fincasa, IXE’s specialized mortgage lender, received the authorization from the CNBV to be merged with and into us, with Banorte as the surviving entity. On May 2, 2017, we consolidated our credit card operations by merging our wholly-owned subsidiary Banorte-Ixe Tarjetas, S.A. de C.V., SOFOM, E.R., with and into the Bank.

On July 13, 2018, the merger of GFInter into our parent company, GFNorte, became effective. Subsequently, on the same date, Banco Interacciones, the banking subsidiary of GFInter, merged into the Bank. As a result of the Interacciones Merger, we consolidated our position as the fourth largest bank in Mexico in terms of total assets, performing loans and core deposits, according to information published by the CNBV, and we strengthened our government lending business.

On January 25, 2018, the Board of Directors of Banorte approved the spin-off of Banorte USA and the subsequent investment of Banorte USA’s assets, including the total shareholders’ equity of INBFC and the total shareholders’ equity of Uniteller Financial Services in Banorte Financial Services. The spin-off and the transfer of these assets occurred in December 2018. This spin-off did not have any effect on our financial statements because the Bank consolidated both Banorte USA and Banorte Financial Services as of December 31, 2018. Subsequent to the transfer of Uniteller Financial Services and INBFC’s assets to Banorte Financial Services, on January 14, 2019, Banorte USA was liquidated.

GFNorte’s common shares are publicly traded in the Mexican Stock Exchange (*Bolsa Mexicana de Valores, S.A.B. de C.V.*) and the Institutional Stock Exchange (*Bolsa Institucional de Valores, S.A. de C.V.*) under the ticker symbol “GFNORTEO.”

Competitive Strengths

We believe the following competitive strengths differentiate us from our competitors:

Deep Knowledge of the Mexican Market and Strong Brand Recognition

We are part of GFNorte, which was the fourth-largest financial group in Mexico as of March 31, 2020 in terms of assets, deposits and loan portfolio, and the largest controlled by Mexican investors, according to CNBV data. GFNorte has operated in the Mexican financial industry for 24 years under the “Banorte” brand name. We believe GFNorte’s long standing history in the Mexican market is recognized by our customers and the general public, who associate GFNorte with quality and social responsibility within the Mexican financial industry, based on the various awards received by GFNorte. In January 2019, Global Finance magazine recognized Banorte as the “Best Trade Finance Bank” in Mexico and the “Best Trade Finance Products Provider.” Additionally, on November 1, 2019, GFNorte was named bank of the year in Mexico by Latin Finance.

GFNorte has an in-depth knowledge of the Mexican market and local efficient decision-making processes that allow us to provide timely, specialized and integral responses to our clients’ requests and rapidly adapt to changes in the Mexican banking sector. For instance, during the global financial crisis of 2008, while international groups retrenched to shore up capital, GFNorte seized the opportunity and filled the void by expanding its presence in Mexico. GFNorte focuses on providing comprehensive services to our clients through a multi-product, multi-entity strategy that seeks to meet all of its clients’ banking, insurance, retirement saving and brokerage needs.

GFNorte has consolidated itself as a leading player in commercial banking, asset management, insurance and annuities, and brokerage services in Mexico. We are able to do this as a fully integrated financial group. As of March 31, 2020, GFNorte had the largest Afore in Mexico in terms of assets under management, with a market share of 22.1% of the pension system managed by Afores.

Leading Market Presence across Core Businesses

We believe that our leadership position across our core businesses in Mexico allows us to offer a comprehensive suite of financial products and services to our customers, with access to a customer base of over 3,165 corporate clients and over 11.0 million individual customers as of March 31, 2020. This creates important synergies and efficiencies, as well as cross-selling opportunities.

Through the implementation of our organic growth strategy and acquisitions, we have transformed ourselves from being a regional bank with a 3.0% market share in terms of performing loans in 1992 to becoming the fourth-largest bank in Mexico in terms of total assets (Ps.1,293.6 million), performing loans (Ps.763.1 billion) and total deposits (Ps.791.8 billion), with nationwide presence and a 13.4% market share of total loans as of March 31, 2020, according to the CNBV.

We are the third largest operator of POSs in Mexico (representing a market share of 12.4%), the fourth in ATMs (representing a market share of 15.9%) and the fifth in branches (representing a market share of 9.2%), according to the CNBV, as of March 31, 2020. As of the same date, we had a 28.5% market share of the government banking sector, the largest in the Mexican banking system. As of the same date, we had a market share of 18.9% and 13.4% of mortgage loans and commercial loans, the second and third largest in the Mexican banking system, respectively.

Profitable Business Platform Supported by Prudent Risk-Management Practices

We believe that the successful implementation of our business strategy has allowed us to become one of the most profitable banks in Mexico. We have maintained a solid financial performance, evidenced by the consistent net income yearly growth we have experienced in 35 of the last 41 operating quarters (considering the period from January 2010 through March 2020). During the same period, we maintained a strong capitalization profile and continue to benefit from prudent risk management practices. We serve our customers through an extensive network of branches and ATMs, alternate channels and contact center with products and differentiated services. With a clear segmentation of customers, in retail banking we can offer services according to their specific profiles, through appropriate channels.

This has allowed us to develop and strengthen our banking relationship with our clients, as well as increase our profitability by improving efficiency and following a value-oriented approach.

The positive trend of our financial performance continued in 2019 as we increased our net income by 11% as compared to 2018, while our ROAE and ROAA remained consistent at 24.2% and 2.4%, respectively, in 2019 compared to 25.7% and 2.3%, respectively, in 2018. Our efficiency ratio was stable year over year at 41.4% in 2018 compared to 42.3% in 2019. As of December 31, 2019, we had non-performing loans to total loans ratio of 1.6% and a coverage ratio, defined as allowance for loan losses divided by total non-performing loans, of 137.9%. Recurring net income totaled Ps 6.18 billion in the three-month period ended March 31, 2020, reflecting stability when compared to the first quarter of 2019. In the first quarter of 2020, there was a slight contraction of ROAE and ROAA, at 21.7% and 2.0% respectively. Our efficiency ratio was 43.7% as compared to 40.5% for the corresponding period in 2019. As of March 31, 2020, we had non-performing loans to total loans ratio of 1.7% and a coverage ratio, defined as allowance for loan losses divided by total non-performing loans, of 139.8%.

We believe these ratios reflect our prudent risk management practices. We plan to maintain a balanced growth profile, emphasizing an efficient use of capital, prudent financial and operational risk management and efficient operations.

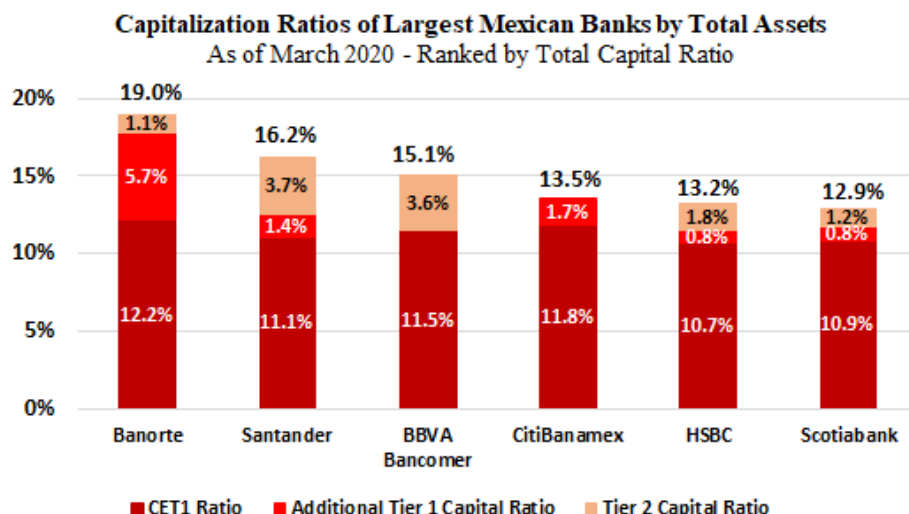
Strong Capital Base and Capitalization Ratios

We believe we have a strong capital base, as evidenced by each of our Capital Ratios, which have been above the average for the G-7 Mexican banks during the past 17 quarters (considering the period from January 2016 through March 2020). Mexican banks already comply with Basel III capitalization requirements and are well capitalized compared to other banks in more developed economies, and within this group of Mexican banks, we compare very favorably in terms of capitalization levels and composition of capital. As of March 31, 2020, our Fundamental Capital ratio was 12.18%, the second highest among the G-7 Mexican banks; our Additional Tier 1 Capital was 5.68%, the highest among the G-7 Mexican banks; and our Total Net Capital ratio was 18.97%, also the highest among the G-7 Mexican banks; in each case, according to data published by the CNBV.

Tier 1 Capital is also an important component of our capitalization and with a Tier 1 Capital ratio of 17.86% as of March 31, 2020, we have 8.46% of our Tier 1 Capital ratio above the current minimum of 9.40% required for us by the Mexican banking regulations to be classified as a grade II D-SIB.

In May 2016, given our status as a grade II D-SIB in Mexico, we were required by the CNBV to constitute a Systemically Important Bank Capital Supplement of 0.90%. In July 2018, the CNBV ratified this requirement, confirmed the Bank as a grade II D-SIB and required to implement an additional Countercyclical Capital Supplement, which we have estimated would correspond to 0.001%. We were required to implement and comply with these Capital Supplements over a four-year period to be constituted in four equal parts in December of each year, on a cumulative basis, commencing on December 31, 2016 through December 31, 2019. Given our strong capital base, our Capital Ratios as of March 31, 2020 are well above such Capital Supplement requirements.

The chart below presents the Capital Ratios for our main competitors by total assets as of March 31, 2020, ranked by Total Capital Ratio.



Source: CNBV

Expanding Business Platform with a Focus on Customer-Oriented Multi-Channel Banking

We have made significant investments to develop what we believe is one of the broadest integrated financial services platforms in Mexico. Between January 1, 2013 and March 31, 2020, we increased the number of ATMs and POSs by 40% and 69%, respectively, reaching a total of 9,090 ATMs and 168,478 POSs, ranking fourth in ATMs and third in POSs in the Mexican banking system. During the same period, we implemented a series of branch consolidations to improve efficiency, ranking fifth in terms of market share for number of branches. In addition, we have developed electronic distribution channels, such as *Banorte por Internet* and *Banorte Móvil*, which we believe are more cost-effective than traditional physical banking channels and provide a high degree of flexibility and convenience to our customers. As of March 31, 2020, we had approximately 2.6 million active internet banking customers and around 2.0 million of our customers utilized *Banorte Móvil*. We also consider ourselves pioneers in banking services through third parties in Mexico, reaching a total of 13,694 contact points as of March 31, 2020.

Over the years, we have moved from a product-oriented to a customer-oriented business approach. We believe our new focus provides us with more value by generating opportunities and giving our clients a better customized service. In 2013, we entered into a strategic agreement with IBM, which allows us to further align our information systems with our customer-oriented business philosophy and benefit from increased cross-selling opportunities and a better overall experience for our customers.

Organic Growth and Successful Integration of Acquisitions

Our organic growth has been complemented with focused strategic and transformational acquisitions that have strengthened our market position across our different lines of business. Since 1996, we have consummated over 15 mergers and acquisitions, which have expanded our geographic reach and complemented our product portfolio and the quality of our professionals. This demonstrates our track record of successfully integrating acquisitions into our platforms and our expertise in deriving important scale and efficiency benefits from acquired assets and businesses. Our acquisition strategy has traditionally been centered on:

- assets and businesses that are aligned with our business model and growth strategy;
- transactions that are accretive to earnings;

- operations that offer potential for significant synergies; and
- transactions with limited integration risk and disruption to our business.

Track Record of Product Innovation

We have a history of innovation and new product development that has been fundamental to our growth story and competitive position. We have been leaders in the development of the banking sector in Mexico through new product launches; for example, we launched a new and easy way for customers to access online mortgages; and mortgages with rate reduction mechanisms for timely payment of interest. Over the years, we have demonstrated the ability to introduce new product offerings focused on our individual, corporate and SME customers. Among the innovative products and services that we have successfully launched are our *Adelanto Nómina* payroll loan product for individuals which can be drawn through ATMs and online banking, and *Banorte Móvil*, our state-of-the-art mobile banking platform. In June 2019, we also finalized a new agreement with Payclip, Inc. to strengthen our existing commercial alliance and to continue to work together on our digital strategy and technological innovation. Through this alliance, we aim to bring important payment method innovations to the Mexican market, and offer to our clients user-friendly, customized and cutting-edge products.

Experienced Leadership and Effective Governance

Our operations are supported by an experienced management team. Our senior management team has, on average, 14 years of experience with us and has more than 22 years of experience in the financial services industry. In recent years, our management team has integrated multiple large-scale acquisitions and improved our competitive position, including throughout the global financial crisis, to become the fourth largest bank in Mexico, generating significant profitability while maintaining effective risk management and a merit-based corporate culture that permeates all levels of our organization. As a consequence of these acquisitions, key employees of acquired companies have remained with our team and have broadened the experience of our team. We are also focused on attracting, developing and maintaining highly qualified personnel.

In addition, our Board of Directors is composed by a majority of independent directors (currently 64%), which ensures collegial decision-making for the benefit of our stakeholders, as well as having several supporting committees, including an audit committee and a risk policies committee, each chaired by independent directors with recognized experience. Our corporate governance model not only complies with applicable standards, but also seeks to apply best practices used in world-class organizations. Over the last several years, we have taken important steps to further improve leadership and governance at all levels of our organization.

Strategy

As part of our short- to medium-term strategy, we intend to:

Selectively Increase our Market Share

We have been able to increase our market share in banking products in a competitive environment. Our market share in total loans and deposits has increased from 8.0% and 6.6%, respectively, as of December 31, 2000, to 13.4% and 12.4% respectively, as of March 31, 2020. We intend to focus on increasing our market share in certain targeted segments through the following initiatives:

Expand our Payroll Loan Business

We are enhancing the use of distribution channels, such as ATMs, mobile devices and the internet banking to increase the origination of payroll loans in Mexico. As of March 31, 2020, we had a 19.2% market share of payroll loans in Mexico according to the CNBV. We also intend to continue to develop specialized sales forces, telemarketing efforts and *Banorte Visita*, through which we have more direct contact with companies in order to increase the channels through which we originate payroll loans. We intend to focus on cross-selling and same-time origination by encouraging customers to open payroll accounts when they request a loan and vice-versa. We intend to leverage our

CCR database to better target our potential payroll loan customer base. Finally, we intend to continue to determine fees and pricing for our payroll loans based on thorough risk assessment models in order to maximize profitability.

Expand our Credit Card Business

We have enhanced our fees and risk-based pricing strategy, improved our underwriting standards, implemented cross-selling initiatives in response to market demand and have developed new sales channels to increase credit card issuance. We believe we have an opportunity to increase our market share in this segment through further product penetration of our existing banking customers.

We issue personal credit cards (associated with both MasterCard and Visa) and offer the following products to our customers depending on their needs: *Banorte Básica; Banorte Fácil; Banorte Clásica; Banorte Oro; Tarjeta de Crédito Mujer Banorte; Banorte Pachuca; Banorte Platinum; Banorte Infinite; Banorte Empresarial; Tarjeta 40; Ixe Clásica; Ixe Oro; Ixe Platino; Ixe Infinite* and *Banorte Por Ti*. We also have two credit cards which are co-branded with United Airlines, the Platinum and Universe – Infinite. In addition, we offer various rewards programs for our credit card holders.

Our market share in the Mexican credit card segment was 10.1% as of March 31, 2020, according to the CNBV. As of that date, we had approximately 1.7 million credit cards outstanding, with a non-performing loan ratio of 5.8%. We believe we can increase our credit card market share in the medium-term while maintaining prudent underwriting practices and monitoring our credit quality ratio through more active marketing and promotions to our current customers. We believe we could increase our market share in the credit card segment to a level consistent with our market share in other products such as performing loans and deposits.

Expand our Car Loan Business

We are expanding our car loan business to customers with lower credit risk by increasing our presence at car dealerships and expanding our business partnerships with automobile manufacturers and distributors in Mexico. As of March 31, 2020, our market share on pre-approved car loans was 18.0% according to the CNBV, excluding financings by automobile manufacturers against whom we compete in this business. We also believe that, given the expected contraction in GDP in Mexico, the automobile sector, and consequently the automobile loan business will not experience growth in the coming years.

Increase our Mortgage Originations

We offer long-term mortgage financing for individuals and families acquiring houses or apartments. Such financings are generally secured by the purchased property and are denominated in Pesos with fixed interest rates for the entire life of the mortgage. The term of a mortgage ranges from one to 20 years for financing of up to 90% of loan-to-value. We offer financings exclusively for residential mortgages. Other products we offer include home equity; home improvement; construction; land acquisition; and construction and land acquisition. For the three-month period ended March 31, 2020, we originated 4,535 mortgages, and the aggregate outstanding balance due from our mortgage loan portfolio at the end of such period was Ps.9,125 million. For the year ended December 31, 2019, we originated 18,661 mortgages, and the aggregate outstanding balance due from our mortgage loan portfolio at the end of such year was Ps.172,059 million, compared to Ps.157,261 million for the year ended December 31, 2018.

The current average of the initial amounts of our mortgage loans (Ps.2.01 million) is 7.9% higher than the current average for other financial institutions (Ps.1.85 million) reflecting our higher income target segment. We also have the lowest delinquency rate in the mortgage loan portfolio in the industry with 1.18% as of March 31, 2020. We plan to continue to attract customers from these segments by providing high-quality service and quick approval response times; offering financings for purchases, refinancing and real estate improvements.

Strengthen our Relationships with Government Entities and their Employees

We intend to strengthen our relationship with Mexican federal, state and municipal governmental entities, which, as of March 31, 2020, together comprised 21.1% of our total loan portfolio. We see an opportunity to cross-sell other

products and services to government employees, whose low levels of staff turnover minimize the risk of non-payment. This opportunity to cross-sell has been enhanced by the merger with Banco Interacciones, whose government lending business has complemented our successful operation. The suite of products and services we offer to government entities includes checking and payroll deposit accounts for employees, cash management services, payment of money orders, trust services, financings, investments and tax bill collection services, which are available through all of our branches as well as through our websites and ATMs. In addition, we believe that developing our relationships with government entities will provide us with access to a broader customer base to market our retail products and services, such as credit cards, payroll loans and mortgage products. We believe that this sector provides us with cross-selling opportunities and attractive return on equity.

Emphasize Multi-Channel Distribution Capabilities

Our customer-oriented business model emphasizes a multi-channel banking strategy aimed at more effectively reaching our target customer segments. We seek to implement this strategy by understanding the channels used by our diverse customer base and by leveraging each channel effectively to generate cost efficiencies. For example, for our broader customer base, we expect to leverage internet and mobile banking as well as our correspondent banking through different initiatives. The use of the internet to research and apply for personal loans, car loans, mortgage loans and credit cards is commonplace today. Our emphasis on multi-channel distribution is aligned with our paperless initiative, which was fully implemented by the end of 2019. As a result of the COVID 19 pandemic, the number of mobile banking transactions has increased.

For instance, Banorte Go is an add-on to Banorte Móvil, our mobile banking platform. Banorte Go allows our customers to check their account balances, transfer funds and make payments among users of Banorte Móvil through social media mobile applications or any mobile application where an alphanumeric key board is used without the need to login to the Banorte Móvil mobile application. This allows users to enjoy the benefits of our mobile banking capabilities without having to exit their favorite mobile application.

We intend to continue to develop new specialized sales forces, telemarketing efforts and use “*Banorte Visita*” in order to increase the channels through which we originate payroll loans. In addition, we have steadily increased the number of ATMs, providing us with a 15.9% of market share as of March 31, 2020, according to the CNBV.

Enhance our Customer-Oriented Business Model

We seek to strengthen our customer-oriented organizational model, focusing on customer segments instead of product segments, optimizing and consolidating processes per business instead of per product and investing in IT infrastructure. We intend to stay connected with our customers and devote resources to learning more about our customers’ needs and expectations from their banking relationships. Our strategic agreement with IBM is aimed at helping us increase our knowledge of our customers by creating a CCR database that consolidates all available customer information, enabling us to gain deeper insight into ways to build more loyal and profitable customer relationships. Our project with IBM has redesigned business processes and applications around customer segments instead of around products and developed a new IT infrastructure to support these new processes.

We believe this IT platform, which will allow us to manage large transaction volumes, will further improve the quality of service and segmentation as well as cross-selling, which will drive revenue increases, higher loyalty, cost efficiencies and increased profitability.

Increase Wallet-Share Penetration with Corporate and SME Customers

We have developed a role as a “relationship banker” for our corporate and SME customers by offering a variety of transactional banking and investment banking products through our network of regional service centers dedicated to these customers. Our transactional banking team intends to offer liability management solutions in the foreign exchange markets as well as cash management services to support our customers’ international operations. Our investment banking team intends to offer a full range of services in advisory and capital markets transactions.

Continue to Increase our Profitability

We intend to continue increasing profitability based on the following initiatives:

Improve the Profitability of our Branches and Optimize Cost Efficiencies

We seek to improve the profitability of our branches by:

- increasing loan origination, particularly in the areas of consumer loans, mortgage loans and credit cards;
- diversifying deposit base by increasing the volume of core deposits in order to achieve a lower cost of funding, based on our wide network of branches;
- increasing non-interest income through the offering of services and using cross-selling efforts;
- implementing continuous cost reduction initiatives, such as streamlining our senior management structure as well as headcount reduction; and
- channeling less value-added transactions to online and mobile services.

We will continue to review the profitability of our branch network by determining its optimal size and seeking to identify non-profitable units.

A central strategy to improve our cost efficiencies is to lower our IT and operational costs as a result of our customer-oriented business model. Another source of efficiency is to reduce personnel and administrative costs, as a result of rationalization efforts that are continuously implemented. For the three-month period ended March 31, 2020, our efficiency ratio was 43.7%, as compared to 40.5% for the corresponding period in 2019 and 42.3% for the year ended December 31, 2019.

Promote Synergies within the GFNorte Group

We intend to increase our market share and profitability by increasing our cross-selling of services and products to our customers and customers of GFNorte's other subsidiaries. We have introduced processes that facilitate our ability to offer additional financial services to our customers and those of GFNorte's other subsidiaries, with an emphasis on service and innovation. We cross-sell consumer loan products, credit cards and mortgages to our checking and savings account customers and to GFNorte's insurance and pension fund customers. We also plan to continue improving synergies and efficiencies within GFNorte's other subsidiaries.

Increase Our Non-Interest Income

Our non-interest income is comprised primarily of commissions and fees, income from trading and foreign exchange activities, income from advisory activities, income from trust activities and income from recovery bank activities. Increasing fee income is a central component of our business strategy. Subject to applicable law and to prevailing market conditions, we seek to increase our fee income by:

- continuously reviewing the fees associated with our products and services in order to find new opportunities or to adjust to market conditions and practices;
- increasing our cross-selling efforts within the GFNorte group;
- promoting the use of technological and electronic payment methods, as well as mobile and internet banking;
- establishing new relationships with businesses generating high volume point-of-sale transactions; and

- optimizing customer profitability by increasing fees and reducing transactional costs to low-value customers and increasing cross-selling within affluent customer base.

Principal Business Activities

One of our principal goals is to efficiently deliver services and products to our clients. In an effort to meet this goal, we have organized our business operations into the following businesses:

- retail banking, which includes, among others:
 - affluent banking;
 - personal banking;
 - SME banking; and
 - state and municipal government banking; and
- wholesale banking, which includes, among others:
 - corporate and enterprise banking;
 - transactional banking;
 - federal government banking; and
 - international banking.

These segments report to the main office in one of our eight territories in Mexico: Northern, Central, Mexico City North, Mexico City South, West, Northeast, North Border and South. In addition, our treasury and the money market divisions are responsible for, among other activities, managing our assets and liabilities while maximizing our income in accordance with certain risk policies and limits established by our Risk Policy Committee. See “—*Treasury and Money Market Divisions*.”

Retail Banking

The retail banking area is responsible for creating value propositions for each segment, in order for us to offer suitable products to each of our customers using diverse channels. Our retail banking area develops strategies to approach every customer in a unique manner, encourages cross-selling, shifts operations to digital platforms and constantly develops innovative products. There are four lines of business within our retail banking:

- **Affluent banking**: Since the last quarter of 2015, our aim is to provide a differentiated service model and proposition to our high value customers. By December 2019 these 870 branches had the new Queue Manager System installed, with the presence of at least one relationship manager; in overall we had 870 relationship managers. Our affluent contact center (*Línea Preferente*) is now a service referral in the market, which received more than 843,408 calls during the three month period ended March 31, 2020, 42% of which were attended by the interactive voice recording system (“**IVR**”) and 58% by telephone banking customer service specialist. As of March 31, 2020, our affluent contact center reached an 83.8% rate of solution response at the first call.
- **Personal banking**: As of March 31, 2020, this area provided services to more than 10.4 million customers with their own profit and loss, focusing on total relationship balance and profitability by seeking to maintain high-value customers and by creating an exit strategy for low-value customers. We continuously work to migrate the operations of our customers in this area to self-service channels. As of March 31, 2020, personal banking represented 22.2% of the wholesale and retail banking of the Bank in terms of net income.

- **SME banking:** As of March 31, 2020, this area offered innovative and competitive financial products and services to approximately 443,185 SMEs. In March 2016, we also re-launched Banorte SME Integral Solution, a package by which we offer to serve our SME customers all of our financial services under a single contract. As of March 31, 2020, SME banking represented 9.09% of the wholesale and retail banking of the Bank in terms of total loans.
- **State and municipal government banking:** We are one of the nationwide leaders in the state and municipal government banking segment in terms of deposits, loans and payroll. As of March 31, 2020, deposits and loans for state and municipal government banking segment represented 9.15% and 4.19% respectively, of the total wholesale and retail banking of the Bank in terms of financial margin, and the state and municipal government banking segment contributed 24.22% of the total payroll served in the bank. We have full coverage in 32 states and over 1,655 municipalities. We believe this area offers unique products and services such as government funds, payroll services, public finance analysis, advisory services and credit risk analysis. We estimate that state and municipal local government banking sales will see significant growth in the following years.

Our retail banking segment targets individual customers and SMEs by providing them with non-specialized banking products and services through our distribution channels. See “—*Distribution Channels*.” Nearly all of the transactions taking place in this segment occur through our branches, telephone banking, on-line banking and ATMs.

Products and services offered through this segment include checking and deposit accounts, credit cards, mortgage loans and consumer loans. See “—*Products and Services*.” One of our main products in this segment, CrediActivo Comercial, is a loan issued in amounts of up to Ps.24 million and is targeted towards SMEs.

We are increasingly becoming a more significant retail bank in the Mexican marketplace, and we believe the contribution of this business, particularly credit cards, payroll loans, SME financing and mortgage loans will grow significantly over the next three years.

Wholesale Banking

The wholesale banking division incorporates: Economic, Research and Fundamental Analysis; Private Banking and Wealth Management; Transactional Banking; Corporate and Enterprise Banking; Federal Government Banking; Trading and Institutional Sales; Warehouse, Leasing and Factoring; International Banking; and Treasury Management. Our wholesale banking area’s contribution to our total net income may increase as we assume a more prominent position in Mexico’s wholesale banking industry, and also as a result of its increasing share in our total loan portfolio.

Corporate and Enterprise Banking

Corporate and enterprise banking is committed to providing integrated financial solutions for our corporate customers through various types of specialized financing, including structured credits, syndicated loans, acquisition financing and financing of investment plans. Other products and services offered to our corporate customers include cash management services, collection services and fiduciary and payroll services. The customers in corporate banking generally consist of Mexican and non-Mexican multinational companies, large Mexican companies and emerging Mexican companies. Our corporate customers consist of 3,165 large corporations. As of March 31, 2020, the average outstanding individual balance of our 1,078 loans to corporations was Ps.107.2 million.

In 2016, we created a team with a high degree of specialization and market recognition in the energy and infrastructure sectors to better position ourselves in light of the opportunities created by the reforms adopted in Mexico in these sectors. This has allowed us to increase our market penetration and further enhance our market share of these sectors with current and future clients.

Our enterprise banking segment specializes in high-margin credit products for medium-sized business customers. Our medium-sized business customers consist primarily of 14,279 enterprises, varying in size from medium businesses to sizable corporate enterprises operating in a broad range of industrial sectors. As of March 31, 2020, the average outstanding individual balance of loans to our enterprise customers was Ps.17.6 million.

Our main products in this segment are:

- loans and lines of credit;
- *CrediActivo Empresarial*, a loan product partially guaranteed by NAFIN;
- cash management services;
- fiduciary services;
- checking account services; and
- payroll services.

In 2016, we implemented a new business model aimed at allowing our relationship managers to dedicate more time to attracting clients and increasing sales. This model is in constant evolution and in 2020 we expect to further enhance the business model by allowing the relationship managers to have client information on their mobile device.

Transactional Banking

Our Transactional Banking area is focused on deploying our cross-selling strategy through sales, implementation and post-sale support of transactional services, to strengthen and deepen our business relationship with existing clients. Through our Transactional Banking area we offer self-service cash solutions to our clients, including: remote deposits, cash counters, addressed payments and online foreign exchange transactions. We have also developed a new cross-selling strategy with Banorte Seguros (GFNorte's insurance subsidiary) to offer specialized insurance products.

As part of our focus on cross-selling opportunities, we deployed a client feedback system to assess our client's perception of our services and products (including NPS, market valuation, etc.) and to increase our new product allocation such as check counters, SWIFT, T2M checks and BTF Modules. This has allowed us to adapt our services in accordance to our clients' expectations, such as the SWIFT operations, which were unavailable on past years, but is now fully operational.

Federal Government Banking

We have increased our presence as a provider of financial services to Mexican federal governmental entities and their agencies, including social security institutions, unions, public trusts, public works and quasi-governmental entities. Through specialized attention, we expect to maintain our commitment to providing services to this important sector of the economy.

The products and services offered by our Federal Government Banking segment include, among others, checking accounts, loans (typically subject to a bidding process), payroll processing, cash management, collection and payment processing services to government agencies. Serving these institutions also allow us to cross-sell checking accounts, credit card services, loan products, insurance products and collection services to their employees.

As of March 31, 2020, the aggregate outstanding balance of our federal government loan portfolio was Ps.48,523 million.

International Banking

Through this segment we offer products and services to our corporate and enterprise banking and SME clients to assist them with international trade needs, as well as provide correspondent banking services to foreign financial institutions. We have strategic agreements with financial institutions outside of Mexico, which allow us to offer highly competitive solutions and financial services to our clients both locally and globally. For instance, on November 15, 2019, Banorte became the first commercial bank in Mexico to sign a bilateral cooperation framework agreement with Sinosure, Export Credit Agency of the Government of China. This agreement allows Banorte to provide short,

medium, and long-term financing to Mexican companies for imports from China and allows Sinosure to grant insurance and credit guarantees to support and encourage exports from China to Mexico. In addition, on January 27, 2020, Operadora de Fondos Banorte, S.A. de C.V. announced that it signed a non-discretionary investment advisory agreement with Bank Lombard Odier & Co. Ltd. (“Lombard”), appointing Lombard as its investment advisor to provide non-discretionary strategic and tactical asset allocation advice and recommendations in support of the investment strategy to be implemented by one of its funds. Casa de Bolsa Banorte also signed a memorandum of understanding with Lombard to develop a relationship focusing on the wealth management and private banking industries.

Among the products and services offered to our import and export clients as well as to those with international or risk mitigation needs are: import and export letters of credit, documentary collections, banking guarantees, stand-by letters of credit, letters of credit financing, cross-border financing for import and export transactions, as well as international transfer services. We also provide specialized local banking services to foreign-based companies with operations in Mexico.

Treasury and Money Market Divisions

Our treasury division is responsible for, among other activities, managing our assets and liabilities, minimizing funding costs and engaging in hedging transactions. Its goal is to maximize our income in accordance with certain risk policies and limits established by our Risk Policy Committee, as explained in “Risk Management—Risk Management Organizational Structure.” The treasury division is also responsible for managing our liquidity requirements and cash flows, monitoring market risks and funding costs, obtaining funding for certain loans and obtaining funding in the international market. The treasury division monitors our positions in fixed income securities, foreign currencies and derivatives positions for hedging and liquidity purposes.

Our money market division is responsible for our repurchase transactions, investments in domestic fixed and floating rate securities and the promotion of instruments and investment alternatives to our high net worth clients. This division also purchases futures to hedge its open risk positions or for trading purposes.

The treasury and money market divisions are monitored on a daily basis by our risk management unit. See “Risk Management—Market Risk.” Strategies relating to these divisions are assessed on bi-weekly basis by our Assets and Liabilities Committee. Our treasury division does not trade equity securities.

Products and Services

Checking and Deposit Accounts

We continually strive to develop innovative, high-quality products and services that meet our clients’ financial needs.

Through our branch network, we offer deposit products which fall into four categories: time and savings deposits, demand deposits, installment deposits and certificates of deposit. Time deposits generally require the customer to maintain a deposit for a fixed term during which interest accrues at a fixed rate and withdrawals may not be made without penalty. Savings deposits allow customers to deposit and withdraw funds at any time and accrue interest at a fixed rate that, in certain cases, increases over time. Demand deposits, which either do not accrue interest or accrue interest at a fixed rate, which is lower than the applicable time and savings deposits rates, allow customers to deposit and withdraw funds at any time and, in the case of “current” deposit accounts, to issue checks against the deposited amount. Installment deposits allow customers to make deposits either on a periodic basis or at any time during a fixed term, during which interest accrues at a fixed rate and there is a penalty for withdrawals. Certificates of deposit, which are sold in a variety of denominations and maturities and are negotiable, require an initial deposit of a fixed amount for a fixed term, during which interest accrues at a fixed rate and withdrawals may not be made without penalty. We believe our products address all of our customers’ financial needs, regardless of their segment. Furthermore, we permanently develop special offers by which we aim to make our products more attractive to our customers than those of our competitors.

We have made significant efforts to increase traditional deposits through the retail banking segment in order to continue to reduce the cost of funds and to increase our net interest income.

During the three-month period ended March 31, 2020, we experienced significant growth in the opening of checking accounts and demand deposits. Our focus on the sale of deposit products and related strategic initiatives put into place during 2016 and 2017 led to an aggregate amount of Ps.791,870 million in total deposits as of March 31, 2020. We have placed particular emphasis on increasing deposits for our low-cost products.

Credit Card Operations

We issue personal credit cards (associated with both MasterCard and Visa) and offer the following products under the Banorte brand: Por Ti de Banorte, Banorte Clásica, Banorte Oro, Mujer Banorte, Tarjeta 40, Banorte Básica, La Comer, Ke Buena, Tarjeta Platinum, Infinite, United and United Universe, the latter two of which are co-branded with United Airlines.

As of March 31, 2020, we had approximately 1.7 million credit cards outstanding, of which 5.80% carried a past-due balance. Credit card approvals are based on an internal credit scoring system, which we believe increases the quality of the portfolio and reduces approval response time. Our credit cards can be used in 9,090 ATMs across Mexico. Revenues from the credit card operations consist principally of merchant fees paid by retail and service establishments, cash advance fees, installment purchase fees, fees on late payments, variable and fixed interest rates charged on monthly account balances and annual membership fees paid by card holders.

We currently rank fourth place, both in number of transactions and in total value of transactions in the Prosa system, an ATM and credit card processing system comprised of seven Mexican banking institutions. Our market share in the Mexican credit card sector was 10.1% as of March 31, 2020 in terms of performing loans according to the CNBV. Currently, the most important channel for promoting credit cards is our branch network; nevertheless, we are expanding our origination channels for all through a more robust sales force, co-branded offers and a one-step underwriting process (origination and first purchase). We also promote our credit cards by cross-selling them to customers across GFNorte's entities.

We charge an average annual fee of Ps.548.26 per credit card. Credit card loans, which are fully underwritten by us, are unsecured, and have an initial maturity of one to two years, accrue interest at effective weighted average annual fixed rates of 27.88%. The average credit limit of credit cards is Ps.59,962; whereas limits range from Ps.2,000 to Ps.1,000,000. Moreover, the minimum required monthly salary for all new cardholders is Ps.7,000. As of March 31, 2020, the past-due loan ratio on our credit card portfolio was 5.80% and charge-offs as a percentage of average receivables were 13.26% compared to 5.90% and 14.70% as of March 31, 2019, respectively. The annual attrition rate with respect to our credit card customers was 35.11% for the year ended March 31, 2020.

We monitor our credit card accounts with an electronic system called "VISION," which allows us to establish credit limit increases, pricing, credit card loan portfolio collection and overdraft protections on an individual cardholder basis.

Mortgages

We offer long-term mortgage financing for individuals and families acquiring houses or apartments. Such financings are generally secured by the purchased property and are denominated in Pesos with fixed interest rates for the entire life of the mortgage. The term of a mortgage ranges from one to 20 years for financing of up to 90% of loan-to-value. We offer financings exclusively for residential mortgages. Other products we offer include home equity; home improvement; construction; land acquisition; and construction and land acquisition. For the three-month period ended March 31, 2020, we originated 4,535 mortgages, and the aggregate outstanding balance due from our mortgage loan portfolio at the end of such period was Ps.9,125 million, compared to Ps.7,746 million for the three-month period ended March 31, 2019.

The current average of the initial amounts of our mortgage loans (Ps.2.01 million) is 7.9% higher than the current average for other financial institutions (Ps.1.85 million) reflecting our higher income target segment. We also have

the lowest delinquency rate among the G-7 Mexican Banks with 1.18% as of March 31, 2020. We plan to continue to attract customers from these segments by providing high-quality service and quick approval response times; offering financings for purchases, refinancings and real estate improvements.

Consumer Loans

We offer two main personal consumer loans: automotive financing and payroll loans. We provide automotive financing through loans that bear interest at a fixed rate with maturities of up to six years. As of March 31, 2020, the aggregate outstanding balance due from our automotive financings was Ps.30,064 million, an increase of 20.0% compared to the same period for 2019 with an aggregate outstanding balance due from automotive financings of Ps.25,046 million.

Commercial Loans

We offer various loan products, including general commercial loans, syndicated loans and letters of credit, to our business customers. Our business customers vary from SMEs to large companies that have revenues in excess of Ps.300 million. As of March 31, 2020, our total performing commercial loans amounted to Ps.473,666 million, 26.7% of which were unsecured.

Collection Services

In 2002, we established an automatic payment collection processing service. This service allows individuals and companies to make payments for telephone bills, school tuition and cellular phone bills, among others, through our branch network and alternative distribution channels. In 2019, we handled approximately 1,171 million transactions, representing a 24% increase compared to 2018. Collection services are complemented by invoice distribution through the Internet or mobile phone banking.

Payroll Services

Since 1993, we have offered our corporate, enterprise, SME and government customers *Nómina Banorte*, a service through which they can pay their personnel payrolls via direct deposits. As of March 31, 2020, over 44.8 thousand corporate, enterprise, SME and government customers processed payrolls of over 5.2 million active employees with us, managing a portfolio of Ps.52,211 million. We believe that *Nómina Banorte* improves customer retention and reduces risk in consumer lending by strengthening customer relationships. Every employee that is paid through *Nómina Banorte* may obtain a personal loan of up to nine months of salary and preferential conditions on other types of loans.

Cash Management Services

Cash management services include collecting and disbursing funds on behalf of companies and their suppliers, distributors, clients and employees in order to facilitate cash flow, reduce operating costs and improve information management.

Money Transfer and Remittances Services

Through UniTeller, we offer cross-border money transfers and remittance paying services. We continue to be one of the largest payers of remittances from the United States. We operate in more than 30 countries.

UniTeller has multiple long-term processing agreements with institutions like Walmart México, Farmacias Guadalajara, Western Union, Wells Fargo, Xoom-Paypal, Remitly, World Remit, Moneygram and others, that allowed UniTeller to become one of the largest wire transfers processors in the industry handling currently approximately 15% of the total transactions paid in the US-Mexico corridor as of March 31, 2020. To offer individuals a more convenient mobile remittance service, UniTeller developed and offers its own digital and mobile remittance platform uLink. With this service, UniTeller improved accessibility and reduced transaction costs, responding to our goal of extending the benefits of low cost and efficient remittances in multiple channels to the largest number of Mexicans utilizing this service.

Banorte Ixe Securities

GFNorte's subsidiary in New York, offers a wide range of international investment strategies, mainly targeted to our Private Banking clients from our brokerage business in Mexico, and to our onshore (domestic) clients in the U.S.

Distribution Channels

Branch Networks

We seek to create an outstanding multi-channel experience for our customers. Towards that end, in 2017 we established an operating model which has improved and we believe will continue to improve all direct channels, customer experience and operational efficiency and, eventually, increase our market share. According to the CNBV, as of March 31, 2020, our branch network accounted for 9.2% of the Mexican market in terms of number of branches as of such date.

As of March 31, 2020, we had 1,178 branches, where 10 corresponded to affluent customer service centers. From December 31, 2019 to December 2020, we plan to open a small number of additional branches, with a greater focus on regions where our market share is relatively low. We are also planning to continue strengthening alternative channels such as ATMs, contact centers, online and mobile banking. We believe that many of our customers have taken advantage of the developments in our ATMs and digital channels, given that as of March 31, 2020, the 600 million transactions in ATMs and digital banking represented an increase of 12% compared to the three months ended March 31, 2019.

ATMs

Our ATM network has grown from 3,384 ATMs as of June 30, 2007 to 9,090 as of March 31, 2020. According to the CNBV, as of March 31, 2020, we had the fourth largest ATM network in the Mexican market. As of March 31, 2020, our ATMs served approximately 9.6 million customers monthly, representing a 2% increase compared to March 2019 and equivalent to approximately 348 million transactions annually. In order to further increase the number of transactions conducted through this channel, we are developing a platform providing personalized offers, functionalities and upgrades for each customer, and we believe that most of our products and services will be available through this channel, which will initially be tested with our corporate and SME customers. In addition, we aim to continue strengthening our debit card initiative, which can be used at all of our ATMs as well as other ATMs worldwide through our participation in the Visa and Plus ATM networks.

Contact Center

Our contact center allows our customers to check balances, transfer funds between their accounts in Banorte and other banks, pay credit card bills and receive account statements. We differentiate affluent and personal customers, to provide the correct assistance and a customized selling strategy for each group.

Currently the system receives nearly 6.6 million calls per month. Approximately 76% of calls are handled through interactive voice recording systems and 24% by telephone banking customer service representatives. For the three months ended March 31, 2020, our contact center responded to 4.6 million incoming calls and 549,440 outgoing calls, maintaining favorable levels of efficiency and customer care, compared to 4.6 million incoming calls and 672,857 outgoing calls for the same period in 2019, which represented a decrease of 0.01% and 18.34%, respectively. Our affluent contact center (Línea Preferente) is now a service referral in the market, which received more than 843,408 calls in the first three months of 2020, 42% which were attended by the IVR and 58% by telephone banking customer service specialist. As of March 31, 2020, our affluent contact center reached an 83.8% rate of solution response at the first call, compared to 84.8% as of March 31, 2019.

SME Centers

Our specialized SME centers are strategically located in close proximity to our key, as well as potential, customers. Each office offers our “SME Integral Solutions,” a bundle of products and services aimed at addressing all of our SME customers’ needs under a single contract.

Our SME Integral Solution include:

- Checking Solutions: investment and debit checking accounts.
- Financial Solutions: SME loans and business credit cards.
- Technology Solutions: electronic banking, POS and payroll services.
- Business Insurance Solutions: car, home and employees insurances.

Additionally, we have developed a 21-day credit approval process for new customers, and an expedite 12-day credit approval process for our best customers.

POS Terminals

As of March 31, 2020, our network increased to 168,478 POS terminals, an increase of 5% as compared to March 31, 2019. During these first three months, the amount transacted increased to Ps. 95,809 million, which represented a 16% increase compared to Ps. 82,265 million for the same period in 2019. During 2019, the amount transacted increased to Ps. 373,587 million, which represented a 20.06% increase compared to Ps. 311,178 million in 2018. Banorte’s POS network is the third largest in Mexico. Total transactions increased to 586 million in 2019, representing an increase of 40.48% compared to 417 million in 2018, mainly as a result of our strategy to change our target customer to a higher level customer profile resulting in major number of transactions and for greater amounts.

Online Banking

Our online banking services allow customers to utilize the Internet to access their credit card and other account balances by means of a 24-hour customer service website with a constant update. Customers are enabled to carry out various operations and transactions, such as checking their accounts, transferring funds domestically and internationally, paying taxes, credit cards and other bills and investing in funds and certificates of deposit. This service is offered to our customers at no additional cost. Online banking transactions were carried out through “Banorte by Internet” (*Banorte por Internet*). Most of our customers were signed up for paperless banking services and their monthly bank statements were sent to them through e-mail. “Banorte in your Business” (*Banorte en su Empresa*) is our corporate online banking service focusing on companies and government entities. Through this service, our corporate customers can access many of the banking services offered at one of our branches, such as transfers of funds, payroll services and payments to suppliers.

In addition BEP “Banking Electronic Pyme” (*Banca Electronica Pyme*) focuses on PFAEs (individual person with business) and Pymes (medium-size companies).

“Banorte Connection” (*Conexión Banorte*) is host to host direct connection with the enterprise resource planning (“ERP”) of our customers. We launched this service in June 2015.

Mobile Banking

Banking service via mobile phone offers a global, efficient, secure and sustainable solution to a wide segment of our customers. Our platform is compatible with almost any mobile phone, which increases customer’s reliance on our services and makes branch visits unnecessary for many transactions. Our mobile banking service has grown over time, increasing the number of clients and therefore the number of transactions.

Banorte Móvil through the development of new functionalities, the use of technological development and the transformation of its internal processes has become more than an app, it is a dynamic contact channel between the client and the institution, representing innovation in the customer experience, for example, with its new activation process for mobile banking, it is enough for a client to download the app from the respective store to activate it on their mobile phone, which has contributed to the depressurization of branches, which means that customers no longer lose time to go to a branch to make lines to activate their digital banking, another example is the investment functionality, which allows them to directly manage the different kinds of investment instruments of the bank from the palm of their hands, the need for an integration of different financial services within the channels that customers use every day also has made us move forward to venture into a feature called Banorte Go which allows the interaction of Banorte Móvil through other digital platforms such as social networks like WhatsApp, Facebook, Twitter, etc.

Also through the contact us feature, makes our Contact Center available to the client so that the bank is the one who contacts them and do not have to wait in an online call, finally being a financial institution and knowing that the most important searched value is security Banorte Móvil has implemented the use of biometrics as a reliable authentication method. Placing the client as the center of our operations has meant that the mobile channel has been designed to create a unique experience for the client, which allows having all the bank's products and services at their hands, with total security that is required for the correct use of the channel.

Third-party Correspondent Banking

Through third-party correspondents, we offer a service to a large segment of the Mexican population that cannot access financial services, and we believe we have positioned ourselves as an important player in this segment. Beginning in January 2018, we began to work alongside the CNBV for over a year and a half to integrate a new model for correspondents, which lead us to the addition of Yastás in 2019. Yastás is a provider of money transfer services, with offices and payment locations (through correspondents) throughout the country.

Pursuant to this new model, small local stores can become correspondents once they affiliate with Yastás. This provides new business opportunities for them and also allows us to have infrastructure in locations where we were not previously present due to lack of big brands and supermarkets or the difficulty in accessing such remote locations, Yastás also allows us to enable new point of contacts for our customers where they are able to withdraw cash, which is a need in a number of regions of Mexico.

We continue to develop strategic points to maintain proximity with every customer and to provide easy access to financial services. As of March 31 2020, we had 13,694 correspondent banking points, with the strategic addition of Yastás, with 3,966 stores, and 1,830 points of contact located at 7-Eleven stores, 1,706 located at TELECOMM-Telégrafos facilities, 1,220 at Extra convenience stores chain, 2,186 at Farmacias Guadalajara, 1,549 at Farmacias del Ahorro, 698 at Soriana stores, 306 at Chedraui stores, 110 at Grupo DSW, 70 at La Comer stores and 53 at Gas mart gas stations. We currently have 67.4% coverage of the municipalities in Mexico, which represents a decrease of 1.2% compared to our 68.2% coverage of the municipalities in Mexico as of December 31, 2019. During the three-month period ended March 31, 2020, Ps.5.4 million in operations were carried out through these third-party correspondent banking points of contact, representing a 58% decrease compared to the Ps.12.8 million in operations carried out during the same period in 2019, mainly resulting from the closing of establishments such as Tiendas OXXO.

The GFInter Merger

On October 25, 2017, GFNorte signed a binding merger agreement by which GFInter merged into GFNorte. On December 5, 2017, the shareholders of GFNorte approved the merger of GFNorte, acting as merging entity, with GFInter, acting as merged entity. GFInter's shareholders received a combination of a cash payment of Ps.13,700 million and 109,727,031 shares of GFNorte, representing approximately 4.0% of the then current shares outstanding of GFNorte.

On June 28, 2018, the Mexican Antitrust Commission granted its unconditional approval to carry out the merger. Similarly, on July 10, 2018, GFNorte and GFInter received the necessary authorizations from the SHCP, which considered the opinion of the Mexican Central Bank, the CNBV and the CNSF, to carry out the merger of: **(i)** GFInter, as the merged company, with GFNorte, as the merging company; **(ii)** Banco Interacciones, as the merged company, with the Bank, as the merging company; **(iii)** Interacciones Casa de Bolsa, S.A. de C.V., as the merged

company, with Casa de Bolsa Banorte, S.A. de C.V., as the merging company; **(iv)** Aseguradora Interacciones, S.A. de C.V., as the merged company, with Seguros Banorte, S.A. de C.V., as the merging company; and **(v)** Interacciones Sociedad Operadora de Fondos de Inversión, S.A. de C.V., as the merged company, with Operadora de Fondos Banorte Ixe, S.A. de C.V., Sociedad Operadora de Fondos de Inversión, as the merging company.

On July 13, 2018, the GFInter Merger became effective. Subsequently, on the same date, Banco Interacciones, the banking subsidiary of GFInter, merged into the Bank.

Banco Interacciones specialized in the financing of basic infrastructure projects through the making of loans to states, municipalities and companies related to the public sector and in the provision of deposit, financing and financial advisory services to all Mexican, federal, state and municipal, government entities, as well as state productive companies. We believe that Banco Interacciones' business and operations complement ours, in particular its government lending business, and we expect that after the full integration of our operations this will contribute to increase our market presence in Mexico and to further diversify our loan portfolio with a higher commission generating power.

Since the Interacciones Merger took place, we have made significant progress in the integration, particularly related to three key aspects: infrastructure business model, IT migration and operating expenses and cost of funding reduction. As a result of the Interacciones Merger, we consolidated our position as the fourth largest bank in Mexico in terms of total assets, performing loans and core deposits, according to information published by the CNBV, and we strengthened our government lending business.

Anti-Fraud Measures

Our branches have sophisticated tools and procedures to minimize fraud in connection with credit and debit cards, checks, branch transactions and internet banking. We use a central system that was deployed ten years ago and has been recently updated. Anti-fraud programs for credit and debit cards examine transactions in real time or near real time occurring at the respective POS or ATM, while anti-fraud programs for checks, branch transactions and internet banking are based on an examination of certain parameters and customer profiles. In each case, alerts as to possible fraud are immediately transmitted and evaluated by a team of our specialists. Any confirmed fraud in connection with credit and debit cards is reported to Visa or MasterCard, as applicable, to regulatory authorities, as applicable, and is subject to our internal procedures to block cards or accounts and reissue cards. Our anti-fraud department operates 24 hours a day, seven days a week, and is linked with other internal departments, such as investigations, audit, legal, security information and human resources, which are available to provide support for anti-fraud activities. In 2019, we invested U.S.\$4.2 million in technology, procedures and training to continue improving our anti-fraud processes. In 2020, we expect to invest approximately U.S.\$52.6 million in our cybersecurity program. We continuously work on new projects to enhance and integrate our anti-fraud management.

Strategic Alliances

IBM

On March 11, 2013, we entered into a 10-year strategic agreement with IBM to create a new customer-centric banking model, improve our operating efficiency and increase our profitability levels. To reach these objectives, we have developed our business intelligence through multichannel architecture and campaigns based on the analytics of each of our client segments and the use of new generation action tools. Additionally, we designed a new comprehensive risk model to assess our clients' risks through an automated process for account opening. This automated process allows us to enroll clients either at our branches or through seamless digital interactions. This digital platform enhances our ability to cross-sell multiproduct contracts to our clients. To protect our clients' personal data and transactions, we released a new secure online banking website and a new mobile application in 2016. We are currently working to improve our customers' experience by concentrating on multichannel sales, credit simulators, market and operations transformations and automating core processes to increase efficiencies. This agreement seeks to create a sustainable platform to achieve world-class efficiencies as well as high levels of customer service and segmentation, retention and contact with clients, through the existing channels and others to be developed. As a result of these efforts, we seek to become the bank with the best customer service and experience in Mexico and Latin America, leading the sector and setting an example of innovation through smarter use of advanced technologies.

Phoenix Software

In August 2015, we selected Phoenix, a Diebold company, as the new software provider for our entire ATM network. As a long-standing customer of Diebold's hardware and services, we added Phoenix's VISTA™ and COMMANDER™ software platforms as part of our strategy to expand our omni-channel capabilities and integrate key back-end systems with our growing ATM network. As banking consumers continue to utilize the increasing number of touch points available to conduct their banking transactions, we believe that a comprehensive omni-channel solution is crucial to provide optimal service. We consider that the software suite provides support for both the multi-vendor ATM fleet and in-branch solutions, while allowing us to be more self-sufficient at developing the tools that improve our efficiency and functionality.

Competition

We face strong competition in all aspects of our business from other Mexican financial groups, commercial banks, insurance companies and brokerage firms, as well as from non-Mexican banks and international financial institutions. Given our focus on commercial and retail banking, we compete for both commercial and retail customers with large Mexican banks, including subsidiaries of foreign banks, which, like Banorte, are part of financial groups. We compete with the subsidiaries of foreign banks (principally those based in the United States and Spain). Our main competitors in Mexico are Scotiabank Inverlat, BBVA Bancomer, Banamex, Santander, HSBC and Inbursa. In some areas of Mexico, we also compete with regional banks, such as Banregio and Banco del Bajío.

Competition is also likely to increase as a result of the entrance of new participants into the banking sector. The Mexican banking authorities have recently granted a number of banking licenses for the establishment and operation of several new banking institutions, including:

- ABC Capital, S.A., Institución de Banca Múltiple;
- Banco Base, S.A., Institución de Banca Múltiple, Grupo Financiero Base;
- Banco Finterra, S.A., Institución de Banca Múltiple;
- Banco Forjadores, S.A., Institución de Banca Múltiple;
- Banco KEB Hana México, S.A., Institución de Banca Múltiple Filial;
- Banco Progreso Chihuahua, S.A., Institución de Banca Múltiple;
- Banco Sabadell, S.A., Institución de Banca Múltiple;
- Banco Shinhan de México, S.A., Institución de Banca Múltiple;
- Banco S3 México, S.A., Institución de Banca Múltiple;
- Bancrea, S.A., Institución de Banca Múltiple;
- Bank of China México, S.A., Institución de Banca Múltiple;
- Consubanco, S.A., Institución de Banca Múltiple;
- Fundación Donde Banco, S.A., Institución de Banca Múltiple; and
- Mizuho Bank México, S.A., Institución de Banca Múltiple.

The CNBV continues granting banking licenses to new participants.

The table below sets forth our rank in, and market share of, the Mexican banking industry in the following categories as of March 31, 2020, December 31, 2019 and as of December 31, 2018:

	March 31, 2020		December 31, 2019		December 31, 2018	
	Rank	Market Share	Rank	Market Share	Rank	Market Share
Total Assets	4	11.31%	4	11.70%	4	12.46%
Commercial loans ⁽¹⁾	2	13.43%	3	13.62%	2	14.93%
Consumer loans ^{(1) (2)}	3	11.17%	3	11.03%	3	11.16%
Mortgage loans ⁽¹⁾	2	18.90%	2	18.91%	2	19.19%
Total Deposits ⁽³⁾	4	12.41%	3	13.20%	3	14.68%
Demand deposits.....	4	11.71%	4	12.22%	4	12.30%
Time deposits.....	1	16.18%	1	16.08%	1	19.36%
Number of branches.....	5	9.18%	5	9.30%	5	8.99%

Source: CNBV.

(1) Commercial, consumer and mortgage loans include only performing loans.

(2) Include credit cards.

(3) Deposits do not include funding through money market, interbank loans or any other sources of wholesale funding.

Mexican law allows for 100% foreign ownership of the equity of Mexican financial groups and commercial banks and any individual or corporation is permitted to acquire control, through one or more transactions, of Mexican financial groups and commercial banks; *provided, however*, that the authorization of the SHCP or the CNBV, for financial services holding companies or banks, respectively, is obtained if the acquired interest exceeds 5% of the total capital stock of such institution.

Commercial banks in Mexico also compete in the retail market Sofoles and Sofomes, both of which focus primarily on offering consumer and mortgage loans to middle- and low-income individuals and limited purpose banks (known as *bancos de nicho*). Until recently, the commercial credit market for middle- and low-income individual customers has been serviced almost exclusively by Sofoles and Sofomes. Currently, Sofoles and Sofomes are licensed to operate in Mexico. Sofoles and Sofomes may engage in certain specific lending activities and may, in certain circumstances, be supervised by the same regulatory authorities as commercial banks, but are prohibited from engaging in many banking operations, including foreign trade financing, receiving deposits, offering checking accounts and engaging in foreign currency operations. Traditional banks have begun to extend their credit services to the markets previously dominated by Sofoles and Sofomes.

Commercial banks also face increasing competition from other financial institutions that can provide larger companies with access to domestic and international capital markets as an alternative to bank loans. To the extent permitted by the Mexican Banking Law, we maintain a competitive position through our investment banking activities.

We acquired three U.S.-based banking entities (INB in 2006, UniTeller in 2006 and Motran in 2007). We sold INB in March 2017, however we face strong competition in the United States from U.S.-based financial groups, commercial banks and other financial institutions as a result of these acquisitions. In particular, we expect to face competition from Wells Fargo & Company, Bank of America Corporation, J.P. Morgan Chase & Company and Banco Bilbao Vizcaya Argentaria, each of which has a significant presence in the regions covered by UniTeller.

Employees and Labor Relations

As of March 31, 2020, we had 24,099 employees (representing a market share of 9.01%, according to CNBV). Approximately 35.9% of our employees were unionized as of such date. All upper-level management positions are held by non-union employees. During each of the years ended December 31, 2019 and 2018 we had 24,154 and 23,137 employees, respectively. In general, we consider labor relations with our employees to be good. Since our privatization in 1992, we have never experienced a work stoppage or strike.

Under Mexican labor law, we are liable for severance payments to employees terminated without cause and are obliged to pay seniority premiums to employees who have been employed for at least 15 years upon their voluntary

departure or upon their dismissal. In addition, we voluntarily provide pension benefits to qualified retired employees and disability and life insurance coverage on behalf of qualified employees. According to Mexican labor law, employees have the right to participate in business profits; in order to accomplish this legal requirement one month of salary is paid to all our employees for profit-sharing, except to our Chief Executive Officer. Furthermore, we have instituted certain other employee benefits and incentive programs to upgrade our workforce.

Properties

As of March 31, 2020, the book value of our real property was Ps.4,998 million. Our principal executive offices are located in Mexico City and Monterrey, Mexico. We also have offices located throughout Mexico on 134 properties, comprising an aggregate of 321,466 square meters, of which we own 51 properties and lease 83 properties. Our aggregate branch space is 465,462 square meters. As of March 31, 2020, we owned 194 of the properties on which our branches were located and leased 984 of the properties.

Litigation and Regulatory Proceedings

Due to the nature of our transactions, we frequently encounter judicial, administrative and arbitration proceedings. Customers, users or suppliers may also take legal action against us. We are currently subject to a number of other legal and regulatory proceedings, including tax and labor claims, arising in the ordinary course of our business, none of which our management believes is reasonably likely to have a material adverse effect on our financial position or results of operations. See Note 35 to our Audited Consolidated Financial Statements and Note 25 to our Unaudited Condensed Consolidated Interim Financial Statements.

OUR CAYMAN ISLANDS BRANCH

General

The Cayman Islands branch of the Bank (“Banorte Cayman”) became a part of our branch network as a result of our merger with Bancrecer. Banorte Cayman was initially registered under Part IX of the Companies Law (2018 Revision) of the Cayman Islands on February 22, 1991 as Banco de Crédito y Servicio, S.N.C. By Special Resolution dated February 9, 1993, the name of that entity was changed to Bancrecer. On March 31, 2002, Banco Mercantil del Norte, S.A., which was registered under Part IX of the Companies Law (2018 Revision) on November 23, 1989, was merged into Bancrecer, the surviving entity, subsequent to which the surviving entity was renamed “Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.” The registered office of Banorte Cayman is at CIBC Bank and Trust Company (Cayman) Limited, CIBC Financial Centre, 11 Dr. Roy’s Drive, P.O. Box 694, Grand Cayman KY1-1107, Cayman Islands. Banorte Cayman is the holder of a category “B” Banking License issued by the Cayman Islands Monetary Authority (“CIMA”), under the Banks and Trust Companies Law (2018 Revision) (the “CI Banking Law”) of the Cayman Islands. Holders of a category “B” banking license may have an office in the Cayman Islands and conduct business with other licensees and offshore companies but, except in limited circumstances, may not do business locally with the public or residents in the Cayman Islands. This license does not allow Banorte Cayman to take deposits from residents of the Cayman Islands, or invest in any asset representing a claim on any person resident in the Cayman Islands, subject to certain exceptions such as exempted or ordinary non-resident companies and other licensees.

Activities

The main activities of Banorte Cayman are:

- to obtain funding, principally for the purposes of lending to Mexican clients;
- to act as a deposit-taker, offering a range of demand and time deposits facilities to corporate clients and individuals;
- to provide treasury, international banking and corporate finance services to clients; and
- to a lesser extent, to buy and sell securities in the international market and securities issued for funding purposes (such as Eurobonds and certificates of deposit).

Regulation of Banorte Cayman

Under Mexican law, the obligations of Banorte Cayman are obligations of Banorte as a whole. Indeed, Banorte Cayman is subject to the regulations issued by the CNBV and the Mexican Central Bank, including liquidity requirements. See “*Supervision and Regulation—Liquidity Requirements for Foreign Currency-Denominated Liabilities.*”

CIMA reviews all applications and is solely responsible for the licensing of banks and trust companies under the CI Banking Law.

Under the CI Banking Law, there are two basic categories of bank licenses:

- a category “A” license, which permits unrestricted domestic and offshore business; and
- a category “B” license, which permits only off-shore business. A category “B” license may be restricted to dealings with certain clients.

Banorte Cayman has been granted an unrestricted category “B” License.

Branches of foreign banks, such as Banorte Cayman, are not subject to separate capital adequacy requirements, but must maintain the minimum capital adequacy requirements required by their home jurisdictions.

CIMA's enforcement powers under the CI Banking Law include the imposition of conditions (or further conditions) on a bank's license; revocation of a license; appointing an adviser to advise a bank on the proper conduct of its affairs; appointing a controller to assume control of a bank's affairs; and petitioning for a bank to be wound up by the court. These powers are exercisable if: **(i)** a bank is or appears likely to become unable to pay its obligations as they fall due; **(ii)** a bank is carrying on business that is, or is likely to be detrimental to the public interest or the interests of depositors or other creditors; **(iii)** a bank contravenes the regulatory laws or regulations of the Cayman Islands; **(iv)** a bank fails to comply with a condition of its license, or any rule imposed by CIMA; **(v)** the direction and management of a bank's business has not been conducted in a fit and proper manner; **(vi)** a director, manager or officer of the bank's business is not a fit and proper person to hold his/her respective position; or **(vii)** a person acquiring control or ownership of the bank in accordance with the law is not a fit and proper person to have such control or ownership.

RISK MANAGEMENT

General

Our risk exposure comprises credit, liquidity, operational (including legal and technological), market and reputational risks.

- Credit risk is defined as the potential loss caused by the partial or total failure of a counterparty or issuer to perform an obligation to us. Credit risk can affect the performance of both our loan portfolio and investment portfolio.
- Liquidity risk encompasses funding liquidity risk, which refers to the inability to renew liabilities or acquire new ones at normal market conditions; and market liquidity risk, which refers to the inability to unwind or offset positions due to a lack of market depth, thereby affecting the value of an asset.
- Operational risk is the potential loss caused by failures or deficiencies in information systems and internal controls, or errors while processing transactions.
- Market risk is the potential loss due to adverse changes in market prices of financial instruments as a result of movements in interest rates, foreign exchange rates or equity prices, and the adverse effect on our traditional banking activities of interest rate and foreign exchange rate fluctuations.
- Reputational risk is an unquantifiable risk included in our risk management's manual, defined as the potential loss in the development of the institutional brand caused by a deterioration in stakeholders' perception, internal and external, on our solvency and viability.

We consider risk management an essential activity that requires continuous improvement and adjustment according to our operations.

Mexican financial authorities have formulated rigorous risk management regulations for the banking sector. The CNBV issued a set of requirements regarding risk management practices for all banking institutions in Mexico. Pursuant to the CNBV regulations, the management process must include sound measurement and monitoring methods. We have implemented policies and procedures, approved by our Board of Directors, that our management believes comply with the CNBV requirements.

Risk Management Organizational Structure

To help ensure adequate risk management, in 1997 our Board of Directors created the Risk Policy Committee in order to manage the risks we are exposed to and to ensure that the performance of our operations adheres to the established risk management objectives, guidelines, policies and procedures.

Furthermore, the Risk Policy Committee 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.

Our Risk Policy Committee designs the strategies to be followed in order to accomplish risk-return objectives and to this end it:

- decides on the strategies and policies related to mitigating financial risks, including the setting of risk limits;
- evaluates Banorte's overall risk-return ratio;
- analyzes sensitivities and stress testing scenarios;
- defines and monitors the general strategy for asset and liability management;

- defines our general pricing processes and monitors their effectiveness; and
- analyzes the impact of operational risk events.

Our Board of Directors reviews and approves the risk management strategies and limits set by our Risk Policy Committee. Our Risk Policy Committee includes three members of our Board of Directors (one of whom serves as Chairman), our Chief Executive Officer, Corporate General Director, Risk Management General Director, Business Area Directors (without voting power) and our Audit General Director (without voting power). Our Risk Policy Committee meets on a monthly basis or more frequently, as needed.

Our Risk Policy Committee receives information on a monthly basis with respect to credit risk, market risk, operational risk, reputational risk and liquidity risk. The policies and procedures of our internal operating committees are subject to approval by our Risk Policy Committee. These internal operating committees also report to our chief executive officer and are comprised of:

- Credit Committees and Workout Committees, which review credit risk;
- the Treasury Committee, which reviews market risk;
- the Assets and Liabilities Committee, or the ALCO Committee, which reviews liquidity risk; and
- each of the Technology and Operations Committee, the Communications and Control Committee, the Fiduciary Business Committee, the Security Committee and the Integrity Committee, to review operational risks.

Credit Risk

Credit Policies

Credit risk management is an essential activity for banks. Banorte's credit policies and procedures are designed to centralize credit decisions to increase uniform application of credit criteria and minimize the risks associated with individual decision-making. Banorte's credit policies include quantitative criteria to ensure minimum credit quality standards.

Individual Loan Credit Risk Evaluation

Individual Loan Risk for Consumer Lending

We perform credit analyses of our individual consumer loans through a parametric credit scoring system. This scoring system considers factors such as the borrower's income, expenses, repayment capacity, demographic data, personal assets and credit history. The implemented scoring systems were developed using internal statistical data for each product.

This scoring system is available in each of our branches and is used to evaluate a wide array of consumer credit applications, including applications for residential mortgages, automobile loans, personal loans, credit cards and SME loans. Within each type of credit application, there can be several specially designed risk evaluation models. In addition, the scoring system has online access to credit bureau information and Banorte's internal records.

Loan applications are rejected if, based on the risk level assigned by the scoring system, the applicant is deemed to pose an unacceptable credit risk.

In addition to the scoring system used in origination, we use certain risk evaluation models and behavioral risk models in order to estimate increases in credit limits and assess the probability of non-fulfillment with respect to credit cards.

Individual Loan Risk for Commercial Lending

The evaluation process of a potential commercial borrower focuses primarily on the credit history of the owners and management, quality of production processes and facilities, historical and projected financial statements and collateral provided in connection with the loan. With respect to loans intended to finance a particular project, our evaluation relies primarily on the existence of technological alliances, the analysis of market conditions and the projected financial position of the borrower.

Account officers are responsible for reviewing commercial loan applications. Each commercial loan application is classified according to its industry sector and is then reviewed by a credit officer. In the case of loans exceeding Ps.40 million, the account officer must present a proposal to either:

- one of our Territorial Credit Committees,
- our National Credit Committee (“NCC”), or
- our Central Credit Committee, or

depending on the loan amount approval limits as indicated below:

<u>Credit Committee</u>	<u>Authority (Millions of Pesos)</u>
Board of Directors	Related Loans Art. 73 LIC
Central Credit Committee	Greater than the NCC Authority
National Credit Committee (NCC)	685
Territorial Credit Committees	185

Loans for less than Ps.40 million do not need committee approval, but must be approved by two of Banorte’s officers, one of whom must be a senior credit officer. Loans above 10% of our net capital and loans to a related party must be approved by our Chief Executive Officer and must be presented to our Risk Policy Committee and our Board of Directors. In addition to our internal lending limits, we are also subject to certain lending limits imposed by law. For a discussion of these regulatory requirements, see “*Supervision and Regulation—Lending Limits*.”

Individual Loan Credit Risk Measurement

Individual risk for wholesale loans is identified, measured and controlled through the use of target markets, criteria for risk acceptance, early alerts and Banorte’s internal risk rating system (“CIR”).

The target markets, criteria for risk acceptance and early alerts are tools that, together with the internal risk rating, are part of our loan strategy and support the estimated level of credit risk.

The target markets are categories of economic activity, separated by region, in which we are interested in granting loans based on economic research and loan behavior analysis as well as by expert opinions.

The risk acceptance criteria refer to parameters that describe different types of risks by industry, in order to estimate the risk taking when granting loans to customers based on their economic activity. The types of risks observed in the risk acceptance criteria are: financial, operational, market, enterprise's life cycle, legal and regulatory Risks, in addition to credit experience and management quality.

Early alerts are a set of criteria based on borrower information and indicators, as well as their environment, established as a mechanism for timely prevention and identification of a probable deterioration in the loan portfolio, thereby enabling us to take prompt preventive actions to mitigate credit risk.

Banorte’s CIR is a borrower’s rating methodology which assesses quantitative and qualitative criteria in order to determine credit quality. CIR applies to commercial loans equal to or greater than the equivalent of 4,000,000 UDIs

in Mexican pesos equivalent on the qualification date or borrowers with sales or incomes equal or greater than the equivalent of 14,000,000 UDIs in Mexican pesos equivalent on their last annual financial statements.

Internal Advanced Model for Credit Card

On November 15, 2017, GFNorte received the approval from the banking regulator (CNBV) to use Internal Rating Based Models (“IM”) to establish the credit card’s reserve and the credit risk’s regulatory capital requirements with an advanced approach (Document 111-3/706/2017).

The IMs improve credit risk management by estimating risk parameters from the bank’s own experience, and have been applied since February 2018. The aforementioned parameters are:

- Probability of Default.
- Severity of Loss.
- Default Exposure.

Basic Internal Model for Corporations

On November 30, 2018, GFNorte received approval from the banking regulator (CNBV) to use Internal Model (IM) for Corporations for reserves constitution and regulatory capital requirements by credit risk with a Basic Approach (Document 111-3/1472/2018) in Banco Mercantil del Norte, and on March 1, 2019 for Arrendadora y Factor Banorte (Documents 111-1/160/2019) and Sólida Administradora de Portafolios (Documents 111-1/161/2019). Exposures subject to this rating are those pertaining to corporations (other than states, municipalities and financial entities), and individuals (sole proprietorships), both with annual sales above 14 million UDIs.

The Internal Model (IM) enhances the overall credit risk management practice by estimating risk parameters through the institution’s own experience with such customers. These models have been applied since February 2019 (with January figures) at Banco Mercantil del Norte, and starting in March 2019 (with February figures) at Arrendadora y Factor Banorte, and Sólida Administradora de Portafolios. The parameter authorized under the Basic Internal Model for Corporations is probability of default.

Monitoring

We operate a central compliance operations center in Monterrey, Mexico, that monitors compliance with the terms and conditions of loans. This central compliance operations center monitors the dates and payments of the loans, the conditions and covenants of the loans and any authorized exceptions to standard procedures.

The monitoring process also includes verification of the use of proceeds and contractual conditions, financial analysis of the borrower and guarantors, on-site visits to the borrower’s place of business, confirmation of credit bureau information and analysis of the economic environment, among others.

Collections

The collection and recovery of non-performing loans is performed through a specialized collection unit (referred to as the Recovery Bank) with the established aim of maximizing the recovery of non-performing and problem loans, as well as foreclosures and execution on collateral.

We have been improving our established program to transfer non-performing and problem loans to our collection unit at earlier stages of loan deterioration in order to optimize their recovery and maximize our collection resources, while also allowing business areas to concentrate their efforts on more preventive measures and enhanced monitoring of performing customers in order to avoid credit problems.

Credit Risk of Financial Instruments

Credit risk management of financial instruments is managed through a series of key pillars with a robust framework of policies for origination, analysis, authorization and management.

Origination policies define the types of eligible negotiable financial instruments, as well as the methodology for assessing credit risk of the different types of originators/issuers and counterparts. Credit risk is allocated through a risk rating obtained with an internal methodology, evaluations of external rating agencies or a combination of both. Maximum parameters of operation are also defined depending on the type of originator/issuer or counterpart, rating and type of operation.

The appropriate credit committee authorizes operation lines with financial instruments for clients and counterparties in accordance with authorization policies. The authorization request is submitted by the business area and other areas involved in the operation, with all the relevant information for analysis by the relevant committee who, if considered appropriate, issues its authorization. Nevertheless, the Unit for the Comprehensive Risk Management (“UAIR” by its acronym in Spanish) is empowered to authorize counterparty credit lines (mainly financial entities) that comply with certain criteria through a parametric methodology approved by the Risk Policy Committee (or CPR by its acronym in Spanish).

In the case of derivative contracts, and in line with best practices, we use a methodology for calculating potential exposure of credit lines, which are analyzed and approved within the appropriate credit committee and are monitored on daily and monthly basis in the CPR, where guarantee analysis for derivative transactions is performed both for clients and financial counterparties.

The National Credit Committee has the authority to approve credit lines for derivatives with clients (except with respect to certain facilities for which the UAIR has the authority). For these transactions, the use of derivatives with margin calls is privileged in order to mitigate the risk of potential exposure to these transactions.

A potential exposure adjustment is considered to determine which lines of credit are adversely correlated (Wrong Way Risk, “WWR”).

On an individual level, the risk concentration on financial instruments is managed on a continuous basis, establishing and monitoring maximum parameters of operation for each counterparty or issuer depending on the rating and type of operation. There are defined risk diversification policies for portfolios, for economic groups and internal groups. Additionally, the concentration of counterparty type or issuer, size of financial institutions and the region in which it operates are monitored so that an appropriate diversification is obtained and undesired concentrations are avoided.

Credit risk is measured through a rating associated with the issuer, security or counterparty which has a previously assigned risk level based on two parameters:

- (i) The probability of default of the issuer, security or counterparty, which is expressed as a percentage between 0% and 100% where the better the rating or lower rate differential compared to the instrument of an equivalent government bond, the lower the probability of default and vice versa.
- (ii) The loss given default that could be experienced with respect to the total of the operation in the event of default, is expressed as a percentage between 0% and 100% where the better the guarantees or credit structures, the smaller the loss given default and vice versa. To mitigate credit risk and to reduce the loss given default in the event of default, the counterparties have signed ISDA contracts and netting agreements, in which credit lines and the use of collateral to mitigate loss in the event of default are implemented.

Portfolio Risk

We developed a portfolio credit risk methodology that, besides including international standards for identifying, measuring, controlling and monitoring risk, has been adapted to function within the context of the Mexican Financial System.

This credit risk methodology provides current value of the entire loan portfolio at Banorte, that is, the loan exposure, in order to monitor risk concentration levels through risk ratings, geographical regions, economic activities, currency and type of product in order to observe the portfolio's profile and take action to improve diversification, which will maximize profitability with the lowest risk.

The methodology considers the balance of each of the loans as the exposure of the loan portfolio, while for the financial instruments portfolio the exposure is calculated taking into account the present value of instruments and their future cash flows. This exposure is sensitive to changes in the market, thereby facilitating calculations under different economic scenarios.

The methodology also takes into consideration the probability of default, recovery rate associated to each client and the modeling of the debtor based on the Merton model. The probability of default is the probability that the debtor will not fulfill his or her debt obligation with the institution according to the originally agreed terms and conditions. The probability of default is based on transition matrixes based on the migration of the debtors through different risk rating levels. The recovery rate is the percentage of total exposure that is estimated to be recovered if the debtor defaults. The modeling of the debtor, based on the Merton model, associates the debtor's future behavior to credit and market factors on which his "credit health" depends, as determined by statistical techniques.

The results of this methodology are risk measures such as the expected and unexpected loss at a one-year horizon. The expected loss is the average of the credit portfolio's loss distribution, which is used to measure the following year's expected loss due to default or variations in debtors' credit quality. The unexpected loss is an indicator of the loss in extreme scenarios and is measured as the difference between the maximum losses given the distribution of losses, at a specific confidence level that for our institution is 99.95% and the expected loss.

These results are used as a tool for better decision-making in granting loans and in the diversification of the portfolio, according to our strategy. The individual risk identification tools and the portfolio credit risk methodology are periodically reviewed and updated in order to include new techniques that may support or strengthen them.

Liquidity Risk

Our liquidity risk management objectives are to:

- Comply with the risk appetite, as defined by the Board of Directors.
- Properly monitor our balance and liquidity risk.
- Inform the senior management in a timely manner of the Balance and Liquidity Risk exposure and on any limits' and risk profile's deviation.
- Measure Institution's vulnerability to extreme market conditions and consider such results for decision making.
- Monitor the institution's coverage policy and review it at least annually.
- Maintain a sufficient level of liquid assets eligible to guarantee the institution's liquidity even under stress conditions.

Our liquidity risk policies include:

- Establishment of global and specific limits of our balance and liquidity risk management.
- Measurement and monitoring of balance and liquidity risk.
- Information and disclosure of liquidity risk to risk-taking areas, CPR, the Board of Directors, Financial Authorities and to public investors.

Balance and liquidity risk is managed through a series of fundamental pillars that include the use of key indicators such as the LCR, re-price gaps and liquidity, as well as stress testing. The latter is based on a framework of policies and manuals, including a funding contingency plan and a contingency plan to preserve solvency and liquidity. Similarly, is enhanced with monitoring limits and risk appetite metrics of Balance and Liquidity Risk. The disclosure of metrics and indicators and their compliance with the established limits and the risk appetite are reviewed through monthly reports to the CPR, weekly reports to the capital and liquidity management group and quarterly reports to the Board of Directors. The LCR measures liquidity risk based on the relationship between liquid assets and net cash outflows in the next 30 days, under a regulatory stress scenario. The LCR is an indicator designed to ensure that the institution has sufficient liquidity to meet its short-term obligations, under an extreme scenario using exclusively high quality liquid assets as source of funding. During the three-month period ended March 31, 2020 and 2019, the average LCR was 119.84% and 116.50%, respectively. The aforementioned levels are above the risk appetite and the regulatory minimum standards. These results show that we can meet all of our short-term obligations in a crisis scenario.

Interest Rate Risk

Interest rate risk entails estimating its impact on the financial margin as well as on equity's economic value. Financial margin is the difference between interest income and costs associated to interest bearing liabilities (interest expense). Depending on the balance's structure, variations in interest rates may have either a positive or negative impact in the rate scenarios. On the other side, economic value measures variations on equity flows due to changes on interest rate structure.

Given that both financial margin and equity's economic value follows the flow structure of assets and liabilities in the balance sheet, the model used to estimate those metrics is a re-pricing model by brackets in which all assets and liabilities are distributed in different bands depending on their re-pricing characteristics and/or tenure. Once categorized by re-pricing structure, the impact that each of these bands have on these metrics can be estimated.

Financial Margin Sensitivity

Financial Margin sensitivity is a metric that takes into consideration a twelve-month period. Only the bands with duration lower than one year are impacted by interest rate simulated fluctuations, and consider a parallel and symmetric shift for both active and passive interest rates. Relevant considerations behind margin sensitivity calculations are:

- All financial assets and liabilities in the balance sheet are considered. The book for trading is monitored separately.
- This metrics takes into consideration all balance sheet behavior models, such as mortgage prepayments and deposit survival.

The balance sheet is regarded as static and constant through time. Neither organic growth nor structural or mix changes are considered.

Operational Risk

Operational risk is defined as the potential loss due to failures or deficiencies in internal controls, errors in operation processing and storing or in data transmitting, as well as to adverse administrative and judicial rulings, fraud or theft (this definition includes technological and legal risk).

The objectives of operational risk management are to:

- Enable and support the organization to reach its institutional objectives through prevention and management of operational risks.
- Ensure that the existing operational risks and the required controls are properly identified, assessed and in line with the risk strategy established by the organization.
- Ensure that operational risks are properly quantified in order to adequately allocate capital taking into account the operational risk.

As part of our institutional regulations, we have documented policies, objectives, guidelines, methodologies and areas that have been designated responsible for managing operating risk.

The operational risk management directors maintain close communication and coordination with the regulatory comptrollership in order to facilitate effective internal control in which proper procedures and controls are established for mitigating operating risk among the processes, and provide monitoring through the internal audit department.

The regulatory comptrollership, as part of the internal control system, carries out the following activities to mitigate risk:

- internal control validations;
- institutional regulations management and control;
- monitoring of operating processes' internal control by means of control indicator reports, which are reported by the process comptrollers in the various areas;
- money laundering prevention process management;
- control and monitoring of the regulatory provisions; and
- analysis and assessment of the operating processes and projects with the participation of the responsible directors of each process in order to ensure adequate internal control.

Market Risk

Our objectives regarding market risk are to:

- Adequately monitor market risk.
- Maintain the senior management adequately informed.
- Quantify our exposure to market risk through the use of various methodologies.
- Define the maximum risk levels we are willing to maintain.
- Measure our vulnerability to extreme market conditions and consider such results when making decisions.

Our market risk policies include the:

- Operation of financial instruments exclusively through authorized markets and approved products.
- Establishment of global and specific limits of market risk.
- Measurement and monitoring of market risk through the Potential Loss commonly known as “expected shortfall” Back Testing, Sensibility Analysis and Stress Testing, among others.
- Information and disclosure of market risk to risk-taking areas, CPR, the Board of Directors, Financial Authorities and to the investment population.

Market Risk Methodology

Market risk management is controlled through a series of fundamental pillars, highlighting the use of models and methodologies such as Potential Loss commonly known as “expected shortfall” Back Testing, Sensibility Analysis and Stress Testing, which are used to measure the risk of traded products and portfolios in the financial markets. Based on Basel requirements referred in the document “Minimum Capital Requirements for Market Risk”, Banorte implemented during January the estimation of expected shortfall, thus substituting the estimation of VaR. In addition, it was implemented the valuation of derivatives by OIS curves and curves adjusted by collateral following international standards.

Risk management is supported by a framework of policies and manuals through which the implementation and monitoring on market risk limits, the disclosure of the aforementioned risk metrics and its tracking regarding the established limits, are set. Key risk ratios are disclosed in monthly reports to the risk policy committee and through a daily report to our top executives, related to the market risk risk-taking.

Market Risk Exposure

Exposure of the Institution’s financial portfolios to Market Risk is quantified using the methodology denominated expected shortfall which is the average of losses once VaR is surpassed.

The expected shortfall model considers a one day horizon base, and considers a non-parametric historical simulation with a 97.5% confidence level and 500 historical observations on risk factors. Furthermore, it considers all the positions (money market, treasury, equities, foreign exchange and derivatives) classified for accounting purposes as trading assets, both on and off the balance sheet.

The average Expected Shortfall of the Bank’s portfolio for the three-months ended March 31, 2020 was Ps.98.7 million, which means that our potential loss will be above Ps.98.7 million in one out of a hundred days.

The following table sets forth the average, maximum and minimum values of the weekly Expected Shortfall for the three-month period ended March 31, 2020:

	Three Months Ended March 31, 2020		
	Average	Maximum	Minimum
	(Ps. millions)		
Interest rate.....	75	110	32
Foreign Exchange.....	60	74	37
Equity	68	87	35
Diversification effect.....	(103)	(136)	(55)
Total	99	136	48

Complementary to expected shortfall and for strengthening risk analysis, Banorte tests under extreme conditions, also known as Stress Testing. This is presented to the Risk Policy Committee on monthly basis with the main objective of assessing the impact on the Institution’s positions of extreme movements in risk factors.

In order to validate the effectiveness and accuracy of the expected shortfall, a monthly Back testing analysis is presented to the Risk Policy Committee. Through this analysis, it is possible to compare losses and gains observed with respect to the estimated expected shortfall and if necessary make the required adjustments to the parameter.

MANAGEMENT

Board of Directors

Management of our business is vested in our Board of Directors, which is currently composed of 14 regular members, each elected for a one-year term at our annual ordinary general meeting of shareholders, and is responsible for the management of our business.

The following table sets forth our current directors and their alternates:

<u>Directors</u>	<u>Alternate Directors</u>
Carlos Hank González (Chairman)	Graciela González Moreno
Juan Antonio González Moreno	Juan Antonio González Marcos
David Juan Villarreal Montemayor	Alberto Halabe Hamui (Independent)
José Marcos Ramírez Miguel	Gerardo Salazar Viezca
Carlos de la Isla Corry	Alberto Pérez-Jácome Friscione
Everardo Elizondo Almaguer (Independent)	Diego Martínez Rueda-Chapital (Independent)
Carmen Patricia Armendáriz Guerra (Independent)	Roberto Kelleher Vales (Independent)
Héctor Federico Reyes Retana y Dahl (Independent)	Clemente Ismael Reyes Retana Valdés (Independent)
Alfredo Elías Ayub (Independent)	Isaac Becker Kabacnik (Independent)
Adrián Sada Cueva (Independent)	José María Garza Treviño (Independent)
David Peñaloza Alanís (Independent)	Carlos Césarman Kolteniuk (Independent)
José Antonio Chedraui Eguía (Independent)	Humberto Tafolla Núñez (Independent)
Alfonso de Angoitia Noriega (Independent)	Guadalupe Phillips Margain (Independent)
Thomas Stanley Heather Rodríguez (Independent)	Ricardo Maldonado Yáñez (Independent)

Members of our Board of Directors receive cash fees per meeting equal to the market value of two Ps.50 gold coins commonly referred to as *centenarios*.

Our bylaws provide that the Board of Directors may designate committees. Our principal committees are the following:

Audit Committee

The purpose, composition, authority and responsibilities of our Audit Committee have been established in a charter approved by the Board of Directors in accordance with Mexican law. The Audit Committee's primary purpose is to assist the Board of Directors in defining, verifying and assessing the effectiveness of our internal control system, overseeing the management and conduct of our business, and fulfilling shareholder resolutions. The Audit Committee is responsible for following up on external and internal audit activities and keeping the Board of Directors informed about their performance. Moreover, the Audit Committee oversees the preparation of financial reports in accordance with regulations and accounting principles applicable to financial institutions. The Audit Committee is also responsible for overseeing cybersecurity. The current members of the Audit Committee, all of whom are independent,

are Héctor Federico Reyes Retana y Dahl (Chairman), Carmen Patricia Armendáriz Guerra, Thomas S. Heather Rodríguez and Clemente Ismael Reyes Retana Valdés.

Risk Policy Committee

Our Risk Policy Committee is comprised of voting members. The objective of the Risk Policy Committee is to manage our risk. The current voting members are: Carlos de la Isla Corry (Chairman), Héctor Federico Reyes Retana y Dahl, Everardo Elizondo Almaguer, Thomas S. Heather Rodríguez, Clemente Ismael Reyes Retana Valdés, José Marcos Ramírez Miguel and Gerardo Salazar Viezca. The Risk Policy Committee can invite guests that shall not have voting privileges, and will include our internal auditor.

Human Resources Committee

Our Human Resources Committee aims to appropriately compensate our staff, protect our integrity, stability, competitiveness and financial soundness and to support our Board of Directors in its functions relating to our compensation system, through the approval of determinations in connection with its human resources and the establishment of a regulatory framework. Our Human Resources Committee is responsible for the implementation, maintenance and evaluation of activities regarding our compensation system. The current members of our Human Resources Committee are: Everardo Elizondo Almaguer (Chairman), Thomas S. Heather Rodríguez, Gerardo Salazar Viezca, Javier Beltrán Cantú, Rafael Arana de la Garza and Isaías Velázquez González (non-voting member).

Alternate Directors

Alternate Directors have been appointed at our annual shareholders' meeting to substitute for Directors in cases of permanent or temporary absences. An Alternate Director attends meetings of our Board of Directors when called to substitute for a Director.

Statutory Auditors

In addition to the Board of Directors, our bylaws provide for a statutory auditor to be designated at a Board of Directors meeting with previous recommendation from the Audit Committee and, if determined at such meeting, an alternate statutory auditor. Under Mexican law, the duties of statutory auditors include, among other things, the examination of the operations, books, records and any other documents of a company, the determination of whether accounting standards and policies have been followed, and the presentation of a report of such examination at the annual ordinary general meeting of shareholders. Our statutory auditors are Galaz, Yamazaki, Ruiz Urquiza, S.C., a member of Deloitte Touche Tohmatsu Limited.

Principal Officers of Banorte

The following persons are our principal officers:

Name	Position	Years with Banorte	Age
Carlos Hank González.....	President and Chairman of the Board	5	48
José Marcos Ramírez Miguel.....	Chief Executive Officer	9	57
Rafael Arana de la Garza.....	Managing Director, Chief Operation Officer and Chief Financial Officer	8	68
Carlos Eduardo Martínez González.	Managing Director, Retail Banking	20	56
Jose Armando Rodal Espinoza.....	Managing Director, Wholesale Banking	27	50
Héctor Ávila Flores.....	Managing Director, Legal	5	53
Jose Francisco Martha González.....	Managing Director, Payment Methods, IT & Digital	5	50
Isaías Velazquez González.....	Managing Director, Audit	21	58
Gerardo Salazar Viesca	Managing Director, Chief Risk Officer	0.3	59
Sergio García Robles Gil	Managing Director, Corporate Officer	25	59
Fernando Solís Soberón.....	Managing Director, Long Term Savings	12	58
	Managing Director, Administration and Human Resources	23	52
Javier Beltrán Cantú.....			
Carlos Rojo Macedo	Managing Director, Chairman's Advisor	1	50

Each of our principal officers has extensive experience in the banking industry. Set forth below is biographical information for each of our principal officers.

Carlos Hank González, 48, Mr. Hank González holds a Bachelor's Degree in Business Management with specialization in Finance from Universidad Iberoamericana. Currently he is Chairman of GFNorte's Board of Directors, a position he has held since January 1, 2015. In Gruma, a global leader in corn flour and tortilla production with operations in more than 100 countries, Mr. Hank González has played a key role since December 2012, when he became Vice President of the Board of Directors and joined the Executive Committee to design a healthy and responsible financial strategy that generated value for the company. Mr. Hank González is a member of the board of directors of the Mexican Stock Exchange and Grupo Televisa, S.A.B. and the chairman of the board of directors of Cerrey, S.A. de C.V.

José Marcos Ramírez Miguel, 57, Mr. Ramírez Miguel holds a Bachelor's Degree in Actuarial Science from Universidad Anahuac, a Postgraduate Degree in Finance from Instituto Tecnológico Autónomo de México ("ITAM") and an MBA from Escuela Superior de Administración y Dirección de Empresas (E.S.A.D.E.) in Barcelona. Mr. Ramírez Miguel is the Chief Executive Officer of GFNorte and the Bank since November 2014.

Rafael Arana de la Garza, 68, Managing Director, Chief Operation Officer and Chief Financial Officer. Mr. Arana joined us in September 2011 and has a bachelor's degree in Electrical Mechanical Engineering. He has previously worked as Grupo Financiero HSBC, S.A. de C.V.'s Managing Director, Personal Banking, for Latin America and the Caribbean, as well as Associate Managing Director for HSBC México.

Carlos Eduardo Martínez González, 56, Managing Director, Government Banking. Mr. Martínez joined us in 1996 and has a master's degree in Banking. He previously worked at Grupo Financiero Santander Serfin, S.A. de C.V.

José Armando Rodal Espinosa, 50, Managing Director, Wholesale Banking. Mr. Rodal joined us in April 1993 and has a master's degree in Business Administration. He has previously worked as Managing Director of Executive Corporate and Enterprise Banking in Banorte.

Héctor Ávila Flores, 53, Managing Director, Legal. Mr. Ávila holds a Bachelor's Degree in Law from Universidad La Salle, with a specialization in Finance Law from ITAM. He has been Secretary of GFNorte's Board

of Directors since April 2011. Currently, is GFNorte's Managing Director, Legal and has more than 13 years of experience in the Mexican financial system.

José Francisco Martha González, 50, Managing Director, Methods of Payment, IT & Digital. Mr. Martha joined us in 2014, he is a Chemical Engineer in Processes of the Universidad Interamericana, and has a master's in Economics Project Management and Control at the ITESM-México. He previously worked as General Director of IT in Scotiabank from 2008 to 2014.

Isaías Velázquez González, 58, Managing Director, Audit. Mr. Velázquez holds a Bachelor's Degree in Public Accounting from Instituto Politécnico Nacional. He has previously worked as Executive Director - Secretary of GFNorte's Audit & Corporate Practices Committee.

Gerardo Salazar Viezca, 59, Managing Director, Chief Risk Officer. Mr. Salazar holds a Bachelor's Degree in Economics from Universidad Iberoamericana. He has also stood out in academics as teacher and by virtue of his graduate studies, including PhD, master's degrees and specializations in Economics, Business Administration, Finance and Social Science in institutions such as ITESM, Universidad Iberoamericana (of which he was the Economics Department Director), ITAM, Harvard University and New York Institute of Finance. Formerly, CEO of Banco Interacciones from 2004 to 2018 and Risk Management Corporate Director of Grupo Financiero Interacciones from 2002 to 2004. Previously, Corporate Banking Director, both at Bancomer and BBVA -Bancomer.

Sergio García Robles Gil, 59, Chief Managing Director, Corporate Officer. Mr. García joined us in October 1994 and has a master's degree in Business Administration. He has previously worked at Fina Consultores.

Fernando Solis Soberón, 58, Managing Director, Long Term Savings. Mr. Solis joined us in July 2007 and has a bachelor's degree and master's degree and a Ph.D. in Economics. Other entities for which he has worked include Grupo Nacional Provincial, the CONSAR, and CNSF.

Javier Beltrán Cantú, 52, Managing Director, Administration and Human Resources. Mr. Beltrán joined us in 1996 and has a master's degree in administration from Instituto Tecnológico EGADE – Graduate School in Business Administration and Management, also has a master's degree in Accounting from the University of Texas. He has previously worked as Deputy Managing Director, Administration and Human Resources in Banorte.

Carlos Rojo Macedo, 50, Managing Director, Chairman's Advisor. Mr. Rojo joined us in July 2018 and has a bachelor's degree in Corporate Finance from UCLA. Other companies for which he has worked include Grupo Financiero Interacciones.

Compensation

For the three-month period ended March 31, 2020, the aggregate compensation paid by us to the members of our Board of Directors was Ps.2.3 million. Excluding any amounts received as members of our Board of Directors, the gross amount of salaries and bonuses we paid to members of our senior management for the three-month period ended March 31, 2020, was Ps.73.3 million.

For the year ended December 31, 2019, the aggregate compensation paid by us to the members of our Board of Directors was Ps.7.7 million. Excluding any amounts received as members of our Board of Directors, the gross amount of salaries and bonuses we paid to members of our senior management for the year ended December 31, 2019, was Ps.293.3 million.

RELATED PARTY TRANSACTIONS

Loans to Related Parties

Pursuant to Mexican rules and regulations, no loans may be made to:

- any bank officer or employee, except in connection with certain employee benefits;
- statutory auditors, including alternate statutory auditors;
- external auditors; and
- certain close relatives of any of the persons mentioned in the bullets above.

In addition, the Mexican Banking Law regulates transactions by a bank with affiliates and other “related party transactions” and limits the aggregate amount of these transactions to 35.0% of our Tier 1 Capital. Related party transactions may only be undertaken by Mexican banks if agreed upon on market terms. The CNBV may, upon request, grant exemptions from these provisions. As permitted by Mexican Banking Law, we currently provide loans to our employees at favorable rates.

Articles 73, 73 Bis and 73 Bis 1 of the Mexican Banking Law regulate and limit our loans to related parties, including loans to:

- holders of 2% or more of our shares or the shares of GFNorte or of an affiliate of GFNorte;
- principal and alternate members of our Board of Directors, or of the Board of Directors of GFNorte or of an affiliate of GFNorte;
- relatives of a Board of Directors member or of a 2% or more shareholder mentioned in the above categories;
- any person not an officer or employee who, nevertheless, is empowered to bind us contractually; and
- an entity in which we or any of our directors or officers, or any of the above persons holds, directly or indirectly, 10% or more of the outstanding capital stock, and board members, officers and employees of entities mentioned in any such entity.

A three-fourths majority of non-conflicted members of our Board of Directors present at the relevant Board meeting must approve such loans. Prior to such approval, however, the loan must undergo our customary review procedures for loans, which vary depending on the nature and amount of the loan, except that such loans must always be reviewed and recommended by the Credit Committee. Loans for amounts of less than 2,000,000 UDIs, or 1% of our Tier 1 Capital, whichever is greater, do not require approval by the Board of Directors. In addition, certain filings must be made with the CNBV with respect to such loans.

As of March 31, 2020, our loans to related parties under Articles 73, 73 Bis and 73 Bis 1 totaled Ps.11,965 million, which comprised 1.5% of our total loan portfolio at such date. Our loans to related parties are made on terms and conditions comparable to other loans of like quality and risk. Of all the related party loans outstanding on March 31, 2020, 98.0% were graded “A” and 2.0% were graded “B or lower” under the Loan Classification and Rating Rules. See Note 24 to our Audited Consolidated Financial Statements and Note 10 to our Unaudited Condensed Consolidated Financial Statements for further information regarding our related party transactions with our parent, subsidiaries and other affiliated companies.

PRINCIPAL SHAREHOLDERS

As of March 31, 2020, 98.26% of our capital stock was owned by GFNorte. Accordingly, GFNorte is in a position to elect all of the members of our Board of Directors and otherwise control the management and affairs of Banorte. The table below sets forth the ownership of our capital stock as of March 31, 2020:

Shareholder	Series O Shares Owned	Percentage
Grupo Financiero Banorte, S.A.B. de C.V. ⁽¹⁾	141,691,146,957	98.26%
Other ⁽²⁾	2,506,268,471	1.74%
Total	144,197,415,428	100.00%

(1) As of April 24, 2020, the date of GFNorte's latest annual ordinary general shareholder's meeting, 9.87% of the shares of Grupo Financiero Banorte S.A.B. de C.V. were held by investment vehicles of the González Family, 5.22% were held by other directors, officers and trusts for GFNorte's employees and the remaining 84.91% was held by non-affiliated third parties.

(2) These shares are held by various third parties.

THE MEXICAN FINANCIAL SYSTEM

General

Mexico's financial system is currently comprised of commercial banks, national development banks, brokerage firms, development trust funds, limited purpose banks and other non-bank institutions, such as insurance and reinsurance companies, bonding companies, credit unions, savings and loans companies, popular financial entities, foreign exchange houses, factoring companies, bonded warehouses, financial leasing companies, mutual fund companies, pension fund management companies, limited purpose financial institutions and financial technology institutions ("Fintech Institutions"). In 1990, the Mexican government adopted the Financial Groups Law aimed at achieving the benefits of universal banking, which permits a number of financial services companies to operate as a single financial services holding company, which was amended and restated on January 10, 2014, as consequence of the Financial Reform. Most major Mexican financial institutions are members of financial groups.

The main financial authorities that regulate financial institutions are the SHCP, the Mexican Central Bank, the CNBV, the CONSAR, the CNSF, the IPAB and the CONDUSEF.

Trend toward multi-purpose banking institutions

Prior to 1978, the Mexican banking system was comprised primarily of specialized institutions, which were authorized to conduct specified financial activities pursuant to concessions granted by the Mexican Government. During the period from 1978 to the nationalization of commercial banks in 1982, the structure of the Mexican banking system evolved towards the creation of multi-purpose banking institutions, which were allowed to engage in the full range of banking activities. This is the model currently prevailing in Mexico.

Nationalization and subsequent privatization

In September 1982, Mexico's president decreed the nationalization of private Mexican commercial banks. Effective November 1982, a constitutional amendment was adopted to implement the nationalization, which granted the Mexican Government a monopoly on banking and credit service. The number of banking institutions was reduced from 68 to 29 in the first two years of nationalized banking. By virtue of the nationalization of the banks, the *Ley Reglamentaria de Servicio Público de Banca y Crédito* was published in the Official Gazette on December 31, 1982, replacing the *Ley General de Instituciones de Crédito y Organizaciones Auxiliares* of 1941. By 1988, the number had been further reduced to 18, of which six had national coverage, five were regional banks and seven were multi-regional banks. Only two banks, Banco Obrero, S.A. and Citibank N.A., were excluded from the nationalization and continued limited operations as privately-owned commercial banks.

Effective June 28, 1990, the Mexican Constitution was amended to permit Mexican individuals and financial services holding companies to own controlling interests in the then-existing 18 Mexican commercial banks owned by the Mexican Government. Subsequently, a new Banking Law was enacted to regulate the ownership and operation of Mexican commercial banks, national development banks and foreign financial institutions. Pursuant to the Banking Law, Mexico began the process of privatizing commercial banks. By the third quarter of 1992, the Mexican Government had privatized all 18 state-owned commercial banks. Since that time, new commercial banks have been chartered and regulations regarding investment in the banking sector by foreign investors, including foreign sovereigns, have been made more flexible.

On November 26, 2013, the Senate approved the Report of the Chamber of Deputies (*Cámara de Diputados*) on the bill presented by President Enrique Peña Nieto amending, supplementing and repealing various provisions with respect to financial matters and issuing the Financial Groups Law (the "Financial Reform").

Thirty-four legal statutes were amended in order to foster greater competition in the financial and banking system by creating incentives to increase lending, as well as a new mandate for development banks. Also, the Financial Reform strengthened the scheme for the stability of the financial institutions and the powers of financial authorities in regulatory, monitoring and enforcement matters.

Financial Groups

The enactment of the former Financial Groups Law in 1990 permitted the development of the universal banking model in Mexico. By July 1992, most major Mexican financial institutions had become part of financial groups controlled by a financial services holding company, such as ourselves, and made up of a number of financial operating entities.

On January 10, 2014, a new Financial Groups Law was published in the Mexican Official Gazette, which replaced the Financial Groups Law of 1990. The operations of financial services holding companies are generally restricted to holding shares representing the capital stock of financial services operating subsidiaries. Such subsidiaries, whether direct or indirect, may include Mexican banks, broker-dealers, insurance companies, bonding companies, mutual fund operators, mutual funds, ancillary credit organizations (such as factoring, financial leasing and bond-warehousing companies), Sofomes, foreign exchange service providers, Afores, financing companies that provide credit to low income borrowers (*sociedades financieras populares*), and Fintech Institutions. As a general rule, a financial services holding company must maintain a majority participation and effective control of at least two financial subsidiaries, provided that the holding of two Sofomes only will not constitute a financial services group.

The Financial Groups Law allows entities controlled by the same financial services holding company:

- to act jointly before the public, offer services that are supplemental to the services provided by the other and hold themselves out as part of the same group;
- maintain common files, for anti-money laundering purposes, that may be used by all entities part of the financial group;
- use similar corporate names (except for Fintech Institutions); and
- conduct their activities in the offices and branches of other entities part of the same group.

In addition, the Financial Groups Law requires that each financial services holding company enter into an agreement (*convenio único de responsabilidades*) with each of its financial services subsidiaries pursuant to which the holding company agrees to be responsible secondarily and without limitation for the satisfaction of the obligations incurred by its subsidiaries as a result of the activities that each such subsidiary is authorized to conduct under the applicable laws and regulations, and is fully responsible for certain losses of its subsidiaries, up to the total amount of the holding company's assets. In the event that the assets of the financial services holding company are insufficient to meet the losses of its subsidiaries if occurred simultaneously, the financial services holding company must first meet the liabilities of the banking institutions that are part of the group and subsequently, the liabilities of any other entities that form the group will be prorated. For such purposes, a subsidiary is deemed to have losses if its assets are insufficient to meet its payment obligations. The subsidiaries will never be held liable for the losses of their financial services holding company or for the losses of the other subsidiaries of the group.

Recent changes included in the Financial Groups Law of 2014 include the following:

- *Shareholding Structure* - It provides for the possibility of the holding company to maintain the shareholding of the members of the group through sub-holding companies, that are partially regulated and not subject to specific capitalization requirements.
- *Capitalization and Corrective Measures* - A holding company shall maintain net capital that shall not be less than its permanent investments in the subsidiaries of the group. It also authorizes the SHCP to determine corrective measures, such as the potential sale of assets, non-distribution of dividends and suspending payments of bonuses to officers and directors, among other measures.
- *Corporate Governance* - The new law provides for a new corporate governance structure, setting forth specific duties of care and fiduciary duties applicable to Board members, even if the financial services holding

company is not publicly traded, similar to the duties provided in the Mexican Securities Market Law (*Ley del Mercado de Valores*) for public corporations.

- Other material changes from the previous law include shareholders' agreements, tied sales, liability agreements, the investment structure of the holding company, accounting and consolidated supervision, among others.
- *Investment Structure of the Holding Company* - In addition to its interest in the financial institutions of the group, a holding company may invest in other instruments, such as securities representing the capital stock of other financial institutions that are not group members, service providers and real estate companies, among others.
- *Investments by Foreign Governments*. Foreign governmental entities to acquire controlling interests and indirect interests in financial services holding companies and banks, and in circumstances such as financial distress.

On March 9, 2018, the Financial Groups Law was modified to permit Fintech Institutions to be part of Financial Groups; provided that Fintech Institutions that are part of a Financial Group may not use denominations or names similar to those used by the other financial institutions member of a Financial Group.

Authorities of the Mexican Financial System

The principal authorities that regulate and supervise financial institutions in Mexico are the Mexican Central Bank, the SHCP, the CNBV, the CONSAR, the CNSF, the IPAB and the CONDUSEF. These authorities are subject to a number of organic laws and other administrative regulations that govern their regulatory, supervisory and other powers. Also, these entities continually enact administrative regulations within the scope of their respective authority for the regulation of the corresponding financial entities, as further mentioned below. We, as a banking institution, are subject to the supervision and regulation of the CNBV and CONDUSEF, particularly as related to retail consumer banking. In addition, our parent company (GFNorte) and its other financial subsidiaries are subject to the supervision and regulation of the mentioned CNBV and other corresponding financial authorities, and are in constant interaction with such authorities during their normal course of business.

Mexican Central Bank

The Mexican Central Bank is an autonomous entity (*organismo constitucionalmente autónomo*) that is not subordinated to any other body in the Mexican federal government. Its primary purpose is to issue the Mexican currency, as well as to maintain the acquisition power of such currency, to establish reference interest rates, to approve fees and commissions charged by banking institutions, to regulate derivatives and to ensure that the banking and payments systems perform under safe and sound principles.

Monetary policy decisions are taken by the members of the Governing Board of the Mexican Central Bank. The Governing Board is composed of a Governor and four Deputy Governors, who are appointed by the President and ratified by the Senate or the Permanent Commission of Congress, as applicable.

Among the decisions that only the Governing Board may take are the authorization of the issuance of currency and the minting of coins, the decision to extend credit to the Mexican government, the determination of policies and criteria that the Mexican Central Bank uses in its operations and in the regulations that it issues, and the approval of its rules of procedure, budget, working conditions and similar internal matters.

SHCP

The SHCP is the regulator in charge of proposing, conducting and controlling the economic policy of the Mexican government in matters of economics, tax, finance, public budget, public debt and income. Together with the CNBV and the Mexican Central Bank, it is the primary regulator of commercial banks and national development banks. The SHCP participates in the process of incorporation, revocation, operation, merger, control and stock purchase of

financial institutions, by providing opinions in each process.

CNBV

The CNBV is a governmental body subordinate to the SHCP, and has independent technical and executive powers. The CNBV is in charge of the supervision and regulation of financial entities, with the purpose of ensuring their stability and sound performance, as well as the maintenance of a safe and sound financial system. The scope of the CNBV's authority includes inspection, supervision, prevention and correction powers, including imposing and supervising capitalization requirements and requirements for the creation of loan-loss reserves. The primary financial entities regulated by the CNBV are commercial banks, national development banks, regulated multiple purpose financial institutions, brokerage firms, as well as publicly traded companies and other entities that have issued debt securities to the public. The CNBV is also in charge of granting and revoking banking, securities brokerage and fintech licenses in Mexico.

CONSAR

The CONSAR is a governmental body under the SHCP, and has independent technical and executive powers. The CONSAR was created in 1994 as part of a comprehensive reform of the retirement savings and pensions system, and is in charge of protecting the retirement savings of employees through the regulation and supervision of Afores, entities that manage independent retirement accounts, and *Siefores*, specialized pension funds. The CONSAR evaluates risks borne by the participants in the retirement savings system (*sistema de ahorro para el retiro*) and makes sure these participants are solvent and maintain adequate liquidity levels.

CNSF

The CNSF is a governmental body subordinate to the SHCP, and has independent technical and executive powers. The CNSF is in charge of the supervision and regulation of insurance and bonding companies, promoting the safe and sound development of the insurance and guaranty bond financial sectors.

IPAB

After the 1994 financial crisis, the Mexican government created the IPAB, an independent, decentralized governmental institution with its own legal standing and assets. The IPAB's primary purpose is the protection and insurance of bank deposits, having also powers to provide financial support to banking institutions, contributing to the safe and sound development of the banking sector and the national payments system. The IPAB is also entitled to acquire assets from distressed banking institutions.

CONDUSEF

The CONDUSEF is a governmental body subordinate to the SHCP. The CONDUSEF is in charge of protecting and defending the rights of users of financial services and serves as an arbitrator between financial institutions and their customers. Among other powers, CONDUSEF has the authority to order the amendment of standardized agreements used by financial entities when it considers that such agreements contain abusive clauses, it may issue general recommendations to financial institutions, and suspend the distribution of information regarding financial services and products that it considers confusing.

The History of the Banking Sector

Banking activities in Mexico have been and continue to be affected by prevailing conditions in the Mexican economy, and the demand for and supply of banking services have been vulnerable to economic downturns and changes in government policies. Prior to the early 1990s, lending by Mexican banks to the private sector had fallen to very low levels. It is estimated, however, that by the end of 1994, average total indebtedness of the private sector to Mexican commercial banks had grown to represent approximately 40.7% of Mexican GDP, with mortgage loans and credit card indebtedness generally growing faster than commercial loans. The devaluation of the Mexican Peso in December 1994 initiated a crisis, and the resulting high interest rates and contraction of the Mexican economy in

1995 severely impacted most borrowers' ability to both repay loans when due and meet debt service requirements. These effects, among others, caused an increase in the non-performing loan portfolio of Mexican financial institutions, particularly during 1995, which adversely affected the capitalization level of financial institutions. Also, increased domestic interest rates and the deteriorating value of the Peso made it more difficult for financial institutions to renew dollar-denominated certificates of deposit and credit lines.

From 1995 through the end of 1997, the CNBV had assumed or intervened in the operations of 13 banks and had adopted several measures designed to protect, stabilize and strengthen the Mexican banking sector. These measures included:

- creating a temporary capitalization program to assist banks;
- establishing a foreign exchange credit facility with the Mexican Central Bank to help banks with dollar liquidity problems;
- increasing the level of required loss reserves;
- establishing a temporary program for the reduction of interest rates on certain loans;
- establishing various programs to absorb a portion of debt service cost for mortgage loan debtors (including debt restructuring and conversion support programs); and
- broadening the ability of foreign and Mexican investors to participate in Mexican financial institutions.

Reforms to Mexican Banking Law

On January 10, 2014, several amendments to the Mexican Banking Law were published in the Official Gazette, and are currently in effect, with the following purposes:

Update capital requirements according to Basel III. The amendments to the Mexican Banking Law updated the capital requirements for banking institutions by incorporating the requirements of the Basel III accords, currently included in the General Rules Applicable to Mexican Banks. The amendments specify that net capital will be comprised of capital contributions, retained profits and capital reserves. The CNBV is authorized to allow or prevent the inclusion of other items to calculate a bank's net capital, subject to the terms and conditions of the general rules to be issued by CNBV to further regulate the capital requirements for bank institutions. We currently comply with applicable capitalization requirements.

Enhancing the CNBV supervisory practices. The reforms granted ample authority to the CNBV for the supervision of the financial entities under the Mexican Banking Law. The CNBV may perform visits to banks, with the aim to review, verify, test and evaluate the operations, processes, capitalization and loan classification, systems of internal control and risk management among others elements that may affect the financial position of banks.

Increasing requirements for the granting of loans to customers. For the granting of loans, banks are required to analyze and evaluate the viability of payment by borrowers or counterparties, relying on an analysis based on quantitative and qualitative information that allows establishing their creditworthiness and ability of timely payment of the loan. Banks must issue guidelines and lending process manuals and credit procedures shall be performed in accordance with such policies.

Establishing new provisions on transparency and reliability. Banks are required to publicly disclose their corporate, financial, administrative, operational, economic and legal information, as determined by the CNBV. Banks must post on their website and in a national newspaper their balance sheets and other relevant information periodically.

Establishing supervisory powers for external auditors. The CNBV has powers of inspection and surveillance with respect to entities that provide external audit services to banks, including those partners or employees who are part of the audit team, in order to verify the compliance with the Mexican Banking Law. The CNBV is allowed to:

- request any information and documentation related to the services rendered;
- practice inspection visits;
- require the attendance of partners, legal representatives and other employees; and
- issue audit procedures to be complied by the auditors, in connection with the tax opinions and practices performed by them.

Limited-purpose banks. The reform introduced limited-purpose banks (*bancos de nicho*), which can only engage in a limited amount of banking activities which are specifically set forth in their bylaws. The minimum required capital of limited-purpose banks can vary depending on the activities carried out by such entities, from a range of 90,000,000 UDIs to 36,000,000 UDIs. UDIs are *Unidades de Inversión*, a Peso-equivalent unit of account indexed to Mexican inflation.

Under the Financial Reform, the Mexican Congress approved additional changes to the Mexican Banking Law. Relevant changes include the following:

Participation of Foreign Governments. It clarifies the rules that require prior approval from the CNBV for the investment of foreign governments in commercial banks, in cases where foreign entities receive financial support or are rescued, when indirect investments are made or when control is acquired. Such intervention should be through official entities not exercising authority, and participation should be indirect and without control. The shareholding structure in broker-dealers, retirement fund administrators, insurance companies and mutual insurance companies, bonding companies, financial groups and credit information companies was also amended.

Capitalization Requirements. The concepts of “Minimum Basic Capital,” “Fundamental Capital” and “Capital Supplement” have been incorporated into the law. The law also provides for capital requirements, additions and restrictions, as well as asset disposal in cases where the entities with significant influence on banks are facing liquidity or solvency problems. It also entitles development banks to support banks should they require capitalization.

Limit on Transactions with Related Parties. The limit on the aggregate number of transactions with related parties has changed, which shall not exceed 35 percent of the net capital.

Liquidity Requirements. The amendments to the Mexican Banking Law grant authority to the CNBV to order adjustments to a bank’s accounting registries. If a bank fails to meet the liquidity requirements imposed by CNBV and the Mexican Central Bank, the CNBV may order the bank to adopt actions toward restoring the corresponding liquidity requirements, including suspending or partially limiting certain lending, borrowing or service operations of the bank, and requiring the bank to present a liquidity restoration plan.

Risk Control, Banking Resolutions and New Judicial Liquidation/Bank Bankruptcy Rules. The early warning, preventive and corrective action system changed. The Financial Reform provides for new rules in the event that the Mexican Central Bank acts as lender of last resort so that it requires collateral on the bank’s shares. It also introduces the obligation to have a plan of stress scenarios, contingency and resolution plans as well as participation in mock resolutions. It also has amended certain articles regarding the structure of bank resolutions, including new deadlines for exercising the right of audience prior to the revocation of the authorization to operate as a bank and includes a new scheme of judicial liquidation/bank bankruptcy, replacing the provisions of the Bankruptcy Act.

Self-Correcting Programs. The Mexican Banking Law and other financial laws state that the financial institutions may submit to the CNBV self-correcting programs when they detect defaults to the provisions regulating them, taking into consideration that irregularities detected by the CNBV or serious defaults or offenses may not be part of the self-correcting programs.

Transactions with Members of the Same Group or Consortium. New rules and limitations have been established. Transactions with members of the same group shall be agreed to on market terms.

Measures to Encourage Credit and Performance Evaluations. The SHCP is authorized to assess the performance of commercial banks regarding compliance with the support of the country's productive forces and the growth of the economy; the SHCP shall issue the relevant guidelines for such assessment. It also authorizes the CNBV to encourage the channeling of more resources to the productive sector by setting parameters on the execution of transactions with securities. The financial authorities shall take into account the results of the assessments to decide on the authorizations it will grant in general.

Administrative Offenses and Penalties. It significantly increases the number and severity of the sanctions, which are to be disclosed to the general public, although none are definitive or final. It also provides for sanctions for officials involved in transactions with related parties in excess of the statutory limits. Amendments to the administrative sanction system were made consistently in all financial laws amended by the Reform.

SHCP Blacklist. With respect to the prevention of transactions with funds from illegal sources and terrorist financing, it provides for the obligation to immediately suspend transactions with the persons included in the blacklist issued by the SHCP and the initiation of criminal proceedings against offenders. This obligation is also set for the other financial institutions in their respective laws.

Asymmetric Regulation. It authorizes the SHCP, the CNBV and the Mexican Central Bank to issue asymmetric regulation, *i.e.*, one that considers the regulatory burden in accordance with the size of each institution.

Exchange of Information with Foreign Financial Authorities. It regulates in more detail the procedure for the exchange of information with foreign authorities and verification visits.

On March 9, 2019, reforms to the Mexican Banking Law were published in the Official Gazette, with the following purposes: (i) allowing banking institutions to execute agreements with clients, through the use of the advanced electronic signature (*firma electronica avanzada*) and other digital authentication tools, pursuant to rules issued by the CNBV and (ii) allowing Fintech Institutions to be funded by the public without breaching the Mexican Banking Law.

Initiatives to Improve Creditors' Rights and Remedies

Mexico has enacted legislation to improve creditors' rights and remedies. These laws include collateral pledge mechanisms and a new bankruptcy law, which implies benefits for the Bank with respect to the operations and activities entered into with its clients.

Collateral Mechanisms

On June 13, 2002, the Mexican Commerce Code (*Código de Comercio*), the General Law of Negotiable Instruments and Credit Transactions (*Ley General de Títulos y Operaciones de Crédito*), the Mexican Securities Market Law, the Mexican Banking Law, the replaced Insurance Companies Law (*Ley General de Instituciones y Sociedades Mutualistas de Seguros*), the replaced Bonding Companies Law (*Ley Federal de Instituciones de Fianzas*) and the General Law of Ancillary Credit Organizations and Activities (*Ley General de Organizaciones y Actividades Auxiliares del Crédito*) were amended with the purpose of providing an improved legal framework for secured lending and, as a consequence, encourage banks to increase their lending activities. Among its provisions, the decree eliminated a prior non-recourse provision applicable to non-possessory pledges (which allowed the creation of a pledge over all the assets used in the main business activity of the debtor, but limited recourse to the applicable collateral) and collateral trusts, to allow creditors further recourse against debtors in the event that proceeds derived from the sale or foreclosure of collateral are insufficient to repay secured obligations; changes to these laws also permit the non-judicial foreclosure of collateral.

Laws regarding the perfection and enforcement of security interests include mechanism for pledging without transferring possession, as well as a common security device known in Mexico as the security trust. All personal property being used in a debtor's main business activity may be pledged, by making only a generic description of such property. The provisions regulating the security trust are similar to those governing pledges of personal property, except they provide that title to the collateral must be held by the trustee.

Also, for security pledges, there are provisions allowing the transfer of title to pledgee of the pledged assets, if agreed by the parties. Under the Mexican Securities Market Law, if the transfer of property over the pledged securities is agreed upon by the parties, the pledgee may apply the market value of the pledged securities to the payment of the corresponding obligation in the event of default, without requiring the enforcement of such pledge before a court.

Foreclosure of Securities Loans

The Mexican Congress also approved changes to the Commerce Code intended to expedite proceedings relating to the foreclosure of secured loans by financial institutions. These changes grant authority to Mexican courts to issue interim measures, such as ordering persons not to leave Mexico or ordering assets to be frozen.

Reforms to the Bankruptcy Law

The Mexican Bankruptcy Law (*Ley de Concursos Mercantiles*) was published in the Official Gazette on May 12, 2000, and since such date it has undergone several reforms, including those published in the Official Gazette on January 10, 2014. By virtue of such reforms, and pursuant to Article 245 of the Mexican Bankruptcy Law, the insolvency of Mexican banking institutions is subject to the provisions of the Mexican Banking Law.

The Mexican Bankruptcy Law provides for a single insolvency proceeding encompassing two successive phases: a conciliatory phase of mediation between creditors and debtor, and bankruptcy, which is only applicable to persons that carry out commercial activities, including individuals. The insolvency procedure applicable to persons that do not carry commercial activities, is regulated by the applicable Civil Code (*Código Civil*).

The Mexican Bankruptcy Law establishes precise rules that determine when a debtor is in general default in its payment obligations. The principal indications are failure by a debtor to comply with its payment obligations in respect of two or more creditors, and the existence of any of the following two conditions: **(i)** 35.0% or more of a debtor's outstanding liabilities are 30 days past due; or **(ii)** the debtor fails to have certain specifically defined liquid assets and receivables to cover at least 80.0% of its obligations which are due and payable.

Applicable law provides for the use and training of experts in the field of insolvency and the creation of an entity to coordinate their efforts. Such experts include the comptroller (*interventor*), conciliator (*conciliador*), who mediates between creditors and the bankrupt debtor, and receiver (*síndico*).

On the date the insolvency judgment is entered, all Peso-denominated obligations are converted into UDIs, and foreign currency-denominated obligations are converted into Pesos at the rate of exchange for that date and then converted into UDIs. Only creditors with a perfected security interest (i.e., mortgage, pledge or security trust) continue to accrue interest on their loans. The Mexican Bankruptcy Law mandates the netting of derivative transactions upon the declaration of insolvency.

The Mexican Bankruptcy Law provides for a general rule as to the period when transactions may be scrutinized by the judge to determine if they were entered into for fraudulent purposes, which is 270 calendar days prior to the judgment declaring insolvency, but which may be extended, at the request of creditors, if the bankruptcy hypotheticals were presented at a prior time. This period is referred to as the retroactivity period. Nevertheless, upon the reasoned request of the conciliator, the comptroller, who may be appointed by the creditors to oversee the process, or any creditor, the judge may set a longer period.

In December 2007, the Mexican Bankruptcy Law was amended to incorporate provisions relating to pre-agreed insolvency proceedings, frequently used in other jurisdictions that permit debtors and creditors to agree upon the terms of a restructuring and thereafter file, as a means to obtain the judicial recognition of a restructuring reached on an out-of-court basis. This also provides protection against dissident minority creditors.

The Mexican Congress also approved changes to Mexico's Bankruptcy Law, intended to improve the application of such law. Relevant changes include:

- the consolidation of bankruptcy proceedings affecting parent and subsidiary companies;

- the application of liquid assets provided as collateral, in connection with the netting and close out of derivative and similar contracts;
- setting forth an outside limit to bankruptcy restructuring (three years);
- permitting trustees and other creditor representatives, to submit claims on behalf of groups of creditors;
- expressly recognizing subordinated creditors, and deeming related party creditors as subordinated creditors; and
- making members of the Board of Directors liable to the bankrupt debtor if such member acted when affected by a conflict of interest, self-dealing and otherwise against the interests of the bankrupt debtor.

On January 2014, the Mexican Bankruptcy Law was further amended. Relevant changes include the following:

- First, the law introduces the concept of a statutory “subordinated creditor.” “Subordinated creditor” is defined to include an unsecured creditor who has the same board members as the bankrupt debtor, or which is controlled by the debtor or is under common control with the debtor.
- The amendment authorizes the debtor to enter into credit facilities (similar to debtor-in-possession financings), if it is indispensable to continue the operation of the debtor.
- The amendments provide that the automatic stay is not applicable with respect to collateral consisting of real property collateral, unless such real property is strictly indispensable for the operation of the debtor’s business.

Amendments to Financial Regulations Impacting Banks

The Mexican financial system has continued to advance in recent years, consistent with demands from regulators and market participants, developments in other jurisdictions and to address systemic issues resulting from the global financial crisis. In particular, in June 2007, a new Law for the Transparency and Ordering of Financial Services (*Ley para la Transparencia y Ordenamiento de los Servicios Financieros*) was approved, which granted the Mexican Central Bank authority to regulate interest rates and fees and the terms of disclosure of fees charged by banks to their customers.

Even though the recent global financial crisis did not affect Mexican banks directly, many Mexican corporations were affected, primarily by having engaged in foreign-currency linked derivative transactions, which increased exposures substantially as a result of the devaluation of the Peso, triggering a new regulation issued by the CNBV that seeks to improve disclosure standards as they relate to derivative transactions.

The Federal Law for Protection of Personal Data Held by Private Persons (*Ley Federal de Protección de Datos Personales en Posesión de Particulares*) that protects personal data collected by private individuals or entities was published on July 5, 2010 and is now fully effective along with its Regulations. Under such law, we are required to ensure the confidentiality of information received from clients. We have modified our processes, procedures and systems as required to implement this law and the supervision of our activities thereunder and as a means to obtain the consent of our customers prior to using any personal information provided by them. We may be subject to fines and penalties in the event of violations to the provisions of such law.

On January 9, 2015, the General Rules Applicable to Financial Entities and Other Entities that Provide Investment Services (*Disposiciones de Carácter General Aplicables a las Entidades Financieras y Demás Personas que Proporcionen Servicios de Inversión*) (the “Investment Services Rules”) were published in the Official Gazette. The purpose of the Investment Services Rules, among others, was to have a single body of rules applicable to brokerage firms, credit institutions and investment advisors, companies that operate mutual funds and companies or entities that distribute shares of mutual funds.

In accordance with the Investment Services Rules, banks and brokerage firms rendering advisory services in connection with investments shall ensure that any advice, recommendation or suggestion given to the client is reasonable for such client, and consistent with the client's investment profile.

The Investment Services Rules establish an obligation for banks and brokerage firms to create a committee which shall be responsible for the analysis of financial products offered by such entities, and whose members shall be independent from the structuring area of the relevant entity, or an equivalent institution or responsible person.

The Investment Services Rules also require the creation of an Analysis Committee. The Analysis Committee shall maintain minutes for each committee meeting held together with the relevant presentations, which documentation shall be kept by the entity and made available to the CNBV for at least five years.

The Analysis Committee shall approve each financial product offered, compensation of investment portfolios, guidelines in respect of the provision of services, and prior to its delivery, all information given to any client regarding any investment recommendation, which information shall include at least the prospectus or memorandum describing the relevant securities or offering.

The Investment Services Rules also provide that the board of directors of the relevant bank or brokerage firm shall approve the policies and guidelines required for each entity to:

- approve the terms and policies for such financial institutions to make the assessment of the client profile;
- carry out the analysis of the financial products to be offered to the clients; and
- comply with the evaluation of the "reasonableness" of recommendations, required to render advisory investment services.

Such policies and guidelines must be submitted to the CNBV within 10 days from its approval date, and the CNBV may order the relevant entity to incorporate corrections in order to make them consistent with the Investment Services Rules.

The Investment Services Rules provide that each bank and brokerage firm must appoint an officer to verify compliance of each firm with the Investment Services Rules.

Reforms to the Mexican Securities Market Law

Under the Financial Reform, the Mexican Congress approved additional changes to the Mexican Securities Market Law. Relevant changes include the following:

Offerings of Securities Abroad. The CNBV must be notified of any type of securities' offerings made outside of Mexico, in the case of securities issued by Mexican entities, even if the offerings are private.

Various Modifications to the Obligations Related to the Information of an Issuer. The CEO of the issuer shall be responsible for the content of the disclosed information, the material events and other information that must be disclosed to the public, based upon guidelines approved by the board of directors.

It also provides for tighter controls on persons having access to material non-public information, the publication of which is deferred. Persons related to the underwriter, persons providing independent or subordinated personal services to the issuer and third parties that have had contact with those who have access to material non-public information must be included in the list of persons who are considered to have access to privileged information, unless proven otherwise.

Finally, with respect to misleading information, disclosure of information that is prohibited by applicable law has been excluded as an omission of disclosure.

Capitalization Rules for Broker-Dealers. The capitalization of broker-dealers has been harmonized to that of the

banking institutions.

Liability of Underwriters. The liability structure of broker-dealers, who may be liable for damages and losses caused by breach of their obligations, has been extended.

Stock Pledge. It provides for modified rules for the application of payments of securities pledged, without any judicial proceeding, and permitting the transfer of title to pledged securities.

SUPERVISION AND REGULATION

The following is a summary of certain matters relating to the Mexican banking system, including provisions of Mexican law and regulations applicable to financial institutions in Mexico, and of certain matters related to the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act's regulation of derivatives. This summary is not intended to constitute a complete analysis of all laws and regulations applicable to financial institutions in Mexico or of U.S. regulations applicable to such financial institutions.

Introduction

Our operations are primarily regulated by the Mexican Banking Law and the rules and regulations issued by the SHCP, the CNBV, the Mexican Central Bank and the IPAB. The authorities that supervise us and our operations are the SHCP, the Mexican Central Bank, CONDUSEF and the CNBV.

Banking Regulation

The SHCP, either directly or through the CNBV, possesses broad regulatory powers over the banking system. Banks are required to report regularly to the financial regulatory authorities. Reports to bank regulators are often supplemented by periodic meetings, between senior management of the banks and senior officials of the CNBV. Banks must submit their unaudited monthly and quarterly and audited annual financial statements to the CNBV for review, and must publish on their website and in a national newspaper their unaudited quarterly balance sheets and audited annual balance sheets. The CNBV may correct, order a bank to correct, modify and, as precautionary measure, republish such balance sheets.

Additionally, each bank must publish on its website, among other information:

- the bank's basic consolidated and audited annual financial statements, together with a report containing the management's discussion and analysis of the financial statements and the bank's financial position, including any important changes thereto and a description of the bank's internal control systems;
- a description of the bank's Board of Directors, identifying independent and non-independent directors and including their respective resumes;
- a description and the total compensation and benefits paid to the members of the Board of Directors and senior officers during the past year;
- unaudited quarterly financial statements for the periods ending March, June and September of each year, together with the notes thereto;
- any information requested by the CNBV to approve the special accounting criteria, specific measures for loan-loss classifications and special registries;
- a detailed explanation of the main differences in the accounting standards used by the bank to prepare the financial statements;
- the credit rating of their portfolio;
- the capitalization level of the bank, its classification (as determined by the CNBV) and any modifications thereto;
- financial ratios;
- a brief summary of the resolutions adopted by any shareholders' meeting, debenture holders' meeting, or by holders of other securities or instruments; and
- the bank's bylaws.

The CNBV has the authority to impose sanctions for failure to comply with the provisions of the Mexican Banking Law, or the regulations issued thereunder. In addition, the Mexican Central Bank has authority to impose certain fines and administrative sanctions for failure to comply with the provisions of the Law of the Mexican Central Bank (*Ley del Banco de México*) and its regulations and the Law for the Transparency and Ordering of Financial Services, particularly as violations relate to interest rates, fees and the terms of disclosure of fees charged by banks to clients. Violations of specified provisions of the Mexican Banking Law are subject to administrative sanctions and criminal penalties.

The Mexican Banking Law permits foreign governments to acquire equity securities of Mexican banks, on a temporary basis in connection with rescue or similar packages, which was not possible in the past, and to acquire control of Mexican banks and indirect acquisitions, with the prior approval of the CNBV.

Mexican banks are now required to expense carefully, through their Boards of Directors, compensation payable to officers and, for that purpose, will be required to observe general rules to be issued by the CNBV and to establish and maintain a compensation committee.

Changes approved by the Mexican Congress clarify capitalization requirements, causes for revocation of a license and terms pursuant to which the Mexican government may provide assistance to troubled Mexican banks.

The amended Mexican Banking Law includes a provision for self-correcting irregularities detected by Mexican banks, arising from non-compliance with applicable law. Programs for self-correction are required to be approved by the Board of Directors of the applicable Mexican bank and must be supervised by the bank's audit committee. General rules implementing the provisions are expected to be issued by the CNBV.

Provisions were added to the Mexican Banking Law, in connection with the dissolutions and liquidation of Mexican banks facing liquidity or solvency problems. A Mexican bank may only be dissolved and liquidated, if the CNBV has issued a determination to that effect. Prior to such dissolution and liquidation, the IPAB may provide temporary financial assistance to Mexican banks having liquidity problems. The Mexican Banking Law now includes a specific procedure for the dissolution and liquidation of Mexican banks.

Non-viable Mexican banks will be liquidated pursuant to a procedure set forth in the Mexican Banking Law, under which the IPAB will act as liquidator, will conduct the procedures necessary to collect fees and pay creditors (respective parties specified under the Mexican Banking Law) and will take all measures conducive to the bank's liquidations. The Mexican Banking Law now reflects certain provisions that were regulated by the Mexican Bankruptcy Law, as they relate to the dissolutions and liquidation of Mexican banks. Liquidation proceedings may be conducted in-court or out of court, depending upon the circumstances affecting the relevant Mexican bank.

Licensing of Banks

An authorization of the Mexican government is required to be organized and to conduct banking activities. The CNBV, with the approval of its Governing Board and subject to the prior favorable opinion of the Mexican Central Bank, has the power to authorize the establishment of new banks, subject to minimum capital standards, among other things. Approval of the CNBV is also required prior to opening, closing or relocating offices, including branches outside of Mexico or transfer of assets or liabilities between branches.

Intervention

The CNBV, with the approval of its Governing Board, may declare the managerial intervention (*intervención*) of a banking institution pursuant to Articles 129 through 141 of the Mexican Banking Law (a "CNBV Intervention"). In addition, the Governing Board of the IPAB may also appoint a peremptory manager (*administrador cautelar*) if the IPAB provides liquidity, in accordance with applicable law, to a banking institution.

A CNBV Intervention pursuant to Articles 129 through 141 of the Mexican Banking Law will only occur when:

- during a calendar month, any of the Capital Ratios of a bank is reduced from a level equal to or above the minimum Capital Ratios required under the Mexican Capitalization Requirements, to 50% or less than such minimum Capital Ratios;
- the banking institution does not comply with the minimum Capital Ratios required under the Mexican Banking Law and it does not submit itself to the conditional operation regime under Article 29 Bis 2 of the Mexican Banking Law; or
- the banking institution defaults with respect to any of the following payment obligations:
 - in the case of obligations in an amount greater than 20,000,000 UDIs or its equivalent: **(1)** loans granted by other banking institutions, foreign financial institutions or Mexican Central Bank, or **(2)** payments of principal or interest on securities issued, that have been deposited with a clearing system; and
 - in the case of obligations in an amount greater than 2,000,000 UDIs or its equivalent, if during two business days or more, **(1)** it does not pay its obligations with one or more participants in clearing systems or central counterparts or does not pay three or more checks for a total amount of two million UDIs, that have been excluded from a clearinghouse for causes attributable to the drawee institution in terms of the applicable provisions, or **(2)** it does not pay in two or more of its branches, banking deposits claimed by 100 or more of its customers, could occur.

In addition, a CNBV Intervention may occur when the CNBV, in its sole discretion, determines the existence of irregularities that affect the stability or solvency of the bank or the public interest or the bank's creditors.

The peremptory manager will be appointed by the IPAB, if the IPAB has granted extraordinary financial support to a bank in accordance with the Mexican Banking Law. The peremptory manager appointed by the IPAB will assume the authority of the Board of Directors and the shareholders. The peremptory manager will have the authority to represent and manage with the broadest powers under Mexican law, will prepare and submit to the IPAB the bank's budget (for approval), will be authorized the contract liabilities, make investments, undertake acquisitions or dispositions and incur expenses, is authorized to hire and fire personnel and may suspend operations. The appointment of the peremptory manager must be registered in the Public Registry of Commerce of the corresponding domicile.

Revocation of a License; Payment of Guaranteed Obligations

Revocation of Banking License. In the case that the CNBV revokes a license to be organized and operate as a banking institution, the IPAB's Governing Board will determine the manner under which the corresponding banking institution shall be liquidated in accordance with Articles 165 through 220 of the Mexican Banking Law. In such a case, the IPAB's Governing Board may determine to carry out the liquidation through any or a combination of the following transactions:

- transfer the liabilities and assets of the banking institution in liquidation to another banking institution directly or indirectly through a trust set up for such purposes;
- constitute, organize and manage a new banking institution owned and operated directly by the IPAB with the exclusive purpose of transferring the liabilities and assets of the banking institution in liquidation; or
- any other alternative that may be determined within the limits and conditions provided by the Mexican Banking Law that the IPAB considers as the best and least expensive option to protect the interests of bank depositors.

As described above, amendments to the Mexican Banking Law approved by the Mexican Congress will substitute these provisions.

Causes to Revoke a Banking License. The abovementioned amendments significantly expanded the events upon

which the CNBV may revoke a banking license. The following are among the most relevant events:

- if the bank does not start operations within the term of thirty days as from the notification of such authorization;
- if the banking institution is dissolved or initiates liquidation according to the procedure in the Mexican Banking Law;
- if the banking institution:
 - does not comply with any minimum corrective measures ordered by the CNBV pursuant to Article 122 of the Mexican Banking Law;
 - does not comply with any special corrective measure ordered by the CNBV pursuant to such Article 122; or
 - consistently does not comply with an additional special corrective measure ordered by the CNBV;
- if the banking institution does not comply with the minimum Capital Ratios required under the Mexican Banking Law and the Mexican Capitalization Requirements;
- if the banking institution defaults with respect to any of the following payment obligations:
 - in the case of obligations in an amount greater than 20,000,000 UDIs or its equivalent: (1) loans granted by other banking institutions, foreign financial institutions or Mexican Central Bank, or (2) payments of principal or interest on securities issued, that have been deposited with a clearing system; and
 - in the case of obligations in an amount greater than 2,000,000 UDIs or its equivalent, if during two business days or more, (1) it does not pay its obligations with one or more participants in clearing systems or central counterparts, or (2) it does not pay in two or more of its branches, banking deposits claimed by 100 or more of its customers; or
- if the assets of the banking institution are insufficient to meet its liabilities.

Upon publication of the resolution of the CNBV revoking a banking license in the Official Gazette and in two newspapers of wide distribution in Mexico and registration of such resolution with the corresponding Public Registry of Commerce, the relevant banking institution will be dissolved and liquidation will be initiated. Upon liquidation of a banking institution, the IPAB shall proceed to make payment of all “guaranteed obligations” of the relevant banking institution, in compliance with the terms and conditions set forth by the Mexican Banking Law, other than those “guaranteed obligations” that have been actually transferred pursuant to article 186 of the Mexican Banking Law.

Obligations of a banking institution in liquidation that are not considered “guaranteed obligations” pursuant to the Banking Deposit Insurance Law (*Ley de Protección al Ahorro Bancario*) (“IPAB Law”), and that are not effectively transferred out of the insolvent banking institution, will be treated as follows:

- term obligations will become due (including interest accrued);
- unpaid principal amounts, interest and other amounts due in respect of unsecured obligations denominated in Pesos or UDIs will cease to accrue interest;
- unpaid principal amounts, interest and other amounts due in respect of unsecured obligations denominated in foreign currencies, regardless of their place of payment, will cease to accrue interest and will be converted into Pesos at the prevailing exchange rate determined by the Mexican Central Bank;

- secured liabilities, regardless of their place of payment will continue to be denominated in the agreed currency, and will continue to accrue ordinary interest, up to an amount of principal and interest equal to the value of the assets securing such obligations;
- obligations subject to a condition precedent, shall be deemed unconditional;
- obligations subject to a condition subsequent, shall be deemed as if the condition had occurred, and the relevant parties will have no obligation to return the benefits received during the period in which the obligation subsisted; and
- derivatives, repurchase transactions and securities loans will be early terminated and netted after two business days following the publication of the resolution of the CNBV revoking a banking license in the Official Gazette and in two newspapers of wide distribution in Mexico.
- Liabilities owed by the banking institution in liquidation will be paid in the following order of preference:
 - liquid and enforceable labor liabilities;
 - secured liabilities;
 - tax liabilities;
 - liabilities to the IPAB, as a result of the partial payment of obligations of the banking institution supported by the IPAB in accordance with the Mexican Banking Law;
 - bank deposits, loans and other liabilities as provided by Article 46, Sections I and II of the Mexican Banking Law, to the extent not transferred to another banking institution, as well as any other liabilities in favor of the IPAB different from those referred to above;
 - any other liabilities (other than those referred to below);
 - preferred subordinated debentures;
 - non-preferred subordinated debentures (such as the Notes); and
 - the remaining amounts, if any, shall be distributed to stockholders.

Financial Support

Determination by the Banking Stability Committee. The BSC includes representatives of the SHCP, the Mexican Central Bank, the CNBV and the IPAB. In the case that the BSC determines that if a bank were to default on its payment obligations and such default may **(i)** generate, directly or indirectly, severe negative effects in one or more commercial banks or other financial entities, endangering their financial stability or solvency, and such circumstance may affect the stability or solvency of the financial system, or **(ii)** put in risk the operation of the payments' systems required for the development of the economic activity, then the BSC may determine, on a case-by-case basis, that a general percentage of all of the outstanding obligations of the troubled bank that are not considered "guaranteed obligations" under the IPAB Law and guaranteed obligations in amounts equal to or higher than the amount set forth under Article 11 of the IPAB Law (400,000 UDIs per person per entity), be paid as a means to avoid the occurrence of any of such circumstances. Notwithstanding the foregoing, under no circumstance may the transactions referred to in Sections II, IV and V of Article 10 of the IPAB Law (which include transactions such as liabilities or deposits in favor of shareholders, members of the Board of Directors and certain senior officers, and certain illegal transactions) or the liabilities resulting from the issuance of subordinated debentures, be covered or paid by the IPAB or any other Mexican governmental agency.

Types of Financial Support. In the case that the BSC makes the determination referred to in the prior paragraph, then the IPAB's Governing Board will determine the manner according to which the troubled commercial bank will receive financial support, which may be through either of the options described below:

- If the BSC determines that the full amount of all of the outstanding liabilities of the relevant troubled bank (guaranteed and non-guaranteed) must be paid, then the financial support may be implemented through **(a)** capital contributions granted by the IPAB in accordance with Articles 151 through 155 of the Mexican Banking Law, or **(b)** credit support granted by the IPAB also in accordance with Articles 156 through 164 of the Mexican Banking Law, and in either case the CNBV shall refrain from revoking the banking license granted to such commercial bank.
- If the BSC determines that less than the full amount of all the outstanding liabilities of the troubled commercial bank (guaranteed and non-guaranteed) must be paid, then the support will consist of the payment of the general percentage of outstanding obligations of the relevant troubled banking institution in determined by the BSC, in terms of article 198 of the Mexican Banking Law, or transferring the assets and liabilities of such bank to a third party, as set forth in Articles 194 or 197 of the Mexican Banking Law.

Conditional Management Regime. As an alternative to revoking the banking license, the relevant bank may request, with the prior approval of its shareholders, the application of a conditional management regime. The conditional management regime may be requested when any of the Capital Ratios of the relevant bank is below the minimum required pursuant to the Mexican Capitalization Requirements. In order to qualify for such regime, the relevant commercial bank should **(i)** deliver to the CNBV a plan for the reconstitution of its capital, and **(ii)** transfer at least 75% of its shares to an irrevocable trust.

Banking institutions that fail to meet the minimum core capital required by the Mexican Capitalization Requirements may not adopt the conditional management regime.

Bank Liquidation Process

According to the amendments to the Mexican Banking Law, enacted on January 10, 2014, upon publication of the resolution of the CNBV revoking a banking license, in the Official Gazette and two newspapers of wide distribution in Mexico and registration of such resolution with the corresponding Public Registry of Commerce, the relevant banking institution will be dissolved and liquidation will be initiated, in terms of the procedure set forth in the Mexican Banking Law. The IPAB will be appointed liquidator of the banking institution.

In the event that the banking license is revoked because the assets of the relevant bank are insufficient to meet its liabilities, the IPAB shall undertake the liquidation procedure before a competent Federal court, according to the terms and conditions provided for a court liquidation (*liquidación judicial*) procedure under the Mexican Banking Law, in substitution of the *concurso mercantil* under the Mexican Bankruptcy Law. Moreover, the IPAB will be appointed as receiver (*liquidador judicial*) for purposes of the court liquidation procedure.

The IPAB will carry out the creditors' identification process. The IPAB must also comply with the following preference for the payment of the banking institution's debts: first, secured creditors; second, labor obligations; third, debts with a special privilege provided by statute; fourth, the unpaid balance with respect to the deposits insured by the IPAB and thereafter, payments shall be made in the preference provided in article 241 of the Mexican Banking Law, noting that the last debts to be paid are subordinated preferred and non-preferred obligations.

Capitalization

The minimum subscribed and paid-in capital for banks is set in accordance with three different components: credit risk, market risk and operational risk. Pursuant to the Mexican Banking Law and the General Rules Applicable to Mexican Banks, banks may participate in any of the activities and render the services as provided under Article 46 of the Mexican Banking Law, as well as those permitted under other laws.

In accordance with the capitalization rules in effect on the date of this offering memorandum, the minimum equity capital required for banks that engage in all banking activities under the Mexican Banking Law (such as Banorte) is 90,000,000 UDIs (approximately Ps.584,925,660 million as of March 31, 2020).

The Mexican Capitalization Requirements set forth the methodology to determine the net capital (*capital neto*) relative to market risk, risk-weighted assets incurred in its operation, and operations risk, which may not be less than the capital required in respect of each type of risk. The Mexican Capitalization Requirements set forth the methodology to determine the net capital relative to market risk, risk-weighted assets and operations risk. Under the relevant regulations, the CNBV may impose additional capital requirements. The Mexican Capitalization Requirements provide capitalization standards for Mexican banks similar to international capitalization standards, particularly with respect to the recommendations of the Basel Committee which includes the supervisory authorities of twelve major industrial countries.

Adoption of Basel III Standards in Mexico

On July 26, 2010, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee, reached a broad agreement on the overall design of a capital and liquidity reform package for internationally active banking organizations around the world, known as Basel III, which includes, among other things, the definition of capital, the treatment of counterparty credit risk, the leverage ratio and the global liquidity standard. On September 12, 2010, the Basel Committee announced a substantial strengthening of existing capital requirements in connection with Basel III. The full text of the Basel III rules and the results of a quantitative impact study to determine the effects of the reforms on banking organizations were published on December 16, 2010.

On November 28, 2012, the CNBV published an amendment to the Mexican Banking Regulations anticipating the adoption of Basel III guidelines. Most aspects of the new set of rules became effective on January 1, 2013, while others will be phased until the year 2022. The new regulation aims to, among others: **(i)** strengthen the composition of the net capital of banking institutions under Basel III guidelines, and **(ii)** allow certain securities issued by commercial banks to have the ability to absorb losses incurred by these institutions when submitting a detriment in their capital, either through a conversion into their shares or by the loss of the agreed value at the time of issuance in order to be recognized as part of the net capital of such institutions.

Among other changes, the amendments to the General Rules Applicable to Mexican Banks implementing the Basel III rules include the following:

Quality and level of capital. Greater focus on common equity and Fundamental Capital. The minimum Fundamental Capital was raised to 4.5% of risk-weighted assets, after deductions.

Capital loss absorption at the point of non-viability. Contractual terms of capital instruments include a clause that allows – at the discretion of the relevant authority – write-off or conversion to common shares if the bank is judged to be non-viable. This principle increases the contribution of the private sector to resolving future banking crises.

Capital conservation buffer. Banks shall constitute a Capital Supplement of 2.5% of the risk-weighted assets, bringing the total minimum Fundamental Capital standard to 7%. Constraint on a bank's discretionary distributions will be imposed when banks fall into the buffer range. On April 8, 2020, the CNBV announced that banks could disregard their Capital Conservation Buffer from April 1, 2020 to March 31, 2021, without penalty in response to the COVID-19 pandemic. See "Summary—Recent Developments—Measures Adopted by the Mexican Government in Connection with the COVID-19."

Countercyclical buffer. This buffer is imposed within a range of 0-2% comprising Fundamental Capital, when the CNBV judges that a credit growth is resulting from an unacceptable build-up of systemic risk, and is based on the credit activities carried by the financial institution in foreign markets.

Pursuant to the General Rules Applicable to Mexican Banks, this capital supplement is calculated taking into consideration the financing activities performed by banks in different jurisdictions.

Systemically Important Domestic Banks. D-SIBs must have higher loss absorbency capacity to reflect the greater risks that they pose to the domestic financial system. The additional loss absorbency requirements are to be met with a progressive Fundamental Capital requirement ranging from 0.60% to 2.25%, depending on a bank's systemic importance.

The General Rules Applicable to Mexican Banks, currently specify that Mexican banks may be classified in several categories based on their Total Net Capital ratio, Tier 1 Capital and Fundamental Capital. The relevant corrective measures applicable to us are determined based on the following classifications.

Fundamental Capital or CET1 (CCF)	Tier 1 Capital (CCB)	Net Capital Ratio (ICAP)				
		≥ 10.5% + CBF	≥ 8.0%	≥ 7.0% + CBF	≥ 4.5%	< 4.5%
≥ 7% + CBF	≥ 8.5% + CBF	I	II			
	≥ 7% + CBF	II	II	III		
≥ 4.5%	≥ 8.5% + CBF	II	II			
	≥ 6%	II	II	III	IV	
	≥ 4.5%	III	III	IV	IV	
< 4.5%						V

Where:

ICAP = Net Capital Ratio (*Índice de Capitalización*)

CCB = Tier 1 Capital Ratio (*Coeficiente de Capital Básico*)

CCF = Fundamental Capital Ratio (*Coeficiente de Capital Básico Fundamental*)

CBF = Capital Supplements (Systemically Important Bank Capital Supplement + Countercyclical Capital Supplement)

This table is based upon the tables set forth in Article 220 of the General Rules Applicable to Mexican Banks, which should be consulted for a complete understanding of the applicable requirements, including in relation to the applicable Capital Supplements to be constituted by the Bank.

Furthermore, the General Rules Applicable to Mexican Banks provide that:

- The Total Net Capital will include a Tier 1 Capital (*capital básico*) and a Tier 2 Capital (*capital complementario*). The minimum Total Net Capital ratio required for each bank shall be equal to 10.5%, including the Capital Conservation Buffer (or 8%, but subject to certain corrective measures);

- The Tier 1 Capital shall include:
 - a Tier 1 Capital ratio of at least 6%;
 - a Fundamental Capital coefficient of at least 4.5%; and
 - **(a)** a capital conservation buffer equivalent to 2.5% of the Risk-Weighted Assets, **(b)** in case of D-SIBs, the Systemically Important Bank Capital Supplement, and **(c)** the Countercyclical Capital Supplement.
- The Tier 1 Capital of the Total Net Capital will be divided into a Fundamental Capital (*capital básico fundamental*) and a Non-Core Tier 1 Capital (*capital básico no fundamental*).

For clarification purposes, Tier 1 Capital refers to the basic portion (*parte básica*) of Total Net Capital, as such term is defined in the General Rules Applicable to Mexican Banks. Tier 1 Capital is comprised of the two components of basic capital (*capital básico fundamental* and *capital básico no fundamental*) as such terms are defined in the General Rules Applicable to Mexican Banks. Fundamental Capital (*capital básico fundamental*) means only the amount of the fundamental capital as such term is defined in the General Rules Applicable to Mexican Banks. Non-Fundamental Capital (*capital básico no fundamental*) means the non-fundamental basic capital as such term is defined in the General Rules Applicable to Mexican Banks. Tier 2 Capital refers to the additional portion (*parte complementaria*) of Total Net Capital, as such term is defined in the General Rules Applicable to Mexican Banks.

The General Rules Applicable to Mexican Banks require banks to maintain a Total Net Capital ratio of at least 10.5%, including the Capital Conservation Buffer, to avoid the imposition of corrective measures notwithstanding that the minimum required Total Net Capital ratio is 8%.

Total Net Capital consists of Tier 1 Capital (which, in turn, consists of Fundamental Capital and Non-Fundamental Capital) and Tier 2 Capital. The Mexican Capitalization Requirements include among the Core Equity Tier 1 Capital, mainly, paid-in capital, which represents the most subordinated right to collect in case of liquidation of a credit institution, which are not due and do not grant reimbursement rights, profits (mainly including retained profits), and capital reserves, and subtract from such Fundamental Capital, among other things, certain subordinated debt instruments, issued by financial and non-financial entities, securities representing residual parts of portfolio securitization, investments in the equity of venture-capital funds and investments in or credits to related companies, reserves pending creation, loans and other transactions that contravene applicable law, and intangibles (including goodwill). Non-Fundamental Capital is comprised of preferential shares, regarding which the issuer has the right to cancel the dividend payments, and subordinated debt instruments, which are not subject to a due date or forced conversion, regarding which it is possible to cancel the interest payments and which may become shares of a credit institution or a controlling entity or are subject to cancellation (when capitalization problems arise).

Tier 2 Capital comprises capitalization instruments, as long as such capitalization instruments are registered with the RNV, are subordinated to deposits and any other debt of the credit institution, do not have any specific guarantee, have a term of at least five years and may be convertible into shares at their maturity date or are subject of write-down procedures. These instruments shall be included as capital based on their maturity date: 100% of the outstanding amount of the instruments if the due date exceeds five years, 80% if the due date exceeds four years but is less than five years, 60% if the due date exceeds three years but is less than four years, 40% if the due date exceeds two years but is less than three years, 20% if the due date exceeds one year but is less than two years, and 0% if the due date is less than one year.

Every Mexican bank must create certain legal reserves (*fondo de reserva de capital*), that are considered to be part of Tier 1 Capital. Banks must separate and allocate 10.0% of their net income to such reserve each year until the legal reserve equals 100.0% of their paid-in capital (without adjustment for inflation). The remainder of net income, to the extent not distributed to shareholders as dividends, is added to the retained earnings account. Under Mexican law, dividends may not be paid out against the legal reserve.

In May 2016, given our status as a grade II D-SIB in Mexico, we were required by the CNBV to constitute a Systemically Important Bank Capital Supplement of 0.90%. In July 2018, the CNBV ratified this requirement,

confirmed the Bank as a grade II D-SIB and also ratified the requirement to implement an additional Countercyclical Capital Supplement, which we have estimated would correspond to 0.001%. These Capital Supplements were required to be constituted by the Bank in four equal parts in December of each year, on a cumulative basis, from December 31, 2016 through December 31, 2019. Given our strong capital base, our Capital Ratios as of March 31, 2020 are well above such Capital Supplement requirements.

As a result of the foregoing, and considering the Capital Supplements required to be implemented by the Bank during the four-year period from December 31, 2016 to December 31, 2019, the minimum Capital Ratios applicable to the Bank as of the date hereof, to remain classified as Class I pursuant to the Mexican Capitalization Requirements are as follows:

	Commencing December 31,			
	2016	2017	2018	2019
Minimum Capital Ratios				
Total Net Capital (<i>capital neto</i>).....	10.7%	11.0%	11.2%	11.4%
Tier 1 Capital (<i>capital básico</i>).....	8.7%	9.0%	9.2%	9.4%
Common Equity Tier 1 Capital (<i>capital básico fundamental</i>).....	7.2%	7.5%	7.7%	7.9%

As of March 31, 2020, the Bank's Capital Ratios were **(i)** 18.97% in the case of Total Net Capital, **(ii)** 17.86% in the case of Tier 1 Capital and **(iii)** 12.18% in the case of Fundamental Capital. Such ratios exceed the current regulatory requirements.

The Bank is currently classified as Class I and, as a result, it is not subject to any corrective measures.

Corrective Measures

The Mexican Banking Law and the General Rules Applicable to Mexican Banks establish the minimum corrective and special additional measures that banks must fulfill according to the category in which they were classified based on their capital. These corrective measures are designed to prevent and, when necessary, correct the operations of the banks that could negatively affect their solvency or financial stability. The CNBV is required to notify the relevant bank in writing of the corrective measures that it must observe, within five business days after Mexican Central Bank has notified the CNBV the capitalization ratio of the bank, as well as verify its compliance with the corrective measures imposed. Class I is exempted from any corrective measure, but for the remainder of the categories such corrective measures include:

For Class II:

- requiring the bank to:
 - inform the Board of Directors about the bank's classification, as well as the causes for the CNBV to make such classification, and submit a detailed report containing a comprehensive evaluation of the bank's financial situation, its level of compliance with the regulatory framework and the main indicators that reflect the degree of stability and solvency of the bank, within 20 business days after the bank has received the CNBV notification of the corrective measure;
 - include in such report the causes of the weakening of their Capitalization Ratio and the Tier 1 Capital and Tier 2 Capital;
 - include in such report any observations mandated, in accordance with their respective scope of authority, by each of the CNBV and the Mexican Central Bank;
 - report in writing the financial situation to the chief executive officer and chairman of the board of directors of the bank or the board of directors of the bank's holding company, in the event the bank is part of a financial group;

- abstain from entering transactions that will cause its Capitalization Ratio to be lower than required under the Capitalization Requirements;
- abstain from increasing the current amounts of the financings granted to relevant related parties; and
- submit for approval to the CNBV, a plan for capital restoration which has as a result an increase of its Capitalization Ratio in order for the institution to be placed in Class I.

Such plan shall be presented to the CNBV no later than 20 business days after the date the bank receives the CNBV notification of the corrective measure.

In addition to the corrective measures applicable to Class II, for Class III and above:

- requiring the bank's Board of Directors to:
 - within 15 business days as of the notice of its classification, submit to the CNBV, for its approval, a plan for capital restoration that will result in an increase in its Capitalization Ratio, which may contemplate a program for improvement in operational efficiency, streamlining costs and increasing profitability, the carrying out of contributions to the capital and limits to the operations that the banks may carry out in compliance with their bylaws, or to the risks derived from such operations. The capital restoration plan shall be approved by such bank's board of directors before being presented to the CNBV. The bank shall determine in the capital restoration plan that, in accordance with this subsection, it must submit, periodic targets, as well as the date in which the capital of such bank will get the capitalization level required in accordance with the applicable provisions. The CNBV, through its governing board, must resolve all that corresponds to the capital restoration plan that has been presented to them, in a maximum of 60 calendar days from the date the plan was submitted; and
 - comply with the plan within the period specified by the CNBV, which in no case may exceed 270 calendar days starting the day after the bank was notified of the respective approval. To determine the period for the completion of the restoration plan, the CNBV shall take into consideration the bank's category, its financial situation, as well as the general conditions prevailing in the financial market. The CNBV, by agreement of its governing board, may extend the deadline once by a period that will not exceed 90 calendar days. The CNBV will monitor and verify compliance with the capital restoration plan, without prejudice of the provenance of other corrective measures depending on the category in which the corresponding bank is classified;
- requiring the bank to:
 - suspend any payment of dividends to its shareholders, as well as any mechanism or act that involves the transfer of any economic benefits to the shareholders. If the bank belongs to the holding company, the measure provided in this subsection will apply to the holding company to which the bank belongs, as well as the financial entities or companies that are part of such holding company. This restriction on the payment of dividends for entities that are part of the same financial group will not apply in the event the dividend is being applied to the capitalization of the bank;
 - requiring the bank to suspend any capital stock repurchase programs of the bank and, in the event that the bank belongs to a financial group, also the programs of the holding company of such group;
 - requiring the bank to defer or cancel the interest payments on outstanding subordinated debt and, when applicable, defer the payment of the principal or exchange the debt into shares of the bank in the amount necessary to cover the capital deficiency, in advance and proportionately, according to the nature of such obligations. This corrective measure will be applicable to those obligations that are identified as subordinated debt in their indenture or issuance document;
 - requiring the bank to suspend payment of any extraordinary benefits and bonuses that are not a

component of the ordinary salary of the chief executive officer or any officer within the next two levels, as well as not granting any new benefits in the future for the chief executive officer and the officers until the bank complies with the minimum levels of capitalization required by the CNBV;

- requiring the bank to refrain from increasing outstanding amounts of any credit granted to any individual who is a related party; and

In addition to the corrective measures applicable to Class II and III, for Class IV and above:

- refraining from making new investments on non-financial assets, opening branches or performing activities other than those made in the ordinary course of business.

In addition to the minimum corrective measures, the CNBV may order the implementation of additional and special corrective measures for banks with a classification from II to V. The additional and special corrective measures that, if applicable, the banks must comply with are:

- define the concrete actions that it will carry out in order not to deteriorate its Capitalization Ratio;
- inform the chief executive officer of the foreign holding company about the bank's classification, as well as the causes that caused the CNBV to make such classification, and submit a detailed report containing a comprehensive evaluation of the bank's financial situation, its level of compliance with the regulatory framework and the main indicators that reflect the degree of stability and solvency of the bank, within 20 business days after the bank has received the CNBV notification of the corrective measure, only in case of banks owned by foreign financial groups;
- hire the services of external auditors or any other specialized third party for special audits on specific issues;
- refrain from agreeing to increases in the salaries and benefits of the officers and employees in general, except for agreed salary revisions and in compliance with labor rights;
- substitute officers, members of the board or external auditors with appointed persons occupying the respective positions;
- undergo other actions or be subject to other limitations as determined by the CNBV, based on the result of its functions of monitoring and inspection, as well as with sound banking and financial practices; or
- refrain from entering into new agreements that may cause an increase on the Risk -Weighted Assets or may cause a higher deterioration on the Capitalization Ratio.

Reserve and Compulsory Deposit Requirements

The compulsory reserve requirement is one of the monetary policy instruments used as a mechanism to control the liquidity of the Mexican economy to reduce inflation. The objective of the Mexican Central Bank's monetary policy is to maintain the stability of the purchasing power of the Mexican Peso and in this context, to maintain a low inflation level. Given the historic inflation levels in Mexico, the efforts of the Mexican Central Bank have been directed towards a restrictive monetary policy.

Under this policy, the Mexican Central Bank has elected to maintain a short-term financial creditor stance with respect to the Mexican financial money markets, where every day, market commenced operations with a liquidity deficit which is then compensated by the Mexican Central Bank through daily operations in the money market to provide adequate liquidity and stability to those markets. The Mexican Central Bank's own experience has shown that its implementation of monetary policy is more effective if it starts from a deficit liquidity position at the beginning of each market day.

In order to manage its maturity exposures to the Mexican financial markets, the Mexican Central Bank has been

extending the maturities of its liabilities for longer terms to avoid the need for continuing refinancing of its liabilities. Those liabilities have been restructured into voluntary and compulsory deposits (*Depósitos de Regulación Monetaria*), and into investment securities such as longer-term government bonds (*Bondes*) and compulsory monetary regulatory bonds (*Brems*). At the same time, the Mexican Central Bank has elected to hold short-term assets, thus allowing it the ability readily to refinance its positions of assets and reduce its maturity exposure to the financial markets.

The Mexican Central Bank imposes reserve and compulsory deposit requirements on Mexican commercial banks. Bulletin 36/2008 published on August 1, 2008, stated that the total compulsory reserve deposit required of Mexican commercial banks was Ps.280.0 billion, which had to be deposited in eight installments by eight deposits of Ps.35.0 billion each on August 21 and 28; September 4, 11, 18 and 25; and October 2 and 9, 2008. The amount of the deposit that each bank had to make was determined based on each bank's pro rata share of total Mexican financial institution time deposits allocated as of May 31, 2008. Likewise, in addition to the compulsory reserve abovementioned, the Mexican Central Bank imposed an additional reserve and compulsory deposit requirement on Mexican commercial banks. Bulletin 11/2014 published on June 27, 2014, stated an additional compulsory reserve deposit of Ps.41.5 billion, which had to be deposited in four installments by four deposits of Ps.10.4 billion each on August 14; September 11, October 9 and November 6, 2014. The amount of the deposit that each bank had to make was determined based on each bank's pro rata share of total Mexican financial institution time deposits allocated as of May 31, 2014.

The compulsory deposit reserves required under the terms of the Bulletins 36/2008 and 11/2014 have an indefinite term. During the time these reserves are maintained on deposit with the Mexican Central Bank, each banking institution receives interest on such deposits every 28 days. The Mexican Central Bank will provide advance notice of the date and the procedure to withdraw the balance of these compulsory deposits at such time, if any, that the compulsory deposit reserves are suspended or terminated.

To promote the sound development of the financial system and improve monetary policies, on May 12, 2016, the Mexican Central Bank published in the Official Gazette the rules for auctions of *Bonos de Regulación Monetaria Reportables* ("**BREMS R**"), as an alternative for the banking institutions to comply with the compulsory deposit reserves (through the purchase of BREMS R). The BREMS R may only be acquired by Mexican banks, through auctions carried out by the Mexican Central Bank or through *reportos* (repurchase transactions). Thus, there is no secondary market for BREMS R. The BREMS R maintained by banking institutions may only be sold directly or through *reportos* to the Mexican Central Bank or to other banking institutions. Furthermore, on June 13, 2019, the Mexican Central Bank issued Bulletin 9/2019, allowing banking institutions to use its BREMS R to secure overdrafts (*sobregiros*) of their sole accounts (*cuenta única*) maintained with the Mexican Central Bank.

Classification of Loans and Allowance for Loan Losses

Non-performing 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 as 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 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 or subsequent 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 and 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.

Renewed loans in which the borrower has not paid on time or when the accrued interest balance equals at least 25% of the original loan amount are considered past-due until evidence of sustained payment is obtained.

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 discount or term extensions.

We regularly evaluate whether a past-due loan should remain in 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 Financial Group 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

The loan portfolio is classified according to the rules issued by the SHCP and the methodology established by the CNBV. Our internal methodology authorized by such CNBV may also be used. In the case of consumer mortgage and commercial loans, we apply the General Rules Applicable to Mexican Banks for rating the loan portfolio as issued by the CNBV and published in the Official Gazette on June 24, 2013.

On June 24, 2013, the CNBV 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 rating and calculating the allowance for each type of loan, where also allowing credit institutions to classify and calculate allowances based on internal methodologies, when previously approved by the CNBV.

The commercial loan portfolio rating procedure requires that 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, whereas 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 canceled 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.

On March 25, 2020, in order to mitigate the economic impact of the COVID-19 pandemic, the CNBV announced certain special temporary accounting criteria applicable to banks, including (i) the total or partial deferral of principal and/or interest payments by debtors of mortgages, credit cards, automobile, personal, payroll, and SME loans that were in good standing as of February 28, 2020, for up to four months (with the possibility to extend them for two additional months), and (ii) to freeze the balances of existing loans that were in good standing as of February 28, 2020, without interest charges; in each case, without considering such loans to be non-performing, and therefore, without requiring banks to create loan-loss provisions.

General Description of Rules Established by the CNBV

The rules for grading 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 default, loss given default and exposure to default are determined by considering the following:

Probability of Default

- For non-revolving consumer loans, the probability of default is determined based on the number of days past due, the payments made on outstanding balances, the loan to asset value ratio, the type of consumer loan and the term to maturity, among others.
- For revolving consumer loans, the probability of default is determined based on the current situation and historical behavior of the borrower regarding the number of past due payments, number of days past due, the payments made on outstanding balances, as well as the percentage of utilization of the authorized line of credit.
- For mortgage loans, the probability of default is determined based on the number of days past due, highest number of past due payments over the last four periods, the borrower's willingness to pay and the loan to asset value ratio.
- For commercial loans, the probability of default is determined based on the type of borrower, the borrower's historical payment behavior, payment history with Infonavit, rating agencies' evaluation, financial risk, social-economical risk, financial soundness, country and industry risk, market positioning, transparency, standards and corporate governance.

Loss Given Default

- For consumer loans (non-revolving and revolving), the loss given default is determined based on the number of past due payments.
- For mortgage loans, the loss given default is determined based on the outstanding balance of the mortgage loan, unemployment insurance and the state where the loan was granted.
- For commercial loans, the loss given default is determined based on the value of the financial and non-financial collateral securing the loan, as well as guarantees granted by the borrower.

Exposure at Default

- For non-revolving consumer loans, the exposure at default is determined based on the outstanding loan balance as of the grading date.
- For revolving consumer loans, the exposure at default is determined based on the current percentage of utilization of the authorized line of credit line, which is used to estimate how much such utilization would increase in the event of a default.
- For mortgage loans, the exposure at default is determined based on the outstanding loan balance as of the grading date.
- For commercial loans, the exposure at default **(i)** in the case of uncommitted lines of credit, it is determined based on the outstanding loan balance as of the grading date and **(ii)** in the case of committed lines of credit, it is determined based on the current percentage of utilization of the authorized line of credit, which is used to estimate how much such utilization would increase in the event of a default.

The CNBV'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.

Liquidity Requirements for Foreign Currency-Denominated Liabilities

Pursuant to regulations of the Mexican Central Bank, the total amount of maturity-adjusted (by applying a factor, depending upon the maturity of the relevant liability) net liabilities denominated or indexed to foreign currencies that Mexican banks, their subsidiaries or their foreign agencies or branches may maintain (calculated daily), is limited to 1.83 times the amount of their Tier 1 Capital. To calculate such limit, maturity-adjusted foreign currency-denominated or indexed assets (including liquid assets, assets with a maturity of less than one year, short-term derivatives and spot foreign exchange transactions) are subtracted from maturity-adjusted foreign currency-denominated or indexed liabilities, and the aforementioned factor is applied to the resulting amount.

The maturity-adjusted net liabilities of Mexican banks denominated or indexed to foreign currencies (including dollars) are subject to a liquidity coefficient (i.e., to maintaining sufficient foreign currency-denominated or indexed liquid assets). These permitted liquid assets include, among others:

- U.S. dollar-denominated cash or cash denominated in any other currency freely convertible;
- deposits with the Mexican Central Bank;
- treasury bills, treasury bonds and treasury notes issued by the United States government or debt certificates issued by agencies of the U.S. government, which have the unconditional guarantee of the U.S. government;

- demand deposits or one-day deposits or one- to seven-day deposits in foreign financial institutions rated at least P-2 by Moody's, or A-2 by S&P;
- investments in mutual or similar funds or companies approved by the Mexican Central Bank, that satisfy certain requirements; and
- unused lines of credit granted by foreign financial institutions rated at least P-2 by Moody's or A-2 by S&P, subject to certain requirements.

Such liquid assets may not be posted as collateral, lent or be subject to repurchase transactions or any other similar transactions that may limit their transferability.

On April 8, 2020, the Committee of Banking Liquidity Regulation issued a number of exceptions to the liquidity requirements applicable to banks, to foster the banks' capacity to continue lending in the midst of the COVID-19 pandemic. Among other things, these exceptions provide that: (i) banks can consider as liquid assets those assets that were eligible to be considered as such as of February 28, 2020, even if they would otherwise no longer be eligible as a result of the recent volatility in financial markets, (ii) banks can exclude the data corresponding to March 2020 from the calculation of liquidity reserves for potential margin calls or for changes in the valuation of derivative portfolios, and (iii) banks will be temporarily exempt from the application of certain corrective measures that would be applicable when their LCR falls below 100%. These temporary measures will be in place for a period of six months starting on February 28, 2020, which could be extended by additional six months. There is a risk that these measures may imply the deterioration in market position.

We comply with the applicable reserve requirement and liquidity coefficients in all material aspects.

Lending Limits

In accordance with the General Rules Applicable to Mexican Banks, limits relating to the diversification of a bank's lending transactions are determined in accordance with the bank's compliance with Mexican Capitalization Requirements. For a bank with:

- a Capitalization Ratio greater than 8.0% and up to 9.0%, the maximum financing exposure to a person or a group of persons representing common risk to the bank, is limited to 12.0% of the bank's Tier 1 Capital;
- a Capitalization Ratio greater than 9.0% and up to 10.0%, the maximum financing exposure to a person or a group of persons representing common risk to the bank is limited to 15.0% of the bank's Tier 1 Capital;
- a Capitalization Ratio greater than 10.0% and up to 12.0%, the maximum financing exposure to a person or a group of persons representing common risk to the bank is limited to 25.0% of the bank's Tier 1 Capital;
- a Capitalization Ratio greater than 12.0% and up to 15.0%, the maximum financing exposure to a person or a group of persons representing common risk to the bank is limited to 30.0% of the bank's Tier 1 Capital; and
- a Capitalization Ratio greater than 15.0%, the maximum financing exposure to a person or a group of persons representing common risk to the bank is limited to 40.0% of the bank's Tier 1 Capital.

These lending limits are required to be measured on a quarterly basis. The CNBV has discretion to reduce the aforementioned limits, if internal control systems or the risk management of the bank is inadequate.

The following financings are exempt from these lending limits:

- financings guaranteed by unconditional and irrevocable security interests or guarantees, that may be enforced immediately and without judicial action, granted by Mexican credit institutions or foreign financial institutions with investment grade ratings and established in a country member of the European Union or the Organization

for Economic Cooperation and Development (which guarantees must be accompanied with a legal opinion as to their enforceability);

- securities issued by the Mexican government and financings made to the Mexican government, Mexican local governments (subject to such financings being guaranteed by the right to receive certain Federal taxes), the Mexican Central Bank, the IPAB and development banks guaranteed by the Mexican government; and
- cash (transferred to the bank lender under a deposit that may be freely disposed of by the lender).

However, such financings may not exceed 100% of a bank's Tier 1 Capital.

Likewise, financings granted to Sofomes for which the bank owns at least 99% of its capital stock, are exempted from the aforementioned limits, but such financings may not exceed 100% of a bank's Tier 1 Capital. In turn, the controlled Sofomes maintain or grant financing (regardless of the origin of the resources) to a person or a group of persons representing common risk; such financing shall comply with the aforementioned limits.

The aggregate amount of financings granted to the three largest borrowers of a bank, may not exceed 100.0% of the bank's Tier 1 Capital.

Banks are not obligated to comply with the aforementioned limits with respect to financings granted to the Mexican federal government, local governments (subject to such financings being guaranteed by the right to receive certain Federal taxes), the Mexican Central Bank, the IPAB and development banks guaranteed by the Mexican government. The aforementioned guidelines do not apply to financings made to Mexican banks. The aggregate financings to Mexican banks and to government-controlled companies and decentralized agencies may not exceed 100.0% of such bank's Tier 1 Capital.

Banks are required to disclose, in the notes to their financial statements for Mexican Banking GAAP purposes, **(i)** the number and amount of financings that exceed 10.0% of Tier 1 Capital, and **(ii)** the aggregate amount of financings made to their three largest borrowers.

Funding Limits

In accordance with the General Rules Applicable to Mexican Banks, Mexican banks are required to diversify their funding risks. In particular, a Mexican bank is required to notify the CNBV, on the business day following the occurrence of the event, in the event it receives funds from a person or a group of persons acting in concert that represent in one or more funding transactions, more than 100% of such bank's Tier 1 Capital. None of our liabilities to a person or group of persons exceeds the 100% threshold.

Related Party Loans

Pursuant to the Mexican Banking Law, the total amount of the transactions with related parties may not exceed 35% of the bank's Tier 1 Capital. For the case of loans and revocable credits, only the disposed amount will be counted. See *“Related Party Transactions—Loans to Related Parties.”*

The General Rules Applicable to Mexican Banks establish that the aggregate amount of operations subject to credit risk relating to relevant related parties shall not exceed 25% of the bank's Tier 1 Capital corresponding to the immediately preceding month. If the amount exceeds 25%, then the excess must be subtracted in order to determine Tier 1 Capital.

Foreign Currency Transactions

The Mexican Central Bank regulations govern transactions by banks, denominated in foreign currencies. Mexican banks may, without any specific additional approval, engage in spot, foreign exchange transactions (i.e., transactions having a maturity not exceeding four business days). Other foreign currency transactions are deemed derivative transactions and require approvals as discussed below. At the end of each trading day, banks are generally obligated

to maintain a balanced foreign currency position (both in the aggregate and by currency). However, short and long positions are permitted in the aggregate, so long as such positions do not exceed 15% of a bank's Tier 1 Capital. In addition, Mexican banks must maintain certain minimum liquidity, prescribed by regulations issued by the Mexican Central Bank, in connection with maturities of obligations denominated in foreign currencies (see “—*Liquidity Requirements for Foreign Currency-Denominated Liabilities*”).

Derivative Transactions

The Mexican Central Bank has issued rules that apply to derivative transactions entered into by Mexican banks. Mexican banks are permitted to enter into swaps, credit derivatives, futures, forwards and options with respect to the following underlying assets:

- specific shares, groups of shares or securities referenced to shares that are listed in a securities exchange,
- stock exchange indexes,
- Mexican currency, foreign currencies and UDIs,
- inflation indexes,
- gold or silver,
- pork bellies, pork and cattle;
- wheat, corn, soybean and sugar,
- rice, sorghum, cotton, oats, coffee, orange juice, cocoa, barley, cattle, swine, milk, canola, soybean oil, and soybean paste, lean value hog carcasses, natural gas, heating oil, gasoline, gas oil, crude oil, aluminum, copper, nickel, platinum, lead and zinc,
- nominal or real interest rates with respect to any debt instrument,
- loans or other advances; and
- futures, forwards, options and swaps with respect to the underlying assets mentioned above.

Mexican banks require an express general approval, issued in writing by the Mexican Central Bank to enter into, as so-called intermediaries, derivative transactions, with respect to each class or type of derivative. Mexican banks that have not received the relevant general approval would require a specific approval from the Mexican Central Bank to enter into such derivative transactions (or even if in possession of such general approval, to enter into derivative transactions with underlying assets different from the assets specified above). Mexican banks may enter into credit derivatives, if expressly approved by the Mexican Central Bank; only Mexican banks, and no other financial institutions, may enter into credit derivatives (such as total return swaps and credit default swaps). Mexican banks may, however, enter into derivatives without the authorization of the Mexican Central Bank, if the exclusive purpose of such derivatives is to hedge the relevant bank's existing risks. Authorizations may be revoked if, among other things, the applicable Mexican bank fails to comply with Mexican Capitalization Requirements, does not timely comply with reporting requirements, or enters into transactions that contravene applicable law or sound market practices.

Banks that execute derivative transactions with related parties or with respect to underlying assets of which the issuer or debtor are related parties, shall comply with the corresponding limits set forth in the Mexican Banking Law in respect of related party transactions.

Institutions may collateralize derivative transactions through cash deposits, receivables and/or securities of its

portfolio. Derivative transactions that are entered into in over-the-counter (OTC) markets, may be collateralized only when the counterparties are credit institutions, brokerage firms, foreign financial institutions, mutual funds, pension fund managers, Sofomes, and any other counterparty authorized by the Mexican Central Bank. Mexican banks are required to periodically inform their Board of Directors with respect to the derivative transactions entered into, and whether or not the Mexican bank is in compliance with limits imposed by the Board of Directors and any applicable committee. Mexican banks must also inform the Mexican Central Bank periodically of derivative transactions entered into and whether any such transaction was entered into with a related party. The counterparties in respect of hedging derivatives transactions entered into by Mexican banks must be other Mexican banks, or Mexican financial entities authorized to enter into such derivatives by the Mexican Central Bank or foreign financial institutions or recognized markets. Derivatives must be entered into pursuant to master agreements that must include terms and guidelines, similar to international standards such as ISDA master agreements and master agreements approved for the domestic market. As an exception to applicable rules, Mexican banks may pledge cash, receivables and securities to secure obligations resulting from their derivative transactions.

We have received approval from the Mexican Central Bank to engage in swaps, forwards and options related to stocks, indices, currencies, interest rates and credit default swaps.

Repurchase Operations and Securities Lending

Under a circular issued by the Mexican Central Bank, Mexican banks may enter into repurchase operations with Mexican and foreign counterparts. Repurchase operations may be entered into in respect of bank securities, Mexican Government securities, debt securities registered with the CNBV and certain foreign securities. Repurchase operations must be entered into under master agreements, such as the master agreements of the International Securities Market Association and the Public Securities Association. Collateral may be provided in connection with repurchase operations.

Mexican Central Bank has also authorized Mexican banks to participate in securities lending activities on terms similar to those applicable to repurchase operations.

Limitations on Investments in Other Entities

Under the Financial Groups Law, subsidiaries of a financial services holding company may not directly or indirectly own capital stock of their own financial services holding company, unless they hold such stock as institutional investors under the Financial Groups Law. Institutional investors under the Financial Groups Law are insurance and bond companies that invest their technical reserves, investment funds and pension funds. In addition, members of a financial group may not extend credit in connection with the acquisition of their capital stock, the capital stock of their financial services holding company or the capital stock of other subsidiaries of their financial services holding company. Without the prior approval of the SHCP (which shall take into consideration the opinions of the Mexican Central Bank and the primary Mexican regulatory commission supervising the financial entity), members of a financial group may not accept as collateral shares of stock of Mexican financial institutions. Mexican banks may not acquire or receive as collateral, certain securities issued by other Mexican banks in authorization from the SHCP is required prior to acquisition of shares of capital stock of non-Mexican financial entities.

In addition, Mexican Banking Law imposes certain restrictions on investments by Mexican banks in equity securities of companies engaged in non-financial activities. Mexican banks may own equity capital in such companies in accordance with the following guidelines:

- up to 5.0% of the capital of such companies at any time;
- more than 5.0% and up to 15.0% of the capital of such companies for a period not to exceed three years, upon prior authorization of a majority of the members of each class of the bank's board of directors; and
- for higher percentages and for longer periods, or in companies engaged in new long-term projects or carrying out development related activities, with prior authorization of the CNBV.

The total of all such investments made by a bank may not exceed 30.0% of such Tier 1 Capital.

Restrictions on Liens and Guarantees

Under the Mexican Banking Law, banks are specifically prohibited from, among others: **(i)** pledging their properties as collateral (except when pledging collection rights or securities in transactions with the Mexican Central Bank, development banks, public federal trust and IPAB or if the CNBV so authorizes or as described above with respect to derivative transactions, securities, lending and repurchase transactions) and **(ii)** guaranteeing the obligations of third parties, except, generally, in connection with letters of credit and bankers' acceptances. Other exceptions include derivative transactions and repurchase transactions, subject to specific requirements.

Bank Secrecy Provisions; Credit Bureaus

Pursuant to the Mexican Banking Law, a Mexican bank may not provide any information relating to the identity of its customers or specific deposits, services or any other banking transactions (including loans) to any third parties (including any purchaser, underwriter or broker, or holder of any of the bank's securities), other than:

- the depositor, debtor, accountholder or beneficiary and their legal representatives or attorneys-in-fact;
- judicial authorities in trial proceedings in which the accountholder is a party or defendant;
- the Mexican federal tax authorities for tax purposes;
- the SHCP for purposes of the implementation of measures and procedures to prevent terrorism and money laundering;
- the Federal Auditor (*Auditoría Superior de la Federación*), to exercise its supervisory authority (including information on accounts or agreements involving federal public resources);
- the supervisory unit of the federal electoral agency (*Unidad de Fiscalización de los Recursos de los Partidos Políticos*);
- the Federal Attorney General's office (*Procuraduría General de la República*) for purposes of criminal proceedings;
- the Treasurer of the Federation (*Tesorería de la Federación*), as applicable, to request account statements and any other information regarding the personal accounts of public officers, assistants and, as the case may be, individuals related to the corresponding investigation; and
- the Secretary and undersecretaries of the Ministry of Interior (*Secretaría de la Función Pública*) when investigating or auditing the estates and assets of federal public officers, among others.

In most cases, the information needs to be requested through the CNBV. The CNBV is authorized to furnish foreign financial authorities with certain protected information under the Mexican bank secrecy laws, provided that an agreement must be in effect between the CNBV and such authority for the reciprocal exchange of information. The CNBV must abstain from furnishing information to foreign financial authorities if, in its sole discretion, such information may be used for purposes other than financial supervision, or by reason of public order, national security or any other cause set forth in the relevant agreement.

Banks and other financial entities are allowed to provide credit related information to duly authorized Mexican credit bureaus.

Money Laundering Regulations

Mexico has in effect rules relating to money laundering; the set of rules applicable to banking institutions have

been in effect since April 21, 2009 and have subsequently been amended (the “Money Laundering Rules”).

Under the Money Laundering Rules, we are required to satisfy various requirements, including:

- the establishment and implementation of procedures and policies, including client identification and know your customer policies, to prevent and detect actions, omissions or transactions that might favor, assist or cooperate in any manner with terrorism or money laundering activities (as defined in the Mexican Federal Criminal Code (*Código Penal Federal*));
- implementing procedures for detecting relevant, unusual and suspicious transactions (as defined in the Money Laundering Rules);
- reporting of relevant, unusual and suspicious transactions to the SHCP, through the CNBV; and
- the establishment of a communication and control committee (which, in turn, must appoint a compliance officer) in charge of, among other matters, supervising compliance with anti-money laundering provisions.

We are also required to organize and maintain a file before opening an account or entering into any kind of transaction, for the identification of each client (each, an “Identification File”).

An individual’s Identification File shall include, among other information, a copy of the following documentation or data (which must be maintained and updated): **(i)** full name, **(ii)** sex, **(iii)** date of birth, **(iv)** nationality and country of birth, **(v)** tax identification number and the certificate evidencing the tax identification number issued by the SHCP or the population registry identification number and evidence thereof issued by the Ministry of Interior, as the case may be, **(vi)** occupation, profession, main activity or line of business, **(vii)** complete domicile (including telephone number), **(viii)** e-mail address, if any, **(ix)** advanced electronic signature series number, when applicable, and **(x)** a copy of certain identification documents specified in the applicable regulations.

An entity’s Identification File shall include, among other information, a copy of the following documentation or data (which must be maintained and updated): **(i)** corporate name, **(ii)** domicile, **(iii)** nationality, **(iv)** name of the sole administrator, the members of the Board of Directors, the general manager or any relevant attorney-in-fact, **(v)** main activity or line of business, **(vi)** tax identification number and the certificate evidencing the tax identification number issued by the SHCP, **(vii)** advanced electronic signature series number, when applicable, **(viii)** copy of the public deed containing its constitutive documents, and **(ix)** a copy of certain identification documents specified in the applicable regulations.

Identification Files shall be maintained for the complete duration of the corresponding agreement entered into with such client, and for a minimum term of ten years from the date such agreement is terminated.

The Mexican Banking Law requires banks to have a manual for anti-money laundering procedures that is approved by the board of directors and certified by the CNBV. Identification Files may be shared with other financial entities part of the same financial group.

Under the Money Laundering Rules, we must provide to the SHCP, through the CNBV:

- quarterly reports (within ten business days from the end of each quarter) with respect to transactions equal to, or exceeding, U.S.\$10,000;
- monthly reports (within 15 business days from the end of the month) with respect to international funds transfers, received or sent by a client, with respect to transactions equal to, or exceeding, U.S.\$10,000;
- reports of unusual transactions, within 60 calendar days counted from the date an unusual transaction is detected by our systems; and

- periodic reports of suspicious transactions, within 60 calendar days counted from the date the suspicious transaction is detected.

In June 2010, the SHCP issued regulations, as amended in September and December 2010 and August 2011, restricting cash transactions denominated in U.S. dollars that may be entered into by Mexican banks. Pursuant to such regulations, Mexican banks are not permitted to receive physical cash amounts, in U.S. dollars, from individuals in excess of U.S.\$4,000 per month for deposits. Mexican banks are also not permitted to receive physical cash amounts, in U.S. dollars, from their corporate clients, except in very limited circumstances.

Also, Mexican banks are not permitted to receive physical cash amounts, in U.S. dollars, from individuals, in excess of U.S.\$300 per day for individual foreign exchange transactions. In each case, the monthly amount per individual for such transactions cannot exceed U.S.\$1,500.

In addition, the enacted regulations set forth certain reporting obligations for Mexican banks regarding their U.S. dollar cash transactions, to the SHCP (through the CNBV).

In October, 2012, the Federal Law to Prevent and Identify Transactions with Illegal Proceeds (*Ley Federal para la Prevención e Identificación de Operaciones con Recursos de Procedencia Ilícita*) was published in the Official Gazette of the Federation (the “Money Laundering Law”). The Money Laundering Law became effective on July 17, 2013. Under such law, the SHCP is given broad authority to obtain information about unlawful activities, coordinate activities with foreign authorities and present claims related to unlawful activities. This law also grants authority to the Federal Attorney General to investigate and prosecute illegal activities, in coordination with the SHCP. Pursuant to the law, we are required to satisfy the following requirements:

- the establishment and implementation of policies and procedures, including client identification and know your customer policies, to prevent and detect actions, omissions or transactions that might favor, assist or cooperate in any manner with terrorism or money laundering activities;
- the reporting of relevant, unusual and suspicious transactions to the SHCP, through the CNBV; and
- the maintenance of information and documentation regarding the client identification, as well as of relevant, unusual and suspicious transactions, for at least 10 years.

Additionally, pursuant to the Mexican Banking Law reforms published on the Official Gazette on January 10, 2014, the following sanctions were included, with the purpose of preventing and detecting operations that might encourage acts of terrorism:

- A fine of 10% to 100% of the amount of the activity, operation or service performed by an entity for a client or user the entity knows to be on the blocked persons list prepared by the SHCP;
- A fine of 10% to 100% of the amount of any unreported unusual transaction and, if applicable, any additional transactions related to same client or user involved in the unreported transaction;
- A fine of 30,000 to 100,000 days’ worth of the minimum wage applicable in Mexico for significant transactions or, if applicable, a series of related transactions involving international transfers and unreported transactions in cash undertaken in a foreign currency;
- A fine of 5,000 to 50,000 days’ worth of the minimum wage applicable in Mexico for other failures to comply with applicable law.

The amendments to the General Provisions on Money Laundering and Terrorist Financing published on the Official Gazette on April 25, 2014, September 12, 2014 and December 31, 2014, added the following obligations to the prevention of money laundering and terrorist financing:

- Provide the CNBV, through the Financial Intelligence Unit (*Unidad de Inteligencia Financiera*), within the first ten business days of January, April, July and October of each year, a report for each issuance or payment of cashier's checks carried out with its clients or users in the previous three months in an amount equal to or exceeding U.S.\$10,000.
- Inform the CNBV prior to, or simultaneously with, the sharing of information regarding money laundering and terrorist financing activities.
- Immediate cancellation of any transaction or service related to a client or user identified to be on the SHCP's blocked persons list and notification to the client that it has been included on such list.

Amendments to the regulation on money laundering prevention and financing of terrorism applicable to financial institutions

In March 2017, amendments to the General Provisions on Money Laundering Terrorism Financing were published in the Official Gazette. The following are the principal changes resulting from such amendments:

1. Implementation of a Risk-Based Approach

Banks must incorporate and implement methodology to carry out a risk assessment arising from their products, services, practices and information technologies. Such methodology must establish the processes for the identification, measurement and mitigation of risks, for which the identified risk factors must be taken into account, together with the national risk assessment and its respective updates conducted by SHCP, and communicated to the CNBV.

In the case of entities that are part of a financial group, like the Bank, the results of the methodology that, if applicable, has been implemented by the other entities that are part of the same financial group should be taken into account.

2. Identification of the shareholdings and corporate structure of clients that are legal entities

In respect of clients that are legal entities, information that identifies the following must be gathered in the identification file of the client: **(i)** shareholding structure and **(ii)** in the event that the client has a degree of risk other than "low," its internal corporate structure, which refers to the organizational chart of the client as a legal entity, taking into account at least the full name and position of those individuals who occupy the positions of CEO and the immediate lower positions, as well as the full name and corresponding position of each of the members of its board of directors or equivalent. Likewise, the beneficiaries (i.e., the individuals who benefit from an account, contract or transaction and are ultimately the owners) who have the control of the clients that are legal entities must be identified.

3. Threshold of Relevant Transactions

The threshold is modified in the definition of "relevant transaction" to include in such definition a transaction carried out with the bills and coins of legal tender in the United Mexican States or in any other country, as well as with traveler's checks, and coins minted in platinum, gold and silver for an amount equal to or greater than the equivalent in national currency at U.S.\$7,500. Previously, this threshold was U.S.\$10,000.

4. Terms for the submission of Unusual Transactions and Alarming Internal Transactions

For each unusual transaction identified by a bank, a corresponding report must be submitted to the SHCP through the CNBV within three business days from the conclusion of the determination that establishes such transaction as unusual. For purposes of carrying out such resolution, the bank, through the communication and control committee, will have a term that will not exceed 60 calendar days from the generation of the alert through the respective system, model, process, or by the employee of the bank, whichever occurs first.

5. Internal appointment of a Compliance Officer for a specific period

To be able to comply with the applicable provisions regarding the obligation to have, at all times, an officer who acts as a representative with authorities, it is possible to appoint an internal compliance officer in case the current officer in charge is revoked from his position or is unable to carry out his duties. The period for which the internal compliance officer may occupy the position shall be up to ninety calendar days in a calendar year.

6. Agreement for the exchange of information between Entities that belong to the same financial group

Financial entities that belong to the same financial group in accordance with the Financial Groups Law may exchange information with regard to the prevention of transactions with resources of illicit origin and financing of terrorism at a group level.

Financial entities have a maximum term of 45 calendar days counted from the implementation of the applicable resolution, in order to, at the latest within 270 calendar days, make the necessary adjustments to their systems and start to collect the client information according to the stated terms, submit their internal policies to the CNBV and comply with the rest of the imposed obligations.

Rules on Interest Rates

The Mexican Central Bank regulations limit the number of reference rates that may be used by Mexican banks as a basis for determining interest rates on loans. For Peso-denominated loans, banks may choose any of a fixed rate, the TIIE, Cetes rate, CCP (*costo de captación promedio a plazo*), the rate determined by the Mexican Central Bank as applied to loans funded by or discounted with NAFIN, the rate agreed upon with development banks in loans funded or discounted with them, the weighted bank funding rate (*tasa ponderada de fondeo interbancario*) and the weighted governmental funding rate (*tasa ponderada de fondeo gubernamental*). For UDI-denominated loans, the reference rate is the UDIBONOS. For foreign currency-denominated loans, banks may choose any of a fixed rate or floating market reference rates that are not unilaterally determined by a financial institution, including LIBOR or the rate agreed upon with international or national development banks or funds, for loans funded by or discounted with such banks or funds. For dollar-denominated loans, banks may choose either a fixed rate or any of the rates referred to in the prior sentence or CCP-Dollars, as calculated and published in the Official Gazette by the Mexican Central Bank.

On January 15, 2020, the Mexican Central Bank published Bulletin 1/2020, pursuant to which a new reference rate, denominated “*TIIE de Fondeo*,” which is a one-day reference rate, was established.

The rules also provide that only one reference rate can be used for each transaction and that no alternative reference rate is permitted, unless the selected reference rate is discontinued, in which event a substitute reference rate may be established. A rate, or the mechanism to determine a rate, may not be modified unilaterally by a bank. Rates must be calculated annually, based upon 360-day periods.

On November 11, 2010, the Mexican Central Bank published new rules that regulate the issuance and use of credit cards. Such rules standardize the regulations and forms that enable cardholders to authorize charges for recurrent payments relating to goods and services and standardize the procedures for objecting to improper charges and canceling such services quickly and securely. The rules also establish the way in which credit card issuers shall determine the amount of the minimum payment in each period by means of a formula that favors payment of a part of the principal at the time of each minimum payment, with the aim of achieving payment of debts within a reasonable time period. Such rules also include certain protection provisions for card users in case of theft or loss of their credit cards, the creation of incentives to credit card issuers to adopt additional measures to reduce risks derived from use of credit cards in internet transactions and the wrongful use of information contained in credit cards.

In June 2014, the Mexican Supreme Court of Justice issued jurisprudential guidance, of mandatory application, allowing federal judges to determine *ex officio* if an interest rate agreed on a promissory note is evidently excessive, violating an individual's human rights and, consequently, establish a reduced rate. The elements the judge should take into account to determine if a rate is evidently excessive are: **(a)** the type of relationship between the parties; **(b)** the qualification of the persons intervening in the subscription of the note and if the activity of the creditor is regulated;

(**c**) the purpose of the extension of credit; (**d**) the amount of the loan; (**e**) the term of the loan; (**f**) the existence of guaranties for the payment of the loan; (**g**) the interest rates applied by financial institutions in transactions similar to the one under analysis, as a mere reference; (**h**) the variation of NCPI during the term of the loan; (**i**) market conditions; and (**j**) other issues that the judge may deem relevant.

Fees

Under the Mexican Central Bank regulations, Mexican banks and Sofomes may not, in respect of loans, deposits or other forms of funding and services with their respective clients, among others:

- charge fees that are not included in their respective, publicly disclosed, aggregate annual cost (*costo anual total*);
- charge alternative fees, except if the fee charged is the lower fee; and
- charge fees for the cancellation of credit cards issued.
- In addition, among other things, Mexican banks may not:
 - charge simultaneous fees, in respect of demand deposits, for account management and relating to not maintaining minimum amounts;
 - charge fees for returned checks received for deposit in a deposit account or as payment for loans granted;
 - charge fees for cancellation of deposit accounts, debit or teller cards, or the use of electronic banking services; or
 - charge different fees depending upon the amount of a money transfer. Under the regulations, fees arising from the use of ATMs must be disclosed to users.

Mexican banks and Sofomes operating or permitting customers to use ATMs must choose between two options for charging fees to clients withdrawing cash or requesting balances: (**i**) specifying a fee for the relevant transactions, in which case, Mexican banks and Sofomes issuing credit or debit cards may not charge cardholders any additional fee (credit or debit card issuers are entitled to charge operators the respective fee), or (**ii**) permit credit card or debit card issuers to charge a fee to clients, in which case, banks and Sofomes may not charge additional fees to clients.

The Mexican Central Bank, on its own initiative or as per request from the CONDUSEF, banks or Sofomes, may assess whether reasonable competitive conditions exist in connection with fees charged by banks or Sofomes in performing financial operations. The Mexican Central Bank must obtain the opinion of the Mexican Antitrust Commission in carrying out this assessment. The Mexican Central Bank may take measures to address these issues.

On October 3, 2014, the Mexican Central Bank published a bulletin that modified the rules on ATM user fees which limited our ability to charge fees for the use of ATMs by customers and the amount of such fees for services including:

- cash withdrawals;
- checking account balances;
- account deposits; and
- credit payments, both in bank windows and ATMs operated by the clients' bank.

The bulletin also specifies that ATMs shall show a clear legend on their screens regarding costs of the transaction

so the client may decide whether to proceed with the transaction.

An initiative has been introduced to Congress seeking to further limit fees that may be charged by Mexican banks to consumers. No assurance may be given as to whether such initiative and commissions may be approved or the terms of such approval.

IPAB Law

The IPAB Law, which became effective January 20, 1999, provides for the creation, organization and functions of the IPAB, the bank savings protection agency. The IPAB is a decentralized public entity that regulates the financial support granted to banks for the protection of bank deposits. Only in exceptional cases may the IPAB grant financial support to banking institutions.

According to the IPAB Law, banks must provide the information required by the IPAB for the assessment of their financial situation and notify the IPAB about any event that could affect their financial stability. The IPAB Law expressly excludes the release of such data from bank secrecy provisions contained in the Mexican Banking Law and expressly provides that the IPAB and the CNBV can share information and databases of banks.

The IPAB is authorized to manage and sell the loans, rights, shares and any other assets that it acquires to perform its activity according to the IPAB Law, to maximize their recovery value. The IPAB must ensure that the sale of such assets is made through open and public procedures. The Mexican President is required to present annually a report to Congress prepared by the IPAB with a detailed account of the transactions conducted by the IPAB in the prior year.

The IPAB has a governing board of seven members:

- the Minister of Finance and Public Credit;
- the Governor of the Mexican Central Bank;
- the President of the CNBV; and
- four other members appointed by the President of Mexico, with the approval of two-thirds of the Senate.

The deposit insurance to be provided by the IPAB to a bank's depositors will be paid upon determination of liquidation of a bank. The IPAB will act as liquidator or receiver, or both, in the liquidation of banks, according to the Mexican Banking Law. The IPAB will guaranty obligations of banks to certain depositors and creditors (excluding, among others, financial institutions) only up to the amount of 400,000 UDIs per person per bank. The IPAB will not guarantee:

- deposits and loans constituting negotiable instruments and bearer promissory notes;
- liabilities for financial institutions or subsidiaries of the bank;
- liabilities not incurred in the ordinary course of business and related party transactions; or
- liabilities assumed in bad faith or in connection with money laundering or other illegal activities.

Banks have the obligation to pay the IPAB ordinary and extraordinary contributions as determined from time to time by the Governing Board of the IPAB. Under the IPAB Law, banks are required to make monthly ordinary contributions to the IPAB, equal to 1/12 of 0.4% multiplied by the average of the daily outstanding liabilities of the respective bank in a specific month, less:

- holdings of term bonds issued by other commercial banks;

- financing granted to other commercial banks;
- financing granted by the IPAB;
- subordinated debentures that are mandatorily convertible in shares representing the capital stock of the banking institution; and
- certain forward- operations.

The IPAB's Governing Board also has the authority to impose extraordinary contributions in the case that, given the conditions of the Mexican financial system, the IPAB does not have available sufficient funds to comply with its obligations. The determination of the extraordinary contributions is subject to the following limitations: **(i)** such extraordinary contributions may not exceed, on an annual basis, the amount equivalent to 0.3% multiplied by the total amount of the liabilities outstanding of the banking institutions that are subject to the IPAB contributions; and **(ii)** the aggregate amount of the ordinary and extraordinary contributions may not exceed, in any event, on an annual basis, an amount equivalent to 0.8% multiplied by the total amount of the liabilities outstanding of the applicable banking institution.

The Mexican Congress allocates funds to the IPAB on a yearly basis to manage and service the IPAB's liabilities. In emergency situations, the IPAB is authorized to incur additional financing every three years in an amount not to exceed 6.0% of the total liabilities of Mexican banks.

Limitations on Investments in Other Entities

The Mexican Banking Law imposes certain restrictions on investments by Mexican banks in equity securities of companies engaged in non-financial activities. Mexican banks may own equity capital in such companies in accordance with the following guidelines:

- up to 5.0% of the capital of such companies at any time, without any approval;
- more than 5.0% and up to 15.0% of the capital of such companies, for a period not to exceed three years, upon prior authorization of a majority of the members of the bank's Board of Directors; and
- higher percentages and for longer periods, or in companies engaged in new long-term projects or carrying out development related activities, whether directly or indirectly, with prior authorization of the CNBV.

The total of all such investments (divided considering investments in listed and in non-listed companies) made by a bank may not exceed 30.0% of such bank's Mexican Tier 1 Capital.

A Mexican bank requires the prior approval of the CNBV to invest in the capital stock of companies that render ancillary services to such bank and of companies that hold real estate where the offices of the applicable bank may be located.

Under the Mexican Banking Law, the approval of the CNBV is required prior to the merger of a commercial bank with any other entity taking into consideration the opinion of the Mexican Antitrust Commission and the favorable opinion of the Mexican Central Bank.

At the end of 2014, pursuant to the Mexican Financial Groups Law, the SHCP issued the General Rules for Financial Groups. These rules repealed the previous General Rules for the Incorporation and Operation of Financial Groups and provide the requirements for the operation of financial groups.

Law for the Protection and Defense of Financial Services Users

A Law for the Protection and Defense of Financial Services Users is in effect in Mexico. The purpose of this law is to protect and defend the rights and interests of users of financial services. To this end, the law provides for the

creation of CONDUSEF, an autonomous entity that protects the interests of users of financial services and that has very wide authority to protect users of financial services (including imposing fines). CONDUSEF acts as mediator and arbitrator in disputes submitted to its jurisdiction and seeks to promote better relationships among users of financial institutions and the financial institutions. As a banking institution, we must submit to CONDUSEF's jurisdiction in all conciliation proceedings (initial stages of a dispute) and may choose to submit to CONDUSEF's jurisdiction in all arbitration proceedings that may be brought before it. The law requires banks, such as us, to maintain an internal unit designated to resolve any and all controversies submitted by clients. We maintain such a unit.

CONDUSEF maintains a Registry of Financial Service Providers (*Registro de Prestadores de Servicios Financieros*), in which all financial services providers must be registered, that assists CONDUSEF in the performance of its activities. This Registry will be replaced as explained below. CONDUSEF is required to publicly disclose the products and services offered by financial service providers, including interest rates. To satisfy this duty, CONDUSEF has wide authority to request any and all necessary information from financial institutions. Furthermore, CONDUSEF may scrutinize banking services provided by approving and supervising the use of standard accession agreements.

We may be required to provide reserves against contingencies which could arise from proceedings pending before CONDUSEF. We may also be subject to recommendations by CONDUSEF regarding our standard agreements or information used to provide our services. We may be subject to coercive measures or sanctions imposed by CONDUSEF. As of the date of this offering memorandum, we are not the subject of any material proceedings before CONDUSEF.

As part of the financial reform being undertaken in Mexico in 2013, the Mexican Congress approved changes to the Law for the Protection and Defense of Financial Services Users pursuant to which, among other things:

- CONDUSEF is entitled to initiate class actions against Mexican financial institutions, in connection with events affecting groups of users of financial services;
- CONDUSEF shall maintain a new Bureau of Financial Entities (*Buró de Entidades Financieras*), which is to set forth any and all information deemed material for users of financial services;
- CONDUSEF is empowered to order amendments to any of the standard form commercial banking documentation (such as account and loan agreements) used by financial institutions, if it considers provisions thereof as detrimental to users;
- CONDUSEF is permitted to issue resolutions as part of arbitration proceedings, for the benefit of issuers, that would permit users to attach assets of a financial institution prior to the completion of arbitration proceedings; and
- CONDUSEF is given broader authority to fine financial institutions, if any such financial institution does not comply with an order issued by CONDUSEF.

Law for the Transparency and Ordering of Financial Services

The Law for the Transparency and Ordering of Financial Services regulates:

- the fees charged to clients of financial institutions for the use and/or acceptance of means of payment, as with debit cards, credit cards, checks and orders for the transfer of funds;
- the fees that financial institutions charge to each other for the use of any payment system;
- interest rates that may be charged to clients; and
- other aspects related to financial services, all in an effort to make financial services more transparent and protect the interests of the users of such services.

This law grants Mexican Central Bank the authority to regulate interest rates and fees and establish general guidelines and requirements relating to payment devices and credit card account statements (see “—*Rules on Interest Rates*” and “—*Fees*” above). The Mexican Central Bank has the authority to specify the basis upon which each bank must calculate its aggregate annual cost (*costo anual total*), which comprises interest rates and fees, on an aggregate basis, charged in respect of loans and other services. The aggregate annual cost must be publicly disclosed by each bank. The law also regulates the terms that banks must include in standard accession agreements and the terms of any publicity and of information provided in account statements. We must inform the Mexican Central Bank of any changes in fees at least 30 calendar days before they become effective.

As part of the financial reform passed in 2013, the Mexican Congress approved changes to the Law for the Transparency and Ordering of Financial Services pursuant to which the Mexican Central Bank may issue temporary regulations applicable to interest rates and fees, if it or the Mexican Federal Economic Competitive Commission determine that no reasonable competitive conditions exist among financial institutions. Also, the Mexican Central Bank and the CNBV are given authority to issue rules regulating the means to obtain funds (i.e., credit cards, debit cards, checks and funds transfers), as a means to ensure competition, free access, no discrimination and protecting the interests of users.

Law on Transparency and Development of Competition for Secured Credit

The Law on Transparency and Development of Competition for Secured Credit (*Ley de Transparencia y de Fomento a la Competencia en el Crédito Garantizado*) (“Secured Credit Law”) provides a legal framework for financial activities and certain other services performed by private credit institutions (as opposed to governmental entities) in connection with secured loans relating to real property in general and housing in particular (i.e., purchase, construction, restoration or refinancing). In particular, the Secured Credit Law established specific rules requiring the following:

- the disclosure of certain information by credit institutions to their clients prior to the execution of the relevant loan agreement, including the disclosure of certain terms relating to interest rates, aggregate costs and expenses payable;
- the compliance by credit institutions and borrowers with certain requirements in the application process;
- the binding effect of offers made by credit institutions granting secured loans;
- the inclusion of mandatory provisions in loan agreements; and
- the assumption of certain obligations by public officers (or notaries) before whom secured loans are granted.

In addition, the Secured Credit Law seeks to foster competition among credit institutions by permitting security interests underlying a secured loan to survive any refinancing thereof, even if such loans were granted by different credit institutions. This provision of the Secured Credit Law is designed to reduce expenditures made by borrowers.

Financial Groups Statutory Responsibility

The Financial Groups Law requires that each financial services holding company enter into an agreement with each of its financial services subsidiaries. GFNorte has entered into such an agreement with its financial services subsidiaries, which includes us. Pursuant to such agreement, the financial services holding company is responsible secondarily and without limitation for the satisfaction of the obligations undertaken by its subsidiaries as a result of the activities that each such subsidiary is authorized to conduct under the applicable laws and regulations, and is fully responsible for the losses of its subsidiaries, up to the total amount of the holding company’s assets. For such purposes, a subsidiary is deemed to have losses if its assets are insufficient to meet its payment obligations.

In the event of a financial services holding company’s statutory responsibility with respect to a bank, the IPAB must determine the amount of the preliminary losses of such bank. The financial services holding company is required to create a capital reserve for the amount of such losses. The financial services holding company is also required to

collateralize the payment of the bank's losses that are paid by the IPAB pursuant to the Mexican Banking Law. Such collateral may be created over the financial services holding company's assets or over such company's shares or those of its subsidiaries.

A financial services holding company is not allowed to pay any dividends or transfer any monetary benefit to its shareholders as of the date on which the IPAB determines the bank's losses, up to the date on which the financial services holding company has paid for the bank's losses.

No subsidiary is responsible for the losses of the financial services holding company or of the financial services holding company's subsidiaries.

Ownership Restrictions; Foreign Financial Affiliates

Ownership of a financial services holding company's capital stock is no longer limited to specified persons and entities under the Financial Groups Law and the group's corporate charter. Series F shares may be purchased, directly or indirectly, by foreign financial institutions who are residents of a country that has entered into a free trade agreement with Mexico and must represent at all times at least 51% of the paid-in capital.

Notwithstanding the above, under the Financial Groups Law, foreign governments cannot purchase a financial services holding company's capital stock, directly or indirectly, except:

- pursuant to preventive temporary measures, such as financial support or rescue programs;
- when control over such institution is held through official entities (such as funds or support governmental entities) and there is evidence that such entities do not exercise any authority functions and their decision making bodies operate separately from the relevant foreign government; and
- when the participation is indirect and does not imply the control by the relevant foreign government over the financial services holding company.

Mexican financial entities, including those that form part of a financial group, cannot purchase a financial services holding company's capital stock, unless such entities are qualified investors as defined in the Financial Groups Law. In accordance with applicable law:

- the capital of banks may be composed of voting Series O shares, which may be owned both by Mexican and non-Mexican investors, by Series F shares, which may be owned only by foreign financial institutions or Series B shares, which represent a minority interest in a bank controlled by a foreign financial institution and may be owned by Mexican or foreign investors;
- any transfer of shares representing more than 2% of the outstanding capital stock of a Mexican bank is required to be reported to the CNBV;
- the CNBV has been granted broader discretion to authorize the acquisition of more than 5% or 20% of the outstanding shares of a Mexican bank; and
- the composition of the boards of directors of Mexican banks has been limited to a total of 15 members and their alternates (as opposed to the former rule of 11 members or multiples thereof), 25% or more of whom must qualify as independent.

The change in foreign ownership rules continued the liberalization of the Mexican banking system commenced under NAFTA. Pursuant to the USMCA, the Free Trade Agreement between Mexico and the European Union, the Free Trade Agreement between Mexico and Japan, the Free Trade Agreement between Mexico and European Free Trade Zone and applicable Mexican laws and regulations, foreign financial entities incorporated in the United States, Canada, Member States of the European Union, Japan and other countries with which Mexico has executed relevant international trade agreements, or financial services holding companies formed in Mexico by such foreign financial

entities, will be treated identically to Mexican investors when investing in affiliate banks and other financial entities.

A holder that acquires shares in violation of the foregoing restrictions, or in violation of the percentage ownership restrictions, will have their corporate and economic rights under such shares suspended, and may not be enforced until the necessary authorizations have been obtained or the necessary requirements have been met, as required under the Financial Groups Law.

Other Regulation Applicable to our Business

Law on Financial Discipline for States and Municipalities

The Law of Financial Discipline of the Federative Entities and Municipalities (*Ley de Disciplina Financiera de las Entidades Federativas y los Municipios*) was promulgated on April 27, 2016, published in the Official Gazette with the purpose of supporting government entities by helping them obtain improved financing terms and conditions to foster growth and development without damaging public finances and continue endorsing state sovereignty and independence, through a transparent system, accountability, and efficient public spending leading to financial discipline for states and municipalities.

The law considers the following:

- Financial stability is considered the foundation for development and it should be observed when preparing and implementing the National Development Plan, and the states' and municipalities' plans.
- The Mexican Congress has the faculty to set the guidelines on how subnational governments should resort to financial debt and to issue laws on fiscal accountability aiming to manage finance adequately. Such guidelines will include the following concepts:
 - Limits and procedures for subnational governments to modify their contributions in order to secure their loans and meet their payment obligations;
 - The obligation to register and publish the total amount of loans and payment obligations in a single public registry, indicating, for each loan or obligation: debtor, creditor, amount, interest rate, maturity date, type of guaranty or source of payment, and any other information deemed necessary to enhance transparency and access to information;
 - The creation of a warning system on debt management;
 - Sanctions to government officials for improper management of public resources and public debt; and
 - Limits and requirements for contracting short-term liabilities which should be settled, at the latest, three months before the end of the government term.
- A bicameral commission (*comisión legislativa bicameral*) must be created, through which, the Congress will analyze the adjustment strategy made by the federal government in order to strengthen public finance for those states and municipalities with high indebtedness. Such states will be able to celebrate agreements with the federal government to obtain guarantees. The committee should be informed in the case such an agreement has been celebrated.
- Greater Tax Audit. The Superior Audit Office of Mexico ("SAO") will be in charge of auditing revenues, expenditures, debt and guarantees that the Federal Government grants in the form of states and municipalities loans. In the case of those states that have a guaranty from the Federation, the SAO will audit the fiscal year and the destination of the corresponding resources of the local governments. At the local level, the audit bodies from the state legislatures will be responsible for auditing the states and municipalities actions regarding funds, local resources and public debt.

- Accountability of government officers. State and municipality officers in office will be accountable for improper management of public resources and public debt.
- Destination of the loan and negotiation of agreements under the best market conditions. Subnational governments can only take on obligations or loans destined for productive public investment, refinancing or restructure; and these will be negotiated under the best market conditions. The Regulatory Act will establish the arrangements and conditions of the public debt that will be selected through a bidding process, as well as the mechanisms to ensure the market conditions or even better ones. Under no circumstances loans should be destined to cover current expenditure.
- Local congresses must authorize the debt under the following conditions:
 - By the vote of two thirds of its members.
 - Establishing a debt ceiling and ensuring negotiation of agreements under the best market conditions.
 - Previous analysis of the loan destination, ability to pay, the grant of guaranty and the source of payment.

The purpose of this law is to support government entities by helping them obtain improved financing terms and conditions to foster growth and development without damaging public finances and continue endorsing state sovereignty and independence, through a transparent system, accountability, and efficient public spending leading to a Financial Discipline for States and Municipalities.

Recent COVID-19 related and other Regulatory Developments

During 2020, the Mexican Central Bank has issued several new bulletins and reforms to bulletins, with implications and effects on the regulation of the operations and businesses of Mexican banking institutions, in connection with COVID-19, including:

- Bulletin 3/2020, modifying bulletin 8/2009, regarding auctions of dollar-denominated credits, pursuant to which an updated framework for the participation of banking institutions in such auctions was established.
- Bulletins 4/2020 and 15/2020, reforming bulletin 10/2015, regarding financing granted by the Mexican Central Bank to banking institutions requiring the coverage of additional liquidity needs, which softened the rules, requirements and procedures to access such financings by securing such short-term deposits with different eligible securities.
- Bulletin 7/2020, reforming 7/2014 regarding monetary regulation deposits, pursuant to which the total amount of the monetary regulation deposits to be maintained by the banking institutions was reduced by \$50,000 million.
- Bulletins 8/2020 and bulletin 14/2020, regarding interim measures for cashier operations (*operaciones de caja*) and corresponding banking cashier services (*corresponsalía de caja*) in connection with the COVID-19 pandemic.
- Bulletin 9/2020, regarding the interim measures applicable to the reporting obligations of banking institutions, in connection with the COVID-19 pandemic (exempting institutions that do not meet timely reporting requirements from sanctions).
- Exception rules issued by the Mexican Central Bank and the CNBV on April 14, 2020, regarding liquidity requirements for banking institutions set forth in the General Rules for Liquidity Requirements of Banking Institutions (*Disposiciones de Carácter General sobre los Requerimientos de Liquidez para las Instituciones de Banca Múltiple*). These exceptions permit the following: (i) assets that were eligible as liquid assets as of February 28, 2020, may continue to be considered as such, even if they would otherwise no longer be eligible as a result of the volatility in financial markets in recent weeks, and (ii) the liquidity reserves calculation for

potential margin calls and valuation changes of portfolios of derivatives may exclude data for March 2020. In addition, no corrective actions will be taken for financial institutions whose Liquidity Coverage Ratio (*Coefficiente de Cobertura de Liquidez*) falls below 100%. These temporary measures will be in place for six months starting on February 28, 2020 and could be extended by another six months.

- Bulletin 13/2020 and 22/2020, regarding interim measures with respect to the minimum payments applicable to loans associated to a credit card.
- Bulletin 16/2020, regarding the temporary facility for securities lending operations with the Mexican Central Bank, pursuant to which Mexican banks may exchange collateral held consisting of corporate debt for government securities (*Cetes and Bondes*).
- Bulletin 17/2020, regarding applicable rules to repo transactions with respect to Mexican government securities to cover liquidity needs.
- Bulletin 18/2020, regarding applicable rules to repo transactions with respect to corporate securities to cover liquidity needs.
- Bulletin 19/2020, regarding certain amendments to the rules applicable to banks, brokers (*casas de bolsa*), investment companies, Afores and rural financial institutions (*financiera rural*) in connection with their repo transactions, pursuant to which (i) the method for calculating adjustment factors was strengthened, in order to guarantee the net exposure of repo transactions, (ii) insurance and bonding companies and *Sofomes* with economic and patrimonial links to banks and general deposit warehouses (*almacenes generales de depósito*) were authorized to carry out repo transactions, and (iii) deposit certificates (*certificados de depósito*) issued by general bonded warehouses (*almacenes generales de depósito*) were added as market-representative titles, enabling such for repo transactions, and (iv) banks and brokers were authorized to carry out repo transactions on behalf of third parties.
- Bulletin 20/2020, regarding the rules applicable to the provision of financing to banks in order to channel credit to micro, small and medium enterprises.
- Bulletin 25/2020, regarding the rules applicable to loans of the Mexican Central Bank secured with credit assets of banks, for its channeling to micro, small and medium enterprises.
- Bulletin 26/2020, regarding amendments to the bulletin 8/2009 (rules applicable to actions of loans in Dollars).

In addition to the foregoing, the CNBV has issued a set of rules intending to address the effects of the COVID-19 pandemic:

- On March 25, 2020, the CNBV issued temporary special accounting principles applicable to financial institutions relating to the treatment of mortgages, automotive loans, personal loans, payroll loans, credit cards, microcredits and small and medium sized company loans. The temporary special accounting principles allow financial institutions (i) to permit borrowers to partially or fully defer principal and/or interest payments on their loans for a period of four months, with the possibility of extending such period for two additional months, and (ii) to freeze the balances of existing loans that were in good standing as of February 28, 2020, without interest charges, in each case without considering such loans to be non-performing. Financial institutions that take advantage of these temporary special accounting principles would not be required to constitute reserves for such loans. We have taken advantage of these temporary accounting principles and launched debtor relief programs to support individuals and small and medium-sized companies with qualifying loans under these CNBV principles;
- on March 31, 2020, the CNBV issued a recommendation that financial institutions abstain from paying dividends, repurchasing shares and granting other benefits to its shareholders for the fiscal years ended December 31, 2019 and 2020. The purpose is to enhance the financial position of financial institutions against potential losses due to the coronavirus pandemic and to ensure that the system has more resources to support the local economy. These measures are consistent with those taken by other central banks and

regulatory authorities around the world. More specifically, the recommendation establishes that financial institutions shall refrain from (i) paying dividends to their shareholders, as well as from implementing any other mechanism that results in a transfer of economic benefits to the shareholders or assuming the irrevocable commitment to pay them any such benefits with respect the fiscal years of 2019 and 2020, including the distribution of reserves, and (ii) repurchasing stock or implementing any other mechanism the intention of which is to compensate the shareholders. For financial institutions that are part of a larger financial group, the recommendation to refrain from paying dividends or implementing other similar mechanisms also applies to such institution's controlling entity, as well as its affiliates and other entities of the group; and

- on April 8, 2020, the CNBV issued a number of temporary regulatory flexibility measures aimed at ensuring that financial institutions are able to continue supplying credit to their customers in a high-volatility environment and mitigating the impact of the coronavirus pandemic on the local credit markets. The temporary measures will be effective from April 1, 2020 to March 31, 2021, and will allow financial institutions such as us to use their Capital Conservation Buffer of 2.5% without triggering any regulatory corrective measures.

Dodd-Frank Act and Regulation of Derivatives

Title VII of the U.S. Dodd-Frank Wall Street Reform and Consumer Protection Act) ("Dodd-Frank") establishes a new U.S. regulatory regime for derivatives contracts, including swaps, security-based swaps and mixed swaps (generically referred to in this paragraph as "swaps"). Among other things, Title VII provides the Commodity Futures Exchange Commission) (the "CFTC") and the SEC with jurisdiction and regulatory authority over swaps, establishes a comprehensive registration and regulatory framework applicable to swap dealers and other major market participants in swaps (referred to as "major swap participants"), imposes clearing and execution requirements on many types of swaps, requires higher-margin requirements for uncleared swaps, and requires swap market participants to report all swaps transactions to swap data repositories. Entities that are swap dealers, security-based swap dealers, major swap participants or major security-based swap participants will be required to register with the SEC or the CFTC, or both, and will become subject to requirements as to capital, business conduct, recordkeeping, collateral segregation, and other requirements. The specific parameters of these requirements are being developed through CFTC, SEC and bank regulator rulemakings. While some of these requirements are already final and effective, others are subject to further rulemaking or deferred compliance dates.

DESCRIPTION OF THE NOTES

Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte (the “Bank”), will issue its 8.375% Perpetual 10-Year Callable Subordinated Non-Preferred Non-Cumulative Tier 1 Capital Notes (the “Notes”) through its Cayman Islands branch (the “Branch”). The Notes will be issued under a *declaración unilateral de voluntad* evidenced by an Indenture to be dated as of July 14, 2020, executed by the Bank and The Bank of New York Mellon, as trustee, paying agent, registrar and transfer agent (the “Trustee”), and acknowledged by the Mexican National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*; the “CNBV”), which may be amended or supplemented from time to time (the “Indenture”), pursuant to Article 64 of the Law of Credit Institutions (*Ley de Instituciones de Crédito*) and Circular 3/2012 issued by the Mexican Central Bank (the “Circular 3/2012”), with the prior approval of the stockholders’ meeting of the Bank and the Mexican Central Bank.

This summary description of certain provisions of the Notes does not purport to be complete and is subject to, and is qualified in its entirety by reference to, all of the provisions of the Indenture and the Notes, including the definitions of certain terms included therein. The Bank urges you to read each of the Indenture and the forms of the Notes because they, and not this description, define your rights as a holder of Notes. In case of any conflict regarding the rights and obligations of the holders of the Notes under the Indenture, the Notes and this offering memorandum, the terms of the Indenture will prevail. In case of any conflict regarding the translation of the provisions of applicable Mexican law, the official text in Spanish of the relevant Mexican law will prevail. Capitalized terms not otherwise defined in this “*Description of the Notes*” have the meanings ascribed to them in the Indenture. You may obtain a copy of the Indenture and the forms of the Notes by contacting the Trustee at the address indicated in this offering memorandum.

The Notes are perpetual instruments with no fixed maturity or fixed redemption date. The Bank has the option to redeem the then Current Principal Amount (as defined below) of the Notes on October 14, 2030 and on every Interest Payment Date (as defined below) thereafter.

General

The Notes will be issued in the aggregate principal amount of U.S.\$500,000,000 in registered form, in minimum denominations of U.S.\$200,000 and integral multiples of U.S.\$1,000 in excess thereof. The Bank will issue the Notes through the Branch, but the Notes will represent the Bank’s general, unsecured and subordinated non-preferred obligations. The Notes constitute Subordinated Non-Preferred Indebtedness (as defined below) and will rank **(i)** subordinate and junior in right of payment and in liquidation to all of the Bank’s present and future Senior Indebtedness (as defined below) and Subordinated Preferred Indebtedness (as defined below), **(ii)** *pari passu* without preference among themselves and with all the Bank’s present and future other unsecured Subordinated Non-Preferred Indebtedness and **(iii)** senior only to all classes of the Bank’s equity or capital stock, as described in this offering memorandum. See “—*Subordination*.” The Bank may incur additional Senior Indebtedness, Subordinated Preferred Indebtedness and Subordinated Non-Preferred Indebtedness from time to time, and the provisions of the Indenture do not prohibit or limit the incurrence of additional indebtedness, including additional Senior Indebtedness, Subordinated Preferred Indebtedness and Subordinated Non-Preferred Indebtedness.

As of March 31, 2020, the Bank had approximately Ps.8,508 million (U.S.\$362 million) aggregate principal amount of outstanding Subordinated Preferred Indebtedness, and Ps.49,590 million (U.S.\$2,112 million) aggregate principal amount of outstanding Subordinated Non-Preferred Indebtedness.

THE NOTES WILL BE UNSECURED AND NOT GUARANTEED, OR OTHERWISE ELIGIBLE FOR REIMBURSEMENT, BY THE INSTITUTO PARA LA PROTECCIÓN AL AHORRO BANCARIO (THE “IPAB”) OR ANY OTHER MEXICAN GOVERNMENTAL AGENCY OR BY GRUPO FINANCIERO BANORTE, S.A.B. DE C.V. (“GRUPO FINANCIERO BANORTE”) OR BY ANY OF ITS SUBSIDIARIES OR AFFILIATES, OR ANY OTHER ENTITY THAT IS A PART OF GRUPO FINANCIERO BANORTE, INCLUDING ANY PAYMENT OBLIGATION UNDER THE CONVENIO ÚNICO DE RESPONSABILIDADES ENTERED AMONG GRUPO FINANCIERO BANORTE AND ITS FINANCIAL SUBSIDIARIES (INCLUDING THE BANK OR ANY OTHER THIRD PARTY). THE NOTES ARE NOT CONVERTIBLE, BY THEIR TERMS, INTO THE BANK’S SHARES OR EQUITY CAPITAL.

THE BANK MAY REDEEM THE NOTES UNDER THE CIRCUMSTANCES DESCRIBED BELOW UNDER “—REDEMPTION—OPTIONAL REDEMPTION,” “—REDEMPTION—WITHHOLDING TAX REDEMPTION” AND “—REDEMPTION—SPECIAL EVENT REDEMPTION”, IN EACH CASE WITH THE PRIOR APPROVAL OF BANCO DE MÉXICO. OTHER THAN IN ACCORDANCE WITH AN OPTIONAL REDEMPTION, A WITHHOLDING TAX REDEMPTION OR A SPECIAL EVENT REDEMPTION, THE NOTES WILL NOT BE REDEEMABLE.

Unless other arrangements are made, payments of principal and interest on the Notes will be made as described below under “—Book-Entry System.”

The Bank will maintain an office or agency in the Borough of Manhattan, The City of New York, where the Notes may be presented for exchange or transfer. Such office or agency initially will be located at The Bank of New York Mellon, 240 Greenwich Street, Floor 7-East, New York, NY 10286, Attention: Global Finance Americas. The holders of the Notes will not have to pay a service charge to register the transfer or exchange of any Notes, but the Bank may require that holders pay any applicable tax or other governmental charge.

The Indenture and the Notes do not contain any provision, of any nature whatsoever, that would protect the holders of the Notes against a sudden and dramatic decline in the Bank’s credit quality resulting from a takeover, recapitalization or restructuring or any other event involving the Bank that may adversely affect the Bank’s credit quality.

Interest

Subject to a prior redemption and/or one or more Write-Downs (as defined below), the Notes will bear interest on the then Current Principal Amount from time to time outstanding from and including July 14, 2020 (the “Issue Date”), to (but excluding) October 14, 2030 (the “First Call Date”), at an initial fixed rate *per annum* equal to 8.375%. Interest, to the extent paid, shall be paid from amounts maintained in the Bank’s net retained earnings (*utilidades netas acumuladas*) account. The First Call Date and every tenth anniversary thereafter shall each be a “Reset Date”. Subject to a prior redemption and/or one or more Write-Downs, the Notes will bear interest on the then Current Principal Amount from time to time outstanding from and including each Reset Date, including the First Call Date, to (but excluding) the next succeeding Reset Date, at a fixed rate *per annum* equal to the sum of **(a)** the Treasury Yield (as defined below) and **(b)** 776.0 basis points (rounded to two decimal places, with any value equal to or lesser than 0.005 being rounded down).

“Treasury Yield” means, as of any Reset Determination Date (as defined below), an interest rate (expressed as a decimal and, in the case of United States Treasury bills, converted to a bond equivalent yield) determined to be the *per annum* rate equal to the semiannual yield to maturity for United States Treasury securities maturing on the Reset Date following the next succeeding Reset Determination Date, and trading in the public securities markets either as determined by interpolation between the most recent weekly average yield to maturity for two series of United States Treasury securities trading in the public securities market, **(A)** one maturing as close as possible to, but earlier than, the Reset Date following the next succeeding Reset Determination Date, and **(B)** the other maturity as close as possible to, but later than the Reset Date following the next succeeding Reset Determination Date, in each case as published in the most recent H.15 (519) or, if a weekly average yield to maturity for United States Treasury securities maturing on the Reset Date following the next succeeding Reset Determination Date is published in the most recent H.15 (519), such weekly average yield to maturity as published in such H.15 (519).

“H.15 (519)” means the weekly statistical release designated as such, or any successor publication, published by the Board of Governors of the United States Federal Reserve System and most recent H.15 (519) means the H.15 (519) published closest in time but prior to the close of business on the third Business Day prior to the applicable Reset Date.

“Reset Determination Date” means, with respect to any Reset Date, the second Business Day immediately preceding such Reset Date.

“Current Principal Amount” means in respect of each Note, at any time, the outstanding principal amount of such

Note, being the Original Principal Amount (as defined below) of such Note, as such amount may be reduced, on one or more occasions, as a result of a Write-Down or a redemption of the Notes as permitted herein, as the case may be.

“Original Principal Amount” means, in respect of each Note, the amount of the denomination of such Note on the Issue Date.

Upon the occurrence of a Write-Down, any holder of Notes will be deemed to have irrevocably waived its right to claim or receive the Written-Down Principal (as defined below) of the Notes or any interest with respect thereto (or Additional Amounts), including any and all unpaid interest.

Subject to the provisions under “—*Interest Cancellation*” and “—*Trigger Event and Write-Down—Write-Down*,” from and including the Issue Date, interest on the Notes, if any, will be payable quarterly in arrears on October 14, January 14, April 14 and July 14 of each year (each an “Interest Payment Date”), commencing on October 14, 2020. The period beginning on and including the Issue Date and ending on but excluding the first Interest Payment Date and each successive period beginning on and including an Interest Payment Date and ending on but excluding the next succeeding Interest Payment Date, the First Call Date or an earlier redemption date, as the case may be, is called an “Interest Period”. If any Interest Payment Date would otherwise fall on a date that is not a Business Day (as defined below), the required payment of interest shall be made on the next succeeding Business Day, with the same force and effect as if made on such Interest Payment Date, and no further interest shall accrue as a result of the delay. Subject to the provisions described in this section, if an interest payment is to be made in respect of the Notes, on any scheduled redemption date that is not an Interest Payment Date, it shall be calculated by the Paying Agent by applying the interest rate as described above on the basis of a 360-day year of twelve 30-day months and rounding the resulting figure to the nearest cent (half a cent being rounded upward). Interest on the Notes will be paid on the dates specified above to the person in whose name a Note is registered at the close of business on the fifteenth day preceding the respective Interest Payment Date (such date, a “Record Date”, whether or not a Business Day).

For purposes hereof, the term Business Day is defined in the Indenture for the Notes as any day other than a Saturday or a Sunday, or a day on which banking institutions in The City of New York, New York or Mexico City, Mexico are authorized or required by law or executive order to remain closed.

Interest Cancellation

Interest Payments Discretionary and Non-Cumulative

Interest on the Notes will be due and payable at the Bank’s sole discretion and the Bank shall have sole and absolute discretion at all times and for any reason to cancel any interest payment (in whole or in part) that would otherwise be payable on any Interest Payment Date. Subject to the limitations set forth under “—*Restrictions on Certain Payments*” below, the Bank may use the funds corresponding to such canceled payments to meet the Bank’s other obligations as they become due or to be maintained by it to satisfy capitalization requirements under the Mexican Capitalization Requirements (as defined below) or for any other reason.

IF THE BANK ELECTS NOT TO MAKE AN INTEREST PAYMENT ON THE RELEVANT INTEREST PAYMENT DATE, OR IF THE BANK ELECTS TO MAKE A PAYMENT OF A PORTION, BUT NOT ALL, OF SUCH INTEREST PAYMENT, SUCH NON-PAYMENT SHALL EVIDENCE ITS EXERCISE OF DISCRETION TO CANCEL SUCH INTEREST PAYMENT, OR THE PORTION OF SUCH INTEREST PAYMENT NOT PAID, AND ACCORDINGLY SUCH INTEREST PAYMENT, OR PORTION THEREOF, SHALL BE CANCELED AND SHALL NOT BE OR BECOME DUE AND PAYABLE. FOR THE AVOIDANCE OF DOUBT, IF THE BANK PROVIDES NOTICE TO CANCEL A PORTION, BUT NOT ALL, OF AN INTEREST PAYMENT IN RESPECT OF THE NOTES, AND THE BANK SUBSEQUENTLY DOES NOT MAKE A PAYMENT OF THE REMAINING PORTION OF SUCH INTEREST PAYMENT ON THE RELEVANT INTEREST PAYMENT DATE, SUCH NON-PAYMENT WILL EVIDENCE THE BANK’S EXERCISE OF ITS DISCRETION TO CANCEL SUCH REMAINING PORTION OF SUCH INTEREST PAYMENT, AND ACCORDINGLY SUCH REMAINING PORTION OF THE INTEREST PAYMENT WILL ALSO NOT BE DUE AND PAYABLE.

SUCH CANCELED INTEREST SHALL NOT ACCUMULATE OR BE DUE AND PAYABLE AT ANYTIME

THEREAFTER AND THE HOLDERS AND THE BENEFICIAL OWNERS OF THE NOTES SHALL NOT HAVE ANY RIGHT TO OR CLAIM AGAINST THE BANK WITH RESPECT TO SUCH UNPAID INTEREST AMOUNT. ANY SUCH CANCELLATION OF ANY INTEREST PAYMENT SHALL NOT CONSTITUTE A DEFAULT OR AN ENFORCEMENT EVENT (AS DEFINED BELOW) UNDER THE TERMS OF THE NOTES OR THE INDENTURE AND THE HOLDERS AND BENEFICIAL OWNERS OF THE NOTES SHALL HAVE NO RIGHTS THERETO OR TO RECEIVE ANY ADDITIONAL INTEREST OR AMOUNTS, PENALTY OR COMPENSATION AS A RESULT OF SUCH CANCELLATION.

In addition, the Notes will cease to bear interest from, and including, the date of any redemption of the Notes as described under “—*Redemption*”, unless payment and performance of all amounts and obligations due by the Bank in respect of the Notes is not properly and duly made, in which event interest shall continue to accrue on the Notes until payment and performance of all amounts and obligations has been properly and duly made.

Furthermore, in the event of one or more Write-Downs of the Notes upon the occurrence of a Trigger Event (as defined below), as described under “—*Trigger Event and Write-Down—Write-Down*” below, any accrued but unpaid interest on the Notes shall be canceled upon the occurrence of such Trigger Event, and such interest shall not become due and payable at any time.

See also “—*Agreement to Interest Cancellation*” and “—*Notice of Interest Cancellation*” below.

Restrictions on Certain Payments

Unless the most recent payable interest and any Additional Amounts (as defined below) payable in connection therewith have been paid, the Bank shall not:

- (1) declare or pay any dividends or distributions on, or redeem, purchase, acquire, or make a liquidation payment with respect to, any of its capital stock; or
- (2) make any payment of premium, principal or interest on or repay, repurchase or redeem any other Subordinated Non-Preferred Indebtedness of the Bank.

Mandatory Cancellation of Interest Payments

INTEREST DUE ON THE NOTES FROM THE BANK WILL BE AUTOMATICALLY CANCELED IF (A) THE BANK IS CLASSIFIED AS CLASS II OR BELOW PURSUANT TO ARTICLES 121 AND 122 OF THE MEXICAN BANKING LAW (AS DEFINED BELOW) AND THE REGULATIONS THEREUNDER, WHICH SPECIFY CAPITALIZATION REQUIREMENTS, OR (B) AS A RESULT OF THE APPLICABLE PAYMENT OF INTEREST, THE BANK WOULD BE CLASSIFIED AS CLASS II OR BELOW (AN “INTEREST CANCELLATION EVENT”). CURRENTLY, THE MINIMUM CAPITAL RATIOS TO BE CLASSIFIED AS CLASS I (AND, AS A RESULT, NOT CLASS II OR BELOW), INCLUDING THE CAPITAL CONSERVATION BUFFER, ARE (I) 10.5% IN RESPECT OF TOTAL NET CAPITAL (CAPITAL NETO), (II) 8.5% IN THE CASE OF TIER 1 CAPITAL (CAPITAL BÁSICO) AND (III) 7.0% IN THE CASE OF FUNDAMENTAL CAPITAL (CAPITAL BÁSICO FUNDAMENTAL), PLUS IN EACH CASE, ANY OTHER APPLICABLE CAPITAL SUPPLEMENT (CURRENTLY, A SYSTEMICALLY IMPORTANT BANK CAPITAL SUPPLEMENT (AS DEFINED BELOW) FOR GRADE II DOMESTIC SYSTEMICALLY IMPORTANT BANKS OF 0.90% AND ANY COUNTERCYCLICAL CAPITAL SUPPLEMENT (AS DEFINED BELOW, AND TOGETHER WITH THE SYSTEMICALLY IMPORTANT BANK CAPITAL SUPPLEMENT, A “CAPITAL SUPPLEMENT”) APPLICABLE TO THE BANK).

IN THE EVENT OF A CANCELLATION OF THE PAYMENT OF INTEREST ON THE NOTES DUE TO THE OCCURRENCE OF AN INTEREST CANCELLATION EVENT, THE BANK WILL NOTIFY THE HOLDERS OF THE NOTES AND THE TRUSTEE IN ACCORDANCE WITH THE PROCEDURES DESCRIBED IN THE INDENTURE. FAILURE TO PROVIDE SUCH NOTICE WILL HAVE NO IMPACT ON THE EFFECTIVENESS OF, OR OTHERWISE INVALIDATE, ANY SUCH CANCELLATION OF INTEREST (AND ACCORDINGLY, SUCH INTEREST WILL NOT BE DUE AND PAYABLE), OR GIVE

THE HOLDERS AND BENEFICIAL OWNERS OF THE NOTES ANY RIGHTS. CANCELED INTEREST WILL NOT BE DUE AND PAYABLE. ANY SUCH CANCELLATION WILL NOT CONSTITUTE A DEFAULT OR AN ENFORCEMENT EVENT UNDER THE TERMS OF THE NOTES OR THE INDENTURE, AND THE HOLDERS AND BENEFICIAL OWNERS OF THE NOTES WILL NOT HAVE ANY RIGHT TO SUCH INTEREST OR TO RECEIVE ANY ADDITIONAL AMOUNTS OR COMPENSATION AS A RESULT OF SUCH CANCELLATION. PAYMENTS OF INTEREST DUE ON THE NOTES WILL NOT BE CUMULATIVE, SO THAT IN THE EVENT THAT PAYMENTS OF INTEREST ARE CANCELED, HOLDERS OF THE NOTES WILL NOT HAVE THE RIGHT TO CLAIM AND RECEIVE CANCELED INTEREST, EVEN IF THE BANK THEREAFTER SATISFIES THE APPLICABLE CAPITALIZATION REQUIREMENTS. IF AN INTEREST CANCELLATION EVENT IS IN EFFECT ON THE DATE OF ANY WRITE-DOWN OF THE NOTES UPON THE OCCURRENCE OF A TRIGGER EVENT, THE NOTES WILL BE WRITTEN DOWN AND ANY AND ALL PREVIOUSLY CANCELED INTEREST WILL CONTINUE TO BE CANCELED.

Agreement to Interest Cancellation

By acquiring the Notes, holders and beneficial owners of the Notes acknowledge and agree that:

- (a) interest is payable solely at the Bank's discretion, and no amount of interest shall become due and payable in respect of the relevant Interest Period to the extent that it has been canceled by the Bank (in whole or in part) at its sole discretion and/or has been canceled as a result of the occurrence and continuation of an Interest Cancellation Event; and
- (b) a cancellation of interest (in whole or in part) in accordance with the terms of the Indenture and the Notes shall not constitute a default in payment or otherwise, or an Enforcement Event, under the terms of the Notes or the Indenture.

Interest will only be due and payable on an Interest Payment Date to the extent that it is not canceled (in whole or in part) in accordance with the provisions described under “—*Interest Cancellation*” and “—*Trigger Event and Write-Down—Write-Down*”. Any interest canceled (in whole or in part) under the circumstances described herein shall not be due and shall not accumulate or be payable at any time thereafter, and holders and beneficial owners of the Notes shall have no rights thereto or to receive any additional amounts or compensation as a result of such cancellation.

Notice of Interest Cancellation

If practicable, the Bank will provide notice of any cancellation of interest (in whole or in part) to the holders of the Notes through DTC (or, if the Notes are held in definitive form, to the holders of the Notes directly at their addresses shown on the register for the Notes) and to the Trustee directly on or prior to the relevant Interest Payment Date. Failure to provide such notice will have no impact on the effectiveness of, or otherwise invalidate, any such cancellation of interest (and accordingly, such interest will not be due and payable), or give the holders and beneficial owners of the Notes any rights as a result of such failure.

General Rules Applicable to Mexican Banks and their Application to the Bank

Article 121 of the Mexican Banking Law provides that in the exercise of its supervisory duties the CNBV, through general regulations issued thereby, will classify banking institutions based on their compliance with the provisions of the Mexican Capitalization Requirements, which may take into account Capital Ratios that reflect the degree of stability and solvency of a bank.

ARTICLE 122 OF THE MEXICAN BANKING LAW PROVIDES THAT IF A MEXICAN BANK DOES NOT COMPLY WITH THE CAPITAL RATIOS REQUIRED TO BE CLASSIFIED AS CLASS I PURSUANT TO THE MEXICAN CAPITALIZATION REQUIREMENTS, SUCH BANK MUST

IMPLEMENT THE CORRECTIVE MEASURES ORDERED BY THE CNBV, WHICH MAY INCLUDE:

(1) INFORMING THE BANK'S BOARD OF DIRECTORS OF ITS CLASSIFICATION, BASED ON THE CAPITAL RATIOS THEREOF, AND SUBMIT A DETAILED REPORT CONTAINING AN EVALUATION OF THE BANK'S OVERALL FINANCIAL STATUS AND ITS LEVEL OF COMPLIANCE WITH APPLICABLE REGULATIONS; THE BANK SHALL PROVIDE WRITTEN NOTICE TO THE GENERAL DIRECTOR AND THE CHAIRMAN OF THE BOARD OF DIRECTORS OF THE BANK'S REGULATED HOLDING COMPANY (*SOCIEDAD CONTROLADORA DEL GRUPO FINANCIERO*) WITH RESPECT TO SUCH EVENTS AND THE STATUS THEREOF;

(2) WITHIN A PERIOD NOT TO EXCEED SEVEN (7) BUSINESS DAYS, FILING WITH THE CNBV, FOR ITS APPROVAL, A CAPITAL RECOVERY PLAN TO INCREASE THE BANK'S CAPITAL RATIOS; THE BANK'S CAPITAL RECOVERY PLAN SHALL BE APPROVED BY SUCH BANK'S BOARD OF DIRECTORS BEFORE IT IS SUBMITTED TO THE CNBV;

(3) SUSPENDING ANY PAYMENT OF DIVIDENDS TO ITS SHAREHOLDERS, AS WELL AS ANY MECHANISM OR ACT FOR THE MAKING OF ANY DISTRIBUTIONS OR THE GRANTING OF ANY ECONOMIC BENEFITS TO SHAREHOLDERS;

(4) SUSPENDING ANY SHARE REPURCHASE PROGRAMS;

(5) DEFERRING OR CANCELING PAYMENT OF INTEREST AND DEFERRING OR CANCELING THE PAYMENT OF PRINCIPAL ON OUTSTANDING SUBORDINATED DEBT, AS THE CASE MAY BE, OR, IF APPLICABLE, EXCHANGING OUTSTANDING CONVERTIBLE SUBORDINATED DEBT INTO SHARES OF THE BANK IN THE AMOUNT NECESSARY TO COVER THE CAPITAL DEFICIENCY IF ORDERED BY THE CNBV; THESE CORRECTIVE MEASURES SHALL BE APPLICABLE TO SUBORDINATED DEBT CONSIDERED PART OF THE BANK'S TIER 1 CAPITAL (*CAPITAL BÁSICO*) OR TIER 2 CAPITAL (*CAPITAL COMPLEMENTARIO*); IN THE EVENT THAT THE BANK ISSUES SUBORDINATED DEBT, THE BANK IS OBLIGATED TO INCLUDE IN THE DOCUMENTATION EVIDENCING SUCH DEBT, IN THE APPLICABLE INDENTURE AND IN THE APPLICABLE OFFERING DOCUMENT, THAT SUCH DEFERRAL OR CANCELLATION OF PAYMENT OF PRINCIPAL OR DEFERRAL AND CANCELLATION OF PAYMENTS OF INTEREST, AS THE CASE MAY BE, SHALL APPLY UPON THE OCCURRENCE OF CERTAIN EVENTS AS PROVIDED IN THE GENERAL RULES APPLICABLE TO MEXICAN BANKS AND THAT THE IMPLEMENTATION OF SUCH MEASURES SHALL NOT BE CONSIDERED A DEFAULT UNDER THE RELEVANT DEBT DOCUMENTATION;

(6) SUSPENDING PAYMENT OF ANY EXTRAORDINARY BENEFITS AND BONUSES THAT ARE NOT A COMPONENT OF THE ORDINARY SALARY OF THE GENERAL DIRECTOR OR ANY OFFICER WITHIN THE NEXT TWO LEVELS OF SENIORITY, AND SUSPENDING THE GRANTING OF NEW BENEFITS TO THE GENERAL DIRECTOR AND THE OFFICERS MENTIONED ABOVE UNTIL THE BANK COMPLIES WITH THE MINIMUM CAPITAL RATIOS SET FORTH UNDER THE MEXICAN CAPITALIZATION REQUIREMENTS;

(7) ABSTAINING FROM INCREASING OUTSTANDING AMOUNTS OF ANY LOANS GRANTED TO ANY PERSON WHO IS A RELATED PARTY OF THE BANK PURSUANT TO ARTICLE 73 AND RELATED PROVISIONS OF THE MEXICAN BANKING LAW; AND

(8) ANY OTHER CORRECTIVE MEASURES THAT, IN EACH CASE, ARE PROVIDED BY THE GENERAL RULES APPLICABLE TO MEXICAN BANKS.

ARTICLE 122 OF THE MEXICAN BANKING LAW FURTHER PROVIDES THAT:

(1) IF A MEXICAN BANK COMPLIES WITH THE MINIMUM CAPITAL RATIOS REQUIRED PURSUANT TO THE MEXICAN CAPITALIZATION REQUIREMENTS BUT ANY OF ITS CAPITAL RATIOS IS BELOW THE CAPITAL RATIOS REQUIRED TO BE SATISFIED FOR A BANK NOT TO BE SUBJECT TO ANY CORRECTIVE MEASURES, SUCH BANK MUST IMPLEMENT CERTAIN CORRECTIVE MEASURES ORDERED BY THE CNBV, INCLUDING, AMONG OTHERS, (A) INFORMING THE BANK'S BOARD OF DIRECTORS OF ITS CLASSIFICATION, BASED ON THE CAPITAL RATIOS THEREOF AND SUBMITTING A DETAILED REPORT CONTAINING AN EVALUATION OF THE BANK'S OVERALL FINANCIAL STATUS AND ITS LEVEL OF COMPLIANCE WITH APPLICABLE REGULATIONS INCLUDING THE PRINCIPAL REGULATORY RATIOS, THAT REFLECT THE BANK'S DEGREE OF STABILITY AND SOLVENCY (TOGETHER WITH ANY DETERMINATIONS OR INDICATIONS MADE BY ANY OF THE CNBV OR *BANCO DE MÉXICO*) AND PROVIDING WRITTEN NOTICE TO THE GENERAL DIRECTOR AND THE CHAIRMAN OF THE BOARD OF DIRECTORS OF THE BANK'S REGULATED HOLDING COMPANY (*SOCIEDAD CONTROLADORA DEL GRUPO FINANCIERO*) WITH RESPECT TO SUCH EVENTS AND THE STATUS THEREOF; (B) ABSTAINING FROM ENTERING INTO ANY TRANSACTION THAT MAY DECREASE THE BANK'S CAPITAL RATIOS BELOW THE MEXICAN CAPITALIZATION REQUIREMENTS; AND (C) ANY OTHER CORRECTIVE MEASURES ORDERED BY THE CNBV.

(2) REGARDLESS OF THE CAPITALIZATION LEVEL, THE CNBV MAY ORDER THE IMPLEMENTATION OF ADDITIONAL SPECIAL CORRECTIVE MEASURES, INCLUDING, AMONG OTHERS: (1) REQUIRING COMPLIANCE WITH ADDITIONAL CORRECTIVE MEASURES THAT THE BANK WILL BE REQUIRED TO CARRY OUT TO AVOID A DECREASE OF ITS CAPITAL RATIOS; (2) SPECIAL AUDITS TO BE PERFORMED BY SPECIAL AUDITORS IN CONNECTION WITH SPECIFIC MATTERS; (3) ABSTAINING FROM INCREASING THE SALARIES AND BENEFITS OF ALL OFFICERS AND EMPLOYEES OF THE BANK, EXCEPT FOR ANY CHANGE IN SALARY PREVIOUSLY AGREED ON AND SUBJECT TO THE OFFICERS' AND EMPLOYEES' LABOR RIGHTS; (4) REMOVING OFFICERS, DIRECTORS, STATUTORY AUDITORS OR EXTERNAL AUDITORS OR APPOINTING ANY PERSONS TO SUCH POSITIONS; OR (5) ANY OTHER MEASURES ORDERED BY THE CNBV, BASED ON ITS INSPECTION AND SUPERVISION AUTHORITIES.

(3) IF A MEXICAN BANK DOES NOT COMPLY WITH ANY CAPITAL SUPPLEMENT REQUIREMENTS PURSUANT TO THE MEXICAN BANKING LAW AND THE MEXICAN CAPITALIZATION REQUIREMENTS, THE CNBV MAY ORDER THE BANK TO SUSPEND ANY PAYMENT OF DIVIDENDS OR OTHER DISTRIBUTIONS TO ITS SHAREHOLDERS.

(4) CORRECTIVE MEASURES WILL NOT BE APPLICABLE TO MEXICAN BANKS WITH A CAPITAL RATIO EQUAL TO OR GREATER THAN THE CAPITAL RATIOS REQUIRED TO BE CLASSIFIED AS CLASS I PURSUANT TO THE MEXICAN CAPITALIZATION REQUIREMENTS.

The Mexican Banking Law and the General Rules Applicable to Mexican Banks classify Mexican banks in categories from I through V based on their capital ratios for Total Net Capital (*capital neto*), Tier 1 Capital (*capital básico*) and Fundamental Capital (*capital básico fundamental*); corrective measures are imposed based on such classification, starting at the time a bank is included in the category Class II.

ARTICLE 122 OF THE MEXICAN BANKING LAW SPECIFIES THAT IF A BANK DOES NOT SATISFY THE CAPITAL RATIOS REQUIRED TO BE CLASSIFIED AS CLASS I PURSUANT TO THE MEXICAN CAPITALIZATION REQUIREMENTS, THE BANK MUST IMPLEMENT THE CORRECTIVE MEASURES ORDERED BY THE CNBV. CURRENTLY, THE MINIMUM CAPITAL RATIOS REQUIRED TO BE CLASSIFIED AS CLASS I ARE, INCLUDING THE CAPITAL CONSERVATION BUFFER, (I) 10.5% IN THE CASE OF THE TOTAL NET CAPITAL (*CAPITAL NETO*), (II) 8.5% IN THE CASE OF TIER 1 CAPITAL (*CAPITAL BÁSICO*) AND (III) 7.0% IN THE CASE OF FUNDAMENTAL CAPITAL

(CAPITAL BÁSICO FUNDAMENTAL), PLUS, IN EACH CASE, ANY APPLICABLE CAPITAL SUPPLEMENT.

Further, according to the General Rules Applicable to Mexican Banks in effect on the date hereof, Mexican banks are classified as Class II, III, IV or V, if any of its Capital Ratios is below certain minimum Capital Ratios, which as of the date hereof are, including the Capital Conservation Buffer: **(a)** 10.5% in the case of Total Net Capital (*capital neto*), **(b)** 8.5% in the case of Tier 1 Capital (*capital básico*), or **(c)** 7.0% in the case of Fundamental Capital (*capital básico fundamental*), plus, in each case, any applicable Capital Supplement thereof required under the Mexican Capitalization Requirements.

The General Rules Applicable to Mexican Banks further provide that corrective measures applicable to Mexican banks classified in Class II, III, IV or V include, among others, requiring a bank to suspend or cancel payment of interest and defer or cancel payment of any principal on outstanding subordinated debt or exchange outstanding convertible subordinated debt into shares of the bank in the amount necessary to cover the capital deficiency; in the event that a bank issues subordinated debt, such bank must include in the relevant debt documentation, in the applicable indenture and in the applicable offering memorandum, that such suspension or cancellation of payment of interest and deferral or cancellation of payment of principal shall apply to subordinated debt in the event that such bank is classified in Class II, III, IV or V and that the implementation of such measures shall not be considered a default under the relevant debt documentation.

Mexican banks that are determined by the CNBV to be of systemic importance, in light of the impact that their default may cause to the Mexican financial system, the Mexican payment system or the Mexican economy, are required by the CNBV to constitute an additional capital supplement, as determined from time to time (the “Systemically Important Bank Capital Supplement”). The CNBV also has the authority to require a countercyclical capital supplement (the “Countercyclical Capital Supplement”) on any and all Mexican banks, designed to cover adverse economic cycles, in the event that the aggregate financing received by the Mexican private sector grows at a higher level as compared to the level of growth of the Mexican economy.

In May 2016, as a grade II domestic systemically important bank, the Bank was required by the CNBV to constitute a Systemically Important Bank Capital Supplement of 0.90%. In July 2018, the CNBV ratified this requirement and confirmed the Bank as a grade II domestic systemically important bank. Also, an additional Countercyclical Capital Supplement of 0.001% was imposed. These Capital Supplements were required to be implemented by the Bank in four annual steps, one fourth each December, from December 31, 2016 to December 31, 2019.

As a result of the foregoing, and considering the Capital Supplements required, the minimum Capital Ratios applicable to the Bank as of the date hereof, to remain classified as Class I pursuant to the Mexican Capitalization Requirements are as follows:

	Commencing December 31,			
	2016	2017	2018	2019
Minimum Capital Ratios				
Total Net Capital (<i>capital neto</i>).....	10.7%	11%	11.2%	11.4%
Tier 1 Capital (<i>capital básico</i>).....	8.7%	9.0%	9.2%	9.4%
Fundamental Capital (<i>capital básico fundamental</i>).....	7.2%	7.5%	7.7%	7.9%

As of March 31, 2020, the Bank’s Capital Ratios were (i) 18.97% in the case of Total Net Capital, (ii) 17.86% in the case of Tier 1 Capital and (iii) 12.18% in the case of Fundamental Capital, which exceed the applicable regulatory requirements.

The Bank is currently classified as Class I and, as a result, it is not subject to any corrective measures.

Waiver of Right of Set-Off

Subject to applicable law, neither any holder or beneficial owner of the Notes nor the Trustee acting on behalf of the holders of the Notes may exercise, claim or plead any right of set-off, compensation or retention in respect of any amount owed to it or deemed to be owed by the Bank in respect of, or arising under, or in connection with, the Notes or the Indenture and each holder and beneficial owner of the Notes, by virtue of its holding of any Notes or any interest therein, and the Trustee acting on behalf of the holders of the Notes, shall be deemed to have waived all such rights of set-off, compensation or retention. If, notwithstanding the foregoing, any amounts due and payable to any holder or beneficial owner of a Note or any interest therein by the Bank in respect of, or arising under, the Notes are discharged by set-off, such holder or beneficial owner shall, subject to applicable law, immediately pay an amount equal to the amount of such discharge to the Bank (or, if the liquidation (*resolución*) of the Bank shall have occurred, the liquidator, administrator or *conciliador* of the Bank or any other applicable person designated for such purposes, as the case may be) and, until such time as payment is made, shall hold an amount equal to such amount in trust or deposit (as applicable) or otherwise for the Bank (or the liquidator, administrator or *conciliador* of the Bank or any other applicable person designated for such purposes, as the case may be) and, accordingly, any such discharge shall be deemed not to have taken place.

Unclaimed Money, Prescription

If money deposited with the Trustee or any agent for the payment of principal of, premium, if any, or interest or Additional Amounts (as defined below), if any, on the Notes remains unclaimed for two years, the Trustee or such paying agent shall return the money to the Bank, upon its written request, subject to applicable unclaimed property law. After that, holders of the Notes entitled to the money must look to the Bank for payment unless applicable unclaimed property law designates another person. Other than as set forth in this paragraph, the Indenture does not provide for any prescription periods for the payment of principal of, premium, if any, or interest or Additional Amounts, if any, on the Notes.

Indebtedness and Reserves

The Indenture does not limit the Bank's ability to incur senior, secured, preferred, subordinated, or any other additional indebtedness, nor does the Indenture require the Bank to create or maintain any reserves.

Payment of Additional Amounts

All payments made by or on the Bank's behalf in respect of the Notes will be made free and clear of and without withholding or deduction for or on account of any present or future taxes, duties, levies, imposts, assessments or governmental charges of whatever nature, imposed or levied by or on behalf of Mexico, the Cayman Islands, or any other jurisdiction through which payments are made (each a "Relevant Jurisdiction") or any authority or agency therein or thereof having power to tax (collectively, "Relevant Tax") unless the withholding or deduction of such Relevant Tax is required by law. In that event, the Bank will pay additional amounts ("Additional Amounts") as may be necessary so that the net amounts received by the holders of the Notes or their nominees (the term "holders" only refers to the registered holders), after such withholding or deduction, will equal the amount which would have been received in respect of the Notes in the absence of such withholding or deduction, except that no Additional Amounts will be payable to a holder to the extent that such Relevant Tax:

(1) is imposed only by virtue of such holder (or beneficial owner) having some connection with the Relevant Jurisdiction, other than being a holder (or beneficial owner) of the Notes or, receiving payments, of any nature, on the Notes or enforcing rights under the Notes; or

(2) is imposed only by virtue of such holder, beneficial owner or any other person having failed to comply with any certification, identification or other reporting requirement concerning the nationality, residence, identity or other lack of connection with the Relevant Jurisdiction or any similar claim for exemption or reduction in the rate of withholding, if satisfying such requirement or making such claim is a precondition to exemption from, or reduction in the rate of, the imposition, withholding or deduction of any Relevant Tax, *provided that* (x) the Bank or an agent acting for the Bank has provided the Trustee with at least 60 days' prior

written notice of an opportunity to satisfy such a requirement or make such a claim (such notice to be provided by the Trustee to the registered holder of the Notes), and (y) in no event, shall such holder's obligation to satisfy such a requirement or to make such a claim require such holder to provide any materially more onerous information, documents or other evidence than would be required to be provided had such holder been required to file IRS Forms W-8BEN, W-8BEN-E, W-8ECI, W-8EXP and/or W-8IMY; or

(3) is imposed only by virtue of such holder not having presented the Notes (where presentation is required) for payment within 30 days after the date on which such payment becomes due and payable or the date on which such payment thereof is duly provided for, whichever occurs earlier, except to the extent such holder would be entitled to Additional Amounts had the Notes been surrendered during such 30-day period; or

(4) is imposed only by virtue of such holder or beneficial owner (or any financial institution through which the holder or beneficial owner holds any Notes through which payment on such Note are made) having failed to comply with any certification, information, identification, documentation or other reporting requirement (including entering into and complying with an agreement with the Internal Revenue Service) imposed pursuant to Sections 1471 through 1474 of the Internal Revenue Code and the Treasury regulations thereunder ("FATCA"), including any agreement with the U.S. Internal Revenue Service with respect thereto, any intergovernmental agreement between the United States and Mexico or any other jurisdiction (including, without limitation, the Cayman Islands) with respect to FATCA, or any law, regulation or other official guidance enacted in any jurisdiction implementing, or in connection with, FATCA or any intergovernmental agreement with respect to FATCA; or

(5) is imposed on a Note presented for payment (where presentation is required) by a holder that could have avoided such Relevant Tax by presenting such Note to another paying agent in a member state of the European Union; or

(6) in the event that the holder is a fiduciary, a partnership or any person other than the sole beneficial owner of such payment, would not have been imposed had the beneficiary or settlor with respect to such fiduciary, member of such partnership or beneficial owner of such payment been the actual holder of the Note; or

(7) is an estate, inheritance, gift, sale, transfer, personal property or similar tax or assessment; or

(8) is imposed as a result of any combination of (1) through (7) above.

The Bank will also (1) make such withholding or deduction and (2) remit the full amount withheld or deducted to the relevant taxing authority in the Relevant Jurisdiction in accordance with applicable law.

The Bank will furnish to the Trustee, within 30 Business Days after the date of payment of any such taxes or the receipt of any credit or refund in respect to such taxes, documentation acceptable to the Trustee, including certified copies of returns, evidencing such payment (or credit or refund received) by the Bank. Upon written request made by the holders to the Trustee, copies of such documentation will be made available to the holders.

The Bank will also pay any stamp, administrative, court, documentary, excise or similar taxes arising in a Relevant Jurisdiction in connection with the Notes and will indemnify the holders for any such taxes paid by holders.

All references to principal or interest payable on the Notes shall be deemed to include any Additional Amounts payable by the Bank under the Notes or the Indenture. The foregoing obligations shall survive any termination, defeasance or discharge of the Notes and the Indenture.

If the Bank shall at any time be required to pay Additional Amounts to holders pursuant to the terms of the Notes and the Indenture, the Bank will use its reasonable efforts to obtain an exemption from the payment of the Relevant Tax that has resulted in the requirement that the Bank pay such Additional Amounts.

In the event that Additional Amounts actually paid with respect to the Notes pursuant to the preceding paragraphs

are based on rates of deduction or withholding of withholding taxes in excess of the appropriate rate applicable to the holder of the Notes, and as a result thereof such holder is entitled to make a claim for a refund or credit of such excess from the authority imposing such withholding tax, such holder shall, by accepting the Notes, be deemed to have assigned and transferred all right, title and interest to any such claim for a refund or credit of such excess to the Bank. However, by making such assignment, the holder makes no representation or warranty that the Bank will be entitled to receive such claim for a refund or credit and incurs no other obligation with respect thereto, including taking any action to obtain or receive the relevant refund. The Bank will inform the Trustee of the refund or credit within 30 Business Days of its determination that the Bank is entitled to receive such refund or credit.

Trigger Event and Write-Down

Trigger Event

A “**TRIGGER EVENT**” WILL BE DEEMED TO HAVE OCCURRED IF:

(I) THE CNBV PUBLISHES A DETERMINATION, IN ITS OFFICIAL PUBLICATION OF CAPITALIZATION LEVELS FOR MEXICAN BANKS, THAT THE BANK’S FUNDAMENTAL CAPITAL RATIO, AS CALCULATED PURSUANT TO THE APPLICABLE MEXICAN CAPITALIZATION REQUIREMENTS, IS EQUAL TO OR BELOW 5.125% (FIVE POINT ONE HUNDREDTH TWENTY-FIVE PERCENT); OR

(II) BOTH (A) THE CNBV HAS NOTIFIED THE BANK THAT IT HAS MADE A DETERMINATION, PURSUANT TO ARTICLE 29 BIS OF THE MEXICAN BANKING LAW, THAT A CAUSE FOR REVOCATION OF THE BANK’S LICENSE HAS OCCURRED RESULTING FROM (X) THE BANK’S ASSETS BEING INSUFFICIENT TO SATISFY ITS LIABILITIES, (Y) THE BANK’S NON-COMPLIANCE WITH CORRECTIVE MEASURES IMPOSED BY THE CNBV PURSUANT TO THE MEXICAN BANKING LAW, OR (Z) THE BANK’S NON-COMPLIANCE WITH THE CAPITALIZATION REQUIREMENTS SET FORTH IN THE MEXICAN CAPITALIZATION REQUIREMENTS AND (B) THE BANK HAS NOT CURED SUCH CAUSE FOR REVOCATION, BY (a) COMPLYING WITH SUCH CORRECTIVE MEASURES, OR (b)(1) SUBMITTING A CAPITAL RESTORATION PLAN TO, AND RECEIVING APPROVAL OF SUCH PLAN BY, THE CNBV, (2) NOT BEING CLASSIFIED IN CLASS III, IV OR V, AND (3) TRANSFERRING AT LEAST 75% (SEVENTY-FIVE PERCENT) OF ITS SHARES TO AN IRREVOCABLE TRUST, OR (c) REMEDYING ANY CAPITAL DEFICIENCY, IN EACH CASE, ON OR BEFORE THE THIRD (IN THE CASE OF (A)(X)) OR SEVENTH (IN THE CASE OF (A)(Y) AND (A)(Z)) BUSINESS DAY IN MEXICO, AS APPLICABLE, FOLLOWING THE DATE ON WHICH THE CNBV NOTIFIES THE BANK OF SUCH DETERMINATION.

Write-Down

IF A TRIGGER EVENT OCCURS, THE FOLLOWING WRITE-DOWNS SHALL BE DEEMED TO HAVE OCCURRED ON THE WRITE-DOWN DATE (AS DEFINED BELOW), AUTOMATICALLY AND WITHOUT ANY ADDITIONAL ACTION BY THE BANK, THE TRUSTEE OR THE HOLDERS OF THE NOTES:

(I) THE THEN CURRENT PRINCIPAL AMOUNT OF THE NOTES WILL AUTOMATICALLY BE REDUCED BY ONE OR MORE WRITE-DOWNS BY EACH APPLICABLE WRITE-DOWN AMOUNT (AS DEFINED BELOW) AND ANY SUCH WRITE-DOWN SHALL NOT CONSTITUTE A DEFAULT OR AN ENFORCEMENT EVENT (AS DEFINED BELOW); AND

(II) ANY HOLDER OF NOTES WILL AUTOMATICALLY BE DEEMED TO HAVE IRREVOCABLY WAIVED ITS RIGHT TO CLAIM OR RECEIVE, AND WILL NOT HAVE ANY RIGHTS AGAINST THE BANK OR THE TRUSTEE WITH RESPECT TO, REPAYMENT OF, THE WRITTEN-DOWN PRINCIPAL OF THE NOTES OR ANY INTEREST WITH RESPECT THERETO (OR ADDITIONAL AMOUNTS PAYABLE IN CONNECTION THEREWITH), INCLUDING ANY

AND ALL UNPAID INTEREST WITH RESPECT TO SUCH WRITTEN-DOWN PRINCIPAL AS OF THE WRITE-DOWN DATE, IRRESPECTIVE OF WHETHER SUCH AMOUNTS HAVE BECOME DUE AND PAYABLE PRIOR TO THE DATE ON WHICH THE TRIGGER EVENT SHALL HAVE OCCURRED.

THE BANK SHALL PROVIDE NOTICE TO HOLDERS VIA THE APPLICABLE CLEARING SYSTEM AS WELL AS WRITTEN NOTICE TO THE TRUSTEE (A “WRITE-DOWN NOTICE”) THAT A TRIGGER EVENT HAS OCCURRED, NOT LATER THAN THE NEXT BUSINESS DAY SUCCEEDING SUCH TRIGGER EVENT. ANY WRITE-DOWN NOTICE TO THE TRUSTEE MUST BE IN WRITING AND ACCOMPANIED BY A CERTIFICATE SIGNED BY AN OFFICER OF THE BANK STATING THAT A TRIGGER EVENT HAS OCCURRED AND SETTING OUT THE METHOD OF CALCULATION OF THE RELEVANT WRITE-DOWN AMOUNT.

“WRITE-DOWN AMOUNT” MEANS AN (I) AMOUNT OF THE THEN CURRENT PRINCIPAL AMOUNT OF THE NOTES THAT WOULD BE SUFFICIENT, TOGETHER WITH ANY CONCURRENT *PRO RATA* WRITE DOWN OR CONVERSION OF ANY OTHER SUBORDINATED NON-PREFERRED INDEBTEDNESS ISSUED BY THE BANK AND THEN OUTSTANDING, TO RETURN THE FUNDAMENTAL CAPITAL RATIO OF THE BANK TO THE LEVEL OF THE THEN-APPLICABLE FUNDAMENTAL CAPITAL RATIO REQUIRED BY THE CNBV IN ACCORDANCE WITH SECTION IV, C), 1 iii) OF ANNEX 1-R OF THE GENERAL RULES APPLICABLE TO MEXICAN BANKS OR ANY SUCCESSOR REGULATION, WHICH AS OF THE DATE OF THIS OFFERING MEMORANDUM IS 7% (SEVEN PERCENT) (WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER) PLUS THE AMOUNT REQUIRED TO RESTORE ANY COUNTERCYCLICAL CAPITAL SUPPLEMENT AND ANY SYSTEMICALLY IMPORTANT BANK CAPITAL SUPPLEMENT TO THE MINIMUM AMOUNTS REQUIRED UNDER THE MEXICAN CAPITALIZATION REQUIREMENTS ON SUCH WRITE-DOWN DATE; OR (II) IF ANY WRITE-DOWN OF THE CURRENT PRINCIPAL AMOUNT, TOGETHER WITH ANY CONCURRENT *PRO RATA* WRITE DOWN OR CONVERSION OF ANY SUBORDINATED NON-PREFERRED INDEBTEDNESS, WOULD BE INSUFFICIENT TO RETURN THE FUNDAMENTAL CAPITAL RATIO OF THE BANK TO THE AFOREMENTIONED AMOUNT, THEN THE AMOUNT NECESSARY TO REDUCE THE CURRENT PRINCIPAL AMOUNT OF EACH OUTSTANDING NOTE TO ZERO.

“WRITE-DOWN DATE” MEANS THE DATE ON WHICH A WRITE-DOWN WILL BE DEEMED TO TAKE EFFECT, WHICH SHALL BE THE NEXT BUSINESS DAY SUCCEEDING THE DATE OF THE TRIGGER EVENT.

“WRITTEN-DOWN PRINCIPAL” MEANS THE AMOUNT BY WHICH THE PRINCIPAL OF ANY NOTE HAS BEEN WRITTEN DOWN BY ANY ONE OR MORE WRITE-DOWNS.

AS REQUIRED UNDER THE MEXICAN CAPITALIZATION REQUIREMENTS, A FULL WRITE-DOWN (WHEREBY THE PRINCIPAL AMOUNT OF THE NOTES HAS BEEN WRITTEN DOWN TO ZERO) SHALL BE COMPLETED BEFORE ANY PUBLIC FUNDS ARE CONTRIBUTED OR ANY PUBLIC ASSISTANCE IS PROVIDED TO THE BANK IN THE TERMS OF ARTICLE 148, SECTION II, SUBSECTIONS A) AND B) OF THE MEXICAN BANKING LAW, INCLUDING, AMONG OTHERS IN THE FORM OF (I) SUBSCRIPTION OF SHARES, (II) GRANTING OF LOANS, (III) PAYMENT OF THE LIABILITIES OF THE BANK, (IV) GRANTING OF GUARANTIES AND (V) THE TRANSFER OF ASSETS AND LIABILITIES.

Subordination

THE INDENTURE FOR THE NOTES WILL PROVIDE THAT THE NOTES CONSTITUTE SUBORDINATED NON-PREFERRED INDEBTEDNESS (*OBLIGACIONES SUBORDINADAS NO PREFERENTES*) AND (I) WILL RANK SUBORDINATE AND JUNIOR IN RIGHT OF PAYMENT AND IN LIQUIDATION TO ALL PRESENT AND FUTURE SENIOR INDEBTEDNESS AND SUBORDINATED PREFERRED INDEBTEDNESS (*OBLIGACIONES SUBORDINADAS PREFERENTES*) OF THE BANK, (II) WILL RANK *PARI PASSU* WITHOUT PREFERENCE AMONG THEMSELVES AND WITH ALL

OTHER PRESENT OR FUTURE UNSECURED SUBORDINATED NON-PREFERRED INDEBTEDNESS OF THE BANK AND (III) WILL RANK SENIOR ONLY TO ALL OUR PRESENT AND FUTURE CLASSES OF EQUITY OR CAPITAL STOCK OF THE BANK.

IN THE EVENT OF THE BANK'S INSOLVENCY (*RESOLUCIÓN*) OR LIQUIDATION, AND UPON ANY DISTRIBUTION OF ASSETS TO CREDITORS UPON ANY LIQUIDATION, DISSOLUTION, WINDING UP, REORGANIZATION, ASSIGNMENT FOR THE BENEFIT OF CREDITORS, MARSHALING OF ASSETS OR ANY BANKRUPTCY, INSOLVENCY, *LIQUIDACIÓN* OR *RESOLUCIÓN* OR SIMILAR PROCEEDINGS IN CONNECTION WITH THE INSOLVENCY OR BANKRUPTCY OF THE BANK, (1) ALL PRINCIPAL, PREMIUM, IF ANY, AND INTEREST DUE OR TO BECOME DUE ON ALL SENIOR INDEBTEDNESS AND SUBORDINATED PREFERRED INDEBTEDNESS MUST BE PAID IN FULL BEFORE THE HOLDERS OF SUBORDINATED NON-PREFERRED INDEBTEDNESS (INCLUDING THE NOTES) ARE ENTITLED TO RECEIVE OR RETAIN ANY PAYMENT IN RESPECT THEREOF, AND (2) THE HOLDERS OF UNSECURED SUBORDINATED NON-PREFERRED INDEBTEDNESS (INCLUDING THE NOTES) WILL BE ENTITLED TO RECEIVE *PARI PASSU* AMONG THEMSELVES ANY PAYMENT IN RESPECT THEREOF. THE NOTES AND ALL OTHER SUBORDINATED NON-PREFERRED INDEBTEDNESS WILL BE SENIOR TO ALL CLASSES OF EQUITY OR CAPITAL STOCK OF THE BANK.

Definitions

For the purposes of the Notes:

(1) The term “*Senior Indebtedness*” is defined in the Indenture to mean all Indebtedness for Money Borrowed, whether outstanding on the date of execution of the Indenture or thereafter created, assumed or incurred, unless the terms thereof specifically provide that it is not superior in right of payment and in liquidation to the Subordinated Preferred Indebtedness or Subordinated Non-Preferred Indebtedness (including the Notes), and any deferrals, renewals or extensions of such Senior Indebtedness;

(2) The term “*Subordinated Preferred Indebtedness*” refers to *obligaciones subordinadas preferentes* and is defined in the Indenture to mean all Indebtedness for Money Borrowed, whether outstanding on the date of execution of the Indenture or thereafter created, assumed or incurred, which terms specifically provide that it is junior in right of payment and in liquidation to Senior Indebtedness, but is senior in right of payment and in liquidation to Subordinated Non-Preferred Indebtedness (including the Notes) and all classes of capital stock of the Bank, and any deferrals, renewals or extensions of such Subordinated Preferred Indebtedness;

(3) The term “*Subordinated Non-Preferred Indebtedness*” (including the Notes) refers to *obligaciones subordinadas no preferentes* and is defined in the Indenture to mean all Indebtedness for Money Borrowed, whether outstanding on the date of execution of the Indenture or thereafter created, assumed or incurred, which terms specifically provide that it is junior in right of payment and in liquidation to Senior Indebtedness and Subordinated Preferred Indebtedness, but is senior in right of payment and in liquidation to all classes of capital stock of the Bank, and any deferrals, renewals or extensions of such Subordinated Non-Preferred Indebtedness;

(4) The term “*Indebtedness for Money Borrowed*” is defined in the Indenture to mean any obligation of, or any obligation guaranteed by, the Bank (to the extent permitted under applicable law) for the repayment of borrowed money, whether or not evidenced by notes, debentures, debt securities or other written instruments, but shall not include (a) any trade accounts payable in the ordinary course of business, (b) any such indebtedness that by its terms ranks junior in right of payment and in liquidation to Subordinated Non-Preferred Indebtedness, (c) indebtedness to any of the Bank's employees, (d) indebtedness of the Bank which, when incurred, was without recourse to the Bank, and (e) any other indebtedness that would otherwise qualify as Indebtedness for Money Borrowed to the extent that such indebtedness, by its terms, ranks *pari passu* with or junior in right of payment and in liquidation to any of the indebtedness described in clause (a) or (b) above; and

(5) The term “*Mexican Capitalization Requirements*” is defined in the Indenture to mean the capitalization requirements for commercial banks, including the Bank, set forth under the Mexican Banking Law and the General Rules Applicable to Mexican Banks, as such laws and regulations may be amended or

superseded.

Redemption

Optional Redemption

THE BANK HAS THE OPTION, BUT NO OBLIGATION, UNDER THE INDENTURE TO REDEEM THE NOTES ON THE FIRST CALL DATE AND ON ANY INTEREST PAYMENT DATE THEREAFTER, IN WHOLE (UP TO THE THEN CURRENT PRINCIPAL AMOUNT) OR IN PART, AT PAR PLUS ACCRUED AND UNPAID (AND NOT CANCELED) INTEREST DUE ON, OR WITH RESPECT TO, THE NOTES, PLUS ADDITIONAL AMOUNTS, IF ANY, UP TO, BUT EXCLUDING, THE DATE OF REDEMPTION (AN “OPTIONAL REDEMPTION”).

THE BANK MAY REDEEM THE NOTES ONLY IF (I) THE BANK IS THEN IN COMPLIANCE WITH THE APPLICABLE MEXICAN CAPITALIZATION REQUIREMENTS IN EFFECT ON THE APPLICABLE REDEMPTION DATE, (II) AFTER GIVING EFFECT TO SUCH OPTIONAL REDEMPTION, THE BANK MAINTAINS EACH OF ITS CAPITAL RATIOS EQUAL TO, OR EXCEEDING, THE THEN-APPLICABLE CAPITAL RATIOS REQUIRED BY THE CNBV IN ACCORDANCE WITH SECTION IV, C), 1 OF ANNEX 1-R OF THE GENERAL RULES APPLICABLE TO MEXICAN BANKS OR ANY SUCCESSOR REGULATION, WHICH AS OF THE DATE OF THIS OFFERING MEMORANDUM ARE (X) 10.5 % IN THE CASE OF TOTAL NET CAPITAL (*CAPITAL NETO*), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, (Y) 8.5 % IN THE CASE OF TIER 1 CAPITAL (*CAPITAL BÁSICO*), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, AND (Z) 7.0 % IN THE CASE OF FUNDAMENTAL CAPITAL (*CAPITAL BÁSICO FUNDAMENTAL*), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, PLUS, IN EACH CASE, THE THEN-APPLICABLE COUNTERCYCLICAL CAPITAL SUPPLEMENT AND SYSTEMICALLY IMPORTANT BANK CAPITAL SUPPLEMENT, OR THE BANK ISSUES SECURITIES THAT REPLACE THE NOTES SUCH THAT IT REMAINS IN COMPLIANCE WITH THE MEXICAN CAPITALIZATION REQUIREMENTS, AND (III) THE BANK HAS OBTAINED THE AUTHORIZATION FROM BANCO DE MÉXICO TO REDEEM THE NOTES PRIOR TO THE APPLICABLE REDEMPTION DATE, AS EVIDENCED BY AN OFFICER’S CERTIFICATE DELIVERED TO THE TRUSTEE PRIOR TO THE DELIVERY OF THE NOTICE OF REDEMPTION TO THE HOLDERS; *PROVIDED, HOWEVER*, THAT IF AT ANY TIME A TRIGGER EVENT SHALL HAVE OCCURRED, THEN THE BANK SHALL HAVE NO OBLIGATION TO REDEEM ANY NOTES CALLED FOR OPTIONAL REDEMPTION.

IN THE EVENT OF SUCH AN OPTIONAL REDEMPTION, THE BANK IS REQUIRED TO OBTAIN THE AUTHORIZATION OF BANCO DE MÉXICO TO REDEEM THE NOTES PRIOR TO THE APPLICABLE REDEMPTION DATE. THE BANK’S OBLIGATION TO OBTAIN *BANCODE MÉXICO*’S AUTHORIZATION TO REDEEM THE NOTES SHALL NOT GRANT ANY RIGHTS TO THE TRUSTEE OR THE HOLDERS OF THE NOTES TO HAVE THE NOTES REDEEMED, EVEN IF SUCH AUTHORIZATION IS OBTAINED.

Withholding Tax Redemption

THE BANK HAS THE OPTION, BUT NO OBLIGATION, UNDER THE INDENTURE TO REDEEM THE NOTES AT ANY TIME, IN WHOLE (UP TO THE THEN CURRENT PRINCIPAL AMOUNT) BUT NOT IN PART, AT PAR PLUS ACCRUED AND UNPAID (AND NOT CANCELED) INTEREST DUE ON, OR WITH RESPECT TO, THE NOTES, PLUS ADDITIONAL AMOUNTS, IF ANY, UP TO, BUT EXCLUDING, THE DATE OF REDEMPTION, UPON THE OCCURRENCE OF A WITHHOLDING TAX EVENT (AS DEFINED BELOW) AFFECTING THE NOTES (A “WITHHOLDING TAX REDEMPTION”); *PROVIDED, HOWEVER*, THAT IN THE EVENT OF SUCH A WITHHOLDING TAX REDEMPTION, THE BANK MAY ONLY REDEEM THE NOTES IF (I) THE BANK SHALL BE IN COMPLIANCE WITH THE APPLICABLE MEXICAN CAPITALIZATION REQUIREMENTS IN EFFECT ON THE APPLICABLE REDEMPTION DATE, (II) AFTER GIVING EFFECT TO THE WITHHOLDING TAX REDEMPTION, THE BANK MAINTAINS EACH OF ITS CAPITAL RATIOS EQUAL TO, OR EXCEEDING, THE THEN-APPLICABLE CAPITAL RATIOS REQUIRED BY THE CNBV IN ACCORDANCE WITH

SECTION IV, C), 1 OF ANNEX 1-R OF THE GENERAL RULES APPLICABLE TO MEXICAN BANKS OR ANY SUCCESSOR REGULATION, WHICH AS OF THE DATE OF THIS OFFERING MEMORANDUM ARE (X) 10.5% IN THE CASE OF TOTAL NET CAPITAL (*CAPITAL NETO*), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, (Y) 8.5% IN THE CASE OF TIER 1 CAPITAL (*CAPITAL BÁSICO*), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, AND (Z) 7.0% IN THE CASE OF FUNDAMENTAL CAPITAL (*CAPITAL BÁSICO FUNDAMENTAL*), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, PLUS, IN EACH CASE, THE THEN-APPLICABLE COUNTERCYCLICAL CAPITAL SUPPLEMENT AND SYSTEMICALLY IMPORTANT BANK CAPITAL SUPPLEMENT, OR THE BANK ISSUES SECURITIES THAT REPLACE THE NOTES SUCH THAT IT REMAINS IN COMPLIANCE WITH THE MEXICAN CAPITALIZATION REQUIREMENTS, AND (III) THE BANK HAS OBTAINED THE AUTHORIZATION FROM BANCO DE MÉXICO TO REDEEM THE NOTES PRIOR TO THE APPLICABLE REDEMPTION DATE, AS EVIDENCED BY AN OFFICER'S CERTIFICATE DELIVERED TO THE TRUSTEE PRIOR TO THE DELIVERY OF THE NOTICE OF REDEMPTION TO THE HOLDERS; *PROVIDED, HOWEVER*, THAT IF AT ANY TIME A TRIGGER EVENT SHALL HAVE OCCURRED, THEN THE BANK SHALL HAVE NO OBLIGATION TO REDEEM ANY NOTES CALLED FOR WITHHOLDING TAX REDEMPTION.

IN THE EVENT OF SUCH A WITHHOLDING TAX REDEMPTION, THE BANK IS REQUIRED TO OBTAIN THE AUTHORIZATION OF BANCO DE MÉXICO TO REDEEM THE NOTES PRIOR TO THE APPLICABLE REDEMPTION DATE. THE BANK'S OBLIGATION TO OBTAIN BANCO DE MÉXICO'S AUTHORIZATION TO REDEEM THE NOTES SHALL NOT GRANT ANY RIGHTS TO THE TRUSTEE OR THE HOLDERS OF THE NOTES TO HAVE THE NOTES REDEEMED, EVEN IF SUCH AUTHORIZATION IS OBTAINED.

FOR THE PURPOSES OF THE FOREGOING, THE TERM "WITHHOLDING TAX EVENT" IS DEFINED IN THE INDENTURE TO MEAN (I) THE RECEIPT BY THE BANK AND THE DELIVERY TO THE TRUSTEE OF AN OPINION OF A NATIONALLY RECOGNIZED LAW FIRM IN MEXICO OR THE CAYMAN ISLANDS (OR IN THE RELEVANT JURISDICTION, IN THE CASE OF A WITHHOLDING TAX EVENT INVOLVING A RELEVANT JURISDICTION OTHER THAN MEXICO OR THE CAYMAN ISLANDS) EXPERIENCED IN SUCH MATTERS TO THE EFFECT THAT, AS A RESULT OF (A) ANY AMENDMENT TO OR CHANGE (INCLUDING ANY ANNOUNCED PROSPECTIVE CHANGE) IN THE LAWS OR TREATIES (OR ANY RULES OR REGULATIONS THEREUNDER) OF ANY RELEVANT JURISDICTION AFFECTING TAXATION, (B) ANY JUDICIAL DECISION OR OFFICIAL ADMINISTRATIVE PRONOUNCEMENT OF ANY RELEVANT JURISDICTION, (EACH AN "ADMINISTRATIVE ACTION"), OR (C) ANY AMENDMENT TO OR CHANGE IN THE OFFICIAL PRONOUNCEMENT THAT PROVIDES FOR A POSITION THAT DIFFERS FROM THE THERETOFORE GENERALLY ACCEPTED POSITION, IN EACH CASE, BY ANY LEGISLATIVE BODY, COURT, GOVERNMENTAL AUTHORITY OR REGULATORY BODY HAVING APPROPRIATE JURISDICTION, AND PROVIDED THAT SUCH AMENDMENT, CHANGE, JUDICIAL DECISION OR PRONOUNCEMENT IS EFFECTIVE ON OR AFTER THE DATE OF ISSUANCE OF THE NOTES OR, WITH RESPECT TO ANY JURISDICTION OTHER THAN MEXICO AND THE CAYMAN ISLANDS, AFTER SUCH JURISDICTION HAS BECOME A RELEVANT JURISDICTION (COLLECTIVELY, A "CHANGE IN TAX LAW"), THERE IS MORE THAN AN INSUBSTANTIAL RISK THAT THE BANK IS OR WILL BE LIABLE FOR MORE THAN A *DE MINIMUS* PAYMENT OF ADDITIONAL AMOUNTS IN RESPECT OF THE NOTES IN EXCESS OF THE GROSS AMOUNT OF ADDITIONAL AMOUNTS PAYABLE IN RESPECT OF THE NOTES PRIOR TO SUCH CHANGE IN TAX LAW AND (II) THE DELIVERY TO THE TRUSTEE OF AN OFFICER'S CERTIFICATE STATING THAT THE REQUIREMENT TO PAY SUCH ADDITIONAL AMOUNTS CANNOT BE AVOIDED BY TAKING REASONABLE MEASURES AVAILABLE TO THE BANK (SUCH MEASURES NOT INVOLVING ANY MATERIAL COST TO THE BANK OR THE INCURRING BY THE BANK OF ANY OTHER TAX OR PENALTY).

Special Event Redemption

THE BANK ALSO HAS THE OPTION, BUT NO OBLIGATION, UNDER THE INDENTURE TO REDEEM THE NOTES AT ANY TIME, IN WHOLE (UP TO THE THEN CURRENT PRINCIPAL

AMOUNT) BUT NOT IN PART, AT PAR PLUS ACCRUED AND UNPAID (AND NOT CANCELED) INTEREST DUE ON, OR WITH RESPECT TO, THE NOTES, PLUS ADDITIONAL AMOUNTS, IF ANY, UP TO, BUT EXCLUDING, THE REDEMPTION DATE, UPON THE OCCURRENCE OF A SPECIAL EVENT (AS DEFINED BELOW) AFFECTING THE NOTES (A “SPECIAL EVENT REDEMPTION”); *PROVIDED, HOWEVER, IN THE EVENT OF SUCH A SPECIAL EVENT REDEMPTION WITH RESPECT TO THE NOTES, THE BANK MAY ONLY REDEEM THE NOTES IF (I) THE BANK SHALL BE IN COMPLIANCE WITH APPLICABLE MEXICAN CAPITALIZATION REQUIREMENTS IN EFFECT ON THE APPLICABLE REDEMPTION DATE, (II) AFTER GIVING EFFECT TO THE REDEMPTION, THE BANK MAINTAINS EACH OF ITS CAPITAL RATIOS EQUAL TO, OR EXCEEDING, THE THEN-APPLICABLE CAPITAL RATIOS REQUIRED BY THE CNBV IN ACCORDANCE WITH SECTION IV, C), 1 OF ANNEX 1-R OF THE GENERAL RULES APPLICABLE TO MEXICAN BANKS OR ANY SUCCESSOR REGULATION, WHICH AS OF THE DATE OF THIS OFFERING MEMORANDUM ARE (X) 10.5% IN THE CASE OF TOTAL NET CAPITAL (CAPITAL NETO), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, (Y) 8.5% IN THE CASE OF TIER 1 CAPITAL (CAPITAL BÁSICO), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, AND (Z) 7.0% IN THE CASE OF FUNDAMENTAL CAPITAL (CAPITAL BÁSICO FUNDAMENTAL), WHICH INCLUDES THE CAPITAL CONSERVATION BUFFER, PLUS, IN EACH CASE, THE THEN-APPLICABLE COUNTERCYCLICAL CAPITAL SUPPLEMENT AND SYSTEMICALLY IMPORTANT BANK CAPITAL SUPPLEMENT, OR THE BANK ISSUES SECURITIES THAT REPLACE THE NOTES SUCH THAT IT REMAINS IN COMPLIANCE WITH THE MEXICAN CAPITALIZATION REQUIREMENTS, AND (III) THE BANK HAS OBTAINED THE AUTHORIZATION FROM BANCO DE MÉXICO TO REDEEM THE NOTES PRIOR TO THE APPLICABLE REDEMPTION DATE, AS EVIDENCED BY AN OFFICER’S CERTIFICATE DELIVERED TO THE TRUSTEE PRIOR TO THE DELIVERY OF THE NOTICE OF REDEMPTION TO THE HOLDERS; PROVIDED, HOWEVER, THAT IF AT ANY TIME A TRIGGER EVENT SHALL HAVE OCCURRED, THEN THE BANK SHALL HAVE NO OBLIGATION TO REDEEM ANY NOTES CALLED FOR SPECIAL EVENT REDEMPTION.*

IN THE EVENT OF SUCH A SPECIAL EVENT REDEMPTION, THE BANK IS REQUIRED TO OBTAIN THE AUTHORIZATION OF *BANCODE MÉXICO* TO REDEEM THE NOTES PRIOR TO THE APPLICABLE REDEMPTION DATE. THE BANK’S OBLIGATION TO OBTAIN *BANCODE MÉXICO*’S AUTHORIZATION TO REDEEM THE NOTES SHALL NOT GRANT ANY RIGHTS TO THE TRUSTEE OR THE HOLDERS OF THE NOTES TO HAVE THE NOTES REDEEMED, EVEN IF SUCH AUTHORIZATION IS OBTAINED.

FOR THE PURPOSES OF THE FOREGOING:

(1) THE TERM “SPECIAL EVENT” IN RESPECT OF THE NOTES IS DEFINED IN THE INDENTURE TO MEAN A CAPITAL EVENT OR A TAX EVENT (BOTH AS DEFINED BELOW);

(2) THE TERM “CAPITAL EVENT” IN RESPECT OF THE NOTES IS DEFINED IN THE INDENTURE TO MEAN THE REASONABLE DETERMINATION BY THE BANK THAT, AS A RESULT OF (A) THE OCCURRENCE OF ANY AMENDMENT TO OR CHANGE IN THE LAWS OR ANY REGULATIONS THEREUNDER OF MEXICO OR (B) ANY OFFICIAL ADMINISTRATIVE PRONOUNCEMENT OR JUDICIAL DECISION INTERPRETING OR APPLYING THESE LAWS OR REGULATIONS, WHICH AMENDMENT OR CHANGE IS EFFECTIVE OR WHICH PRONOUNCEMENT OR DECISION IS ANNOUNCED ON OR AFTER THE ISSUE DATE, THERE IS MORE THAN AN INSUBSTANTIAL RISK THAT THE BANK WILL NOT BE ENTITLED TO TREAT THE NOTES AS TIER 1 CAPITAL (CAPITAL BÁSICO), OR THE THEN EQUIVALENT OF TIER 1 CAPITAL (CAPITAL BÁSICO) FOR PURPOSES OF THE MEXICAN CAPITALIZATION REQUIREMENTS, AS THEN IN EFFECT AND APPLICABLE TO THE BANK;

(3) THE TERM “TAX EVENT” IS DEFINED IN THE INDENTURE TO MEAN THE RECEIPT BY THE BANK OF AN OPINION OF A NATIONALLY RECOGNIZED LAW FIRM IN MEXICO EXPERIENCED IN SUCH MATTERS TO THE EFFECT THAT, AS A RESULT OF A CHANGE IN TAX LAW, THERE IS MORE THAN AN INSUBSTANTIAL RISK THAT INTEREST

PAYABLE BY THE BANK ON THE NOTES IS NOT OR WILL NOT BE DEDUCTIBLE BY THE BANK IN WHOLE OR IN PART FOR MEXICAN INCOME TAX PURPOSES.

Redemption Procedures

IF THE BANK GIVES A NOTICE OF AN OPTIONAL REDEMPTION, A WITHHOLDING TAX REDEMPTION OR A SPECIAL EVENT REDEMPTION IN RESPECT OF THE NOTES IN ACCORDANCE WITH THE INDENTURE, AT LEAST ONE BUSINESS DAY PRIOR TO THE APPLICABLE REDEMPTION DATE, BY 11:00 A.M. NEW YORK CITY TIME, THE BANK SHALL DEPOSIT WITH THE TRUSTEE OR WITH A PAYING AGENT FUNDS SUFFICIENT TO PAY THE APPLICABLE REDEMPTION PRICE AND ACCRUED AND UNPAID (AND NOT CANCELED) INTEREST, TO THE APPLICABLE REDEMPTION DATE, ON THE NOTES SUBJECT TO REDEMPTION; PROVIDED, HOWEVER, THAT IF AT ANY TIME A TRIGGER EVENT SHALL HAVE OCCURRED THE BANK SHALL HAVE NO OBLIGATION TO REDEEM ANY NOTES CALLED FOR REDEMPTION. SUCH NOTICE WILL ALSO BE GIVEN TO THE HOLDERS IN ACCORDANCE WITH THE PROCEDURE SET FORTH IN “—NOTICES”. WITH RESPECT TO THE NOTES BEING REDEEMED AND HELD IN CERTIFICATED FORM, THE TRUSTEE, TO THE EXTENT FUNDS ARE LEGALLY AVAILABLE, WILL PAY THE APPLICABLE REDEMPTION PRICE TO THE HOLDERS THEREOF UPON SURRENDER OF THEIR CERTIFICATES EVIDENCING THE NOTES. IF NOT PREVIOUSLY CANCELED, INTEREST PAYABLE ON OR PRIOR TO THE REDEMPTION DATE SHALL BE PAYABLE TO THE HOLDERS OF THE NOTES ON THE RELEVANT RECORD DATES. IF NOTICE OF REDEMPTION SHALL HAVE BEEN GIVEN AND FUNDS DEPOSITED WITH THE TRUSTEE TO PAY THE APPLICABLE REDEMPTION PRICE FOR THE NOTES BEING REDEEMED, THEN UPON THE DATE OF SUCH DEPOSIT, ALL RIGHTS OF THE HOLDERS OF THE NOTES WILL CEASE WITH RESPECT TO THE PORTION OF NOTES BEING SO REDEEMED, EXCEPT THE RIGHT OF THE HOLDERS OF THE NOTES TO RECEIVE THE APPLICABLE REDEMPTION PRICE, BUT WITHOUT INTEREST ON SUCH REDEMPTION PRICE, AND THE NOTES SO REDEEMED WILL CEASE TO BE OUTSTANDING. IN THE EVENT THAT ANY REDEMPTION DATE IN RESPECT OF THE NOTES IS NOT A BUSINESS DAY, THEN THE APPLICABLE REDEMPTION PRICE PAYABLE ON SUCH DATE WILL BE PAID ON THE NEXT SUCCEEDING DAY THAT IS A BUSINESS DAY (WITHOUT ANY INTEREST OR OTHER PAYMENT IN RESPECT OF ANY SUCH DELAY) WITH THE SAME FORCE AND EFFECT AS IF MADE ON SUCH REDEMPTION DATE. IN THE EVENT THAT PAYMENT OF THE APPLICABLE REDEMPTION PRICE IS IMPROPERLY WITHHELD OR REFUSED AND NOT PAID BY THE BANK (1) INTEREST DUE ON THE NOTES BEING REDEEMED WILL CONTINUE TO ACCRUE AT THE THEN APPLICABLE RATE, FROM THE REDEMPTION DATE ORIGINALLY ESTABLISHED BY THE BANK TO THE DATE SUCH APPLICABLE REDEMPTION PRICE IS ACTUALLY PAID, AND (2) THE ACTUAL PAYMENT DATE WILL BE THE REDEMPTION DATE FOR PURPOSES OF CALCULATING THE APPLICABLE REDEMPTION PRICE.

IF THE BANK HAS DELIVERED A NOTICE OF REDEMPTION, BUT PRIOR TO THE PAYMENT OF THE REDEMPTION AMOUNT WITH RESPECT TO SUCH REDEMPTION, A TRIGGER EVENT HAS OCCURRED, SUCH NOTICE OF REDEMPTION SHALL BE AUTOMATICALLY RESCINDED AND SHALL BE OF NO FORCE AND EFFECT, AND NO PAYMENT IN RESPECT OF THE REDEMPTION AMOUNT SHALL BE DUE AND PAYABLE.

IF THE BANK HAS DELIVERED A NOTICE OF REDEMPTION, BUT PRIOR TO THE DATE OF ANY SUCH REDEMPTION, BANCO DE MÉXICO HAS OBJECTED TO OR REFUSED TO GRANT PERMISSION TO THE BANK, TO REDEEM THE RELEVANT NOTES, SUCH NOTICE OF REDEMPTION SHALL BE AUTOMATICALLY RESCINDED AND SHALL BE OF NO FORCE AND EFFECT AND NO PAYMENT IN RESPECT OF THE REDEMPTION AMOUNT SHALL BE DUE AND PAYABLE.

IF THE BANK HAS DELIVERED A NOTICE OF REDEMPTION, BUT PRIOR TO THE PAYMENT OF THE REDEMPTION AMOUNT WITH RESPECT TO SUCH REDEMPTION THE BANK IS NOT IN COMPLIANCE WITH THE MEXICAN CAPITALIZATION REQUIREMENTS OR ANY ALTERNATIVE OR ADDITIONAL PRE-CONDITIONS REQUIRED BY BANCO DE MÉXICO AS A PREREQUISITE TO

ITS AUTHORIZATION FOR SUCH REDEMPTION, SUCH NOTICE OF REDEMPTION SHALL BE AUTOMATICALLY RESCINDED AND SHALL BE OF NO FORCE AND EFFECT, AND NO PAYMENT IN RESPECT OF THE REDEMPTION AMOUNT SHALL BE DUE AND PAYABLE.

IN THE EVENT OF A PARTIAL OPTIONAL REDEMPTION OF THE NOTES, THE NOTES SHALL BE REDEEMED FROM EACH HOLDER THEREOF *PRO RATA* ACCORDING TO THE THEN CURRENT PRINCIPAL AMOUNT OF THE NOTES HELD BY THE RELEVANT HOLDER IN RELATION TO THE THEN CURRENT PRINCIPAL AMOUNT OF ALL NOTES; *PROVIDED, HOWEVER*, THAT GLOBAL NOTES TO BE REDEEMED THAT ARE HELD THROUGH DTC SHALL BE SELECTED IN ACCORDANCE WITH THE APPLICABLE PROCEDURES OF DTC. IN RESPECT OF THE NOTES HELD BY DTC OR ITS NOMINEE, THE DISTRIBUTION OF THE PROCEEDS FROM SUCH REDEMPTION WILL BE MADE TO DTC OR ITS NOMINEE AND DISBURSED BY DTC OR ITS NOMINEE IN ACCORDANCE WITH THE PROCEDURES APPLIED BY DTC OR ITS NOMINEE. IN DETERMINING THE PRORATION OF THE NOTES TO BE REDEEMED, THE BANK MAY MAKE SUCH ADJUSTMENTS AS MAY BE APPROPRIATE IN ORDER THAT ONLY THE NOTES IN AUTHORIZED DENOMINATIONS SHALL BE REDEEMED, SUBJECT TO THE MINIMUM DENOMINATIONS SET FORTH IN THIS OFFERING MEMORANDUM.

THE BANK SHALL DELIVER NOTICE OF ANY REDEMPTION TO THE TRUSTEE AT LEAST 40 DAYS PRIOR TO THE APPLICABLE REDEMPTION DATE (OR ANY SHORTER PERIOD THAT MAY BE AGREED UPON BY THE BANK AND THE TRUSTEE). THE BANK SHALL, OR SHALL CAUSE THE TRUSTEE TO, GIVE NOTICE OF ANY SUCH REDEMPTION AT LEAST 30 DAYS BUT NOT MORE THAN 60 DAYS PRIOR TO THE REDEMPTION DATE TO EACH HOLDER OF THE NOTES IN ACCORDANCE WITH THE PROCEDURES DESCRIBED IN THE INDENTURE. UNLESS THE BANK DEFAULTS IN PAYMENT OF THE APPLICABLE AMOUNTS DUE ON, OR IN THE REPAYMENT OF, THE NOTES, ON AND AFTER THE APPLICABLE REDEMPTION DATE, INTEREST DUE WILL CEASE TO ACCRUE ON THE NOTES CALLED FOR REDEMPTION.

IF ANY SCHEDULED REDEMPTION DATE IS NOT A BUSINESS DAY, PAYMENT OF INTEREST, IF ANY, AND PRINCIPAL SHALL BE POSTPONED TO THE NEXT BUSINESS DAY, BUT INTEREST ON THAT PAYMENT WILL NOT ACCRUE DURING THE PERIOD FROM AND AFTER THE SCHEDULED REDEMPTION DATE.

ANY WITHHOLDING TAX REDEMPTION OR SPECIAL EVENTS REDEMPTION MAY OCCUR ON A NON-INTEREST PAYMENT DATE, IN THE BANK'S DISCRETION.

Open Market Purchases and Other Repurchase of Notes

Subject to applicable law, the Bank may at any time and from time to time repurchase, or procure others to repurchase for its account, the Notes in the open market, by tender or by private agreement in any manner and at any price or at differing prices. Notes purchased or otherwise acquired by the Bank shall be surrendered to the Trustee for cancellation (in which case all Notes so surrendered will forthwith be canceled in accordance with applicable law and thereafter may not be reissued or resold). Any such purchases will be subject to the satisfaction of the following conditions: (x)(a) the Bank maintains, and after giving effect to the repurchase of the Notes will maintain, each of its Capital Ratios equal to, or exceeding, the then-applicable Capital Ratios required by the CNBV in accordance with Section IV, c), 1 of Annex 1-R of the General Rules Applicable to Mexican Banks or any successor regulation, which as of the date of this offering memorandum are, including the Capital Conservation Buffer, (i) 10.5% in the case of Total Net Capital (*capital neto*), (ii) 8.5% in the case of Tier 1 Capital (*capital básico*), and (iii) 7.0% in the case of Fundamental Capital (*capital básico fundamental*), plus, in each case, the then-applicable Countercyclical Capital Supplement and Systemically Important Bank Capital Supplement, or (b) the Bank issues securities that replace the amount of Notes so canceled such that it remains in compliance with the Mexican Capitalization Requirements, and (y) the Bank has obtained the authorization from *Banco de México* to repurchase the Notes prior to the applicable repurchase date; *provided, however*, that if at any time a Trigger Event shall have occurred, then the Bank shall have no obligation to repurchase any Notes it had agreed to repurchase.

Rule 144A Information

For so long as any of the Notes remain outstanding and are “restricted securities” within the meaning of Rule 144(a)(3) under the Securities Act, the Bank shall furnish, upon the request of any holder, such information as is specified in Rule 144A(d)(4) under the Securities Act: (i) to such holder, (ii) to a prospective purchaser of such Note (or beneficial interests therein) who is a qualified institutional buyer (“QIB”) designated by such holder and (iii) to the Trustee for delivery to any applicable holders or such prospective purchaser so designated, in each case in order to permit compliance by such holder with Rule 144A in connection with the resale of such Note (or beneficial interest therein) in reliance upon Rule 144A. All such information shall be in the English language.

Periodic Reports

So long as the Notes are outstanding, the Bank will furnish to the Trustee, who will in turn furnish to the holders of such Notes:

(a) Within 120 days following the end of each of the Bank’s fiscal years, an English version of its consolidated audited balance sheets, statements of income, statements of shareholders equity and statements of cash flow and the related notes thereto for the two most recent fiscal years prepared in accordance with Mexican Banking GAAP (“GAAP”), together with an audit report thereon by the Bank’s independent auditors; and

(b) Within 60 days following the end of the first three fiscal quarters in each of the Bank’s fiscal years, an English version of its consolidated unaudited balance sheets, statements of income, statements of shareholders equity and statements of cash flows and the related notes thereto for the quarterly period then ended and the corresponding quarterly period in the prior fiscal year and prepared in accordance with GAAP.

In addition, the Bank shall furnish to the holders of the Notes, upon the requests of such holders, any information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act so long as such Notes are not freely transferable under the Securities Act by Persons who are not “affiliates” under the Securities Act.

Enforcement Events and Remedies

There are no events of default under the Notes. In addition, under the terms of the Indenture, any Write-Down or cancellation of interest will not constitute an Enforcement Event.

Enforcement Events

Each of the following events described in clauses (i), (ii) and (iii) is an “Enforcement Event”:

- (i) certain events involving the insolvency (*resolución*) or liquidation of the Bank;
- (ii) a Principal Non-Payment Event (as defined below); or
- (iii) breach of a Performance Obligation (as defined below).

Remedies

- (i) *The occurrence of an insolvency (resolución) or liquidation of the Bank.* If an insolvency (*resolución*) or liquidation of the Bank occurs, the Current Principal Amount of the Notes, without any accrued and unpaid interest to the date of such occurrence, shall become immediately due and payable and neither the Trustee nor the holders of the Notes are required to declare such amount to be due and payable. In that event, holders of the Notes may not be able to collect the full amount payable under the Notes and laws applicable to an insolvency (*resolución*) or liquidation may affect the timing or amount paid to holders of the Notes. See “Risk Factors—Risks Relating to the Notes—The Notes do not contain events of default and if the Bank does not satisfy its obligations under the Notes, whether due to a Write-Down or otherwise, your remedies will be limited.”

- (ii) *Principal Non-Payment Event.* In the event of any redemption of the Notes described under “—*Redemption*” above, if the Bank does not make payment of principal in respect of the Notes for a period of fourteen (14) calendar days or more after the date on which such payment is due (a “Principal Non-Payment Event”), then the Trustee, on behalf of the holders and beneficial owners of the Notes, may, at its discretion, or shall at the direction of holders of 25% or more of the aggregate principal amount of outstanding Notes, subject to any applicable laws, institute proceedings for the Bank’s declaration of insolvency (*resolución*) or liquidation. In such event, whether or not instituted by the Trustee, the Trustee may prove the claims of the holders and beneficial owners of the Notes and the Trustee. For the avoidance of doubt, the Trustee may not declare the principal amount of any outstanding Notes to be due and payable and may not pursue any other legal remedy, including a judicial proceeding for the collection of the sums due and unpaid on the Notes.
- (iii) *Breach of a Performance Obligation.* In the event of a breach of any term, obligation or condition binding on the Bank under the Notes or the Indenture (other than any of the Bank’s payment obligations under or arising from the Notes or the Indenture, including payment of any principal or interest, including any damages awarded for breach of any obligation) (such obligation, a “Performance Obligation”), the Trustee may without further notice institute such proceedings against the Bank as it may deem fit to enforce the Performance Obligation; *provided* that the Bank shall not by virtue of the institution of any such proceedings be obliged to pay any sum or sums, in cash or otherwise (including any damages) earlier than the same would otherwise have been payable under the Notes or the Indenture, if any.

For the avoidance of doubt, the breach by the Bank of any Performance Obligation shall not give the Trustee acting on behalf of the holders with respect to the Notes and/or the holders or beneficial owners of the Notes a claim for damages, and, in such circumstances, the sole and exclusive remedy that the Trustee and/or the holders or beneficial owners of the Notes may seek under the Notes and the Indenture is specific performance under New York law. By its acquisition of the Notes, each holder and beneficial owner of Notes acknowledges and agrees that such holder and beneficial owner will not seek, and will not direct the Trustee to seek, a claim for damages against the Bank in respect of a breach by it of a Performance Obligation and that the sole and exclusive remedy that such holder and the Trustee acting on behalf of the holders with respect to the Notes may seek under the Notes and the Indenture for a breach by the Bank of a Performance Obligation is specific performance under New York law. See “Risk Factors—Risks Relating to the Notes—The Notes do not contain events of default and if the Bank does not satisfy its obligations under the Notes, whether due to a Write-Down or otherwise, your remedies will be limited.”

No Other Remedies

Other than the limited remedies specified above, no remedy against the Bank shall be available to the Trustee (acting on behalf of the holders of the Notes) or to the holders and beneficial owners of the Notes. For the avoidance of doubt, such limitations shall not apply to the Bank’s obligations to pay the fees and expenses of, and to indemnify, the Trustee, and the Trustee’s rights to apply money collected to first pay its fees and expenses shall not be subject to the subordination provisions set forth in this offering memorandum.

The Notes are perpetual securities in respect of which there is no fixed redemption date or maturity date. Holders and beneficial owners of the Notes may not request the redemption of any of the Notes at any time.

Trustee’s Duties

Holders of not less than a majority in aggregate of the Current Principal Amount of the Notes may on behalf of all holders of the Notes waive any past Enforcement Event that results from a breach by the Bank of a Performance Obligation.

Holders of a majority in aggregate of the Current Principal Amount of the Notes may not waive any past Enforcement Event that results from an insolvency (*resolución*) or liquidation of the Bank.

If an Enforcement Event has occurred and is continuing, the Trustee will have no obligation to take any action at the direction of any holders of the Notes, unless they have offered the Trustee security or indemnity satisfactory to the Trustee in its sole discretion. The holders of a majority in aggregate of the Current Principal Amount of the Notes

shall have the right to direct the time, method and place of conducting any proceeding in the name of and on the behalf of the Trustee for any remedy available to the Trustee or exercising any trust or power conferred on the Trustee with respect to the Notes. However, this direction (**a**) must not be in conflict with any rule of law or the Indenture and (**b**) must not be unjustly prejudicial to the holders of the Notes not taking part in the direction, in the case of either (a) or (b) as determined by the Trustee in its sole discretion. The Trustee may also take any other action, consistent with the direction of the holders, that it deems proper.

Modification of Indenture; Waiver of Covenants

Subject to authorization by *Banco de México*, the Bank and the Trustee may, without the consent of any holders of Notes, amend, waive or supplement each of the Indenture or the Notes in certain circumstances, including, among other things, to cure any ambiguity, omission, defect or inconsistency, to conform the text of the Indenture or the Notes to any provision in this “*Description of the Notes*” and to make any other change that does not adversely affect the rights of any relevant holder in any material respect. In addition, subject to authorization by *Banco de México*, the Bank and the Trustee may amend, waive or supplement the Indenture or the Notes with the written consent of the holders of at least a majority in aggregate of the Current Principal Amount of the Notes. However, without the consent of the holder of each Note and subject to authorization by *Banco de México*, the Bank may not, among other things:

- change any Interest Payment Date (or Interest Periods) on any Note;
- reduce the principal amount of or interest on any Note (except in the case of a Write-Down or a cancellation of interest, as applicable);
- change the currency of payment of principal or interest on any Note;
- modify any other payment provision of any Note, including any provision relating to the obligation of the Bank to pay Additional Amounts, in any manner adverse to the holders of the Notes;
- impair the right to sue for the enforcement of any payment on or with respect to any Note;
- reduce the percentage in principal amount of outstanding Notes that is required for the consent of the holders in order to modify or amend the Indenture or to waive compliance with some provisions of the Indenture or to waive any Enforcement Event; or
- modify the provisions relating to any Trigger Event, subordination provisions, provisions relating to consolidation, merger, conveyance or transfer of the Bank and/or all of its properties, and any provision dealing with insolvency (*resolución*) or liquidation of the Bank and the governing law of the Notes, in each case in any manner adverse to the holders of the Notes.

The holders of not less than a majority in aggregate of the Current Principal Amount of the Notes may waive any past non-compliance or Enforcement Event under the Indenture, except the non-compliance with a provision that cannot be modified without the consent of each holder of a Note that would be affected. Upon the occurrence of any such waiver, such past non-compliance or Enforcement Event shall be deemed to have been cured and not to have occurred for every purpose of the Indenture.

Consolidation, Merger, Sale or Transfer of Assets

The Bank may not, without the consent of holders of at least 66 2/3% in aggregate of the Current Principal Amount of the Notes, consolidate with or merge into any other person, or convey or transfer, in one transaction or a series of transactions, all or substantially all of its properties and assets to any person, unless:

- (1) the resulting entity, if other than the Bank, shall be organized and existing under the laws of Mexico and, by execution of a supplemental indenture delivered to and in form satisfactory to the Trustee, assumes all of the obligations of the Bank to:

- (x) pay the principal of, and interest (and any Additional Amounts, if any) on, the Notes; and
 - (y) perform and observe all of the other obligations of the Bank under the Indenture;
- (2) immediately after giving effect to any such transaction, no Enforcement Event, shall have happened and be continuing; and
- (3) the Bank has delivered to the Trustee an officer's certificate and an opinion of counsel, each stating that such consolidation, merger, conveyance or transfer of asset and comply with the foregoing provisions relating to such transaction and all conditions precedent in the Indenture relating to such a transaction have been complied with.

In case of any such consolidation, merger, conveyance or transfer, such successor person will succeed to and be substituted for the Bank as obligor on the Notes with the same effect as if it had issued the Notes. Upon the assumption of its obligations by any such successor person in such circumstances, subject to certain exceptions, the Bank will be discharged from all obligations under the Notes and the Indenture.

Restrictions Applicable to Mexican Financial Institutions

Unless otherwise permitted by applicable law, the Indenture will provide that the Notes (i) may not constitute collateral granted in favor of Mexican credit institutions (*instituciones de crédito*) including the Bank and (ii) may not be directly or indirectly acquired by the Bank for its own account (except as set forth under “—Open Market Purchases and Other Repurchase of Notes”) or by any person controlled by the Bank, or by any of the following entities:

- (a) Mexican financial entities (*entidades financieras*) of any kind that acquire the Notes for their own accounts except for (1) investment funds authorized to invest in subordinated instruments as part of their investment assets, (2) securities brokers (*casas de bolsa*) that acquire the Notes for placement with investors, (3) insurance companies (*instituciones y sociedades mutualistas de seguros*) and bonding companies (*instituciones de fianzas*) to the extent they acquire the Notes to invest their technical reserves and for securities fluctuations, (4) the holding company of the financial group to which the Bank belongs, in terms of the Mexican Law to Regulate Financial Groups, and (5) the Bank, in the event set forth in section II of the first paragraph of article 28 of the Circular 3/2012; *provided, however*, that the exceptions referred to in (1), (2) and (3) of this paragraph shall not apply to (x) investment companies in which the Bank or any other entity that forms part of the Bank's financial group (*grupo financiero*) holds, directly or indirectly, the majority of its fixed capital and (y) financial entities that form part of the Bank's financial group (*grupo financiero*);
- (b) Mexican or non-Mexican entities with respect to which the Bank (1) owns voting stock representing more than 50 percent of their outstanding paid-in capital, (2) has control of the shareholders' meetings of such entity, as such term is defined in the Mexican Securities Market Law or (3) is in a position to appoint the majority of the members of such entity's board of directors;
- (c) Mexican pension or retirement funds if managed by the Bank or another entity that forms part of the Bank's financial group (*grupo financiero*);
- (d) the Bank or another entity that forms part of its financial group (*grupo financiero*) acting in its capacity of trustee, representative, agent or attorney-in-fact if, by acting in such capacity, it has discretionary investment authority; and
- (e) related parties to the Bank, as defined in article 73 of the Mexican Banking Law, except in the case that the respective notes are placed through:
 - (i) public offer; or
 - (ii) any other mechanism, different to a public offering, subject to the previous authorization of *Banco de México*, at the request of the Bank in which it states the convenience to carry out the

forementioned mechanism instead of the public offering, pursuant to the provisions of article 27 of the Circular 3/2012.

Any Mexican financial entity or Mexican pension or retirement fund that is not otherwise prevented from investing in the Notes may acquire, together with any other such entity that is an affiliate or that forms part of the same financial group or corporate group on a collective basis, up to 10% of the aggregate principal amount of the outstanding Notes.

Notices

Notice to holders of the Notes, if they are global Notes, will be given in accordance with the procedures of the applicable clearing system; if they are certificated Notes, notice to holders will be given by mail to the addresses of such holders as they appear in the security register. Neither the failure to give any notice to a particular holder, nor any defect in a notice given to a particular holder, will affect the sufficiency of any notice given to another holder.

Notices to be given by any holders of the Notes to the Trustee shall be in writing to the Trustee at its corporate trust office. While any of the Notes are represented by a Global Note, such notice may be given by any holder to the Trustee through DTC in such manner as DTC may approve for this purpose.

Book-Entry System

The Notes will be initially represented by one or more Global Notes (as defined below).

The Global Notes representing the Notes will be issued in the form of one or more registered notes in global form, without interest coupons and will be deposited with a custodian for DTC and registered in the name of Cede & Co., as nominee of DTC.

The Notes are being offered and sold in this initial offering in the United States solely to qualified institutional buyers under Rule 144A under the Securities Act and in offshore transactions to persons other than U.S. persons, as defined in Regulation S under the Securities Act, in reliance on Regulation S. Following this offering, the Notes may be sold:

- to qualified institutional buyers under Rule 144A;
- to non-U.S. persons outside the United States in reliance on Regulation S; and
- under other exemptions from, or in transactions not subject to, the registration requirements of the Securities Act, as described under “*Transfer Restrictions*”.

Rule 144A Global Notes

Notes offered and sold to qualified institutional buyers under Rule 144A are referred to collectively as the “*Rule 144A Global Notes*”. Interests in the Rule 144A Global Notes will be available for purchase only by qualified institutional buyers.

Regulation S Global Notes

Notes offered and sold in offshore transactions in reliance on Regulation S under the U.S. Securities Act of 1933 to persons which are non-U.S. persons are referred to collectively as the “*Regulation S Global Notes*” and, together with the Rule 144A Global Notes, the “*Global Notes*”.

On or prior to the 40th day after the date of issuance of the Notes sold pursuant to Regulation S, any resale or transfer of beneficial interests in the Regulation S Global Notes to U.S. persons shall not be permitted unless such resale or transfer is made pursuant to Rule 144A or Regulation S.

Investors may hold their interest in a Global Note representing the Notes through organizations that are participants in DTC (including, Euroclear or Clearstream).

Exchanges among the Global Notes

Transfers by an owner of a beneficial interest in a Regulation S Global Note representing the Notes to a transferee who takes delivery of that interest through a Rule 144A Global Note representing the Notes will be made only in accordance with applicable procedures and upon receipt by the Trustee of a written certification from the transferor of the beneficial interest in the form provided in the Indenture to the effect that the transfer is being made to a qualified institutional buyer within the meaning of Rule 144A in a transaction meeting the requirements of Rule 144A.

Transfers by an owner of a beneficial interest in a Rule 144A Global Note representing the Notes to a transferee who takes delivery of the interest through a Regulation S Global Note representing the Notes will be made only upon receipt by the Trustee of a certification from the transferor of the beneficial interest in the form provided in the Indenture that the transfer is being made outside the United States to a non-U.S. person in accordance with Regulation S or, if available, Rule 144 under the Securities Act.

Any beneficial interest in one of the Global Notes representing the Notes that is transferred to a person who takes delivery in the form of an interest in another Global Note representing the Notes will, upon transfer, cease to be an interest in that Global Note and become an interest in the other Global Note and, accordingly, will then be subject to any transfer restrictions and other procedures applicable to beneficial interests in the other Global Note.

Book-entry procedures for the Global Notes

Ownership of beneficial interests in a Global Note representing the Notes will be limited to DTC and to persons that may hold interests through institutions that have accounts with DTC. Beneficial interests in a Global Note will be shown on, and transfers of those ownership interests will be effected only through, records maintained by DTC, and its respective participants for that Global Note. The conveyance of notices and other communications by DTC to its participants and by its participants to owners of beneficial interests in the Notes will be governed by arrangements among them, subject to any statutory or regulatory requirements in effect.

DTC holds the securities of its respective participants and facilitates the clearance and settlement of securities transactions among its respective participants through electronic book-entry changes in accounts.

Principal and interest payments on the Notes represented by a Global Note will be made to DTC, as the sole registered owner and the sole holder of the Notes represented by the Global Note for all purposes under the Indenture. Accordingly, the Bank, the Trustee, any paying agents, transfer agents or registrars will have no responsibility or liability for:

- any aspect of DTC's records relating to, or payments made on account of, beneficial ownership interests in a Note represented by a Global Note;
- any other aspect of the relationship between DTC and its participants or the relationship between those participants and the owners of beneficial interests in a Global Note held through those participants; or
- the maintenance, supervision or review of any of DTC's records relating to those beneficial ownership interests.

DTC

DTC has advised the Bank that upon receipt of any payment of principal of or interest on a Global Note representing the Notes, DTC will credit, on its book-entry registration and transfer system, the accounts of participants with payments in amounts proportionate to their respective beneficial interests in the principal amount of that Global Note as shown on DTC's records. The initial purchasers of the Notes will initially designate the accounts to be credited. Payments by participants to owners of beneficial interests in a Global Note will be governed by standing

instructions and customary practices, as is the case with securities held for customer accounts registered in “street names,” and will be the sole responsibility of those participants.

The Notes represented by a Global Note can be exchanged for definitive Notes of the same series in registered form only if:

- DTC notifies the Bank that it is unwilling or unable to continue as depositary for that Global Note or at any time DTC ceases to be a clearing agency registered under the Exchange Act, and a successor depositary is not appointed by the Bank within 90 calendar days; or
- the Bank, in its sole discretion, determine that such Global Note will be exchangeable for definitive Notes in registered form and notify the Trustee of its decision.

A Global Note representing the Notes that can be exchanged under the preceding paragraph will be exchanged for definitive Notes that are issued in authorized denominations in registered form for the same aggregate amount. Those definitive Notes will be registered in the names of the owners of the beneficial interests in the relevant Global Note as directed by DTC and may bear the legend as set forth under “*Transfer Restrictions*”.

Registrar, Transfer Agent and Paying Agents

The Trustee will act as registrar for the Notes. The Trustee will also act as transfer agent and paying agent for the Notes. The Bank has the right at any time to vary or terminate the appointment of any paying agents and to appoint additional or successor paying agents in respect of the Notes. Registration of transfers of the Notes will be effected without charge, but upon payment (with the giving of such indemnity as the Bank may require) in respect of any tax or other governmental charges that may be imposed in relation to it. The Bank will not be required to register or cause to be registered the transfer of the Notes after the Notes have been called for redemption.

Listing

Application is expected to be made to list the Notes on the SGX-ST. In the event that the Notes are admitted for listing on the SGX-ST, the Bank will use its commercially reasonable efforts to maintain such listing, *provided* that if (1) as a result of applicable rules and regulations relating to listing on the SGX-ST, the Bank could be required to publish financial information either more regularly than it otherwise would be required to or according to accounting principles which are materially different from the accounting principles which the Bank would otherwise use to prepare its published financial information, or (2) the Bank determines that it is unduly burdensome to maintain a listing on the SGX-ST, the Bank may delist the Notes from the SGX-ST in accordance with the rules of the SGX-ST and seek an alternative admission to listing, trading and/or quotation for the Notes on a different listing authority, stock exchange and/or quotation system as the Bank may decide. If such alternative admission to listing, trading and/or quotation of the Notes is not available to the Bank or is, in its commercially reasonable judgment, unduly burdensome, an alternative admission to listing, trading and/or quotation of the Notes may not be obtained. Although there is no assurance as to the liquidity that may result from a listing on the SGX-ST or any other stock exchange, delisting the Notes from the SGX-ST or any other stock exchange may have a material effect on the ability of holders of the Notes to resell the Notes in the secondary market.

Subsequent Holders’ Agreement

Holders of the Notes that acquire the Notes in the secondary market shall be deemed to acknowledge, agree to be bound by and consent to the same provisions specified herein to the same extent as the holders and beneficial owners of the Notes that acquire the Notes upon their initial issuance, including, without limitation, with respect to the acknowledgment and agreement to be bound by and consent to the terms of the Notes, including in relation to interest cancellation, the Write-Down and the limitations on remedies specified in “—*Enforcement Events and Remedies*” above.

The Trustee

The Bank of New York Mellon will act as Trustee under the Indenture. Notices to the Trustee should be directed to the Trustee at its Corporate Trust Office, located at 240 Greenwich Street, Floor 7-East, New York, NY 10286, Attention: Global Finance Americas – Banco Mercantil del Norte, S.A. – Banorte. The Trustee also will initially act as registrar, paying agent, transfer agent and agent for service of demands and notices in connection with the Notes and the Indenture. The Trustee may resign or be removed under circumstances described in the Indenture and the Bank may appoint a successor Trustee to act in connection with the Indenture. Any action described in this offering memorandum to be taken by the Trustee may then be taken by the successor trustee. The Trustee has only its express duties under the Indenture and no implied duties.

The Trustee in its individual or any other capacity may become the owner or pledgee of Notes and may otherwise deal with the Bank or its affiliates with the same rights the Trustee would have if it were not trustee. Any paying agent, registrar or co-registrar may do the same with like rights.

The Indenture contains some limitations on the right of the Trustee should it become a creditor of the Bank, to obtain payment of claims in some cases or to realize on some property received regarding any such claim, as security or otherwise. The Trustee will be permitted to engage in transactions with the Bank. The occurrence of an Enforcement Event under the Indenture could create a conflicting interest for the Trustee. In this case, if the Enforcement Event has not been cured or waived within 90 calendar days after the Trustee has or acquires a conflicting interest, the Trustee generally is required to eliminate the conflicting interest or resign as trustee for the Notes. In the event of the Trustee's resignation, the Bank will promptly appoint a successor trustee for the Notes.

The Trustee may be removed by the holders of a majority of the Current Principal Amount of outstanding Notes if an Enforcement Event under the Indenture has occurred and is continuing. No resignation or removal of the Trustee and no appointment of a successor trustee shall be effective until the acceptance of appointment by the successor trustee in accordance with the provisions of the Indenture.

By its acquisition of the Notes, each holder of the Notes, to the extent permitted by applicable law, waives any and all claims against the Trustee for, agrees not to initiate a suit against the Trustee in respect of, and agrees that the Trustee shall not be liable for, any action that the Trustee takes, or abstains from taking, in either case in accordance with any Write-Down or Enforcement Event on the terms set forth herein and in the Indenture.

By its acquisition of the Notes, each holder of the Notes acknowledges and agrees that, upon a Trigger Event the Trustee shall not be required to take any further directions from holders of the Notes under the Indenture, which authorizes holders of a majority in aggregate outstanding principal amount of the Notes to direct certain actions relating to the Notes.

Governing Law; Consent to Jurisdiction

THE INDENTURE AND THE NOTES SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAW OF THE STATE OF NEW YORK. (I) WHETHER A TRIGGER EVENT (LEADING TO A WRITE-DOWN) OR AN INTEREST CANCELLATION EVENT (LEADING TO A CANCELLATION OF INTEREST) HAS OCCURRED IS BASED UPON MEXICAN LAW OR A DETERMINATION BY THE APPLICABLE MEXICAN REGULATOR, AS SET FORTH IN THIS OFFERING MEMORANDUM, IN ACCORDANCE WITH MEXICAN LAW (AS AMENDED FROM TIME TO TIME); (II) WHETHER A WITHHOLDING TAX EVENT OR A TAX EVENT HAS OCCURRED IS BASED UPON A DETERMINATION IN ACCORDANCE WITH MEXICAN LAW (OR OTHER APPLICABLE LAW IN THE CASE OF A WITHHOLDING TAX EVENT INVOLVING A JURISDICTION OTHER THAN MEXICO), AS AMENDED FROM TIME TO TIME, EVIDENCED BY AN OPINION OF A NATIONALLY RECOGNIZED LAW FIRM AND, IF REQUIRED, A CERTIFICATION BY THE BANK; AND (III) WHETHER A CAPITAL EVENT HAS OCCURRED IS DETERMINED BY THE BANK, AS SET FORTH IN THIS OFFERING MEMORANDUM, IN ACCORDANCE WITH MEXICAN LAW (AS AMENDED FROM TIME TO TIME). THE RANKING AND SUBORDINATION OF THE NOTES, WILL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, MEXICAN LAW (AS AMENDED FROM TIME TO TIME). THE BANK, EACH PARTY TO THE INDENTURE AND EACH HOLDER OF A

NOTE WILL WAIVE ANY RIGHTS IT MAY HAVE UNDER THE LAW OF THE STATE OF NEW YORK NOT TO GIVE EFFECT TO ANY SUCH DETERMINATION TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW. ANY PROCEEDINGS IN RESPECT OF THE INSOLVENCY (*RESOLUCIÓN*) OR LIQUIDATION OF THE BANK WILL BE CONDUCTED IN ACCORDANCE WITH THE MEXICAN BANKING LAW, AS AMENDED FROM TIME TO TIME, OR ANY SUCCESSOR THEREOF, AND ANY MERGER OR CONSOLIDATION SHALL BE SUBJECT TO APPLICABLE APPROVALS UNDER THE MEXICAN BANKING LAW AND ANY OTHER APPLICABLE MEXICAN LAWS, AS AMENDED FROM TIME TO TIME, OR ANY SUCCESSOR THEREOF.

THE BANK AND EACH PARTY TO THE INDENTURE WILL CONSENT TO THE JURISDICTION OF THE SUPREME COURT OF THE STATE OF NEW YORK, COUNTY OF NEW YORK, AND THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK, EACH IN THE BOROUGH OF MANHATTAN, AND WILL AGREE THAT ALL DISPUTES UNDER THE INDENTURE AND THE NOTES MAY BE SUBMITTED TO THE JURISDICTION OF SUCH COURTS. THE BANK AND EACH PARTY TO THE INDENTURE WILL IRREVOCABLY CONSENT TO AND WAIVE TO THE FULLEST EXTENT PERMITTED BY LAW ANY OBJECTION THAT THE BANK MAY HAVE TO THE LAYING OF VENUE OF ANY SUIT, ACTION OR PROCEEDING AGAINST THE BANK OR ITS PROPERTIES, ASSETS AND REVENUES WITH RESPECT TO THE INDENTURE AND THE NOTES OR ANY SUCH SUIT, ACTION OR PROCEEDING IN ANY SUCH COURT AND ANY RIGHT TO WHICH THE BANK MAY BE ENTITLED BY VIRTUE OF ITS PRESENT OR FUTURE DOMICILE OR FOR ANY OTHER REASON.

TO THE EXTENT THAT THE BANK OR ANY OF ITS REVENUES, ASSETS OR PROPERTIES SHALL BE ENTITLED TO ANY IMMUNITY FROM SUIT, FROM THE JURISDICTION OF ANY SUCH COURT, FROM ATTACHMENT PRIOR TO JUDGMENT, FROM ATTACHMENT IN AID OF EXECUTION OF JUDGMENT, FROM EXECUTION OF A JUDGMENT OR FROM ANY OTHER LEGAL OR JUDICIAL PROCESS REMEDY, THE BANK WILL IRREVOCABLY AGREE NOT TO CLAIM AND WILL IRREVOCABLY WAIVE SUCH IMMUNITY TO THE FULLEST EXTENT PERMITTED BY THE LAWS OF SUCH JURISDICTION.

THE BANK WILL AGREE THAT SERVICE OF ALL WRITS, CLAIMS, PROCESS AND SUMMONS IN ANY SUIT, ACTION OR PROCEEDING AGAINST THE BANK OR ITS PROPERTIES, ASSETS OR REVENUES WITH RESPECT TO THE INDENTURE AND THE NOTES OR ANY SUIT, ACTION OR PROCEEDING TO ENFORCE OR EXECUTE ANY JUDGMENT BROUGHT AGAINST THE BANK IN THE STATE OF NEW YORK MAY BE MADE UPON C T CORPORATION SYSTEM, 28 LIBERTY STREET, FLOOR 42, NEW YORK, NEW YORK 10005, AND THE BANK WILL IRREVOCABLY APPOINT C T CORPORATION SYSTEM AS ITS AGENT TO ACCEPT SUCH SERVICE OF ANY AND ALL SUCH WRITS, CLAIMS, PROCESS AND SUMMONSES.

Currency Rate Indemnity

The Bank has agreed that, if a judgment or order made by any court for the payment of any amount in respect of the Indenture or any Notes is expressed in a currency other than U.S. dollars, the Bank will indemnify, to the fullest extent permitted by applicable law, the relevant recipient against any deficiency arising from any variation in rates of exchange between the date as of which the denomination currency is notionally converted into the judgment currency for the purposes of the judgment or order and the date of actual payment. This indemnity will constitute a separate and independent obligation from the Bank's other obligations under the Indenture, will give rise to a separate and independent cause of action, will apply irrespective of any indulgence granted from time to time and will continue in full force and effect notwithstanding any judgment or order for a liquidated sum or sums in respect of amounts due under the Indenture or the Notes.

Replacement of Notes

In case of mutilated, defaced, destroyed, lost or stolen Notes, application for replacement thereof may be made to the Trustee or the Bank. Any such Note shall be replaced by the Trustee in compliance with such procedures, on such terms as to evidence and indemnification as the Trustee and the Bank may require and subject to any applicable law

or regulation. All such costs as may be incurred in connection with the replacement of any Notes shall be borne by the applicant. Mutilated Notes must be surrendered before new ones will be issued.

TRANSFER RESTRICTIONS

The Notes are subject to restrictions on transfer as summarized below. By purchasing Notes you will be deemed to have made the following acknowledgements, representations to and agreements with the initial purchasers and us:

1. You acknowledge that:
 - The offering is being made in accordance with Rule 144A and Regulation S;
 - the Notes have not been registered under the Securities Act or any other securities laws and are being offered for resale in transactions that do not require registration under the Securities Act or any other securities laws; and
 - unless so registered, the Notes may not be offered, sold or otherwise transferred except under an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act or any other applicable securities laws, and in each case in compliance with the conditions for transfer set forth in paragraph (4) below.
2. You represent that you are not an affiliate (as defined in Rule 144 under the Securities Act) of ours, that you are not acting on our behalf and that either:
 - you are a qualified institutional buyer (as defined in Rule 144A under the Securities Act) and are purchasing Notes for your own account or for the account of another qualified institutional buyer, and you are aware that the initial purchasers are selling the Notes to you in reliance on Rule 144A; or
 - you are not a U.S. person (as defined in Regulation S) or purchasing for the account or benefit of a U.S. person, other than a distributor, and you are purchasing Notes in an offshore transaction in accordance with Regulation S.
3. You acknowledge that neither we nor the initial purchasers nor any person representing us or the initial purchasers has made any representation to you with respect to us or the offering of the Notes, other than the information contained in this offering memorandum.
4. You represent that you are purchasing Notes for your own account, or for one or more investor accounts for which you are acting as a fiduciary or agent, in each case not with a view to, or for offer or sale in connection with, any distribution of the Notes in violation of the Securities Act, subject to any requirement of law that the disposition of your property or the property of that investor account or accounts be at all times within your or their control and subject to your or their ability to resell the Notes pursuant to Rule 144A or any other available exemption from registration under the Securities Act. You agree on your own behalf and on behalf of any investor account for which you are purchasing Notes, and each subsequent holder of the Notes by its acceptance of the Notes will agree that the Notes may be offered, sold or otherwise transferred only:
 - (a) under a registration statement that has been declared effective under the Securities Act;
 - (b) for so long as the Notes are eligible for resale under Rule 144A, to a person the seller reasonably believes is a qualified institutional buyer that is purchasing for its own account or for the account of another qualified institutional buyer and to whom notice is given that the transfer is being made in reliance on Rule 144A;
 - (c) through offers and sales that occur outside the United States to non-U.S. purchasers within the meaning of Regulation S; or
 - (d) under any other available exemption from the registration requirements of the Securities Act,subject in each of the above cases to any requirement of law that the disposition of the seller's property

or the property of an investor account or accounts be at all times within the seller's or account's control.

5. You understand that the certificates evidencing the Global Notes (other than the Regulation S Global Notes) will bear a legend substantially to the following effect unless otherwise determined by us:

THIS IS A GLOBAL NOTE WITHIN THE MEANING OF THE INDENTURE REFERRED TO HEREINAFTER.

UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY, A NEW YORK CORPORATION ("DTC"), NEW YORK, NEW YORK TO THE BANK OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC (AND ANY PAYMENT IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL INASMUCH AS THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN.

TRANSFERS OF THIS GLOBAL NOTE SHALL BE LIMITED TO TRANSFERS IN WHOLE, BUT NOT IN PART, TO NOMINEES OF DTC OR TO A SUCCESSOR THEREOF OR SUCH SUCCESSOR'S NOMINEE AND TRANSFERS OF PORTIONS OF THIS GLOBAL NOTE SHALL BE LIMITED TO TRANSFERS MADE IN ACCORDANCE WITH THE RESTRICTIONS SET FORTH IN THE INDENTURE REFERRED TO ON THE REVERSE HEREOF.

THE NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED WITH THE MEXICAN NATIONAL SECURITIES REGISTRY (REGISTRO NACIONAL DE VALORES) MAINTAINED BY THE MEXICAN NATIONAL BANKING AND SECURITIES COMMISSION (COMISIÓN NACIONAL BANCARIA Y DE VALORES, OR CNBV), AND, THEREFORE MAY NOT BE OFFERED OR SOLD PUBLICLY IN MEXICO. THE NOTES MAY BE OFFERED TO MEXICAN INSTITUTIONAL OR ACCREDITED INVESTORS (INVERSIONISTAS INSTITUCIONALES OR INVERSIONISTAS CALIFICADOS), PURSUANT TO THE PRIVATE PLACEMENT EXEMPTION SET FORTH IN ARTICLE 8 OF THE MEXICAN SECURITIES MARKET LAW (LEY DEL MERCADO DE VALORES) AND THE REGULATIONS THEREUNDER. AS REQUIRED UNDER THE MEXICAN SECURITIES MARKET LAW, THE BANK WILL NOTIFY THE CNBV OF THE TERMS AND CONDITIONS OF THIS OFFERING AND THE ISSUANCE OF THE NOTES OUTSIDE OF MEXICO. SUCH NOTICE WILL BE DELIVERED TO THE CNBV TO COMPLY WITH ARTICLE 7, SECOND PARAGRAPH, OF THE MEXICAN SECURITIES MARKET LAW AND REGULATIONS THEREUNDER, AND FOR STATISTICAL AND INFORMATIONAL PURPOSES. THE DELIVERY TO AND THE RECEIPT BY THE CNBV OF SUCH NOTICE DOES NOT IMPLY ANY CERTIFICATION AS TO THE INVESTMENT QUALITY OF THE NOTES OR THE SOLVENCY, LIQUIDITY OR CREDIT QUALITY OF THE BANK OR THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH IN THE OFFERING MEMORANDUM. THE ACQUISITION OF THE NOTES BY AN INVESTOR WHO IS A RESIDENT OF MEXICO WILL BE MADE UNDER ITS OWN RESPONSIBILITY.

THE NOTE REPRESENTED HEREBY HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE SECURITIES ACT, OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES, AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT IN ACCORDANCE WITH THE FOLLOWING SENTENCE. BY ITS ACQUISITION HEREOF OR OF A BENEFICIAL INTEREST HEREIN, THE HOLDER OF THIS SECURITY BY ITS ACCEPTANCE HEREOF (**I**) REPRESENTS THAT IT, AND ANY ACCOUNT FOR WHICH IT IS ACTING, (**A**) IS A "QUALIFIED INSTITUTIONAL BUYER" (WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT) OR (**B**) IS NOT A U.S. PERSON AND IS ACQUIRING THIS SECURITY IN AN "OFFSHORE TRANSACTION" PURSUANT TO RULE 903 OR 904 OF REGULATION S AND,

WITH RESPECT TO (A) AND (B), EXERCISES SOLE INVESTMENT DISCRETION WITH RESPECT TO SUCH ACCOUNT, (2) AGREES FOR THE BENEFIT OF THE COMPANY THAT IT WILL NOT OFFER, SELL, PLEDGE OR OTHERWISE TRANSFER THIS SECURITY OR ANY BENEFICIAL INTEREST HEREIN, EXCEPT (A) (I) TO THE COMPANY OR ANY SUBSIDIARY THEREOF, (II) PURSUANT TO A REGISTRATION STATEMENT THAT HAS BECOME EFFECTIVE UNDER THE SECURITIES ACT, (III) TO A QUALIFIED INSTITUTIONAL BUYER IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT, (IV) IN AN OFFSHORE TRANSACTION COMPLYING WITH THE REQUIREMENTS OF RULE 903 OR RULE 904 OF REGULATION S UNDER THE SECURITIES ACT OR (V) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT (IF AVAILABLE), AND (B) IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND OTHER JURISDICTIONS AND (3) AGREES THAT IT WILL GIVE TO EACH PERSON TO WHOM THIS SECURITY IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND. AS USED HEREIN, THE TERMS “OFFSHORE TRANSACTION,” “UNITED STATES” AND “U.S. PERSON” HAVE THE RESPECTIVE MEANINGS GIVEN TO THEM BY REGULATION S UNDER THE SECURITIES ACT.

PRIOR TO THE REGISTRATION OF ANY TRANSFER IN ACCORDANCE WITH PARAGRAPH 2A(V) ABOVE, THE COMPANY RESERVES THE RIGHT TO REQUIRE THE DELIVERY OF SUCH LEGAL OPINIONS, CERTIFICATIONS OR OTHER EVIDENCE AS MAY REASONABLY BE REQUIRED IN ORDER TO DETERMINE THAT THE PROPOSED TRANSFER IS BEING MADE IN COMPLIANCE WITH THE SECURITIES ACT AND APPLICABLE STATE SECURITIES LAWS. NO REPRESENTATION IS MADE AS TO THE AVAILABILITY OF ANY EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT. THIS LEGEND SHALL ONLY BE REMOVED AT THE OPTION OF THE ISSUER.

6. If you are a non-U.S. purchaser acquiring a beneficial interest in a Regulation S Global Note offered pursuant to this offering memorandum, you acknowledge and agree that, until the expiration of the 40-day “distribution compliance period” within the meaning of Regulation S, any offer, sale, pledge or other transfer shall not be made by it in the United States or to, or for the account or benefit of, a U.S. person, except pursuant to Rule 144A to a QIB taking delivery thereof in the form of a beneficial interest in a Global Note, and that each Regulation S Global Note will contain a legend to substantially the following effect:

THIS IS A GLOBAL NOTE WITHIN THE MEANING OF THE INDENTURE REFERRED TO HEREINAFTER.

UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY, A NEW YORK CORPORATION (“DTC”), NEW YORK, NEW YORK TO THE BANK OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR IN SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC (AND ANY PAYMENT IS MADE TO CEDE & CO. OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC), ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL INASMUCH AS THE REGISTERED OWNER HEREOF, CEDE & CO., HAS AN INTEREST HEREIN.

TRANSFERS OF THIS GLOBAL NOTE SHALL BE LIMITED TO TRANSFERS IN WHOLE, BUT NOT IN PART, TO NOMINEES OF DTC OR TO A SUCCESSOR THEREOF OR SUCH SUCCESSOR’S NOMINEE AND TRANSFERS OF PORTIONS OF THIS GLOBAL NOTE SHALL BE LIMITED TO TRANSFERS MADE IN ACCORDANCE WITH THE RESTRICTIONS SET FORTH IN THE INDENTURE REFERRED TO ON THE REVERSE HEREOF.

THE NOTES HAVE NOT BEEN AND WILL NOT BE REGISTERED WITH THE MEXICAN NATIONAL SECURITIES REGISTRY (REGISTRO NACIONAL DE VALORES) MAINTAINED BY THE MEXICAN NATIONAL BANKING AND SECURITIES COMMISSION (COMISIÓN

NACIONAL BANCARIA Y DE VALORES, OR CNBV), AND, THEREFORE MAY NOT BE OFFERED OR SOLD PUBLICLY IN MEXICO. THE NOTES MAY BE OFFERED TO MEXICAN INSTITUTIONAL OR ACCREDITED INVESTORS (INVERSIONISTAS INSTITUCIONALES OR INVERSIONISTAS CALIFICADOS), PURSUANT TO THE PRIVATE PLACEMENT EXEMPTION SET FORTH IN ARTICLE 8 OF THE MEXICAN SECURITIES MARKET LAW (LEY DEL MERCADO DE VALORES) AND THE REGULATIONS THEREUNDER. AS REQUIRED UNDER THE MEXICAN SECURITIES MARKET LAW, THE BANK WILL NOTIFY THE CNBV OF THE TERMS AND CONDITIONS OF THIS OFFERING AND THE ISSUANCE OF THE NOTES OUTSIDE OF MEXICO. SUCH NOTICE WILL BE DELIVERED TO THE CNBV TO COMPLY WITH ARTICLE 7, SECOND PARAGRAPH, OF THE MEXICAN SECURITIES MARKET LAW AND REGULATIONS THEREUNDER, AND FOR STATISTICAL AND INFORMATIONAL PURPOSES. THE DELIVERY TO AND THE RECEIPT BY THE CNBV OF SUCH NOTICE DOES NOT IMPLY ANY CERTIFICATION AS TO THE INVESTMENT QUALITY OF THE NOTES OR THE SOLVENCY, LIQUIDITY OR CREDIT QUALITY OF THE BANK OR THE ACCURACY OR COMPLETENESS OF THE INFORMATION SET FORTH IN THE OFFERING MEMORANDUM. THE ACQUISITION OF THE NOTES BY AN INVESTOR WHO IS A RESIDENT OF MEXICO WILL BE MADE UNDER ITS OWN RESPONSIBILITY.

THE SECURITIES EVIDENCED HEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), OR ANY STATE OR OTHER SECURITIES LAWS. PRIOR TO EXPIRATION OF THE 40-DAY DISTRIBUTION COMPLIANCE PERIOD (AS DEFINED IN REGULATION S (“REGULATION S”) UNDER THE SECURITIES ACT, THIS SECURITY MAY NOT BE REOFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED WITHIN THE UNITED STATES (AS DEFINED IN REGULATION S) OR TO, OR FOR THE ACCOUNT OR BENEFIT OF, A U.S. PERSON (AS DEFINED IN REGULATION S), EXCEPT TO A QUALIFIED INSTITUTIONAL BUYER IN COMPLIANCE WITH RULE 144A UNDER THE SECURITIES ACT IN A TRANSACTION MEETING THE REQUIREMENTS OF THE INDENTURE REFERRED TO HEREIN.

7. You represent that either **(i)** you are not, and for so long as you hold the Notes or any interest therein will not be, and you are not purchasing the Notes with the assets of, or for or on behalf of, **(1)** an employee benefit plan (as defined in Section 3(3) of ERISA) subject to Title I of ERISA or any other plan, individual retirement account or arrangement that is subject Section 4975 of the Code (each, a “Plan”), **(2)** any governmental, church or non-U.S. plan or other arrangement (a “Non-ERISA Arrangement”) that is subject to any applicable federal, state, local, non U.S. or Similar Laws, or **(3)** any entity whose underlying assets are deemed to be the assets of a Plan pursuant to 29 C.F.R. Section 2510.3-101 (as modified by Section 3 (42) of ERISA) or otherwise or **(ii)** your purchase, holding and disposition of the Notes is exempt from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code (or, in the case of a Non-ERISA Arrangement from any Similar Law) pursuant to the exemption provided by U.S. Department of Labor Prohibited Transaction Class Exemption 96-23, 95-60, 91-38, 90-1 or 84-14, Section 408(b)(17) of ERISA or Section 4975(d)(20) of the Code, or another applicable statutory or administrative exemption or, in the case of a Non-ERISA Arrangement, a substantially similar exemption under Similar Laws.
8. You acknowledge that we, the initial purchasers and others will rely upon the truth and accuracy of the above acknowledgments, representations and agreements. You agree that if any of the acknowledgments, representations or agreements you are deemed to have made by your purchase of Notes is no longer accurate, you will promptly notify us and the initial purchasers. If you are purchasing any Notes as a fiduciary or agent for one or more investor accounts, you represent that you have sole investment discretion with respect to each of those accounts and that you have full power to make the above acknowledgments, representations and agreements on behalf of each account.

Each purchaser that is acquiring Notes pursuant to Regulation S under the Securities Act represents that it is not acquiring the Notes with a view to the resale, distribution or other disposition thereof to a U.S. person or in the United States.

FORM OF NOTES, CLEARING AND SETTLEMENT

Global Notes

The notes will be issued in the form of one or more registered notes in global form, without interest coupons (the “Global Notes”), as follows:

- notes sold to qualified institutional buyers under Rule 144A will be represented by a Restricted Global Note; and
- notes sold in offshore transactions to non-U.S. persons in reliance on Regulation S will be represented by a Regulation S Global Note.

Upon issuance, each of the Global Notes will be deposited with the trustee as custodian for DTC and registered in the name of Cede & Co., as nominee of DTC.

Ownership of beneficial interests in each Global Note will be limited to persons who have accounts with DTC (“DTC participants”), including Euroclear Bank S.A./N.V. (“Euroclear”) and Clearstream Banking, société anonyme (“Clearstream”), or persons who hold interests through DTC participants. We expect that under procedures established by DTC:

- upon deposit of each Global Note with DTC’s custodian, DTC will credit portions of the principal amount of the Global Note to the accounts of the DTC participants designated by the initial purchasers; and
- ownership of beneficial interests in each Global Note will be shown on, and transfer of ownership of those interests will be effected only through, records maintained by DTC (with respect to interests of DTC participants) and the records of DTC participants (with respect to other owners of beneficial interests in the Global Note).

Beneficial interests in the Regulation S Global Note will initially be credited within DTC to Euroclear and Clearstream on behalf of the owners of such interests. Investors may hold their interests in the Global Notes directly through DTC, Euroclear or Clearstream, if they are participants in those systems, or indirectly through organizations that are participants in those systems.

Beneficial interests in the Global Notes may not be exchanged for notes in physical, certificated form except in the limited circumstances described below. Each Global Note and beneficial interests in each Global Note will be subject to restrictions on transfer as described under “Transfer Restrictions.”

Exchanges Between the Global Notes

Beneficial interests in one Global Note may generally be exchanged for interests in another Global Note. Depending on whether the transfer is being made during or after the 40-day period commencing on the original issue date of the Notes, and to which Global Note the transfer is being made, the transferor may be required to provide certain written certifications in the form provided in the Indenture.

A beneficial interest in a Global Note that is transferred to a person who takes delivery through another Global Note will, upon transfer, become subject to any transfer restrictions and other procedures applicable to beneficial interests in the other Global Note.

Book-Entry Procedures for the Global Notes

All interests in the Global Notes will be subject to the operations and procedures of DTC, Euroclear and Clearstream. We provide the following summaries of those operations and procedures solely for the convenience of investors. The operations and procedures of each settlement system are controlled by that settlement system and may

be changed at any time. None of us, the trustee, the initial purchasers nor any of our respective agents are responsible for those operations or procedures.

DTC has advised that it is:

- a limited purpose trust company organized under the New York State Banking Law;
- a “banking organization” within the meaning of the New York State Banking Law;
- a member of the U.S. Federal Reserve System;
- a “clearing corporation” within the meaning of the New York Uniform Commercial Code; and
- a “clearing agency” registered under Section 17A of the U.S. Securities Exchange Act of 1934, as amended.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between its participants through electronic book-entry changes to the accounts of its participants. DTC’s participants include securities brokers and dealers, including the initial purchasers; banks and trust companies; clearing corporations; and certain other organizations. Indirect access to DTC’s system is also available to others such as banks, brokers, dealers and trust companies; these indirect participants clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly. Investors who are not DTC participants may beneficially own securities held by or on behalf of DTC only through DTC participants or indirect participants in DTC.

So long as DTC or its nominee is the registered owner of a Global Note, DTC or its nominee will be considered the sole owner or holder of the Notes represented by that Global Note for all purposes under the Indenture. Except as provided below, owners of beneficial interests in a Global Note:

- will not be entitled to have Notes represented by the Global Note registered in their names;
- will not receive or be entitled to receive physical, certificated Notes; and
- will not be considered the registered owners or holders of the Notes under the Indenture for any purpose, including with respect to the giving of any direction, instruction or approval to the trustee under the Indenture.

As a result, each investor who owns a beneficial interest in a Global Note must rely on the procedures of DTC to exercise any rights of a holder of Notes under the Indenture (and, if the investor is not a participant or an indirect participant in DTC, on the procedures of the DTC participant through which the investor owns its interest).

Payments of principal, premium, if any, and interest with respect to the notes represented by a Global Note will be made by the trustee to DTC’s nominee as the registered holder of the Global Note. Neither we nor the trustee will have any responsibility or liability for the payment of amounts to owners of beneficial interests in a Global Note, for any aspect of the records relating to or payments made on account of those interests by DTC, or for maintaining, supervising or reviewing any records of DTC relating to those interests.

Payments by participants and indirect participants in DTC to the owners of beneficial interests in a Global Note will be governed by standing instructions and customary practices and will be the responsibility of those participants or indirect participants and not of DTC, its nominee or us.

Transfers between participants in DTC will be effected under DTC’s procedures and will be settled in same-day funds. Transfers between participants in Euroclear or Clearstream will be effected in the ordinary way under the rules and operating procedures of those systems.

Cross-market transfers between DTC participants, on the one hand, and Euroclear or Clearstream participants, on the other hand, will be effected within DTC through the DTC participants that are acting as

depositories for Euroclear and Clearstream. To deliver or receive an interest in a Global Note held in a Euroclear or Clearstream account, an investor must send transfer instructions to Euroclear or Clearstream, as the case may be, under the rules and procedures of that system and within the established deadlines of that system. If the transaction meets its settlement requirements, Euroclear or Clearstream, as the case may be, will send instructions to its DTC depository to take action to effect final settlement by delivering or receiving interests in the relevant Global Notes in DTC, and making or receiving payment under normal procedures for same-day funds settlement applicable to DTC. Euroclear and Clearstream participants may not deliver instructions directly to the DTC depositories that are acting for Euroclear or Clearstream.

Because of time zone differences, the securities account of a Euroclear or Clearstream participant that purchases an interest in a Global Note from a DTC participant will be credited on the business day for Euroclear or Clearstream immediately following the DTC settlement date. Cash received in Euroclear or Clearstream from the sale of an interest in a Global Note to a DTC participant will be received with value on the DTC settlement date but will be available in the relevant Euroclear or Clearstream cash account as of the business day for Euroclear or Clearstream following the DTC settlement date.

DTC, Euroclear and Clearstream have agreed to the above procedures to facilitate transfers of interests in the Global Notes among participants in those settlement systems. However, the settlement systems are not obligated to perform these procedures and may discontinue or change these procedures at any time. Neither we, the trustee nor any of our respective agents will have any responsibility for the performance by DTC, Euroclear or Clearstream or their participants or indirect participants of their obligations under the rules and procedures governing their operations.

Certificated Notes

Beneficial interests in the Global Notes may not be exchanged for Notes in physical, certificated form unless:

- DTC notifies us at any time that it is unwilling or unable to continue as depository for the Global Notes and a successor depository is not appointed within 90 days;
- DTC ceases to be registered as a clearing agency under the Securities Exchange Act of 1934, as amended, and a successor depository is not appointed within 90 days;
- we, at our option, notify the trustee that we elect to cause the issuance of certificated Notes; or
- certain other events provided in the Indenture occur, including the occurrence and continuance of an event of default with respect to the Notes.

In all cases, certificated Notes delivered in exchange for any Global Note will be registered in the names, and issued in any approved denominations, requested by the depository and will bear a legend indicating the transfer restrictions of that particular Global Note.

For information concerning paying agents and transfer agents for any notes in certificated form, see “*Description of the Notes—General*,” “*Description of the Notes—Interest*” and “*Description of the Notes—Registrar, Transfer Agent and Paying Agents*.”

TAXATION

The following discussion summarizes certain federal Mexican and U.S. income tax consequences to beneficial owners arising from the purchase, ownership or disposition of the Notes. The summary does not purport to be a comprehensive description of all potential Mexican federal income tax and U.S. federal income tax considerations that may be relevant to a decision to purchase, own or dispose of the Notes, and is not intended as tax advice to any particular investor. This discussion is for general information purposes only and is based upon the federal tax laws of Mexico (including the Mexican Income Tax Law –Ley del Impuesto sobre la Renta- and the Mexican Federal Tax Code –Código Fiscal de la Federación) and the United States as in effect on the date of this offering memorandum, which are subject to change, and such changes may have retroactive effect. This summary does not describe any tax consequences arising under the laws of any state, municipality or other taxing jurisdiction other than federal income tax consequences applicable in Mexico and the United States.

Prospective purchasers of the Notes should consult their own tax advisors as to the Mexican, United States or other tax consequences (including tax consequences arising under double-taxation treaties that are in full force and effect) of the purchase, ownership and disposition of the Notes, including, in particular, the application of the tax considerations discussed below to their particular situations, as well as the application of state, local, municipal, foreign or other tax laws.

Certain United States Federal Income Tax Considerations

The following is a summary of certain U.S. federal income tax considerations that may be relevant to a beneficial owner of the Notes that is a U.S. Holder (as defined below). This summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase the Notes. In particular, the summary deals only with holders that will acquire Notes as part of the initial offering and will hold them as capital assets. It does not address the tax treatment of holders that may be subject to special tax rules, such as:

- banks, mutual funds and other financial institutions;
- real estate investment trusts and regulated investment companies;
- traders in securities who elect to apply a mark-to-market method of accounting;
- tax-exempt organizations or governmental organizations;
- insurance companies;
- dealers or brokers in securities or foreign currency;
- individual retirement and other deferred accounts;
- U.S. Holders whose functional currency is not the U.S. dollar;
- U.S. expatriates and former citizens or long-term residents of the United States;
- persons that are resident or ordinarily resident in or have permanent establishment in a jurisdiction outside the United States;
- U.S. Holders who own or are deemed to own 10% or more (by vote or value) of the Bank's stock;
- persons who hold their Notes as part of a straddle, hedging, conversion, constructive sale or other risk reduction transaction;
- persons who purchase or sell their Notes as part of a wash sale for tax purposes; and

- “S corporations,” partnerships or other entities or arrangements classified as partnerships for U.S. federal income tax purposes, or other pass-through entities (and investors therein).

Moreover, this discussion does not address any tax consequences relating to the alternative minimum tax or the Medicare tax on investment income or any tax consequences other than U.S. federal income tax consequences (such as the estate or gift tax).

This summary is based on the Code, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, in each case as of the date hereof, changes to any of which subsequent to the date of this offering memorandum may affect the tax consequences described herein, possibly with retroactive effect. Each holder should consult its own tax advisors about the tax consequences of the purchase, ownership and disposition of the Notes in light of such holder’s particular circumstances, including the tax consequences under state, local, foreign and other tax laws and the possible effects of any changes in applicable tax laws.

For purposes of this discussion, a “U.S. Holder” means a beneficial owner of Notes that for U.S. federal income tax purposes is:

- an individual who is a citizen or resident of the United States;
- a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in the United States, any state thereof or the District of Columbia;
- an estate the income of which is subject to U.S. federal income taxation regardless of its source; or
- a trust if (i) a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (ii) the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person for U.S. federal income tax purposes.

If a partnership, including for this purpose any arrangement or entity that is treated as a partnership for U.S. federal income tax purposes, holds Notes the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. A holder that is a partnership for U.S. federal income tax purposes and the partners in such partnership are urged to consult their tax advisors about the U.S. federal income tax consequences of the acquisition of Notes.

Characterization of the Notes

The determination of whether an obligation represents debt, equity, or some other instrument or interest is based on all the relevant facts and circumstances. Despite the fact that the Notes are denominated as debt, the Notes should be treated as an equity interest in the Bank for U.S. federal income tax purposes. The Notes have several equity-like features, including (1) the absence of a fixed maturity date, (2) provisions for the cancellation of interest payments and the Write-Down of principal, and (3) the subordination of the Notes to Senior Indebtedness and Subordinated Preferred Indebtedness of the Bank. By purchasing a Note, each holder agrees to treat the Note as an equity interest in the Bank for U.S. federal income tax purposes. Accordingly, each “interest” payment should be treated as a distribution by the Bank with respect to such equity interest, and any reference in this discussion to “dividends” or “distributions” refers to the “interest” payments on the Notes. However, the Bank’s characterization of the Notes is not binding on the Internal Revenue Service (the “IRS”). The remainder of this discussion assumes that the Notes will be characterized as equity in the Bank for U.S. federal income tax purposes.

Tax Treatment of Payments on the Notes

Subject to the discussion below under “—PFIC Rules,” payments of stated interest on the Notes will be treated as distributions on our stock and as dividends to the extent paid out of our current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Because we do not expect to maintain calculations of our

earnings and profits under U.S. federal income tax principles, it is expected that distributions paid to a U.S. Holder generally will be reported as dividends.

Subject to the discussion below under “—PFIC Rules,” dividends received by an individual generally will be subject to taxation at the maximum rate applicable to long-term capital gains if the dividends are “qualified dividends.” Generally, dividends will be treated as qualified dividends if: (i) we are eligible for the benefits of a comprehensive income tax treaty with the United States which the United States Treasury Department determines to be satisfactory for these purposes and which includes an exchange of information provision; and (ii) we were not, in the year prior to the year in which the dividend was paid, and are not, in the year in which the dividend is paid, a PFIC. We expect that dividends received or accrued on the Notes will be of the type of dividend that is eligible to be a qualified dividend, although there is some uncertainty as to the application of the qualified dividend rules to instruments that are treated as equity for U.S. federal income tax purposes but have the legal form of debt. U.S. Holders should consult their own tax advisors regarding the availability of this reduced dividend tax rate for interest payments on the Notes.

Sale, Exchange, Redemption or Write-Down of the Notes

Subject to the discussion below under “—PFIC Rules,” a U.S. Holder will recognize capital gain or loss upon the sale, exchange, redemption or other taxable disposition of Notes or a total Write-Down of Notes in an amount equal to the difference between the amount realized on such disposition (or zero in the case of a total Write-Down) and the holder’s adjusted tax basis in such Notes. A U.S. Holder’s tax basis in a Note generally will be the price such holder paid for the Note. Any capital gain or loss will be long-term if the Notes have been held for more than one year at the time of such sale, exchange, redemption or other taxable disposition or Write-Down. Certain non-corporate U.S. Holders (including individuals) may be eligible for preferential rates of taxation on long-term capital gains. The deductibility of capital losses is subject to limitations. U.S. Holders should also consult their own tax advisors regarding potential tax consequences to them in case of a partial Write-Down of the Notes.

PFIC Rules

Special U.S. federal income tax rules would apply to us if we were classified as a PFIC. We will be classified as a PFIC in any taxable year in which, after taking into account our income and gross assets (and the income and assets of our subsidiaries pursuant to applicable “look-through rules”) either (i) 75% or more of our gross income consists of certain types of “passive income” or (ii) 50% or more of the average quarterly value of our assets is attributable to “passive assets” (assets that produce or are held for the production of passive income). For this purpose, passive income generally includes, among other things, dividends, interest, rents, royalties, gains from the disposition of passive assets and gains from commodities transactions. The application of the PFIC rules to banks is unclear under present U.S. federal income tax law. Banks generally derive a substantial part of their income from assets that are interest-bearing or that otherwise could be considered passive under the PFIC rules. The IRS has issued a Notice and has proposed Treasury regulations that exclude from passive income any income derived in the active conduct of a banking business by a qualifying foreign bank (the “Active Bank Exception”). The IRS Notice and proposed Treasury regulations have different requirements for qualifying as a foreign bank and for determining the banking income that may be excluded from passive income under the Active Bank Exception. The proposed Treasury regulations have been outstanding since 1995 and will not be effective unless finalized. Accordingly, the application of these rules to us is subject to substantial uncertainty.

Based on our Audited Consolidated Financial Statements, our Unaudited Condensed Consolidated Interim Financial Statements and certain administrative pronouncements by the IRS and proposed Treasury regulations which are not yet in effect, we believe that we were not classified as a PFIC for the taxable year that ended December 31, 2019 and we do not anticipate becoming a PFIC for our current taxable year; however, given the substantial uncertainty regarding the application of the PFIC rules to us, it is possible that we could be classified as a PFIC for our previous or current taxable year, and that we could be classified as a PFIC for future taxable years. In addition, because the determination of whether we are a PFIC is factual in nature, is made annually and is based upon the composition of our income and assets (including a proportionate amount of the income and assets of certain entities in which we hold at least a 25% interest by value), and will depend on the nature of our activities (including our ability to qualify for the Active Bank Exception), there is additional uncertainty regarding our classification as a PFIC for any taxable year. Accordingly, U.S. Holders could be subject to U.S. federal income tax under the rules described below. U.S. Holders

should consult their own independent tax advisors regarding the application of the PFIC rules under their particular circumstances.

If we are treated as a PFIC for any taxable years, unless a U.S. Holder is eligible to, and elects to be taxed annually on a mark-to-market basis with respect to our Notes, as described below, any gain realized on a sale or other taxable disposition of our Notes and certain “excess distributions” will be treated as ordinary income and will be subject to tax as if (a) the excess distribution or gain had been realized ratably over the U.S. Holder’s holding period for our Notes, (b) the amount deemed realized in each year had been subject to tax in each such year at the highest marginal rate for such year (other than income allocated to the current period of any taxable period before we became a PFIC, which would be subject to tax at the U.S. Holder’s regular ordinary income rate for the current year and would not be subject to the interest charge discussed below), and (c) the interest charge generally applicable to underpayments of tax had been imposed on the taxes deemed to have been payable in those years. In addition, payments on the Notes would not be eligible for treatment as “qualified dividend income.” If we are treated as a PFIC and, at any time, we invest in non-U.S. corporations that are classified as PFICs (“Subsidiary PFICs”), U.S. Holders generally will be deemed to own, and also would be subject to the PFIC rules with respect to, their indirect ownership interest in that Subsidiary PFIC. If we are treated as a PFIC, a U.S. Holder could incur liability for the deferred tax and interest charge described above if either (1) we receive a distribution from, or dispose of all or part of our interest in, the Subsidiary PFIC or (2) the U.S. Holder disposes of all or part of our Notes. Further, a U.S. Holder of our Notes would be subject to additional U.S. tax form filing requirements, including reporting on IRS Form 8621 any payments received and gains realized with respect to each PFIC in which the U.S. Holder holds a direct or indirect interest, and the statute of limitations for collections may be suspended for a U.S. Holder that does not file the appropriate form.

In some cases, a U.S. Holder of a PFIC can avoid the interest charge and the other adverse PFIC consequences described above by making a “qualified electing fund” (“QEF”) election to be taxed currently on its share of the PFIC’s undistributed income. We, however, do not intend to provide information that would allow U.S. Holders to avoid the foregoing consequences by making a QEF election.

A U.S. Holder of stock in a PFIC (but not a Subsidiary PFIC, as discussed below) may make a “mark-to-market” election, provided the PFIC stock is “marketable stock” as defined under applicable Treasury regulations (*i.e.*, “regularly traded” on a “qualified exchange” or “other market”). It is unclear whether instruments such as the Notes, which we are treating as equity for U.S. federal income tax purposes, will be treated as stock for purposes of the mark-to-market election. Under applicable Treasury regulations, a “qualified exchange” includes a national securities exchange that is registered with the SEC or the national market system established under the Exchange Act, or a foreign securities exchange that is regulated or supervised by a governmental authority of the country in which the market is located and meets certain trading, volume, listing, financial disclosure and other requirements. Under applicable Treasury regulations, PFIC stock traded on a qualified exchange is regularly traded on such exchange for any calendar year during which such stock is traded, other than in *de minimis* quantities, on at least 15 days during each calendar quarter. We cannot assure U.S. Holders that our Notes will be treated as “marketable stock” for any taxable year.

If an effective mark-to-market election is made with respect to the Notes, an electing U.S. Holder generally would (i) include in gross income, entirely as ordinary income, an amount equal to the excess, if any, of the fair market value of the Notes as of the close of such taxable year and such holder’s adjusted tax basis in the Notes, (ii) deduct as an ordinary loss the excess, if any, of such holder’s adjusted tax basis of the Notes over the fair market value of the Notes at the end of the taxable year, but only to the extent of the net amount previously included in gross income as a result of the mark-to-market election and (iii) upon the sale or other taxable disposition of a U.S. Holder’s Notes, include any gain recognized as ordinary gain and any loss as ordinary loss, but only to the extent of the net amount previously included in gross income as a result of the mark-to-market election. A U.S. Holder’s adjusted tax basis in our Notes would increase or decrease by the amount of the gain or loss taken into account under the mark-to-market regime. Although a U.S. Holder may be eligible to make a mark-to-market election with respect to our Notes, no such election may be made with respect to the stock of any Subsidiary PFIC that such U.S. Holder is treated as owning, because such Subsidiary PFIC stock is not marketable. The mark-to-market election is made with respect to marketable stock in a PFIC on a shareholder-by-shareholder basis and, once made, is effective for all subsequent tax years unless the Notes are no longer regularly traded on a qualified exchange or other market or the election is revoked with the consent of the IRS. Special rules would apply if the mark-to-market election is not made for the first taxable year in which a U.S. person owns stock of a PFIC.

U.S. Holders should consult with their own independent tax advisors regarding the application of the PFIC rules to our Notes and the availability and advisability of making an election with respect to the Notes to avoid the adverse tax consequences of the PFIC rules should we be considered a PFIC for any taxable year.

Information Reporting and Backup Withholding

Payments on the Notes and proceeds from the sale or other disposition of the Notes, by a U.S. paying agent or other U.S. intermediary, or made into the United States, generally will be reported to the IRS unless the U.S. Holder establishes a basis for exemption. In addition, certain U.S. Holders may be subject to backup withholding tax in respect of such payments if they do not provide their taxpayer identification numbers or certification of exempt status. Any amounts withheld under the backup withholding rules will be allowed as a credit against a U.S. Holder's United States federal income tax liability, if any, or as a refund, provided the required information is timely furnished to the IRS.

Specified Foreign Financial Assets

Individual U.S. Holders that own "specified foreign financial assets" with an aggregate value in excess of \$50,000 are generally required to file an information statement along with their tax returns, currently on Form 8938, with respect to such assets. "Specified foreign financial assets" include any financial accounts held at a non-U.S. financial institution, as well as securities issued by a non-U.S. issuer (which may include Notes issued in certificated form) that are not held in accounts maintained by financial institutions. Higher reporting thresholds apply to certain individuals living abroad and to certain married individuals. Regulations extend this reporting requirement to certain entities that are treated as formed or availed of to hold direct or indirect interests in specified foreign financial assets based on certain objective criteria. U.S. Holders who fail to report the required information could be subject to substantial penalties. In addition, the statute of limitations for assessment of tax would be suspended, in whole or part. Prospective investors should consult their own tax advisors concerning the application of these rules to their investment in the Notes, including the application of the rules to their particular circumstances.

Certain Mexican Income Tax Consequences

The following summary contains a description of the principal Mexican federal income tax consequences of the purchase, holding and disposition of the Notes by a Non-Mexican Holder (as defined below). It does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase, hold or dispose of the Notes. In addition, it does not describe any tax consequences (1) arising under the laws of any taxing jurisdiction other than Mexico, (2) arising under laws other than the federal tax laws of Mexico (it excludes the laws of any state or municipality within Mexico), or (3) that are applicable to a resident of Mexico for tax purposes that may purchase, hold or dispose of the Notes.

For purposes of this summary, the term "Non-Mexican Holder" shall mean a holder that is not a resident of Mexico for tax purposes, as defined by the Mexican Federal Tax Code (*Código Fiscal de la Federación*), or that does not conduct a trade or business in Mexico through a permanent establishment for tax purposes in Mexico, to which income is attributable.

Pursuant to the Mexican Federal Tax Code:

- an individual is a resident of Mexico for tax purposes, if such individual has established his or her primary residence in Mexico. In the event such individual also has a home available to him/her in another country then, the individual will be deemed a resident of Mexico for tax purposes when his or her "center of vital interests" (*centro de intereses vitales*) is located within Mexican territory. This will be deemed to occur if, among other considerations (1) at least 50% of his or her aggregate annual income derives from Mexican sources, or (2) the main center of his or her professional activities is located in Mexico. Mexican nationals who file a change of tax residence to a country or jurisdiction that does not have a comprehensive exchange of information agreement with Mexico, in which his or her income is subject to a preferred tax regime pursuant to the provisions of the Mexican Income Tax Law, will be considered residents of Mexico for tax purposes during the year of filing of the notice of such residence change and during the following three years;

- unless otherwise evidenced, Mexican nationals are deemed residents of Mexico for tax purposes. An individual will also be considered a resident of Mexico for tax purposes, if such individual is a Mexican federal government employee, regardless of the location of the individual's center of vital interests; and
- a legal entity is a resident of Mexico for tax purposes if the principal administration of its business or its place of effective management is established in Mexico. If a legal entity (including foreign legal arrangements treated as legal entities for Mexican tax purposes) or an individual has a permanent establishment in Mexico, any and all income attributable to that permanent establishment of such resident would be subject to Mexican income tax, in accordance with applicable tax provisions.

This summary is based upon Mexican Income Tax Law and Mexican Federal Tax Code in effect as of the date of this offering memorandum, which are subject to change. Prospective purchasers of the Notes should consult their own tax advisors as to the Mexican or other tax consequences of the purchase, holding and disposition of Notes, including, in particular, the effect of any state or municipal tax laws in effect in Mexico. Residents of Mexico who become holders of Notes are urged to analyze the tax consequences, under Mexican and other laws, of the purchase, holding or disposition of the Notes.

Mexico has entered into, and is negotiating several, tax treaties with various countries, that may affect the Mexican withholding tax liability of Non-Mexican Holders. Prospective purchasers of the Notes should consult their own tax advisors as to the tax consequences, if any, of such treaties in respect of the purchase, holding or disposition of the Notes.

Payment of Interest

Under the Mexican Income Tax Law and regulations thereunder, payments of interest made by our Cayman Islands branch, in respect of the Notes (including payments of principal in excess of the issue price for the Notes, if any, which under Mexican law are deemed to be interest), to a Non-Mexican Holder will not be subject to Mexican withholding or other similar taxes.

Payment of Principal

Under the Mexican Income Tax Law and regulations thereunder, payments of principal made by our Cayman Islands branch, in respect of the Notes, to a Non-Mexican Holder will not be subject to Mexican withholding or other similar taxes.

Taxation of Dispositions and Acquisitions of the Notes

Under the Mexican Income Tax Law, gains resulting from the sale or disposition of the Notes by a Non-Mexican Holder to another Non-Mexican Holder, will not be subject to Mexican income tax withholding. Also, amounts deemed to be interest deriving from Notes acquired at a discount by a Non-Mexican Holder from another Non-Mexican Holder will not be subject to income tax withholding in Mexico.

Taxation of Make-Whole Amounts

Under the Mexican Income Tax Law and regulations thereunder, the payment of make-whole amounts, made by our Cayman Islands branch, as a result of the optional redemption of the Notes as provided in “*Description of the Notes—Redemption—Optional Redemption*” if applicable, to a Non-Mexican Holder will not be subject to Mexican withholding or other similar taxes.

Other Mexican Taxes

Under current Mexican laws, a Non-Mexican Holder will not be liable for Mexican estate, gift, inheritance, succession or similar taxes with respect to the acquisition, ownership or disposition of the Notes, nor will it be liable for any Mexican stamp, issue, registration or similar taxes.

Certain Cayman Islands Income Tax Consequences

The following is a discussion of certain Cayman Islands income tax consequences of an investment in the Notes. The discussion is a general summary of present law, which is subject to prospective and retroactive change. It is not intended as tax advice, does not consider any investor's particular circumstances, and does not consider tax consequences other than those arising under Cayman Islands law.

Under existing Cayman Islands laws:

- Payments of interest and principal on the Notes will not be subject to taxation in the Cayman Islands and no withholding will be required on the payment of interest and principal to any holder of the Notes, nor will gains derived from the disposal of the Notes be subject to Cayman Islands income or corporation tax. The Cayman Islands currently have no income, corporation or capital gains tax and no estate duty, inheritance tax or gift tax.
- No stamp duty is payable in respect of the issue or transfer of the Notes although duty may be payable if Notes are executed in or brought into the Cayman Islands; and
- No stamp duties or other similar taxes or charges are payable under the laws of the Cayman Islands in respect of the execution or delivery of the Notes or the performance or enforcement of them, unless they are executed in or thereafter brought within the jurisdiction of the Cayman Islands (e.g. for the purposes of enforcement) in which case stamp duty of 0.25% of the principal amount specified on the face of each Note up to a maximum of CI\$250.00 (U.S.\$304.88) unless CI\$500.00 (U.S.\$609.76) has been paid in respect of the entire issue of Notes, will be payable. An instrument of transfer in respect of a Note if executed in or brought within the jurisdiction of the Cayman Islands will be subject to a Cayman Islands stamp duty of CI\$100.00 (U.S.\$121.95). Subject as aforesaid, a holder of a Note will not incur or become liable for any transfer or other similar taxes or charges under the laws of the Cayman Islands by reason of the acquisition, ownership or disposal of the Notes.

The Cayman Islands – Automatic Exchange of Financial Account Information

The Cayman Islands has entered into two intergovernmental agreements to improve international tax compliance and the exchange of information - one with the United States and one with the United Kingdom (the “US IGA” and the “UK IGA,” respectively). The Cayman Islands has also signed, along with over 80 other countries, a multilateral competent authority agreement to implement the OECD Standard for Automatic Exchange of Financial Account Information – Common Reporting Standard (the “CRS”).

Regulations were issued pursuant to the Cayman Islands Tax Information Authority Law (2017 Revision) on 4 July 2014 to give effect to the US IGA (and the UK IGA), and on 16 October 2015 to give effect to the CRS (together, the “AEOI Regulations”). Pursuant to the AEOI Regulations, the Cayman Islands Tax Information Authority (the “CITIA”) has published guidance notes on the application of the AEOI Regulations. All Cayman Islands “Financial Institutions” (including the Issuer) are required to comply with the reporting requirements of the AEOI Regulations, unless the Issuer can rely on an exemption that permits it to be treated as a “Non-Reporting Cayman Islands Financial Institution” (as defined in the relevant AEOI Regulations), in which case only the registration requirement would apply under the CRS. The Issuer does not propose to rely on any reporting exemption and will therefore comply with all of the requirements of the AEOI Regulations as a “Reporting Financial Institution.” As such, the Issuer is required to (i) register with the IRS to obtain a Global Intermediary Identification Number (for the purposes of the US IGA only), (ii) register with the CITIA, and thereby notify the CITIA of its status as a “Reporting Financial Institution,” (iii) adapt and implement written policies and procedures setting out how it will address its obligations under the CRS, (iv) conduct due diligence on its accounts to identify whether any such accounts are considered “Reportable Accounts,” and (v) report information on such Reportable Accounts to the CITIA. The CITIA will transmit such information to the applicable overseas fiscal authorities as the case may be. Under the terms of the US IGA, withholding will not be imposed on payments made to the Issuer unless the IRS has specifically listed the Issuer as a non-participating financial institution, or on payments made by the Issuer to the holders of the Notes unless the Issuer has otherwise assumed responsibility for withholding under United States tax law.

PLAN OF DISTRIBUTION

Under the terms and subject to the conditions contained in a purchase agreement dated July 9, 2020 we have agreed to sell to the initial purchasers and the initial purchasers have agreed, severally and not jointly, to purchase the principal amount of Notes opposite their name on the table below.

Initial Purchasers of the Notes	Principal Amount of the Notes
Goldman Sachs & Co. LLC	U.S.\$200,000,000
BofA Securities, Inc.	U.S.\$100,000,000
Credit Suisse Securities (USA) LLC	U.S.\$100,000,000
MUFG Securities Americas Inc.	U.S.\$100,000,000
Total.....	<u>U.S.\$500,000,000</u>

The purchase agreement provides that the initial purchasers are required to purchase all of the Notes, if any are purchased. The purchase agreement also provides that if an initial purchaser defaults, the purchase commitments of non-defaulting initial purchasers may be increased or the offering may be terminated.

The initial purchasers propose to offer the Notes initially at the offering price on the cover page of this offering memorandum and may also offer the Notes to selling group members at the offering price less a selling concession. After the initial offering, the offering price may be changed. The offering of the Notes by the initial purchasers is subject to receipt and acceptance and subject to the initial purchasers' right to reject any order in whole or in part. The initial purchasers may offer and sell the notes through their affiliates.

We have agreed that, for a period of 30 days from the date of the initial offering of the Notes, other than with respect to the Notes, we will not, without the prior consent of the initial purchasers, offer, sell, contract to sell, pledge or otherwise dispose of, directly or indirectly, or announce the offering of, or file a registration statement for, any U.S. dollar-denominated debt similar to the Notes that is issued or guaranteed by us or any of our direct or indirect subsidiaries or enter into any agreement to do any of the foregoing.

The Notes have not been and will not be registered under the Securities Act and may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons except to qualified institutional buyers in reliance on Rule 144A under the Securities Act and to persons in offshore transactions in reliance on Regulation S. Each of the initial purchasers has agreed that, except as permitted by the purchase agreement, it will not offer, sell or deliver the Notes (1) as part of its distribution at any time, or (2) otherwise until 40 days after the later of the commencement of this offering and the closing date, within the United States or to, or for the account or benefit of, U.S. persons, and it will have sent to each broker/dealer to which it sells the Notes in reliance on Regulation S during such 40-day period, a confirmation or other notice detailing the restrictions on offers and sales of such Notes within the United States, or to, or for the account or benefit of, U.S. persons. Terms used in this paragraph have the meanings given to them by Regulation S. Resales of the Notes are restricted as described under "*Transfer Restrictions*."

In addition, until 40 days after the commencement of this offering, an offer or sale of the Notes within the United States by a broker/dealer (whether or not it is participating in the offering), may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than pursuant to Rule 144A.

We expect that delivery of the Notes will be made to investors on or about July 14, 2020, which will be the third business day in the United States following the date of this offering memorandum. Under Rule 15c6-1 of the Securities Exchange Act, trades in the secondary market generally are required to settle in two business days, unless the parties to any such trades expressly agree otherwise. Accordingly, purchasers who wish to trade the Notes on the date of the pricing or the next two succeeding business days will be required, by virtue of the fact that the Notes initially will settle in "T+3," to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Purchasers of the Notes who wish to trade the Notes on the date of pricing or the next two succeeding business days should consult their own advisor.

General

Purchasers of Notes sold outside the United States may be required to pay stamp taxes and other charges in compliance with the laws and practices of the country of purchase in addition to the price to investors on the cover page of this offering memorandum.

The initial purchasers and their respective affiliates are full-service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities and other financial and non-financial activities and services. The initial purchasers or their affiliates have in the past engaged, and may in the future engage, in transactions with and perform services, including commercial banking, financial advisory and investment banking services, for us and our affiliates in the ordinary course of business for which they received or will receive customary fees and expenses. The initial purchasers or their affiliates have in the past engaged, and may in the future engage, in transactions with and perform services, including commercial banking, financial advisory and investment banking services for other financial institutions whose interests differ from ours.

In the ordinary course of their various business activities, the initial purchasers and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investment and securities activities may involve assets, securities and/or instruments of the issuer directly, as collateral securing other obligations or otherwise and/or persons and entities with relationships with the issuer. If any of the initial purchasers or their affiliates has a lending relationship with us, certain of those initial purchasers or their affiliates routinely hedge, and certain other of those initial purchasers or their affiliates may hedge, their credit exposure to us consistent with their customary risk management policies. Typically, these initial purchasers and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in our securities, including potentially the Notes offered hereby. Any such credit default swaps or short positions could adversely affect future trading prices of the Notes offered hereby. The initial purchasers and their respective affiliates may also make investment recommendations and/or publish or express independent research views in respect of such assets, securities or instruments and may at any time hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

We have agreed to indemnify the several initial purchasers against liabilities or to contribute to payments which they may be required to make in that respect.

Application will be made to have the Notes listed on the Singapore Stock Exchange. The initial purchasers have advised us that they intend to make a market in the Notes as permitted by applicable law. They are not obligated, however, to make a market in the Notes and any market-making may be discontinued at any time at their sole discretion. Accordingly, no assurance can be given as to the development or liquidity of any market for the Notes.

The initial purchasers may engage in over-allotment, stabilizing transactions and covering transactions.

- Over-allotment involves sales in excess of the offering size, which creates a short position for the initial purchasers.
- Stabilizing transactions permit bids to purchase the underlying security so long as the stabilizing bids do not exceed a specified maximum.
- Covering transactions involve purchases of Notes in the open market after the distribution has been completed in order to cover short positions.

These stabilizing transactions and covering transactions may cause the price of the Notes to be higher than it would otherwise be in the absence of these transactions. These transactions, if commenced, may be discontinued at any time.

Prohibition of Sales to retail investors in the EEA and the UK

This communication is only being distributed to and is only directed at **(i)** persons who are outside the United Kingdom or **(ii)** persons who have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the “Order”) or **(iii)** high net worth entities falling within Article 49(2)(a) to (d) of the Order, and other persons to whom it may lawfully be communicated (all such persons together being referred to as “relevant persons”). The Notes are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such Notes will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this document or any of its contents.

Each of the initial purchasers have advised that:

- it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by it in connection with the issue or sale of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer; and
- it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

The notes are not intended to be offered, sold or otherwise made available, and should not be offered, sold or otherwise make available, to any retail investor in the EEA or the UK. For the purposes of this provision:

- a) the expression “retail investor” means a person who is one (or more) of the following:
- i. a retail client as defined in point (11) of Article 4(1) of MiFID II; or
 - ii. a customer within the meaning of the Insurance Distribution Directive, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; and

the expression “offer” includes the communication in any form and by any means of sufficient information on the terms of the offer and the Notes to be offered so as to enable an investor to decide to purchase or subscribe the Notes.

The Notes discussed in this offering memorandum are complex financial instruments and are not a suitable or appropriate investment for all investors. In some jurisdictions, regulatory authorities have adopted or published laws, regulations or guidance with respect to the offer or sale of securities such as the Notes to retail investors. In particular, in June 2015, the U.K. Financial Conduct Authority (the “FCA”) published the Product Intervention (Contingent Convertible Instruments and Mutual Society Shares) Instrument 2015, which took effect on October 1, 2015 (the “PI Instrument”). In addition, **(i)** on January 1, 2018, the provisions of Regulation (EU) No 1286/2014 (as amended, the “PRIPs Regulation”) on key information documents for packaged and retail and insurance-based investment products became directly applicable in all EEA member states and **(ii)** Directive 2014/65/EU (as amended, “MiFID II”) was required to be implemented in EEA member states by January 3, 2018. Together, the PI Instrument, the PRIIPs Regulation and MiFID II are referred to as the “Regulations”.

The Regulations set out various obligations in relation to **(i)** the manufacturing and distribution of financial instruments and **(ii)** the offering, sale and distribution of packaged retail and insurance-based investment products and certain contingent write down or convertible securities, such as the Notes.

Potential investors should inform themselves of, and comply with, any applicable laws, regulations or regulatory guidance with respect to any resale of the Notes (or any beneficial interests therein), including the Regulations.

The Issuer and each of the initial purchasers is required to comply with some or all of the Regulations. In addition, by purchasing, or making or accepting an offer to purchase, any Notes (or a beneficial interest in such Notes) from the Issuer and/or the initial purchasers, each prospective investor in relation to the Notes (or any beneficial interests

therein) represents, warrants, agrees with and undertakes to the Issuer and each of the initial purchasers that:

- (i) it is not a retail client in the EEA or the UK as defined in MiFID II or the PI Instrument (as applicable);
- (ii) whether or not it is subject to the Regulation, it will not:

- (A) sell or offer the Notes (or any beneficial interests therein) to retail clients in the EEA or the UK (as defined in MiFID II or the PI Instrument (as applicable)); or

- (B) communicate (including the distribution of this offering memorandum) or approve an invitation or inducement to participate in, acquire or underwrite the Notes (or any beneficial interests therein) where that invitation or inducement is addressed to or disseminated in such a way that it is likely to be received by a retail client in the EEA or the UK (as defined in MiFID II or the PI Instrument (as applicable)). In selling or offering Notes or making or approving communications relating to the Notes, that prospective investor may not rely on the limited exemptions set out in the PI Instrument; and

- (iii) it will at all times comply with all applicable laws, regulations and regulatory guidance (whether inside or outside the EEA or the UK) relating to the promotion, offering, distribution and/or sale of the Notes (or any beneficial interests therein), including (without limitation) MiFID II and any such other applicable laws, regulations and regulatory guidance relating to determining the appropriateness and/or suitability of an investment in the Notes (or any beneficial interests therein) by investors in any relevant jurisdiction.

Each prospective investor further acknowledges that:

- (i) the identified target market for the Notes (for the purposes of the product governance obligations in MiFID II) is eligible counterparties and professional clients; and

- (ii) no key information document (“KID”) under PRIIPs has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA or in the UK may be unlawful under PRIIPs.

The Notes, are not intended to be offered, sold or otherwise made available to, and should not be offered, sold or otherwise made available to, any retail investor in the EEA or in the UK. For these purposes, a retail investor means a person who is one (or more) of: **(i)** a retail client as defined in point (11) of Article 4(1) of MiFID II; or **(ii)** a customer within the meaning of the Insurance Distribution Directive, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II. Consequently, no key information document required by the PRIIPs Regulation for offering or selling the Notes or otherwise making them available to retail investors in the EEA or in the UK has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA or in the UK may be unlawful under the PRIIPs Regulation.

Switzerland

This offering memorandum is not intended to constitute an offer or solicitation to purchase or invest in the Notes. The Notes may not be publicly offered, directly or indirectly, in Switzerland within the meaning of the Swiss Financial Services Act (“FinSA”) and no application has or will be made to admit the Notes to trading on any trading venue (exchange or multilateral trading facility) in Switzerland. Neither this offering memorandum nor any other offering or marketing material relating to the Notes constitutes a prospectus pursuant to the FinSA, and neither this offering memorandum nor any other offering or marketing material relating to the Notes may be publicly distributed or otherwise made publicly available in Switzerland.

Hong Kong

The Notes may not be offered or sold in Hong Kong by means of any document other than **(i)** to “professional investors” within the meaning of the Securities and Futures Ordinance (Cap.571, The Laws of Hong Kong) and any rules made thereunder, or **(ii)** in other circumstances which do not result in the document being a “prospectus” within

the meaning of the Companies Ordinance (Cap.32, The Laws of Hong Kong), or which do not constitute an offer to the public within the meaning of the Companies Ordinance, and no advertisement, invitation or document relating to the Notes may be issued or may be in the possession of any person for the purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to the Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” within the meaning of the Securities and Futures Ordinance and any rules made thereunder.

Singapore

This offering memorandum has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this offering memorandum and any other document or material in connection with the offer or sale, or invitation or subscription or purchase, of the Notes may not be circulated or distributed, nor may the Notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than under circumstances in which such offer, sale or invitation does not constitute an offer or sale, or invitation for subscription or purchase, of the Notes to the public in Singapore.

Japan

The Notes have not been and will not be registered under the Financial Instruments and Exchange Law of Japan (the “FIEL”) and each initial purchaser has agreed that it has not offered or sold and will not offer or sell any Notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which terms as used herein means any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEL and any other applicable laws, regulations and ministerial guidelines of Japan.

Mexico

The Notes have not been and will not be registered with the RNV maintained by the CNBV, and therefore the Notes may not be publicly offered or sold in Mexico. The notes may be offered and sold, on a private placement basis, in Mexico to investors that qualify as institutional investors (*inversionistas institucionales*) or accredited investors (*inversionistas calificados*), pursuant to the private placement exemption set forth in Article 8 of the Mexican Securities Market Law and the regulations thereunder. As required under the Mexican Securities Market Law, the Bank will notify the CNBV of the offering and issuance of the Notes outside of Mexico and the terms of the Notes. Such notice will be submitted to the CNBV to comply with Article 7, second paragraph, of the Mexican Securities Market Law, and regulations thereunder, and for statistical and informational purposes. The delivery of such notice to, and the receipt of such notice by, the CNBV, does not imply any certification as to the investment quality of the Notes the Bank’s solvency, liquidity or credit quality or the accuracy or completeness of the information set forth in this offering memorandum. This offering memorandum may not be publicly distributed in Mexico. The acquisition of the Notes by an investor who is a resident in Mexico will be made under such investor’s responsibility.

Chile

The offer of the Notes will begin on July 6, 2020 and is subject to General Rule No. 336 of the Chilean Securities Commission (*Superintendencia de Valores y Seguros de Chile*) (“SVS”). The Notes being offered are not registered in the Securities Registry (*Registro de Valores*) or in the Foreign Securities Registry (*Registro de Valores Extranjeros*) of the SVS and, therefore, the Notes are not subject to the supervision of the SVS. As with all unregistered securities, the issuer of the Notes is not required to disclose public information about the Notes in Chile. The Notes may not be publicly offered in Chile unless they are registered in the corresponding securities registry.

La oferta de los valores comienza el 6 de julio de 2020 y está acogida a la NCG 336 de la superintendencia de Valores y Seguros de Chile (la “SVS”). La oferta versa sobre valores no inscritos en el Registro de Valores o en el Registro de Valores Extranjeros que lleva la SVS, por lo que los valores no están sujetos a la fiscalización de dicho organismo. Por tratarse de valores no inscritos, no existe obligación por parte del emisor de entregar en Chile

información pública respecto de los valores. Estos valores no pueden ser objeto de oferta pública a menos que sean inscritos en el registro de valores correspondiente.

Colombia

The Notes may not be offered, sold or negotiated in Colombia, except under circumstances which do not constitute a public offering of securities under applicable Colombian securities laws and regulations. Furthermore, foreign financial entities must abide by the terms of Decree 2555 of 2010 to offer privately the notes to their Colombian clients.

Peru

This offering memorandum and the Notes have not been, and will not be, registered with or approved by the *Superintendencia del Mercado de Valores*, the Lima Stock Exchange or the *Superintendencia de Banca, Seguros y Administradoras Privadas de Fondos de Pensiones*. Accordingly, the Notes cannot be offered or sold in Peru, except in compliance with the applicable securities laws and regulations of Peru. This notice is for information purposes only and it does not constitute a public offering of any kind in Peru.

Canada

The Notes may be sold in Canada only to purchasers purchasing, or deemed to be purchasing, as principal that are accredited investors, as defined in National Instrument 45-106 Prospectus Exemptions or subsection 73.3(1) of the Securities Act (Ontario), and are permitted clients, as defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. Any resale of the Notes must be made in accordance with an exemption from, or in a transaction not subject to, the prospectus requirements of applicable securities laws.

Securities legislation in certain provinces or territories of Canada may provide a purchaser with remedies for rescission or damages if this offering memorandum (including any amendment thereto) contains a misrepresentation, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province or territory for particulars of these rights or consult with a legal advisor.

Pursuant to Section 3A.3 of National Instrument 33-105 Underwriting Conflicts (NI 33-105), the initial purchasers are not required to comply with the disclosure requirements of NI 33-105 regarding underwriter conflicts of interest in connection with the offering of the Notes.

Cayman Islands

No invitation, whether directly or indirectly, may be made to members of the public in the Cayman Islands to subscribe for the Notes unless the Issuer is listed on the Cayman Islands Stock Exchange. The Notes may, however, be offered and sold to ordinary non-resident and exempted companies in the Cayman Islands.

Brazil

The Notes have not been, and will not be, registered with the Brazilian Securities Commission (*Comissão de Valores Mobiliários*), or the CVM. The Notes may not be offered or sold in Brazil, except in circumstances that do not constitute a public offering or unauthorized distribution under Brazilian laws and regulations. The Notes are not being offered into Brazil. Documents relating to the offering of the Notes, as well as information contained therein, may not be supplied to the public in Brazil, nor be used in connection with any public offer for subscription or sale of the Notes to the public in Brazil.

CERTAIN ERISA CONSIDERATIONS

ERISA imposes certain requirements on “employee benefit plans” (as defined in Section 3(3) of ERISA) subject to Title I of ERISA, including entities such as collective investment funds and separate accounts whose underlying assets include the assets of such plans (collectively, “ERISA Plans”) and on those persons who are fiduciaries with respect to ERISA Plans. Investments by ERISA Plans are subject to ERISA’s general fiduciary requirements, including the requirement of investment prudence and diversification and the requirement that an ERISA Plan’s investments be made in accordance with the documents governing the ERISA Plan.

Section 406 of ERISA and Section 4975 of the Code prohibit certain transactions involving the assets of an ERISA Plan (as well as those plans that are not subject to ERISA but which are subject to Section 4975 of the Code, such as individual retirement accounts (together with ERISA Plans, “Plans”)) and certain persons (referred to as “parties in interest” or “disqualified persons”) having certain relationships to such Plans, unless a statutory or administrative exemption is applicable to the transaction. A party in interest or disqualified person who engages in a non-exempt prohibited transaction may be subject to excise taxes and other penalties and liabilities under ERISA and the Code. In addition, the fiduciary of the Plan that engages in such a non-exempt prohibited transaction may be subject to penalties and liabilities under ERISA and the Code.

Governmental, church or non-U.S. plans or other arrangements (each, a “Non-ERISA Arrangement”), while not subject to the fiduciary responsibility provisions of Title I of ERISA or the provisions of Section 4975 of the Code, may nevertheless be subject to federal, state, local, non U.S. or Similar Law. Fiduciaries of any such plans should consult with their counsel before purchasing any Notes.

Prohibited transactions within the meaning of Section 406 of ERISA or Section 4975 of the Code may arise if any Notes are acquired by a Plan with respect to which the Bank or any of its subsidiaries is a party in interest or a disqualified person. Certain exemptions from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code may be applicable, however, depending in part on the type of Plan fiduciary making the decision to acquire Notes and the circumstances under which such decision is made. Those exemptions include, without limitation:

- PTCE 96-23 (for certain transactions determined by in-house asset managers);
- PTCE 91-38 (for certain transactions involving bank collective investment funds);
- PTCE 95-60 (for certain transactions involving insurance company general accounts);
- PTCE 90-1 (for certain transactions involving insurance company pooled separate accounts);
- PTCE 84-14 (for certain transactions determined by independent qualified professional asset managers); and
- Section 408(b)(17) of ERISA or Section 4975(d)(20) of the Code (for certain transactions with service providers).

There can be no assurance that any class exemption, statutory exemption or other exemption will be available with respect to any particular transaction involving the Notes, or that, if an exemption is available, it will cover all aspects of any particular transaction. By its purchase of any Notes, the purchaser thereof will be deemed to have represented and agreed either that **(i)** it is not and for so long as it holds Notes will not be a Plan, an entity whose underlying assets include the assets of any Plan, or Non-ERISA Arrangement that is subject to Similar Laws or **(ii)** its purchase, holding and any subsequent disposition of the Notes is exempt from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code (or, in the case of a Non-ERISA Arrangement from any Similar Laws) pursuant to the exemption provided by U.S. Department of Labor Prohibited Transaction Class Exemption 96-23, 95-60, 91-38, 90-1 or 84-14, Section 408(b)(17) of ERISA or Section 4975(d)(20) of the Code, or another applicable statutory or administrative exemption or, in the case of a Non-ERISA Arrangement, a substantially similar exemption under Similar Laws. Similarly, each transferee of any Notes, by virtue of the transfer of such Notes to such transferee, will be deemed to have represented and agreed either that **(i)** it is not and for so long as it holds Notes will

not be a Plan, an entity whose underlying assets include the assets of any Plan or a Non-ERISA Arrangement that is subject to any Similar Laws or **(ii)** its purchase, holding and any subsequent disposition of the Notes is exempt from the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code (or, in the case of a Non-ERISA Arrangement from any Similar Law) pursuant to the exemption provided by U.S. Department of Labor Prohibited Transaction Class Exemption 96-23, 95-60, 91-38, 90-1 or 84-14, Section 408(b)(17) of ERISA or Section 4975(d)(20) of the Code, or another applicable statutory or administrative exemption or, in the case of a Non-ERISA Arrangement, a substantially similar exemption under Similar Laws.

The foregoing summary is general in nature and not intended to be all encompassing. This summary does not purport to be complete, and future legislation, court decisions, administrative regulations, rulings or administrative pronouncements could significantly modify the requirements summarized above. Any of these changes may be retroactive and may thereby apply to transactions entered into prior to the date of their enactment or release. Any Plan fiduciary or other persons who proposes to cause a Plan to purchase any Notes should consult with its counsel regarding the potential applicability of ERISA, Section 4975 of the Code or Similar Laws to such an investment, and the availability of an applicable exemption.

The sale of Notes to a Plan is in no respect a representation by the Bank that such an investment meets all relevant requirements with respect to investments by Plans generally or any particular Plan, or that such an investment is appropriate for Plans generally or any particular Plan.

LEGAL MATTERS

Certain matters relating to the validity of the Notes will be passed upon for us by White & Case, S.C., Mexico, White & Case LLP, New York, New York, and Maples and Calder, Cayman Islands. Certain legal matters will be passed upon for the initial purchasers by Ritch, Mueller, Heather y Nicolau, S.C., Mexico, and Cleary Gottlieb Steen & Hamilton LLP, New York, New York.

INDEPENDENT AUDITOR

Our Audited Consolidated Financial Statements as of December 31, 2019 and 2018 and for the years ended December 31, 2019, 2018 and 2017 included in this offering memorandum have been audited by Galaz, Yamazaki, Ruiz Urquiza, S.C., a member of Deloitte Touche Tohmatsu Limited, independent auditors, as stated in their report, which are included in this offering memorandum. Our Unaudited Condensed Consolidated Interim Financial Statements as of March 31, 2020 and for the Three-Month Period Ended March 31, 2020 and 2019 included in this offering memorandum have been subject to a review of interim financial information by Galaz, Yamazaki, Ruiz Urquiza, S.C., a member of Deloitte Touche Tohmatsu, independent auditors, as stated in their review report, which are included in this offering memorandum.

GENERAL INFORMATION

Clearing Systems

Application has been made to have the Notes accepted for clearance through The Depository Trust Company. For the Rule 144A Global Note, the ISIN number is US05971PAC23 and the CUSIP number is 05971PAC2. For the Regulation S Global Note, the ISIN number is USP1400MAC21 and the CUSIP number is P1400MAC2.

Listing

Application is expected to be made to list the Notes on the SGX, and the Bank will use commercially reasonable efforts to obtain and maintain listing of the Notes on the SGX-ST; however, the Notes are not yet listed and the Bank cannot assure the holders of the Notes that they will be accepted for listing. Copies of our bylaws, the Indenture, as may be amended or supplemented from time to time, our published annual audited consolidated financial statements and any published quarterly unaudited consolidated financial statements will be available at our principal executive offices, as well as at the offices of the Trustee, registrar, paying agent and transfer agent, and at the offices of the Singapore listing agent, paying agent and transfer agent, as such addresses are set forth in this offering memorandum. We believe the auditor's reports included herein have been accurately reproduced. We will maintain a paying and transfer agent in Singapore for so long as any of the Notes are listed on the SGX-ST. For so long as the Notes are listed on the SGX-ST and the rules of the SGX-ST so require, the Bank shall appoint and maintain a paying agent in Singapore, where the Notes may be presented or surrendered for payment or redemption, in the event that the Global Notes are exchanged for Notes in definitive form. In addition, an announcement of such exchange shall be made by or on behalf of the Bank through the SGX-ST and such announcement will include all material information with respect to the delivery of the Notes in definitive form, including details of the paying agent in Singapore. The Notes will be traded on the SGX-ST in a minimum board lot size of SGD200,000 (or its equivalent in foreign currencies) for so long as the Notes are listed on the SGX-ST.

The Notes will not be registered with RNV maintained by the CNBV and, pursuant to the Mexican Securities Market Law, may not be offered or sold publicly or otherwise be subject to brokerage activities in Mexico, except that the Notes may be offered in Mexico to investors that qualify as institutional or accredited investors pursuant to a private placement exemption set forth in Article 8 of the Mexican Securities Market Law and regulations thereunder. As required under the Mexican Securities Market Law, we will notify the CNBV of the offering of the Notes outside of Mexico. Such notice will be submitted to the CNBV to comply with a legal requirement and for information purposes only, and the delivery to and the receipt by the CNBV of such notice does not imply any certification as to the investment quality of the Notes, our solvency, liquidity or credit quality or the accuracy or completeness of the information included in this offering memorandum.

Authorization

We have obtained all necessary consents, approvals and authorizations in connection with the issuance and performance of the Notes.

ANNEX A – SIGNIFICANT DIFFERENCES BETWEEN MEXICAN BANKING GAAP AND U.S. GAAP

Mexican banks prepare their financial statements in accordance with Mexican Banking GAAP as prescribed by the CNBV. Mexican Banking GAAP encompasses general accounting rules for banks as issued by the CNBV and MFRS prescribed by the CINIF to the extent that the aforementioned accounting criteria do not address or supersede the accounting to be followed. Mexican Banking GAAP differs in certain significant respects from U.S. GAAP. Such differences might be material to the financial information contained in this offering memorandum. A summary of the significant differences that relate to balances or transactions maintained by Banorte is presented below. We have made no attempt to identify or quantify the impact of those differences. In making an investment decision, investors must rely upon their own examination of the Company, including the terms of this offering and the financial information contained in this offering memorandum. Potential investors should consult with their own professional advisors for an understanding of the differences between Mexican Banking GAAP and U.S. GAAP, and how those differences might affect the financial information herein.

This summary should not be taken as exhaustive of all differences between Mexican Banking GAAP and U.S. GAAP. No attempt has been made to identify all disclosure, presentation or classification differences that would affect the manner in which transactions or events are presented in financial statements, including the notes thereto. We have not included in this offering memorandum a reconciliation of our Mexican Banking GAAP financial statements to U.S. GAAP.

Loan Loss Reserve

We classify our loan portfolio according to the provisions established by the CNBV, which require the rating and creation of allowances for loan losses for each type of loan, providing for the assignment of a rating based on risk (*i.e.*, country, financial and industry), payment records and the value of guarantees for each borrower balance that exceeds 4,000,000 UDIS. The remainder is classified parametrically based on the number of months elapsed as of the first default. This rating is used, among other things, to estimate a potential loan loss provision. Also, the CNBV allows the creation of additional reserves based on preventive criteria.

A loan loss reserve for each loan based on a prescribed range of reserves associated to each risk category.

The outstanding balance of past-due loans is recorded as non-performing as follows:

- when there is evidence that the customer has declared bankruptcy;
- loans with a single payment of principal and interest at maturity are considered past due 30 calendar days after the date of maturity;
- loans with a single payment of principal at maturity and with scheduled interest payments are considered past due 30 calendar days after principal becomes past due and 90 calendar days after interest becomes past due;
- loans whose payment of principal and interest had been agreed to in scheduled payments are considered past due 90 days after the first installment is past due;
- in the case where a revolving line of credit is granted, loans are considered past due when payment has not been received for two normal billing periods or, when the billing period is not monthly, 60 calendar days following maturity; and
- customer bank accounts showing overdrafts are reported as non-performing loans at the time the overdraft occurs.

The U.S. GAAP methodology for recognition of loan losses is provided by the Financial Accounting Standards Board (“FASB”) Accounting Standard Codification (“ASC”) 450 *Contingencies* (previously Statement of Financial Accounting Standard (“SFAS”) No. 5, “Accounting for Contingencies”) and ASC 310 *Receivables* (previously SFAS No. 114, “Accounting by Creditors for Impairment of a Loan”), which establish that an estimated loss should be

accrued when, based on information available prior to the issuance of the financial statements, it is probable that a loan has been impaired at the date of the financial statements and the amount of the loss can be reasonably estimated. For larger non-homogeneous loans, all individual loans should be assessed for impairment under ASC 310 (except for large groups of smaller-balance homogeneous loans which are collectively evaluated for impairment). Specific provisions are calculated when it is determined that it is probable that a bank will not recover the full contractual principal and interest on a loan (impaired loan), in accordance with the original contractual terms.

Under U.S. GAAP, estimated losses on impaired loans that are individually assessed are required to be measured at the present value of expected future cash flows discounted at the loan's effective rate, the loan's observable market price or at the fair value of the collateral if the loan is collateral dependent. To calculate the allowance required for smaller-balance impaired loans and unimpaired loans, historical loss ratios are determined by analyzing historical loss trends. These ratios are determined by loan type to obtain loss estimates for homogeneous groups of clients. Such historical loss ratios are updated to incorporate the most recent data reflective of current economic conditions, in conjunction with industry performance trends, geographic or obligor concentrations within each portfolio segment, and any other pertinent information. These updated ratios serve as the basis for estimating the allowance for loan losses for such smaller-balance impaired loans and non-impaired loans.

Under Mexican Banking GAAP, loans may be written-off when collection efforts have been exhausted or when they have been fully provisioned. On the other hand, for U.S. GAAP, loans (or portions of particular loans) should be written-off in the period that they are deemed uncollectible.

Non-Accrual Loans

Under Mexican Banking GAAP, the recognition of interest income is suspended when loans become past due based on the number of past due periods as established by the CNBV.

Under U.S. GAAP, the accrual of interest is generally discontinued when, in the opinion of management, it is expected that the borrower will not be able to fully pay its principal and interest. Generally this occurs when loans are 90 days or more past due. Any accrued but uncollected interest is reversed against interest income at that time.

Foreclosed Assets

Under Mexican Banking GAAP, there are two categories of foreclosed assets: (1) those received as payment in-kind and (2) those that are repossessed by judicial order. For both categories, foreclosed assets are recorded at the lesser of cost or estimated net realizable value.

On date of foreclosure, if the book value (contractual value) of the loan to be foreclosed is higher than net realizable value of the foreclosed asset the difference will be charged to the loan loss allowance. If the book value (contractual value) of the loan to be foreclosed is lower than the net realizable value of the repossessed asset, the carrying amount of the foreclosed asset is the book value of the loan. Foreclosed assets are subsequently adjusted by standard provisions as issued by the CNBV. The provisions depend on the nature of the foreclosed asset and the number of months outstanding.

Under U.S. GAAP, as required by ASC 470 *Debt* (previously SFAS No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings"), foreclosed assets received in full satisfaction of a receivable are reported at the time of foreclosure or physical possession at their estimated fair value less estimated costs of sale. If the foreclosed asset qualifies as an asset held for a long lived asset to be disposed by sale in accordance with ASC 360 *Property, Plant and Equipment* (previously SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets"), such asset is thereafter carried at the lower of its carrying amount or fair value less estimated sale costs. Those assets not eligible for being considered as assets to be disposed of by sale are considered assets to be held and used and are depreciated based on their useful lives and are subject to impairment tests under ASC 360.

Investment Valuation

Under Mexican Banking GAAP, investments are divided into the following categories:

- Trading securities are defined as those in which management invests to obtain gains from short-term price fluctuations. The unrealized gains or losses resulting from the mark-to-market of these investments are recognized in the statement of income for the period.
- For-sale securities are those in which management invests to obtain medium-term earnings. The unrealized gains or losses resulting from the mark-to-market of equity securities, net of deferred taxes, is recognized in stockholders' equity.
- Held-to-maturity investments are those instruments in which management invests with the intention of holding them until maturity and are recorded at amortized cost. Furthermore, on November 9, 2009, the CNBV issued a ruling to amend the General Rules Applicable to Mexican Banks, which allows securities to be reclassified to the category of securities held to maturity or from the category of trading securities to that of securities available for sale, albeit with the prior express authorization of the CNBV.

Under Mexican Banking GAAP, the fair value amounts are determined by independent third party price quotes or in certain cases based on internal valuation methods. The fair value adjustment for for-sale equity securities is reflected in equity and includes the related deferred income tax effects and loss from monetary position (if determined). All amounts are reversed into earnings upon sale or maturity of the securities.

Under Mexican Banking GAAP, provisions must be made for permanent impairment of for-sale or held-to-maturity securities. If the conditions that led to the provision being established improve sufficiently, then the provision can be reversed.

For U.S. GAAP, under ASC 320 Investments—Debt and Equity Securities (previously SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities”):

- Debt securities must be classified, according to management's intent and ability to hold the security, within one of the following categories: held-to-maturity, trading, or available-for-sale. Marketable equity securities must be classified as either trading securities or available-for-sale securities.
- Trading securities are those actively bought and sold. Such securities are recorded at fair value, with resulting unrealized gains and losses recognized in the statement of income.
- Securities which management has the intent and ability to hold to maturity are classified as held-to-maturity, a classification allowed only for debt securities, except for preferred stock with required redemption dates. Held-to-maturity securities are carried at amortized cost.
- All other debt securities and marketable equity securities that are not classified as debt securities or held-to-maturity securities are classified as available-for-sale securities. Available-for-sale securities are recorded at fair value with the resulting unrealized gains and losses recorded net of applicable deferred taxes as other comprehensive income (“OCI”), a separate component of shareholders' equity until realized, at which time the realized gain or loss is recorded in the income statement. Non-marketable equity securities are valued at cost, less a provision for other-than-temporary impairment in value.

U.S. GAAP has specific criteria limiting reclassifications of securities within the held-to-maturity classification. If any sales are made from the held-to-maturity portfolio other than in certain specific circumstances, then all held-to-maturity securities are deemed to be tainted and are consequently classified as available-for-sale.

U.S. GAAP does not contemplate the monetary position effect which is presently recognized under Mexican Banking GAAP. Nevertheless, under U.S. GAAP, if there is a decline in carrying amount of an available-for-sale or held-to-maturity security below its fair value, it is judged to be other-than-temporary, the cost basis of the individual security is written down to its fair value and the amount of the write-down is recorded as charged to income. The new written down value of the security forms the new cost basis of the security. An impairment loss cannot be reversed if conditions improve.

For Mexican Banking GAAP purposes, any foreign currency effects on available-for-sale debt securities are reported in earnings. However, under U.S. GAAP and per ASC 310-10-35 (*Fair Value Changes of Foreign-Currency-Denominated Available-for-Sale Debt Securities* paragraphs 36-37) (formerly EITF 96-15 “Accounting for the Effects of Changes in Foreign Currency Exchange Rates on Foreign-Currency-Denominated Available-for-Sale Debt Securities”), the entire change in the fair value of foreign-currency-denominated available-for-sale debt securities should be reported in stockholders’ equity. This fair value serves as the basis under which other-than temporary impairment is considered.

Fair Value of Financial Instruments

Mexican Banking GAAP defines fair value as the amount an interested and informed market participant would be willing to exchange for the purchase or sale of an asset or to assume or settle a liability in a free market. This definition can consider either an entry or an exit price.

U.S. GAAP defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This definition only considers an exit price. Consideration must be given to the principal and most advantageous market and the highest and best use of the asset.

Furthermore, U.S. GAAP establishes a three-level hierarchy to be used when measuring and disclosing fair value in a company’s financial statements. Categorization within the fair value hierarchy is based on the lowest level of significant input to its valuation. The following is a description of the three hierarchy levels:

- Level 1—Listed prices for identical instruments in active markets.
- Level 2—Listed prices for similar instruments in active markets; listed prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
- Level 3—Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

Repurchase Agreements

Under Mexican Banking GAAP, at the contracting date of the repurchase transaction, when the financial institution is the reselling party, the entry of cash or a debit settlement account, and an account payable at fair value, initially at the agreed-upon price, is recorded and represents the obligation to reconstitute cash to the repurchasing party. Subsequently, during the term of the repurchase transaction, the account payable is valued at fair value by recognizing the interest on the repurchase agreement using the effective interest method in results of the year. In relation to the collateral granted, the credit institution will reclassify the financial assets in its balance sheet as restricted, which will be valued based on the criteria described above in this note until the maturity of the repurchase transaction.

When an entity acts as repurchasing party, the withdrawal of funds available is recognized on the contracting date of the repurchase transaction or a credit settlement account, with an account receivable recorded at fair value, initially at the agreed-upon price, which represents the right to recover the cash paid. The account receivable will be valued subsequently during the term of the repurchase agreement at fair value through the recognition of interest on the repurchase agreement based on the effective interest method in the results of the year. Similarly, if the repurchasing party becomes a reselling party based on the performance of another repurchase transaction with the collateral received in guarantee for the initial transaction, the interest generated by the second repurchase transaction must be recognized in the results of the year when accrued, according to the effective interest method, and also affects the valued account payable according to the applied cost.

Under U.S. GAAP, repurchase agreements are transfer transactions subject to specific provisions and conditions that must be met in order for a transaction to qualify as a sale rather than a secured borrowing. In most cases, banks

in the U.S. enter into repurchase transactions that qualify as secured borrowings. Accordingly, our assets subject to a repurchase agreement would not be derecognized.

Derivatives

Under Mexican Banking GAAP, the assets and/or liabilities arising from transactions with derivative financial instruments are recognized or canceled in the financial statements on the date the transaction is carried out, regardless of the date of settlement or delivery of the asset. Financial institutions initially recognize all derivatives as assets or liabilities in the balance sheet at fair value, taking into consideration the execution price. Any transaction costs that are directly attributable to the acquisition of the derivative are directly recognized in results. All derivatives are valued at fair value without deducting any estimated sale costs or other types of disposal. The period net valuation effects are recognized in the results of the period as trading gain/loss.

Under Mexican Banking GAAP, a financial institution should consider the following the CNBV requirements for the purposes of classifying a derivative financial instrument:

- Hedging of an open risk position - Consists of the purchase or sale of derivative financial instruments to reduce the risk of a transaction or group of transactions. If they are fair value hedges, the primary position covered is valued at market and the net effect of the derivative hedge instrument is recorded in results of the period. If they are cash flow hedges, the hedge derivative instrument is valued at market and the valuation for the effective portion of the hedge is recorded within OCI account in stockholders' equity. Any ineffective portion is recorded in results.
- Trading positions - Consist of the positions assumed by the financial institution as market participant for purposes other than hedging risk positions. In forward and futures contracts, the balances represent the difference between the fair value of the contract and the contracted forward price. If the difference is positive, it is considered as surplus value and presented under assets; however, if negative, it is considered as a shortfall and presented under liabilities. In options, their balance represents the fair value of the premium and they are valued at fair value, recognizing the valuation effects in the results for the year. In swaps, the balance represents the difference between the fair value of the swap asset and liability.

Under U.S. GAAP, ASC 815 *Derivatives and Hedging* (previously SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities") provides that:

- Derivative financial instruments, although considered to be an effective hedge from an economic perspective that have not been designated as a hedge for accounting purposes are recognized in the balance sheet at fair value with changes in the fair value recognized in earnings concurrently with the change in fair value of the underlying assets and liabilities.
- For all derivative instruments that qualify as fair value hedges for accounting purposes, of existing assets, liabilities or firm commitments, the change in fair value of the derivative should be accounted for in the statement of income, and be fully or partially offset in the statement of income by the change in fair value of the underlying hedged item.
- For all derivative contracts that qualify as hedges of cash flows for accounting purposes, the change in the fair value of the derivative should be initially recorded in OCI in stockholders' equity. Once the effects of the underlying hedged transaction are recognized in earnings, the corresponding amount in OCI is reclassified to the statement of income to offset the effect of the hedged transaction.
- All derivative instruments that qualify as hedges are subject to periodic effectiveness testing. Effectiveness is the derivative instrument's ability to generate offsetting changes in the fair value or cash flows of the underlying hedged item. The ineffective portion of the change in fair value for a hedged derivative is immediately recognized in earnings, regardless of whether the hedged derivative is designated as a cash flow or fair value hedge.

Under Mexican Banking GAAP, the designation of a derivative instrument as a hedge of a net position (“macro hedging”) is allowed. However, macro hedging is not permitted under U.S. GAAP.

However under U.S. GAAP, certain implicit or explicit terms included in host contracts that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument, must be separated from the host contract and accounted for at fair value. Under Mexican Banking GAAP, the recognition of embedded derivative instruments is required beginning in 2009.

Securitized Transactions and the Consolidation of Special-Purpose Entities

Under Mexican Banking GAAP, as of January 1, 2009, securitized transactions must fulfill the requirements established in accounting criterion C-1 “Recognition and derecognition of financial assets” in order to be considered a sale and transfer of assets. If this is not the case, these assets must remain on the balance sheet, together with the respective debt issuances and the effects on results based on this criterion. Furthermore, a company must consolidate a special-purpose entity (SPE) when the economic basis of the relationship between both entities shows that the SPE is controlled by the former. Also, all securitized transactions made before the effective date of criterion C-1, are not consolidated since this criterion was issued considering a prospective implementation.

Under U.S. GAAP, ASC 860 *Transfers and Servicing* (previously SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement 125”) provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. The guidance focuses on control. Under that approach, after a transfer of financial assets (e.g. a securitization), an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings.

A transfer of financial assets in which the transferor surrenders control over those assets is accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if and only if all of the following conditions are met:

- The transferred assets have been isolated from the transferor (beyond the reach of the transferor and its creditors), even in bankruptcy;
- Each transferee (or, if the transferee is a qualifying special-purpose entity (“QSPE”) (for more information on control that eliminates the QSPE exemption under U.S. GAAP beginning in 2016, see “—Consolidation”), each holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor; and
- The transferor does not maintain effective control over the transferred assets through either (1) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity, (2) the ability to unilaterally cause the holder to return specific assets, other than through a cleanup call, or (3) an agreement that permits the transferee to require the transferor to repurchase the transferred financial assets at a price that is so favorable to the transferee that it is probable that the transferee will require the transferor to repurchase them.

Insurance and postretirement activities

According to the accounting practices prescribed by the Mexican National Insurance and Surety Commission (Mexican Insurance GAAP), commissions and costs at the origination of each policy are charged to income as incurred. In addition, for life insurance policies, any amount received from individuals is considered as premium income. As required by U.S. GAAP, commissions and costs at origination are capitalized and amortized over the life of the policy using the effective interest method (deferred acquisition costs). Furthermore, premiums received in excess for life insurance policies are recorded as premium income.

Also, under the accounting practices prescribed by the National System of Saving for the Retirement Commission, the direct costs associated with the reception of new clients for the administration of the bills of retirement is recognized in income as incurred. Under U.S. GAAP the costs are capitalized and amortized over the time in which the borrowed service is yielded, which the time is based on average in which the clients remain active in the company.

Under Mexican Insurance GAAP, certain reserves (disaster) are calculated using internal models previously approved by the Mexican National Insurance and Surety Commission. Generally pension reserves are based on the present value of benefits to be paid together with fees suggested by this Commission. U.S. GAAP establishes the use of a fee that allows policy benefits to be covered through premiums collected for pension reserves. Under U.S. GAAP, provisions for disaster reserves are based on actuarial calculations for losses incurred using the experience of the Financial Group.

The Financial Group records a reserve for catastrophic events under Mexican Banking GAAP as a liability which is not allowed by U.S. GAAP.

Business Combinations

Through December 31, 2004, under Mexican Banking GAAP, the excess of the purchase price over the adjusted book value of net assets acquired was recorded as goodwill and amortized over 20 years (negative goodwill if book value exceeded the purchase price was recognized over a period not exceeding five years). Upon the adoption of NIF B-7, "Business Acquisitions," which is similar to the required accounting practices established by U.S. GAAP, requires the purchase price to be ascribed to the fair value of separately identifiable assets and liabilities acquired and that the difference between the purchase price and the fair value of identifiable assets and liabilities be allocated to goodwill or negative goodwill, as applicable.

Under U.S. GAAP, prior to January 1, 2009, SFAS No. 141, "Business Combinations" required the purchase price over the book value of assets and liabilities acquired to be allocated to the fair value of separately identifiable assets and liabilities acquired.

Under U.S. GAAP, beginning in January 1, 2009, ASC 805-10 (SFAS No. 141(R), "Business Combinations – a replacement of FASB No. 141"), now requires an acquirer in a business combination to (a) recognize assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at fair value as of the acquisition date, and (b) expense all acquisition-related costs. ASC 805-10 (SFAS No. 141(R)), also amends ASC 740-10 (SFAS No. 109, "Accounting for Income Taxes") to require that any reductions to an acquired entity's valuation allowances on deferred taxes and acquired tax contingencies that occur after the measurement period be recorded as a component of income tax expense.

Employee Retirement Obligations

Mexican Banking GAAP requires the recognition of a severance indemnity liability calculated based on actuarial computations. Similar recognition criteria under U.S. GAAP are established in ASC 712 *Compensation—Nonretirement Postemployment Benefits* (previously SFAS No. 112, "Employers' Accounting for Post-employment Benefits"), which requires that a liability for certain termination benefits provided under an ongoing benefit arrangement such as these statutorily mandated severance indemnities, be recognized when the likelihood of future settlement is probable and the liability can be reasonably estimated.

Under Mexican Banking GAAP, pension and seniority premium obligations are determined in accordance with NIF D-3. Under U.S. GAAP, such costs are accounted for in accordance with ASC 715 *Compensation—Retirement Benefits* (previously SFAS No. 87, "Employers' Accounting for Pensions"), whereby the liability is measured, similar to Mexican Banking GAAP, using the projected unit credit method at either corporate or government bonds based discount rates. The U.S. GAAP standard became effective on January 1, 1989 whereas NIF D-3 became effective on January 1, 1993. Therefore, a difference between Mexican Banking GAAP and U.S. GAAP exists due to the accounting for the transition obligation at different implementation dates.

Post-retirement benefits are accounted for under U.S. GAAP in accordance with ASC 715 (previously SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions”), which applies to all post-retirement benefits, such as life insurance provided outside a pension plan or other postretirement health care and welfare benefits expected to be provided by an employer to current and former employees. The cost of postretirement benefits is recognized over the employees’ service periods and actuarial assumptions are used to project the cost of health care benefits and the present value of those benefits. For Mexican Banking GAAP purposes, as required by NIF D-3, we account for such benefits in a manner similar to U.S. GAAP. SFAS No. 106 became effective on January 1, 2003 whereas NIF D-3 became effective on January 1, 1993.

In addition, under U.S. GAAP, the accounting for defined benefit postretirement plans, which include seniority premiums within Mexico, was amended in 2006 such that an employer is required to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its balance sheet, recognizing changes in that funded status in the year in which the changes occur through OCI. Accordingly, unrecognized items may exist in Mexican FRS which are included as part of the employee benefit liability under U.S. GAAP.

Starting January 1, 2016, amendments to NIF D-3 became effective, in which unrecognized actuarial items, should be treated as follows:

- a) the whole balance of the modifications to the plan (past service) not yet recorded, should be recorded affecting the retained earnings of the oldest period presented;
- b) the accumulated unrecorded Profit or Losses of the Plan (GPP) (for entities that used the projected unit credit method), should be recorded affecting the initial balance of OCI for remedies of the oldest period presented.

Therefore, a difference arises since U.S. GAAP has not amended the recognition of actuarial remeasurements.

Guarantees

For Mexican Banking GAAP purposes, guarantees are recorded at cost at inception and disclosed in memorandum accounts unless payments in connection with the guarantee are probable, where the amounts expected to be paid are recorded.

For U.S. GAAP purposes, guarantees are accounted for under ASC 460 *Guarantees* (previously FIN 45, “Guarantor’s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others—an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB interpretation No. 34”), which requires that an entity recognizes, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing such guarantee.

For Mexican Banking GAAP purposes, guarantees are recorded at cost at inception and disclosed in memorandum accounts unless payments in connection with the guarantee are probable, where the amounts expected to be paid are recorded.

Equity Method Investees

Under Mexican Banking GAAP, investments in associated companies in which we have more than a 10% ownership, are accounted for by the equity method.

For U.S. GAAP purposes, investments in associated companies in which we have a 20 to 50% ownership over which we can exert significant influence on the company, but do not have a controlling interest, are accounted for by the equity method. Investments in which we have less than a 20% ownership are generally accounted for under the cost method.

Retained Earnings Adjustments

Where specific approval is given by the CNBV, certain adjustments and provisions which are created during the year may be charged to retained earnings and not to the statement of income for the period.

Under U.S. GAAP, when adjustments which relate to correction of errors in the prior year occur, the prior period financial statements are required to be restated. Under U.S. GAAP, loss provisions or other operating and non-operating expenses are recognized as a charge to income.

Deferred Income Tax

Mexican Banking GAAP is similar to U.S. GAAP with respect to accounting for deferred income taxes in that an asset and liability approach is required. Under Mexican Banking GAAP, deferred tax assets must be reduced by a valuation allowance if it is “highly probable” that all or a portion of the deferred tax assets will not be realized. The determination of the need for a valuation allowance must consider future taxable income and the reversal of temporary taxable differences. Net deferred income tax assets or liabilities are presented within long-term assets or liabilities.

Under U.S. GAAP, deferred income taxes are also accounted for using the asset and liability approach. However, under U.S. GAAP, a valuation allowance is recognized if, based on the weight of all positive and negative available evidence, it is “more likely than not” that all or a portion of the deferred tax asset will not be realized. In order to make this determination, entities must consider future reversals of taxable temporary differences, future taxable income, taxable income in prior carryback years and tax planning strategies. Additionally, if the company has experienced recurring losses, little weight, if any, may be placed on future taxable income as objective evidence to support the recoverability of a deferred income tax asset.

Consolidation

Under Mexican Banking GAAP, an entity is required to consolidate subsidiaries over which it has established control, despite not holding a majority of the voting common stock of the subsidiary. Determining whether an entity has control is based on an analysis of corporate governance and economic risk and benefits.

Under U.S. GAAP, when a company has a controlling financial interest (either through a majority voting interest or through the existence of other control factors) in an entity, such entity’s financial statements should be consolidated, irrespective of whether the activities of the subsidiary are non-homogeneous with those of the parent. In addition to the traditional concept of consolidation, on January 17, 2003, the FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities - an Interpretation of ARB No. 51,” replaced in December 2003, by Interpretation ASC 810 Consolidation (previously No. 46(R) “Consolidation of Variable Interest Entities - an interpretation of APB 51” (“FIN 46R”)), which contained certain clarifications to address accounting for variable interest entities. The primary purpose of ASC 810 is to provide guidance on the identification of, and financial reporting for, entities over which control is achieved through means other than voting rights; such entities are known as variable-interest entities (“VIEs”). Generally, VIEs are to be consolidated by the primary beneficiary which represents the enterprise that will absorb the majority of the VIEs’ expected losses if they occur, receive a majority of the VIEs’ residual returns if they occur, or both. Through 2009, QSPEs and certain other entities are exempt from the consolidation provisions of FIN 46R. As described in ASC 840-40 Transfers to Qualifying Special Purpose Entities (previously SFAS No. 140, par. 35), a QSPE is a trust or other legal vehicle that meets certain conditions. Under U.S. GAAP, a QSPE is not consolidated in the financial statements of a transferor or its affiliates.

Effective beginning January 1, 2019, Accounting Standards Update No. 2009-16, seeks to improve financial reporting by eliminating the exceptions for qualifying special-purpose entities from the consolidation guidance and the exception that permitted sale accounting for certain mortgage securitizations when a transferor has not surrendered control over the transferred financial assets. In addition, the amendments require enhanced disclosures about the risks that a transferor continues to be exposed to because of its continuing involvement in transferred financial assets. Comparability and consistency in accounting for transferred financial assets will also be improved through clarifications of the requirements for isolation and limitations on portions of financial assets that are eligible for sale accounting.

Effects of Inflation

Through December 31, 2007, Mexican Banking GAAP required that the effects of inflation be recorded in financial information and that financial statements be restated to constant Pesos as of the latest balance sheet date presented. Beginning January 1, 2008, Mexican Banking GAAP modified the accounting for the recognition of the effects of inflation and defines two economic environments: **(i)** an “inflationary environment,” in which the cumulative inflation of the three preceding years is 26% or more, in which case the effects of inflation should be recognized using the comprehensive method; and **(ii)** a “non-inflationary environment”, in which the cumulative inflation of the three preceding years is less than 26%, in which case, no inflationary effects should be recognized in the financial statements.

Under U.S. GAAP, historical costs must be maintained in the basic financial statements. Business enterprises are encouraged to disclose certain supplemental information concerning changing prices on selected statement of income and balance sheets items. Typically, however, no gain or loss on monetary position is recognized in the financial statements. However, specific rules and regulations established by the SEC allow for the presentation of inflation in a company’s reconciliation from local GAAP to U.S. GAAP for companies registering securities with the SEC for sale in the United States, when, for local purposes, such company prepares comprehensive price-level adjusted financial statements, as required or permitted by their home-country GAAP.

The recording of appraisals of fixed assets is prohibited, with the objective of maintaining historical cost in the balance sheet. Although the effects of inflation are not recognized in the financial statements under U.S. GAAP, the SEC recognizes that presentation indicating the effects of inflation is more meaningful than historical cost-based financial reporting for Mexican entities because it represents a comprehensive measure of the effects of price level changes in the inflationary Mexican economy. For this reason, the effects of inflation accounting are generally not eliminated from the financial statements of Mexican companies making offerings in the United States securities markets in situations when Mexican MFRS or Mexican Banking GAAP are reconciled to U.S. GAAP.

In addition, under MFRS, NIF B-15, “Foreign Currency Transactions and Translation of Financial Statements of Foreign Operations” allows the restatement of information for prior periods in order to compare such information to information of the most current period presented, based on a weighted average restatement factor that reflects the relative inflation and currency exchange movements of the countries in which we operate. The restatement provisions of NIF B-15 do not meet the SEC’s Regulation S-X requirement that the financial statements be stated in the same currency for all periods, because changes in foreign currency exchange rates are included in the restatement factor. Under U.S. GAAP, the primary financial statements should be presented in the same constant reporting currency for all periods.

Recent Mexican Banking GAAP Accounting Standards

See “*Management’s Discussion and Analysis of Financial Condition and Results of Operations—Changes in Accounting Policies*”.

Recent U.S. GAAP Accounting Standards

In October 2009, FASB ASC 105-10 (SFAS No. 168), the FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles was issued. FASB ASC 105-10 (SFAS No. 168) establishes the FASB Accounting Standards Codification (the “Codification”) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial standards in conformity with U.S. GAAP. FASB ASC 105-10 (SFAS No. 168) is effective for interim and annual periods ending after September 15, 2009. On the effective date, all then-existing non-SEC accounting and reporting standards are superseded, with the exception of certain items listed in FASB ASC 105-10 (SFAS No. 168). The purpose of the Codification is not to create new accounting and reporting guidance, but rather to simplify user access to all authoritative U.S. GAAP.

The disclosure requirements of ASC 820-10 (SFAS No. 157, Fair Value Measurements) in relation to nonfinancial assets and liabilities became effective in 2009.

In January 2009, ASC 810-10 (SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51), which establishes the accounting and reporting standards for the noncontrolling interest in a subsidiary and the deconsolidation of a subsidiary, and also amends certain consolidation guidance for consistency with revised standards regarding business combinations was issued. The accounting provisions of ASC 810-10 (SFAS No. 160) must be applied prospectively starting at the beginning of the fiscal year in which the provisions are initially adopted, while the presentation and disclosure requirements must be applied retrospectively, to provide comparability in the financial statements. ASC 810-10 (SFAS No. 160) was effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008.

In January 2009, ASC 805-10 (SFAS No. 141(R), Business Combinations – a replacement of SFAS No. 141 (R)) was issued and, which among other changes, requires an acquirer in a business combination to (a) recognize assets acquired, liabilities assumed, and any noncontrolling interest in the acquiree at fair value as of the acquisition date, and (b) expense all acquisition-related costs. ASC 805-10 also amends ASC 740-10 (SFAS No. 109, Accounting for Income Taxes) to require that any reductions to an acquired entity's valuation allowances on deferred taxes and acquired tax contingencies that occur after the measurement period be recorded as a component of income tax expense. FASB ASC 805-10 (SFAS No. 141(R)) must be applied prospectively to all business combinations for which the acquisition date occurs during fiscal years beginning on or after December 15, 2008, with the exception to the amendments to ASC 740-10, which will also be applied to business combinations with acquisition dates prior to the effective date of this standard.

In July 2009, the ASC 855-10 (SFAS 165, Subsequent Events). ASC 855-10 (SFAS 165) was issued and establishes accounting and reporting standards for events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In addition, ASC 855-10 requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for selecting that date, that is, whether that date represents the date the financial statements were issued or were available to be issued. ASC 855-10 was effective for fiscal years and interim periods ending after June 15, 2009.

In June 2009, ASC 860-10 (SFAS No. 166, Accounting for Transfer of Financial Assets – an amendment of FASB Statement No. 140), was issued, which eliminates the concept of a QSPE and modifies the derecognition provisions of a previously issued accounting standard. ASC 860-10 (SFAS No. 166) also required additional disclosures which focus on the transferor's continuing involvement with the transferred assets and the related risks retained. ASC 860-10 (SFAS No. 166) is effective for financial asset transfers occurring after the beginning of an entity's first fiscal year that begins after November 15, 2009. Early adoption is prohibited.

In June 2009, ASC 810-10 (SFAS No. 167, Amendments to FASB Interpretation No. 46 (R)) was issued, which amends the consolidation guidance that applies to variable interest entities. The new guidance requires an entity to carefully reconsider its previous consolidation conclusions, including (1) whether an entity is a variable interest entity (VIE), (2) whether the enterprise is the VIE's primary beneficiary, and (3) what type of financial statement disclosures are required. ASC 810-10 (SFAS No. 167) is effective as of the beginning of the first fiscal year that begins after November 15, 2009. The amendments to the consolidation guidance affect all entities and enterprises currently within the scope of ASC 810-10 (SFAS No. 167), as well as qualifying special-purpose entities that are currently outside the scope of ASC 810-10 (FIN 46(R)). Early adoption is prohibited.

In October 2009, the FASB issued Accounting Standards Update (ASU) 2009-13, which contains new guidance on accounting for revenue arrangements with multiple deliverables. When vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. The guidance in the ASU will be effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning after June 15, 2016. Early adoption is permitted.

In January 2016, the FASB issued ASU 2016-06. The ASU amends ASC 820, Fair Value Measurements and Disclosures (SFAS No. 157) to add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. It also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques

used to measure fair value. This ASU amends guidance on employers' disclosures about postretirement benefit plan assets under ASC 715, Compensation – Retirement Benefits, to require that disclosures be provided by classes of assets instead of by major categories of assets. The guidance in the ASU is effective for the first reporting period (including interim periods) beginning after December 15, 2009, except for the requirement to provide the Level 3 activity of purchases, sales, issuances, and settlements on a gross basis, which will be effective for fiscal years beginning after December 15, 2016, and for interim periods within those fiscal years. In the period of initial adoption, entities will not be required to provide the amended disclosures for any previous periods presented for comparative purposes. However, those disclosures are required for periods ending after initial adoption. Early adoption is permitted.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The amendments in this ASU require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments in this ASU also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In addition the amendments in this ASU eliminate the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities and the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet for public business entities. This ASU is effective for annual reporting periods beginning after December 15, 2018.

In February 2016, the FASB issued ASU 2016-02, Leases, which introduces a lessee model that brings most leases on the balance sheet. The new standard also aligns many of the underlying principles of the new lessor model with those of ASC 606, the FASB's new revenue recognition standard (e.g., those related to evaluating when profit can be recognized). Furthermore, the ASU addresses other concerns related to the current leases model. For example, the ASU eliminates the requirement in current U.S. GAAP for an entity to use bright-line tests in determining lease classification. The ASU also requires lessors to increase the transparency of their exposure to changes in value of their residual assets and how they manage that exposure. The amendments in this ASU are effective for annual reporting periods beginning after December 15, 2019 with early application permitted.

In March 2016, the FASB issued ASU 2016-09, Improvements to Employee Share-Based Payment Accounting, which simplifies several aspects of the accounting for employee share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in this ASU are effective for annual periods beginning after December 15, 2017 with early adoption permitted.

In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments, which amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. The ASU eliminates the probable initial recognition threshold in current guidance and, instead, requires an entity to reflect its current estimate of all expected credit losses. This ASU affects entities holding financial assets and net investment in leases that are not accounted for at fair value through net income. The amendments affect loans, debt securities, trade receivables, net investments in leases, off balance sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash. The amendments in this ASU are effective for annual periods beginning after December 15, 2020.

In August 2016, the FASB issued ASU 2016-15, Classification of Certain Cash Receipts and Cash Payments – a consensus of the FASB Emerging Issues Task Force, which addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (COLIs) (including bank-owned life insurance policies (BOLIs)); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The ASU is effective for annual periods beginning after December 15, 2018 with early adoption permitted.

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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, 2019 and 2018, and the consolidated income statements, consolidated statements of changes in stockholders' equity and consolidated statements of cash flows for the years then ended December 31, 2019, 2018 and 2017, and notes to the consolidated financial statements, including a summary of the significant consolidated accounting policies.

In our opinion, the accompanying consolidated financial statements of the Institution as of December 31, 2019, 2018 and 2017, have been prepared, in all material respects, 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).

Basis for Opinion

We conducted our audits in accordance with International Standards on Auditing (ISA). Our responsibilities under those standards are further described in the Auditors' Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Institution in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professionals Accountants (IESBA Code), together with the ethical requirements that are relevant to our audit of the consolidated financial statements in accordance with the Code of Ethics issued by the Mexican Institute of Public Accountants (IMCP Code), and we have fulfilled our other ethical responsibilities in accordance with the IESBA Code with the IMCP Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were most significance in our audit of the consolidated financial statements of the 2019 period. These matters were addressed in the context of our audit of the consolidated financial statements as whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.



- **Information Technology (IT)**

The systems of the Institution in the operation and generation of financial information is a critical component for the development of our audit. Automated accounting records procedures and IT environment controls must be designed and operated effectively to ensure integrity and accuracy in the issuance of the consolidated financial information. We identify the IT systems and the controls on the financial reports as a key audit issue because this requires a high degree of audit effort and the incorporation of our IT specialists to prove the different access to the application systems and on the different general control environments for the different systems.

Our audit procedures to cover this key audit issue included:

- a) We perform an evaluation of the key systems that process the financial information of the Institution.
- b) By identifying these systems, we involve our IT specialists and test the general IT controls where we evaluate those existing controls on the various technological platforms related to Access Security, Change Management and Operations in the production environment.
- c) We evaluate the automatic controls in key processes of our audit, identifying for them the main information systems, of which we have analyzed the vulnerabilities related to the integrity, accuracy and availability of the information and we have identified and evaluated the operational effectiveness of the controls IT implemented.

- **Preventive estimates of credit risks (See Notes 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 implementation, and operational effectiveness of the relevant controls regarding the valuation of the Preventive Estimate for credit risks of the Institution.
- 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.

Information Other than the Consolidated Financial Statements and Auditors' 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 be presented before the Commission and Mexican Stock Exchange (which will not 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.

The information shown in the accompanying financial statements as unaudited, is presented by the requirements of the Accounting Criteria issued by the Commission.



Other Matters

Our audit also comprehended the translation of the Millions of Mexican peso amounts of into Millions U.S. dollars amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 4.

The accompanying consolidated financial statements have been translated into English for the convenience of users.

Responsibilities of Management and Those Charged with the Institution's Corporate Governance for the Consolidated Financial Statements

Management is responsible for the preparation of the consolidated financial statements in accordance with the Accounting Standards issued by the Commission, and for such internal control as Institution's management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Institution's ability to continue as a going concern, disclosing, as applicable, matters, related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Institution or to cease operations, or has no realistic alternative but to do so.

Those charged with the Institution's corporate governance are responsible for overseeing the Institution's financial reporting process.

Independent Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or override of internal control.
- Obtain an understanding of internal control relevant to the audit, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Institution's internal control. Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Institution's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Institution to cease to continue as a going concern.
- We obtained adequate and sufficient related to the financial information of the entities or the business activities in the Institution to express and opinion on the consolidated financial statements. We are responsible of the direction, supervision and realization of the Institution's audit. We are the only responsible of our audit opinion.

We communicate with those charged with the Institution's corporate governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.





We also provide those charged with the Institution's corporate governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with the Institution's corporate governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the 2019 period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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
Monterrey, Nuevo León, México

February 27, 2020



**BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF DECEMBER 31, 2019 AND 2018**
(In millions of Mexican pesos and in millions of U.S. dollars)

ASSETS	2019	2019	2018
CASH AND CASH EQUIVALENTS	US\$ 3,302	Ps. 62,282	Ps. 75,233
MARGIN SECURITIES	314	5,926	1,458
INVESTMENT IN SECURITIES			
Trading securities	3,985	75,169	92,418
Securities available for sale	8,091	152,630	147,986
Securities held to maturity	1,039	19,593	8,492
	13,115	247,392	248,896
DEBTOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS	107	2,016	405
DERIVATIVE FINANCIAL INSTRUMENTS			
For trading purposes	1,182	22,295	28,083
For hedging purposes	9	162	156
	1,191	22,457	28,239
VALUATION ADJUSTMENTS FOR FINANCIAL ASSETS HEDGING	4	69	84
PERFORMING LOAN PORTFOLIO			
Commercial loans			
Business loans	14,124	266,442	275,979
Financial institutions' loans	1,092	20,595	21,088
Government loans	9,020	170,155	192,234
Consumer loans	6,161	116,228	111,237
Mortgage loans			
Medium and residential	8,849	166,921	152,270
Low-income housing	-	9	16
Loans acquired from INFONAVIT or FOVISSSTE	167	3,156	3,511
TOTAL PERFORMING LOAN PORTFOLIO	39,413	743,506	756,335
PAST-DUE LOAN PORTFOLIO			
Commercial loans			
Business loans	326	6,147	7,044
Financial institutions' loans	-	4	-
Consumer loans	226	4,268	4,331
Mortgage loans			
Medium and residential	95	1,786	1,349
Low-income housing	-	-	2
Loans acquired from INFONAVIT or FOVISSSTE	10	187	113
TOTAL PAST-DUE LOAN PORTFOLIO	657	12,392	12,839
LOAN PORTFOLIO	40,070	755,898	769,174
(Minus) ALLOWANCE FOR LOAN LOSSES	(906)	(17,083)	(18,264)
LOAN PORTFOLIO, net	39,164	738,815	750,910
ACQUIRED COLLECTION RIGHTS	72	1,359	2,001
TOTAL LOAN PORTFOLIO, net	39,236	740,174	752,911
RECEIVABLES GENERATED BY SECURITIZATIONS	7	139	61
OTHER ACCOUNTS RECEIVABLE, net	1,559	29,410	36,082
FORECLOSED ASSETS, net	46	860	738
PROPERTY, FURNITURE AND EQUIPMENT, net	800	15,088	13,547
PERMANENT STOCK INVESTMENTS	22	418	342
DEFERRED TAXES AND PROFIT SHARING, net	59	1,104	4,839
OTHER ASSETS, net			
Deferred charges, advance payments and intangibles	1,165	21,978	17,422
Other short-term and long-term assets	12	223	235
TOTAL ASSETS	US\$ 60,939	\$1,149,536	Ps. 1,180,492

MEMORANDUM ACCOUNTS (Note 33)

These consolidated 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, 2019, the stockholders' equity amounts to Ps. 14,420.

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	2019	2019	2018
DEPOSITS			
Demand deposits	US\$ 23,084	Ps. 435,453	Ps. 412,118
Time deposits			
General public	13,873	261,705	277,576
Money market	961	18,122	55,552
Senior debt	1,426	26,907	12,098
Global account of deposit without movement	111	2,085	1,891
	39,455	744,272	759,235
INTERBANK AND OTHER LOANS			
Short-term loans	27	500	-
Short-term loans	492	9,276	13,523
Long-term loans	257	4,854	22,199
	776	14,630	35,722
CREDITOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS	8,624	162,684	163,507
COLLATERAL SOLD OR PLEDGED	6		
Repurchase or resale agreements (creditor balance)		105	2
DERIVATIVE FINANCIAL INSTRUMENTS			
For trading purposes	1,100	20,752	23,605
For hedging purposes	224	4,221	10,963
	1,324	24,973	34,568
OTHER ACCOUNT PAYABLES			
Income taxes	80	1,513	1,696
Employee profit sharing	27	508	485
Creditors from settlements of transactions	498	9,397	4,402
Creditors from cash collateral received	132	2,493	14,319
Sundry creditors and other payables	1,393	26,265	24,059
	2,130	40,176	44,961
SUBORDINATED DEBENTURES	2,547	48,050	33,560
DEFERRED CREDITS AND ADVANCED COLLECTIONS	20	386	535
TOTAL LIABILITIES	54,882	1,035,276	1,072,090
STOCKHOLDERS' EQUITY			
PAID-IN CAPITAL			
Common stock	996	18,794	18,794
Additional paid-in capital	113	2,123	1,184
	1,109	20,917	19,978
OTHER CAPITAL			
Capital reserves	919	17,330	14,847
Retained earnings from prior years	2,697	50,883	53,133
Result from valuation of securities available for sale	100	1,885	(1,994)
Result from valuation of instruments for cash flow hedging	-121	(2,287)	(3,430)
Cumulative foreign currency translation adjustment	-2	(34)	1,659
Remeasurement of employee benefits	-102	(1,930)	(628)
Net income	1,457	27,493	24,834
	4,948	93,340	88,421
NONCONTROLLING INTEREST		3	3
TOTAL STOCKHOLDERS' EQUITY	6,057	114,260	108,402
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	US\$ 60,939	Ps. 1,149,536	Ps. 1,180,492

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, 2019, 2018 AND 2017**
(In millions of Mexican pesos and in millions of U.S. dollars)

	2019	2019	2018	2017
Interest income	US\$6,743	\$127,208	Ps. 117,979	Ps. 95,710
Interest expense	3,108	58,621	53,466	40,062
NET INTEREST INCOME	3,635	68,587	64,513	55,648
Allowance for loan losses	(801)	(15,104)	(15,635)	(14,983)
NET INTEREST INCOME AFTER ALLOWANCE FOR LOAN LOSSES	2,834	53,483	48,878	40,665
Commission and fee income	1,214	22,906	21,379	18,436
Commission and fee expense	(451)	(8,516)	(7,849)	(6,142)
Intermediation income	242	4,560	3,799	2,101
Other operating income	139	2,624	2,869	2,365
Non interest expense	(2,019)	(38,095)	(35,079)	(31,750)
	(875)	(16,521)	(14,881)	(14,990)
OPERATING INCOME	1,959	36,962	33,997	25,675
Equity in earnings of unconsolidated subsidiaries and associated companies	7	128	161	62
INCOME BEFORE INCOME TAX	1,966	37,090	34,158	25,737
Current income tax	(425)	(8,021)	(8,565)	(6,781)
Deferred income taxes	(84)	(1,576)	(759)	(706)
	(509)	(9,597)	(9,324)	(7,487)
RESULT BEFORE DISCONTINUED OPERATIONS	1,457	27,493	24,834	18,250
Discontinued operations	-	-	-	89
NET INCOME	US\$1,457	Ps. \$27,493	Ps. 24,834	Ps. 18,339

These consolidated 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 income statements."

Act. José Marcos Ramírez Miguel
CEO

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

C.P. Isaías Velázquez González
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Deputy Managing Director - Controller

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Executive Director - Accounting



**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, 2019 AND 2018**
(In millions of Mexican pesos and in millions of U.S. dollars)

	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, 2018	Ps. 18,105	Ps. 648	Ps. 13,013	Ps. 38,959	Ps. 4
TRANSACTIONS APPROVED BY STOCKHOLDERS:					
Transfer of prior year's result	-	-	-	18,339	-
Creation of reserves as per General Stockholders' meeting on April 28, 2018	-	-	1,834	(1,834)	-
Special judgement of CNBV for sale of INB	-	-	-	(183)	-
Share-based payments payable in stock options	-	536	-	-	-
Effect due to fusion with Bank Interactions	689	-	-	(154)	165
Total transactions approved by stockholders	689	536	1,834	16,168	165
COMPREHENSIVE INCOME:					
Net income	-	-	-	-	-
Result from valuation of securities available for sale	-	-	-	-	(2,836)
Effect of subsidiaries, affiliates and mutual funds	-	-	-	(37)	-
Cumulative foreign currency translation adjustment	-	-	-	-	-
Defined remedies for employees benefits	-	-	-	(37)	-
Interest on subordinated debentures	-	-	-	(1,247)	-
Result from valuation of instruments for cash flow hedging	-	-	-	-	-
Application of special accounting criteria of the Commission	-	-	-	(673)	673
Total comprehensive income	-	-	-	(1,994)	(2,163)
Minority interest	-	-	-	-	-
Balances, December 31, 2018	18,794	1,184	14,847	53,133	(1,994)
TRANSACTIONS APPROVED BY STOCKHOLDERS:					
Transfer of prior year's result	-	-	-	24,834	-
Creation of reserves as per General Stockholders' meeting on April 30, 2019	-	-	2,483	(2,483)	-
Dividends declared at the General Stockholders' meetings on: May 23, 2019, August 20, 2019 and December 18, 2019	-	-	-	(22,398)	-
Share-based payments payable in stock options	-	795	-	-	-
Effect due to fusion with Bank Interactions	-	-	-	(145)	-
Effect due to clearance of subsidiary Banorte USA	-	-	-	-	-
Sale of share of Operadora de Fondos Banorte	-	144	-	-	-
Total transactions approved by stockholders	-	939	2,483	(192)	-
COMPREHENSIVE INCOME:					
Net income	-	-	-	-	-
Result from valuation of securities available for sale	-	-	-	-	3,879
Effect of subsidiaries, affiliates and mutual funds	-	-	-	(3)	-
Cumulative foreign currency translation adjustment	-	-	-	-	-
Defined remedies for employees benefits	-	-	-	(37)	-
Interest on subordinated obligations	-	-	-	(2,018)	-
Result from valuation of instruments for cash flow hedging	-	-	-	-	-
Total comprehensive income	-	-	-	(2,058)	3,879
Minority interest	-	-	-	-	-
Balances, December 31, 2019	Ps. 18,794	Ps. 2,123	Ps. 17,330	Ps. 50,883	Ps. 1,885

These consolidated statements of changes in stockholders' 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 Stockholders' 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 statements of changes in stockholders' equity."



CAPITAL GANADO							
	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, 2018	Ps. (3,653)	Ps. 1,590	Ps. (943)	Ps. 18,339	Ps. 86,062	Ps. -	Ps. 86,062
TRANSACTIONS APPROVED BY STOCKHOLDERS:							
Transfer of prior year's result	-	-	-	(18,339)	-	-	-
Creation of reserves as per General Stockholders' meeting on April 28, 2019.	-	-	-	-	-	-	-
Special judgement of CNBV for sale of INB	-	-	-	-	(183)	-	(183)
Share-based payments payable in stock options	-	-	-	-	536	-	536
Effect due to fusion with Bank Interactions	-	-	(23)	-	677	-	677
Total movimientos aprobados por los accionistas	-	-	(23)	(18,339)	1,030	-	1,030
COMPREHENSIVE INCOME:							
Net income	-	-	-	24,834	24,834	-	24,834
Result from valuation of securities available for sale	-	-	-	-	(2,836)	-	(2,836)
Effect of subsidiaries, affiliates and mutual funds	-	-	(5)	-	(42)	-	(42)
Cumulative foreign currency translation adjustment	-	69	-	-	69	-	69
Defined remedies for employees benefits	-	-	343	-	306	-	306
Interest on subordinated debentures	-	-	-	-	(1,247)	-	(1,247)
Result from valuation of instruments for cash flow hedging	223	-	-	-	223	-	223
Application of special accounting criteria of the Commission	-	-	-	-	-	-	-
Total resultado integral	223	69	338	24,834	21,307	-	21,307
Participación no controladora	-	-	-	-	-	-	-
Saldo al 31 de diciembre de 2018	(3,430)	1,659	(628)	24,834	108,399	3	108,402
MOVIMIENTOS INHERENTES A LAS DECISIONES DE LOS ACCIONISTAS:							
Transfer of prior year's result	-	-	-	(24,834)	-	-	-
Creation of reserves as per General Stockholders' meeting on April 30, 2019	-	-	-	-	-	-	-
Dividends declared at the General Stockholders' meetings on: May 23, 2019, August 20, 2019 and December 18, 2019	-	-	-	-	(22,398)	-	(22,398)
Share-based payments payable in stock options	-	-	-	-	795	-	795
Effect due to fusion with Bank Interactions	-	-	-	-	(145)	-	(145)
Effect due to clearance of subsidiary Banorte USA	-	(1,661)	-	-	(1,661)	-	(1,661)
Sale of share of Operadora de Fondos Banorte	-	-	-	-	144	-	144
Total transactions approved by stockholders	-	(1,661)	-	(24,834)	(23,265)	-	(23,265)
COMPREHENSIVE INCOME:							
Net income	-	-	-	27,493	27,493	-	27,493
Result from valuation of securities available for sale	-	-	-	-	3,879	-	3,879
Effect of subsidiaries, affiliates and mutual funds	-	-	(2)	-	(5)	-	(5)
Cumulative foreign currency translation adjustment	-	(32)	-	-	(32)	-	(32)
Defined remedies for employees benefits	-	-	(1,300)	-	(1,337)	-	(1,337)
Interest on subordinated obligations	-	-	-	-	(2,018)	-	(2,018)
Result from valuation of instruments for cash flow hedging	1,143	-	-	-	1,143	-	1,143
Total comprehensive income	1,143	(32)	(1,302)	27,493	29,123	-	29,123
Minority interest	-	-	-	-	-	-	-
Balances, December 31, 2019	(Ps. 2,287)	(Ps. 34)	(Ps. 1,930)	PS.27,493	Ps.114,257	P.s 3	P.s 114,260

Act. José Marcos Ramírez Miguel
CEO

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Managing Director - COO, Administration and Finance

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Managing Director – Audit

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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, 2019, 2018 AND 2017
(In millions of Mexican pesos and in millions of U.S. dollars)

	2019	2019	2018	2017
	US\$1,457	Ps. 27,493	Ps. 24,834	Ps. 18,339
Net income				
Items not requiring (generating) resources:				
Real estate, furniture and equipment depreciations	101	1,903	2,055	1,533
Provisions	81	1,527	2,239	(246)
Current and deferred income tax	509	9,597	9,324	7,487
Discontinued operations	-	-	-	89
Equity in earnings of unconsolidated subsidiaries and associated companies	(7)	(128)	(161)	(62)
	2,141	40,392	38,291	27,140
OPERATING ACTIVITIES:				
Changes in margin accounts	(237)	(4,469)	528	200
Changes in investments in securities	285	5,384	36,611	8,703
Changes in debtor balances under repurchase and resale agreements	85	(1,611)	(399)	(5)
Changes in asset position of derivatives	308	5,803	(2,095)	15,385
Change in loan portfolio	641	12,096	(40,682)	(47,762)
Changes in acquired collection rights	34	642	(76)	(524)
Changes in receivables generated by securitizations	(4)	(78)	80	15
Change in foreclosed assets	(6)	(122)	14	470
Change in other operating assets	111	2,101	(2,536)	3,661
Change in deposits	(793)	(14,964)	14,577	72,867
Change in interbank and other loans	(1,118)	(21,091)	(5,542)	(6,022)
Change in creditor balances under repurchase and sale agreements	(44)	(823)	(26,856)	(44,127)
Collateral sold or pledged	51	103	(1)	3
Change in liability position of derivative financial instruments	(151)	(2,853)	(1,106)	(15,796)
Change in subordinated debentures	768	14,490	114	10,952
Change in other operating liabilities	(457)	(8,617)	(13,163)	12,478
Change in hedging instruments related to operations	(297)	(5,605)	(1,166)	2,044
Assets for discontinued operations	-	-	-	(184)
Income tax	(321)	(6,052)	(9,907)	(6,886)
Net cash generated by (used in) operating activities	996	14,726	(13,314)	32,612
INVESTING ACTIVITIES:				
Proceeds on disposal of property, furniture and equipment	24	463	1,981	219
Payments for acquisition of property, furniture and equipment	(207)	(3,913)	(3,454)	(3,308)
Proceeds on disposal of Subsidiaries and associated companies	12	228	(1)	3,195
Cash from business acquired	-	-	15,126	-
Subsidiaries and associated companies acquisitions charges	(5)	(101)	-	-
Charges for cash Dividends	5	90	80	1,214
Net cash generated by (used in) investing activities	(171)	(3,233)	13,732	1,320
FINANCING ACTIVITIES:				
Dividends paid	(1,187)	(22,398)	-	(23,380)
Interest on subordinated debentures paid	(107)	(2,018)	(1,247)	(306)
Net cash used in financing activities	(1,294)	(24,416)	(1,247)	(23,686)
Net (decrease) increase in cash and cash equivalents	(685)	(12,923)	(829)	10,246
Effects from changes in the value of cash and cash equivalents	(1)	(28)	(1)	(27)
Cash and cash equivalents at the beginning of the year	3,988	75,233	76,063	65,844
Cash and cash equivalents at the end of the year	US\$ 3,302	Ps. 62,282	Ps.75,233	Ps.76,063

These consolidated 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."

Act. José Marcos Ramírez Miguel
CEO

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**BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2019, 2018 AND 2017**
(In millions of Mexican pesos and in millions of U.S. dollars, except exchange rates and Note 30)

1 – ACTIVITY AND REGULATORY ENVIRONMENT

Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries (the Institution or Banorte), 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, 2017, the date on which the spin-off of the Institution 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 Institution to maintain a minimum capitalization index for market and credit 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 with all of the above as of December 31, 2019.

The Institution is a 98.26% owned subsidiary 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, in the United States of America.

The Institution's consolidated financial statements have been approved by the Board of Directors at their January 23, 2020 meeting in accordance with the responsibility assigned to them.

2 – SIGNIFICANT EVENTS DURING THE YEAR

Banorte USA liquidation

The Board of Directors of the Institution in the assignment in the meeting held on January 25, 2018 approved the liquidation of Banorte USA to be enhanced once the split of Banorte USA was completed, the settlement was finalized on January 14, 2019 upon receipt of the certificate of dissolution of the state of Delaware, United States of America. For the occasion of the liquidation of Banorte USA, the Institution was given the amount of US \$131,346.00 dollars equivalent to \$2 million pesos at an exchange rate of \$18.90 pesos for each dollar, with which Institution's permanent investment in Banorte USA was written off. Likewise, the cumulative amount of the conversion effect in the stockholders' equity of the Institution was recognized in the income for the year in the amount of \$ 1,661 million pesos as part of the gain derived from the settlement of BUSA pursuant to NIF B -15 "Conversion of Foreign Operations".

Alliance between Banorte and Payclip

On June 17, 2019, the Institution and Payclip, Inc. ("Clip") entered into an alliance by investing Banorte in Clip's common stock for \$70 representing a 2.06% participation, this way the Institution strengthened the existing commercial alliance with Clip and commitment to the continuity of digital strategy and technological innovation.



Issuance of capital notes Tier 1 for USD 1,100 (Subordinated debentures)

On June 27, 2019, the Institution successfully issued Subordinated Perpetual, NonPreferred Non-Cumulative Tier 1 Capital Notes for USD 1,100 million in the international markets under the following features:

Tier 1 Capital Notes were issued in two series:

- NC5 Notes PERP for USD 600 million, callable at the fifth year, carrying a coupon rate of 6.75% and;
- NC10 Notes PERP for USD 500 million, callable at the tenth year, carrying a coupon rate of 7.50%.

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

Prepayment of subordinated obligations Q Banorte

On October 3, 2019, the Institution partially prepaid subordinated preferred & nonconvertible obligations Q Banorte amounting to USD 206, issued on October 4, 2016 and due in 2031.

Prepayment of subordinated obligations BANORTE 08U

On December 23, 2019, the Institution partially prepaid subordinated preferred & nonconvertible obligations BANORTE 08U amounting to Ps 1,085, issued on March 11, 2008 and due in 2028.

3 – BASIS OF PRESENTATION

Presentation of consolidated financial statements

The consolidated financial statements as of December 31, 2019 and 2018, which are accompanied, have been prepared in accordance with the accounting criteria established by the Commission.

Monetary unit of the consolidated financial statements

The consolidated financial statements and notes as of December 31, 2019, 2018 and 2017 and for the years then ended include balances and transactions in millions of Mexican pesos of purchasing power of such dates, except where mentioned.

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, 2019, 2018 and 2017, the Institution's consolidated subsidiaries and its equity ownership is as follows:

	December 31, 2019	December 31, 2018	December 31, 2017
Banorte USA Corporation y Subsidiarias	-	100.00%	100%
Administradora de Servicios Profesionales Especializados, S.A. de C.V.	99.99%	99.99%	99.99%
Casa Servicios Administrativos, S.A. de C.V.	99.60%	99.60%	99.60%
Bonds Finance Company Limited*	100.00%	100.00%	100.00%
Fideicomiso BONY 469	100.00%	100.00%	100.00%
Inmobiliaria Interorbe, S.A. de C.V.	99.99%	99.99%	-
Inmobiliaria Mobinter, S.A. de C.V.	99.99%	99.99%	-
Inmobiliaria Interdiseño, S.A. de C.V.	99.99%	99.95%	-
Estrategia en Finanzas & Infraestructura, S.A. de C.V.	99.99%	99.99%	-



	December 31, 2019	December 31, 2018	December 31, 2017
Fideicomiso de coinversión FCICK16-1	97.50%	97.50%	-
Banorte Financial Services, INC.	100.00%	100.00%	-

* Trust created on January 11, 2018 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 Financial Services, INC. (indirect foreign subsidiary)

In order to consolidate the financial statements of Banorte Financial Services, INC., they are first adjusted to 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 for the year-end rate for assets and liabilities (18.8642 for 2019), historical rate for non-monetary assets and liabilities as well as stockholders' equity, and the weighted average rate of the period for income, costs and expenses (19.2573 for 2019). The conversion effects are presented in the Institution's stockholders' equity.

Application of Special Accounting Criteria

In view of the fact that the Institution is carrying out a process of corporate restructuring, the Commission, based on Article 175 of the "General provisions applicable to credit institutions" and in accordance with the Article 72 of the "General provisions applicable to credit auxiliary entities" authorized Banorte, Sólida and AyF a special accounting criteria through the official letter 320-1/15576/2018.

Those criteria authorized the Institution recognized the result from valuation of Corporación, S.A.B. de C.V. (GEO), URBI Desarrollos Urbanos S.A.B. de C.V. (URBI) y Desarrolladora Homex, S.A.B. de C.V. (HOMEX) shares, classified as available for sale which previously was recognized in the stockholder's equity at the date of issuance of the aforementioned official letter, directly against the heading "Retained earnings from prior years" and not against the "Net income" as established in paragraph 46 of the NIF B-2, "Investments in Securities"

If the authorized Special Accounting Criteria were not applied, the amounts that would have been recognized and presented in the Consolidated Balance Sheet and Consolidated Income Statement as of December 31, 2018 in the items affected would be:

Consolidated Balance Sheet	Figures Without Special Accounting Criteria	Figures with Special Accounting Criteria	Variation
Retained earnings from prior years	Ps. 53,806	Ps.53,133	(Ps. 673)
Net income	24,161	24,834	673
Total stockholders' equity	108,402	108,402	
Total liabilities and stockholders' equity	Ps.1,180,492	Ps. 1,180,492	Ps. -
Consolidated Income Statement	Figures Without Special Accounting Criteria	Figures with Special Accounting Criteria	Variation
Brokerage revenues	Ps. 3,126	Ps. 3,799	(Ps. 673)
Operating income	33,324	33,997	673
Net income	Ps. 24,161	Ps 24,834	Ps. 673



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 2019, 2018 and 2017, 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, Commission special accounting criteria 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 (MFRS or individually referred to as *Normas de Informacion Financiera* (NIFs)), 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.

Explanation for translation into English

The accompanying consolidated financial statements have been translated from Spanish into English for the convenience of users. These consolidated financial statements are presented on the basis of accounting practices prescribed by the Commission. Certain accounting practices applied by the Institution may not conform to Mexican Financial Reporting Standards ("MFRS") or other accounting principles generally accepted outside of Mexico.

Arithmetical translation of the consolidated financial statements from Mexican pesos into United States of America (U.S.) dollars for the year ended December 31, 2019

The consolidated financial statements are stated in millions of Mexican pesos ("Ps.") the currency of the country in which the Institution is incorporated and has its principal operations. The translations of Mexican pesos into U.S. dollars ("US\$") are included solely for the convenience of the readers and have been made at the rate of Ps. 18.8642 per one U.S. dollar on December 31, 2019, as issued by Banco de México. Such translation should not be construed as representations that the Mexican peso amounts have been, could have been, or could in the future, be converted into U.S. dollars at this rate or at any other rate, if at all.

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 2019, 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	Annual application 20%	Gradual recognition as of December 31 2019
Corporate Bonds	\$183	\$37	\$146

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 2019, 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	Annual application 20%	Gradual recognition as of December 31 2019
Corporate Bonds	\$2,729	\$546	\$2,183

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, 2019, had the aforementioned option not been applied in the affected items are

Concepto	Importe
Other assets and short and long term	\$25,683
Total of assets	1,034,693
Retained earnings from prior years	50,847
Reimbursement for benefits to employees	(2,475)
Total stockholders' equity	113,678
Total liabilities and stockholders' equity	\$1,148,371

(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.

Recognition of the effects of inflation in financial consolidated 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 2019 and 2018 was 15.71% and 12.60%, respectively. Therefore, the Mexican economy is considered as non-inflationary. However, assets, liabilities and stockholders' equity as of December 31, 2019 and 2018 include the restatement effects recorded up through December 31, 2007. The cumulative Mexican inflation over the three years including the year ended December 31, 2019 was 15.03%.

The Mexican inflation rates for the years ended December 31, 2019 and 2018 were 2.77% and 4.92%, 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.

Margin securities

Margin securities on cash in transactions with derivative financial instruments in recognized markets are recorded at nominal value.

The cash is intended to ensure the compliance with the obligations corresponding to derivatives held in recognized markets and correspond to the initial margin, to partial or total settlements, additional contributions or withdrawals, returns generated by the account itself, as well as commissions that correspond to charge in the validity of the corresponding contracts.

Partial or total settlements deposited and withdrawn by the clearing house due to fluctuations in the prices of derivatives must be recognized within the margin account, affecting as a counterpart a specific account that may be of a debtor or creditor nature, and that It will reflect the effects of the derivative valuation prior to its liquidation. The counterpart of a debtor or creditor nature will represent an advance received, or, a financing granted by the clearing house prior to the liquidation of the derivative.

The amount of margin accounts granted and received in cash in derivative transactions not carried out in recognized markets or exchanges will be presented under other accounts receivable, while the account payable generated by the receipt of cash collateral It will be presented in other accounts payable.

Collaterals granted in such operations, other than restricted cash must remain in the same area from which they originate. The payable account, which represents the obligation of the assignee to return to the transferor the collateral other than cash that has been sold must be presented in the balance sheet, on collaterals sold or given as collateral. The amount of the collateral other than cash on which the right to sell or give as guarantee has been granted shall be presented in memorandum accounts in a specific item.

As of December 31, 2019 and 2018, the Institution maintained standardized derivative and future operations, so cash collateral (cash margin calls) were recognized to ensure compliance with the obligations corresponding to the operations held in markets recognized for the purpose to mitigate the default risk.

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.



If, in a subsequent period, the fair value of debt classified as available for sale were to be increased and such reversal of the impairment effect may be objectively related to an event occurring after the impairment were to be recognized in the results of the year, the loss due to impairment shall be reversed in the results of the year.

The loss due to impairment recognized in the income statement of securities classified as available for sale shall not be reversed.

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.

General valuation standards

Upon the sale of trading securities, the valuation results 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 to 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 income statement in "Intermediation income" 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 stockholders' 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 "Intermediation income".
- 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 performing 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 valued under the Black-Scholes model, 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 begins 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 Value at Risk (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 Risk Policies 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: 90 calendar days after interest payment overdue, or 30 calendar days after principal payment overdue.



- 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 are renewed with single payment of principal at maturity, regardless of whether the payment of interest is periodic or at maturity; it is considered that there is sustained payment of credit when: The accredited has covered at least 20% 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

Internal methodology Política interna calificación de cartera de consumo tarjeta de crédito y otros créditos revolving

On November 15, 2017, the Institution received approval from the banking regulator to use Internal Models (IM) for credit card rating for reserves and regulatory capital generation by credit risk with an advanced focus (Document 111-3/706/2017).

These internal models improve overall credit risk management by estimating risk parameters from the bank's own experience based on January 2018 data, and have been applied as of February 2018.

The internal methodology describes that the determination of the rating and estimation of the reservation of the credit card consumption portfolio and other revolving credits are considered as the following credit risk parameters:

$$R_i = P_{li} * SP * E_{li}$$

Where:

R_i = Loan reserves to record for E_{li} credit

P_{li} = Probability of default for E_{li} credit

SP_i = Severity of the loss for E_{li} credit

E_{li} = Exposure to default for i –ésimo credit

For the determination of the reserve is necessary to use the probability of default, the severity of the loss and the exposure to breach, agree to the following:

1. Probability of default of the Internal Model

The probability of default (PI) measures how likely it is that an accredited leave to comply with their contractual obligations and is assigned with the information in the following table according to their risk level previously determined by the internal model of Credit Card.

Risk level	PI
A-01	0.00646233
A-02	0.00668129
A-03	0.00770357
A-04	0.00899237
B-01	0.01008105
B-02	0.01538093
B-03	0.01962636
B-04	0.02590753
C-01	0.03379690
C-02	0.04619679
C-03	0.06073381
C-04	0.08180872
D-01	0.11804428
D-02	0.17143767
D-03	0.30358352
D-04	0.71565748
E	1

2. Severity of the loss

Severity of Loss. Measures the intensity of the loss upon default expressed as a percentage of the Exposure at Default (EAD), once considered collateral values and the costs associated regarding the settlement (judicial, administrative collection, and deed in lieu, among others).



Clasification	Overdue payments	SP
Payed	0 – 3	87.16%
Unpaid	4	87.16%
	5	90.30%
	6 and more	100%

3. Probability of Default

Probability of Default (PD) shows the likelihood that a borrower defaults on its contractual obligations within twelve months after the month being rated. Default is defined when loans present 90 or more days past-due.

The credit conversion factor (FCC) assignment to estimate the EI is performing according to the following table:

Delay	Factor
01	1.8475
02	2.0624
03	1.2974
04	1.1693
05	1.2167
06	1.0985
11	1.2583
12	1.1074
13	1.0398
14	1.0790
15	1.0247
21	1.1145
22	1.0907
23	1.0385
24	1.0161
25	1.0241
31	1.0129
32	1.0086
33	1.0053
5	0.6549

Delay segment in defined in the internal model.

The value of the Factor assigned to each segment proceeds to rate the exposure to non-compliance.

When the accountant balance is greater than zero: $EI = \text{Factor\_Arbol} * \text{Accountant balance}$

When the accountant balance is less or equal than zero and the limit credit is empty: $EI = 0.6549 * \text{Credit limit}$.

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.

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 credit 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.

Internal models ratings for reserves and regulatory capital constitution

Applicable Portfolio

The Institution owns a Rating Internal Model for Revolving Consumer portfolio for the constitution of reserves and capital under an Advanced Approach, estimating the three parameters required for its calculation: Probability of Default (PD), Severity of Loss (SL) and Exposure at Default (EAD). Additionally, owns a Rating Internal Model for Corporations portfolio, for the constitution of reserves and capital under a Basic Approach, estimating only the Probability of Default (PD) parameter.

The exposures considered in the Commercial Loans portfolio are those pertaining to corporations (other than states, municipalities and financial entities), and individuals (sole proprietorships), both with annual sales higher or equal to 14 million UDIs.

The methodology used by the Institution in the estimation of the parameters and the calculation of reserves and capital, follows the guidelines established by the banking regulator CNBV (Comisión Nacional Bancaria y de Valores), in relation to the general provisions applicable to Credit Institutions stipulated in the Single Bank Circular (Circular Única de Bancos CUB).

On November 15, 2017, the Institution received approval from the banking regulator CNBV to use Internal Models (IM) for credit card rating for reserves and regulatory capital generation by credit risk with an advanced focus (Document 111-3/706/2017).

Likewise, on November 30, 2018, GFNorte obtained authorization from the banking regulator CNBV (Comisión Nacional Bancaria y de Valores) to use the Internal Model (IM) for Commercial Loans for reserves generation and regulatory capital requirements by credit risk with a Basic Approach, as per Document 111-3/1472/2018 in Banco Mercantil del Norte, and on March 1, 2019 for Arrendadora y Factor Banorte, Sólida Administradora de Portafolios, as per Documents 111-1/160/2019 y 111-1/161/2019 respectively.

Internal Models used by the Institution, like the Standard Models, have an expected loss approach for the next twelve months.

Internal Models grant a comprehensive credit risk management, considering the portfolio's own risk in such a way that the resulting models show greater predictability, derived from the use of specific attributes for each of the segments.

One of the purposes of internal estimations, is to calculate Reserves and Capital Requirements for Credit Card and Commercial Loans Portfolios, which must be rated in accordance with the General Provisions Applicable to Credit Institutions described in the Single Bank Circular.

Internal Rating Process

Commercial Loans

For the Commercial Loans portfolio the estimation of the Probability of Default (PD) is performed using the Internal Model with Basic Approach, considering internal and external variables.



Once PD is determined, Severity of Loss (SL) and the Exposure at Default (EAD) are considered under the Standard Method, and once the above factors have been obtained, the Expected Loss (EL) is computed as follows:

$$EL = PD * SL * EAD$$

Credit Cards Portfolio

In the Credit Card portfolio, the Rating System scale allows the Institution to have a better credit risk management when considering the portfolio's own risk, in order to continuously monitor customers and to prevent or mitigate adverse events.

Its main purpose is to segregate population into homogeneous subsets (buckets), so that the resulting models show greater predictability, derived from the use of specific attributes for each of the segments.

Internal Models' Variable Estimation

Probability of Default

Probability of Default (PD) shows the likelihood that a borrower defaults on its contractual obligations within twelve months after the month being rated. Default is defined when loans present 90 or more days past-due.

For its estimation, information from internal and external variables is used with which a score is obtained, which is mapped to a master rating measuring risk level.

Severity of Loss

Severity of Loss. Measures the intensity of the loss upon default expressed as a percentage of the Exposure at Default (EAD), once considered collateral values and the costs associated regarding the settlement (judicial, administrative collection, and deed in lieu, among others).

The estimation of the Severity of Loss (SL) implies calculating present value of flows at default date, granting a comparable measure for loans with different recovery periods.

Exposure at Default

Exposure at Default (EAD) is the amount of the debt at the time of default of a loan. It is estimated on a conversion factor basis, which considers the relationship between balance and the unused credit line.

In the particular case of the Commercial Loan portfolio, Severity of Loss (SL) and Exposure at Default (EAD) are used in accordance with those established on the CUB for Standard Models.

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 consolidated 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, obtained in accordance with accounting criteria issued by the Commission.

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, 2019, there were no reserves other than 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 equipment 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.

Income 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, 2019 and 2018.

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.

Derived from the entry into force of the New MFRS D-3, "Employee Benefits" (MFRS D-3), the Institution adopted the transitory third article published by the Commission to gradually recognize in the stockholder's equity the changes by reformulation referred to in MFRS D-3. In this way, the Institution gradually recognizes in a period of 5 years, as of 2016, the initial balance of actuarial gains or losses in other comprehensive income, as well as, the initial balance of the improvements to the plan in retained earnings from prior years.

At the end of 2019, actuarial earning / losses were generated in all benefits, these amounts are integrated into the other comprehensive income account and will be recycled to results during the future working life of the workers according to the benefit.

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 or 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 MFRS 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 Institution that are considered as irrevocable commercial loans not disposed by the borrowers. It includes the lines of credit granted 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

As of December 31, 2019, and 2018, cash and cash equivalents are as follows:

	2019	2018
Cash	Ps. 23,841	Ps. 23,553
Banks	38,370	51,606
Other deposits and available funds	71	74
	Ps. 62,282	Ps. 75,233

"Banks" is represented by cash in Mexican pesos and US dollars converted at the exchange rate issued by Banco de México of Ps. 18.8642 and Ps. 19.6512 as of December 31, 2019 and 2018, respectively, and is made up as follows:

	Mexican pesos		USD		Total	
	2019	2018	2019	2018	2019	2018
Call money	Ps. 3,413	Ps. 162	Ps. -	Ps. -	Ps. 3,413	Ps. 162
Deposits with foreign credit institutions	-	-	503	4,184	503	4,184
Domestic banks	2,828	2,127	-	-	2,828	2,127
Banco de México	31,074	43,943	552	1,190	31,626	45,133
	Ps. 37,315	Ps. 46,232	Ps. 1,055	Ps. 5,374	Ps. 38,370	Ps. 51,606

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, 2019, and 2018, the Institution had made monetary regulation deposits of Ps. 33,122 and Ps. 29,707, respectively.

As of December 31, 2019, and 2018, the total sum of restricted cash and cash equivalents is Ps. 33,122 and Ps. 32,493, 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, 2019, and 2018, the balance with Banco de México are Ps. 29,709 and Ps. 21,715, respectively, related to the deposit auctions.

As of December 31, 2019, and 2018, "Other deposits and available funds" includes:

	2019	2018
Minted metals in gold and silver	Ps. 45	Ps. 35
Cashable checks received, pending payment at a 3-day term	25	31
Remittances	1	8
	Ps. 71	Ps. 74

The exchange rates used for the conversion of gold and silver coins (Centenarios and Troy ounces, respectively) was Ps. 702.80 y Ps. 392.85, per unit, respectively, in 2019; and Ps. 618.17 and Ps. 359.52, per unit, respectively, in 2018.



6 - INVESTMENT IN SECURITIES

a. Trading securities

As of December 31, 2019, and 2018, trading securities are as follows:

	2019			2018	
	Acquisition cost	Accrued interest	Valuation increase (decrease)	Book value	Book value
Government securities	Ps. 70,809	Ps. 611	Ps. 51	Ps. 71,471	Ps. 73,902
Not restricted	(835)	-	-	(835)	(1,458)
D Bonds	(199)	-	-	(199)	-
M Bonds	(2)	-	-	(2)	(420)
BPA	(86)	-	-	(86)	-
CETES	(548)	-	-	(548)	(1,044)
Eurobonds	-	-	-	-	11
UDIBONOS	-	-	-	-	(5)
Restricted	71,644	611	51	72,306	75,360
D Bonds	10,637	9	3	10,649	7,864
M Bonds	1,151	5	2	1,158	939
BPA	58,770	596	50	59,416	58,383
CEBUR	380	1	-	381	2,440
CETES	605	-	-	605	2,878
UDIBONOS	101	-	(4)	97	2,856
Bank securities	239	1	1	241	16,460
Not restricted	-	-	-	-	7,006
CEBUR – Development bank	-	-	-	-	(10)
Promissory Notes	-	-	-	-	7,016
Restricted	239	1	1	241	9,454
CEBUR – Development bank	-	-	-	-	920
CEBUR – Bank	-	-	-	-	6,008
CEDES	-	-	-	-	2,178
Other bank securities	-	-	-	-	348
Promissory Notes	239	1	1	241	-
Private securities	3,060	39	358	3,457	2,056
Not restricted	3,060	39	358	3,457	1,639
Shares	128	-	130	258	210
Shares SI	2	-	-	2	37
CEBUR – Corporate	1,228	4	127	1,359	1,344
Eurobonds	1,702	35	101	1,838	48
Restricted	-	-	-	-	417
CEBUR – Corporate	-	-	-	-	417
	Ps. 74,108	Ps. 651	Ps. 410	Ps. 75,169	Ps. 92,418

During 2019 and 2018, the Institution recognized under “Intermediation income” a net profit of Ps. 220 and a net loss of Ps. 21, respectively, for the fair value valuation of these instruments.

As of December 31, 2019, and 2018, there are Ps. 72,547 and Ps. 85,231, respectively, in restricted trading securities associated mainly with repurchase operations.



b. Securities available for sale

As of December 31, 2019, and 2018, securities available for sale are as follows:

	2019				2018
	Acquisition cost	Accrued interest	Valuation increase (decrease)	Book value	Book value
Government securities	Ps. 120,651	Ps. 1,432	Ps. 2,318	Ps. 124,401	Ps. 119,220
Not restricted	34,967	402	1,047	36,417	33,277
M Bonds	-	-	-	-	331
BREMs	7,778	8	-	7,786	7,785
CEBUR – Government	426	2	1	429	575
CEBUR – Municipality	139	4	4	147	143
CETES	613	-	-	613	1,607
Eurobonds– Government	26,011	388	1,043	27,442	22,836
Restricted	85,684	1,029	1,271	87,984	85,943
D Bonds	-	-	-	-	7,381
M Bonds	525	2	10	537	-
BPA	53,972	621	87	54,680	50,233
CEBUR – Government	3,350	9	(8)	3,351	2,340
CETES	48	-	-	48	15
Eurobonds– Government	27,789	397	1,182	29,368	25,974
Bank securities	6,601	37	62	6,700	4,158
Not restricted	6,601	37	62	6,700	4,158
CEBUR –Development bank	1,679	19	60	1,759	540
CEBUR – Bank	1,306	3	9	1,319	1,237
CEDES	1,947	9	-	1,956	1,967
Structured notes	492	-	(13)	479	414
Others	1,177	5	5	1,187	-
Private securities	21,200	338	(9)	21,529	24,608
Not restricted	19,680	299	(24)	19,955	23,118
Shares	114	-	57	171	599
Investment funds	4,214	-	91	4,305	3,968
CEBUR – BORHIS	12	-	(4)	8	12
CEBUR – Corporate	6,769	36	(435)	6,370	6,282
Eurobonds - Private	8,571	263	267	9,101	12,257
Restricted	1,520	40	15	1,575	1,490
Eurobonds - Private	1,520	40	15	1,575	1,490
	Ps. 148,452	Ps. 1,807	Ps. 2,371	Ps. 152,630	Ps. 147,986

As of December 31, 2019, and 2018, there are Ps. 89,559 and Ps. 87,433, respectively, in restricted securities available for sale, mainly associated with securities repurchasing transactions.

As of December 31, 2019, and 2018 there were 77,783,110 of BREMSR securities acquired as of May 2017, 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 have 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, “ Derivates and Hedging Transactions”.



c. Securities held to maturity

As of December 31, 2019 and 2018, securities held to maturity are as follows:

Medium and long-term debt instruments:

	2019			2018
	Acquisition cost	Accrued interest	Book value	Book value
Government securities	Ps. 16,259	Ps. 105	Ps. 16,364	Ps. 5,081
Not restricted	811	2	813	1,741
M Bonds	243	2	245	-
CETES specials	568	-	568	545
UDIBONOS	-	-	-	1,196
Restricted	15,448	103	15,551	3,340
M Bonds	12,564	90	12,654	-
CEBUR Municipality	2,884	13	2,897	3,340
Private securities	3,223	6	3,229	3,411
Not restricted	1,314	-	1,314	1,377
CEBUR – BORHIS	2	-	2	2
Others	1,312	-	1,312	1,375
Restricted	1,909	6	1,915	2,034
CEBUR – Corporate	1,909	6	1,915	2,034
	Ps. 19,482	Ps. 111	Ps. 19,593	Ps. 8,492

As of December 31, 2019 and 2018, there are Ps. 17,466 and Ps. 5,374, respectively, in restricted trading securities associated mainly with repurchasing operations.

As of December 31, 2019, the maturities of the securities (expressed at their book value), 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. 169	Ps. 399	Ps. -	Ps. 568
M Bonds	-	12,899	-	12,899
CEBUR – Municipality	-	-	2,897	2,897
Others	-	-	2	2
CEBUR – BORHIS	-	-	1,312	1,312
CEBUR – Corporate	-	-	1,915	1,915
	Ps. 169	Ps. 13,298	Ps. 6,126	Ps. 19,593

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 as if December 31, 2019 and 2018, is made up as follows:

Type of collateral:	2019		
	Fair value in millions		
	Pesos	USD	EUR
Cash	Ps. 102	Ps. 546	Ps. 38
	Ps. 102	Ps. 546	Ps. 38



2018			
Fair value in millions			
Type of collateral:	Pesos	USD	EUR
Cash	Ps. 7	Ps. 880	Ps. -
	Ps. 7	Ps. 880	Ps. -

As of December 31, 2019 and 2018, the Institution had no instruments received as collateral.

During 2019 and 2018 the interest income from negotiable instruments is as follows:

Concept	2019	2018
Trading securities	Ps. 7,165	Ps. 8,978
Securities available for sale	8,809	9,430
Securities held to maturity	883	566
	Ps. 16,857	Ps. 18,974

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, 2019 and 2018, the amount recorded for the impairment of securities held to maturity and available-for-sale securities amounts to Ps. 0 (Ps. 0 in "Brokerage revenues" and Ps. 0 in "Retained earnings from prior years", See Note 3) and Ps. 734, respectively, are as follows

Instrument	2019	2018
Shares	Ps. -	Ps. 727
CEBUR private	-	7
	Ps. -	Ps. 734

During 2019 and 2018, no interest income was recorded related to the impairment of securities.



7 - DEBTOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS

As of December 31, 2019 and 2018, creditor balances under repurchase and resale agreements are as follows:

Acting as securities purchaser

Instrument	2019				2018			
	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
CETES	Ps -	Ps. -	Ps. -	Ps. -	Ps. 2,263	Ps. 2,263	Ps. -	Ps. -
CEBUR – Government	3,690	3,784	-	94	7,886	7,886	-	-
CEBUR – Development bank	2,571	2,571	-	-	2,348	2,348	-	-
Government UMS								
Bonds (Fix)	1,871	-	1,871	-	-	-	-	-
Bonds IPAB	2,760	2,760	-	-	6,694	6,694	-	-
Quarterly IPAB Bonds	42,017	41,880	145	8	86,283	85,878	405	-
Semi-annual IPAB								
Bonds	24,921	24,921	-	-	23,316	23,316	-	-
M Bonds	4,500	4,500	-	-	123	123	-	-
D Bonds	12,158	12,161	-	3	21,515	21,517	-	2
CEBUR in UDIS	-	-	-	-	-	-	-	-
Government securities	94,488	92,577	2,016	105	150,428	150,025	405	2
Securitized bank certificates	8,676	8,676	-	-	3,754	3,754	-	-
CEDES	10,613	10,613	-	-	3,145	3,145	-	-
Bank bonds	-	-	-	-	500	500	-	-
Others	17	17	-	-	-	-	-	-
Bank securities	19,306	19,306	-	-	7,399	7,399	-	-
CEBUR – Municipality	2,399	2,399	-	-	-	-	-	-
CEBUR in UDIS	1,500	1,500	-	-	500	500	-	-
Short-term CEBUR	437	437	-	-	958	958	-	-
Private securities	4,336	4,336	-	-	1,458	1,458	-	-
	Ps. 118,130	Ps. 116,219	Ps. 2,016	Ps. 105	Ps. 159,285	Ps. 158,882	Ps. 405	Ps. 2

With the Institution acting as the purchaser, accrued premiums charged to the results of operations as of December 31, 2019 and 2018 were Ps. 9,725 and Ps. 6,140, respectively, which are presented in the “Interest Income” Heading.

During 2019, repurchase transactions carried out by the Institution in its capacity as purchaser ranged in term from 1 to 8 days.

As of December 31, 2019, the amount of securities corresponding to guarantees granted and received in repurchase transactions that involved the transfer of property totaled Ps. 116,266 and Ps. 207,870, respectively, and as of December 31, 2018, the totals were Ps. 159,301 in guarantees granted and Ps. 237,642 in guarantees received.

The debtor and creditor balances in repurchase transactions consist of:



Acting as seller of securities

Instrument	2019	2018
CETES	Ps. 156	Ps. 2,591
CEBUR	3,732	5,797
Eurobonds	19,310	17,524
Bonds IPAB	25,770	5,118
Quarterly IPAB bonds	73,852	75,714
Semi-annual IPAB bonds	13,543	24,854
Development bonds	7,607	14,911
Government bonds	14,064	227
UDIBONOS	97	2,842
Government securities	158,131	149,578
CEBUR – bank	-	6,007
CEDES	-	2,178
Financial Institution Negotiable Instruments	245	348
Bank securities	245	8,533
CEBUR – Municipality	2,850	3,409
CEBUR – Corporate	1,458	1,987
Private securities	4,308	5,396
	Ps. 162,684	Ps. 163,507

With the Institution in its capacity as purchaser, accrued interest was charged to the results of operations as of December 31, 2019 and 2018 for Ps. 22,736 and Ps. 21,214, respectively, and recorded under “Interest Expenses”.

During 2019, the period of repurchase transactions carried out by the Institution in its capacity as purchaser ranged in term from 1 to 12 years.

8 - DERIVATIVES FINANCIAL INSTRUMENTS

The transactions carried out by the Institution involving derivative financial instruments correspond mainly to futures, swaps and options contracts. These transactions are entered into in order to hedge various financial risks as well as for trading purposes.

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

As of December 31, 2019 and 2018, positions in derivatives financial instruments are as follows:

Asset position	2019	2018
Forwards		
Foreign currency forwards	Ps. 96	Ps. 87
Options		
Interest rate options	262	961
Stock options	390	-
Foreign currency options	-	518
Swaps		
Interest rate swaps	17,186	22,439
Foreign currency swaps	4,190	4,078
Credit swaps	171	-
Total trading	22,295	28,083
Options		
Rate options	-	3
Exchange rate swaps	162	-
Interest rate swaps	-	153
Total hedging	162	156
Total position	Ps. 22,457	Ps. 28,239



Liability position	2019	2018
Forwards		
Foreign currency forwards	Ps. 176	Ps. 416
Options		
Interest rate options	200	796
Foreign currency options	730	284
Swaps		
Interest rate swaps	12,715	18,132
Foreign currency swaps	6,931	3,977
Total trading	20,752	23,605
Swaps		
Interest rate swaps	273	253
Foreign currency swaps	3,948	10,710
Total hedging	4,221	10,963
Total position	Ps. 24,973	Ps. 34,568

The following are notional bonds in different currencies, depending on the type of product, by December 31, 2019:

Trading Instruments:

Instrument	MXN	USD	EUR	CHF
Foreign currency forwards	Ps. 11,305	Ps. 584	Ps. 123	Ps. -
Interest rate options	21	2	-	-
Foreign currency options	-	-	-	-
Foreign currency swaps (receiving leg)	34,081	707	254	160
Foreign currency swaps (paying leg)	24,630	1,925	350	-
Interest rate swaps (receiving leg)	512,998	8,012	-	-
Interest rate swaps (paying leg)	512,998	8,012	-	-
Credit swaps	-	116	-	-

Hedging Instruments:

Instrument	MXN	USD	EUR	GBP
Foreign currency swaps (receiving leg)	Ps. 4,728	Ps. 215	Ps. -	Ps. 23
Foreign currency swaps (paying leg)	10,990	308	207	106
Interest rate swaps (receiving leg)	36,500	-	-	-
Interest rate swaps (paying leg)	36,500	-	-	-

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
Fx-CHF	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 31.



Transactions carried out for hedging purposes have maturities from 2019 to 2031 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

As of December 31, 2019 and 2018, the collateral granted is constituted mainly by the delivery of cash. The fair value of the collaterals delivered is shown in Note 6 d).

As of December 31, 2019 and 2018, the Institution has not received any collateral.

During 2019 and 2018, the net earnings from the valuation and realization of derivatives financial instruments were Ps. 1,503 and Ps. 1,908, respectively.

The net amount of estimated gains or losses originated by transactions or events recorded in "Comprehensive income" to date in the consolidated financial statements and that are expected to be reclassified to earnings within the next 12 months total Ps. (209).

As of December 31, 2019 and 2018, 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, 2019, 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; therefore as of December 31, 2019, 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, 2019, 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. 123	Ps. 306	Ps. 1,293	Ps. 398
Monetary regulation deposits	603	1,702	5,252	4,135
Assets denominated in Euros	73	210	788	26
Assets denominated in GBP	56	168	624	38
Assets denominated in USD	231	597	2,551	595
	Ps. 1,086	Ps. 2,983	Ps. 10,5078	Ps. 5,192

The fair value of the instruments designated as cash flows hedging, recognized in overall earnings in stockholders' equity on December 31, 2019 and 2018 totaled (Ps. 1,275) and (Ps. 5,001), respectively. Furthermore, Ps. (71) and Ps. 107, respectively, were reclassified from stockholders' equity to results.

Trading derivatives and hedging derivatives: the credit 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, January 1, 2007	(Ps. 58)	Ps. -	Ps. -
Balance, December 31, 2007	(Ps. 308)	(Ps. 250)	Ps. -
Balance, December 31, 2008	(Ps. 1,567)	(Ps. 1,259)	Ps. 18
Balance, December 31, 2009	(Ps. 1,394)	Ps. 173	Ps. 47
Balance, December 31, 2010	(Ps. 2,114)	(Ps. 720)	Ps. 42
Balance, December 31, 2011	(Ps. 2,907)	(Ps. 793)	Ps. 15
Balance, December 31, 2012	(Ps. 2,785)	Ps. 122	Ps. 75
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. 733)	Ps. 63
Balance, December 31, 2017	(Ps. 5,214)	(Ps. 3,083)	Ps. 184
Balance, December 31, 2018	(Ps. 5,001)	Ps. 223	Ps. 107
Balance, December 31, 2019	(Ps. 1,275)	Ps. 3,276	(Ps. 71)

9 - LOAN PORTFOLIO

The loan portfolio by loan type is as follows:

	Performing loan portfolio		Past-due loan portfolio		Total	
	2019	2018	2019	2018	2019	2018
Commercial loans						
Denominated in domestic currency						
Commercial	Ps. 204,805	Ps. 212,759	Ps. 4,563	Ps. 5,416	Ps. 209,368	Ps. 218,175
Rediscounted portfolio	6,760	8,713	-	1	6,760	8,714
Denominated in USD						
Commercial	53,912	51,062	1,584	1,627	55,496	52,689
Rediscounted portfolio	965	3,445	-	-	965	3,445
Loans to financial institutions	20,595	21,088	4	-	20,599	21,088
Consumer loans						
Credit card	39,700	36,657	2,287	2,151	41,987	38,808
Other consumer loans	76,528	74,580	1,981	2,180	78,509	76,760
Mortgage loans						
Denominated in domestic currency	169,983	155,670	1,960	1,448	171,943	157,118
Denominated in USD	103	-	13	-	116	-
Denominated in UDIS	-	127	-	16	-	143
Government loans	170,155	192,234	-	-	170,155	192,234
Total loan portfolio	Ps. 743,506	Ps. 756,335	Ps. 12,392	Ps. 12,839	Ps. 755,898	Ps. 769,174



Restructured loans

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

	2019		2018	
	Performing	Past-due	Performing	Past-due
Commercial loans				
Business loans	Ps. 24,539	Ps. 4,564	Ps. 18,500	Ps. 1,513
Consumer loans	478	80	185	72
Mortgage loans	178	279	39	403
	Ps. 25,195	Ps. 4,923	Ps. 18,724	Ps. 1,988

As of December 31, 2019, 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. 1,217	Ps. 1,441	Ps. 1,310	Ps. 2,183	Ps. 6,151
Consumer loans	4,057	200	2	9	4,268
Mortgage loans	1,123	850	-	-	1,973
	Ps. 6,397	Ps. 2,491	Ps. 1,312	Ps. 2,192	Ps. 12,392

As of December 31, 2018 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. 1,172	Ps. 1,176	Ps. 4,687	Ps. 9	Ps. 7,044
Consumer loans	4,140	183	1	7	4,331
Mortgage loans	1,030	434	-	-	1,464
	Ps. 6,342	Ps. 1,793	Ps. 4,688	Ps. 16	Ps. 12,839

Past-due loan movements for the years ended on December 31, 2019 and 2018 are shown below:

	2019	2018
Balance at the beginning of the year	Ps. 12,839	Ps. 12,192
Liquidations	(2,954)	(2,894)
Write-offs*	(15,341)	(14,676)
Renewals	(617)	(478)
Discounts	(1,649)	(543)
Foreclosures	(305)	(99)
Transfers to performing loans	(7,204)	(7,033)
Transfers from performing loans	27,687	26,371
Fluctuation from foreign exchange rate	(64)	(1)
Year-end balance	Ps. 12,392	Ps. 12,839

* Corresponds to 100% hedged loans.

As of December 31, 2019, the balance of deferred loan origination fees was Ps. 2,498, and the amount recorded in results was Ps. 1,208. Furthermore, the deferred balance of costs and expenses associated with initial loan originations was Ps. 2,201, and the amount recorded in results was Ps. 1,318. As of December 31, 2018, the balance of deferred loan origination fees was Ps. 2,770, and the amount recorded in results was Ps. 1,282. Furthermore, the deferred balance of costs and expenses associated with initial loan originations was Ps. 2,575, and the amount recorded in results was Ps. 1,044.

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 credits and advanced 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 years ended December 31, 2019 and 2018, the balance of fully reserved past-due loans that were written off was Ps. 15,753 and Ps. 14,743, respectively.

On December 31, 2019 and 2018, revenues from recoveries of previously written-off loan portfolios were Ps. 2,006 and Ps. 1,853, respectively.

The loans granted per economic sectors are shown below:

	2019		2018	
	Amount	Concentration percentage	Amount	Concentration percentage
Private (companies and individuals)	Ps. 272,589	36.06%	Ps. 283,021	36.80%
Financial institutions	20,599	2.73%	21,088	2.74%
Credit card and consumer	120,496	15.94%	115,569	15.03%
Mortgage	172,059	22.76%	157,262	20.45%
Government loans	170,155	22.51%	192,234	24.98%
	Ps. 755,898	100.00%	Ps. 769,174	100.00%

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' ratings D and E risk degrees are shown below as distressed loans:

	2019	2018
Distressed commercial loans	Ps. 6,934	Ps. 8,331
Performing	1,001	1,534
Past-due	5,933	6,797
Commercial loans	472,834	515,926
Performing	472,626	515,678
Past-due	208	248
Total rated commercial loans	479,768	524,257
Total portfolio	Ps. 770,717	Ps. 795,031
Distressed Commercial Loans/Total Portfolio	0.90%	1.05%

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, 2019 and 2018 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, 2019, the remaining balance of SPECIAL CETES not repurchased by the Federal Government is Ps. 865 with maturities between 2022 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:

2019							
Risk category	Loan portfolio	Required allowances for losses					Total
		Companies	Government	Financial institutions' loans	Consumer portfolio	Mortgage portfolio	
Risk A1	Ps. 628,235	Ps. 856	Ps. 529	Ps. 67	Ps. 623	Ps. 220	Ps. 2,295
Risk A2	35,967	151	77	9	303	30	570
Risk B1	31,131	59	86	-	844	17	1,006
Risk B2	12,931	57	4	-	379	28	468
Risk B3	25,448	111	366	10	836	15	1,338
Risk C1	8,514	95	90	-	266	78	529
Risk C2	9,616	94	101	-	864	163	1,222
Risk D	14,140	1,974	-	2	2,182	491	4,649
Risk E	6,346	991	-	-	3,208	87	4,286
Unclassified	(1,611)	-	-	-	-	-	-
	Ps. 770,717	Ps. 4,388	Ps. 1,253	Ps. 88	Ps. 9,505	Ps. 1,129	Ps. 16,363
Less: Recorded allowance							17,083
Reserve supplement*							Ps. 720

2018							
Risk category	Loan portfolio	Required allowances for losses					Total
		Companies	Government	Financial institutions' loans	Consumer portfolio	Mortgage portfolio	
Risk A1	Ps. 617,401	Ps. 1,164	Ps. 638	Ps. 103	Ps. 725	Ps. 192	Ps. 2,822
Risk A2	62,160	323	210	6	329	30	898
Risk B1	30,683	99	23	4	781	19	926
Risk B2	13,897	75	64	5	273	27	444
Risk B3	24,883	149	430	10	500	20	1,109
Risk C1	21,110	119	723	-	454	72	1,368
Risk C2	8,250	77	-	-	1,084	135	1,296
Risk D	12,959	2,846	-	-	1,544	398	4,788
Risk E	5,748	723	-	-	3,219	65	4,007
Unclassified	(2,060)	-	-	-	-	-	-
	Ps. 795,031	Ps. 5,575	Ps. 2,088	Ps. 128	Ps. 8,909	Ps. 958	Ps. 17,658
Less: Recorded allowance							18,264
Reserve supplement*							Ps. 606

*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 2019 and 2018, the amount of the rating base for loan portfolios includes Ps. 14,573 and Ps. 25,598, respectively, for Granted Guarantors and Loan Acquisitions, which were recorded in memorandum accounts. Ps. 276 and Ps. 278 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, 2019 and 2018, the allowance for loan losses represents 138% and 142%, 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, 2019 and 2018.

According to the current regulation, as of December 31, 2019, the Institution rated under the regulatory methodologies based on expected losses the commercial portfolios (except credits destined to investment projects with own payment source), Mortgage portfolio and non-revolving consumer portfolio. In the case of the revolving consumption portfolio, beginning January 2019, the Institution uses an internal methodology authorized by the Commission.

Below are shown for each type of portfolio, the exposure to default, probability of breach of contract, and severity of the loss as of December 31, 2019.

Type of portfolio	Exposure to Default	Weighted Probability of Non-compliance	Weighted Severity of Loss
Commercial*	Ps. 374,882	5.2%	27.2%
Mortgage	Ps. 172,059	3.6%	18.1%
Non-revolving consumer	Ps. 78,514	9.2%	69.9%
Revolving Consumer loan	Ps. 63,905	7.9%	87.7%

* 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:

	2019	2018
Balance at the beginning of the year	Ps. 18,264	Ps. 15,551
Increase charged to results	17,112	17,454
Discounts and write-offs	(18,250)	(16,368)
Rebates granted to housing debtors	-	(7)
Recognized against results of previous years	-	1,508
Others	(43)	126
Year-end balance	Ps. 17,083	Ps. 18,264

As of December 31, 2019, the net amount of preventive loan losses reserves charged to the consolidated income statement totals Ps. 15,104 and is presented net of Ps. 1,965 which is recorded in "Other income (expenses)", and due to the variation of the USD Ps. 43 exchange rate; such amounts are offset against results and comprised of Ps. 17,112 credited directly to the estimate. As of December 31, 2018, the net amount of preventive loan loss reserves charged to the consolidated income statement totals Ps. 15,635 and is presented net of (Ps. 343) which is recorded in "Other income (expenses)" Ps. 1,765, and due to the variation of the USD (Ps. 54) exchange rate; such amounts are offset against results and comprised of Ps. 17,454 credited directly to the estimate.

12 - ACQUIRED COLLECTION RIGHTS

The acquired collection rights are comprised as of December 31, 2019 and 2018 as follows:

Valuation Method	2019	2018
Cash Basis Method	Ps. 1,010	Ps. 1,539
Cost Recovery Method	348	453
Interest method	1	9
	Ps. 1,359	Ps. 2,001



As of December 31, 2019, derived from applying the valuation methods (described in Note 4), the Institution recognized income from credit asset portfolios of Ps. 598, together with the respective amortization of Ps. 396, the effects of which were recognized under the "Other income" heading in the consolidated income statement. For the year ended December 31, 2018, the Institution recognized income of Ps. 509, together with the respective amortization of Ps. 367.

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:

	2019	2018
Loans to officers and employees	Ps. 2,899	Ps. 2,726
Debtors from liquidation settlements	9,635	10,401
Debtors from cash collateral	11,212	17,293
Real estate property portfolios	1,241	1,245
Sundry debtors in Mexican pesos	4,382	5,189
Sundry debtors in foreign currency	255	322
Others	232	218
	29,856	37,394
Allowance for doubtful accounts	(446)	(1,312)
	Ps. 29,410	Ps. 36,082

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:

	2019	2018
Moveable property	Ps. 276	Ps. 295
Real estate property	2,529	2,468
Goods pledged for sale	235	233
	3,040	2,996
Allowance for losses on foreclosed assets	(234)	(289)
Allowance for losses on foreclosed real estate assets	(1,808)	(1,777)
Allowance for losses on assets pledged for sale	(138)	(192)
	(2,180)	(2,258)
	Ps. 860	Ps. 738



As of December 31, 2019, the aging of the reserves for foreclosed assets is as follows:

Concept / Months	18 to 24		More than 24		Total	
Moveable property	Ps. -		Ps. 234		Ps. 234	

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. 21	Ps. 10	Ps. 15	Ps. 14	Ps. 10	Ps. 1,738	Ps. 1,808
Goods pledged for sale	-	-	-	-	-	138	138
	Ps. 21	Ps. 10	Ps. 15	Ps. 14	Ps. 10	Ps. 1,876	Ps. 1,946

As of December 31, 2018, the aging of the reserves for foreclosed assets is as follows:

Concept / Months	18 to 24		More than 24		Total	
Moveable property	Ps. -		Ps. 289		Ps. 289	

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. 20	Ps. 6	Ps. 18	Ps. 16	Ps. 4	Ps. 1,713	Ps. 1,777
Goods pledged for sale	21	-	-	-	-	171	192
	Ps. 41	Ps. 6	Ps. 18	Ps. 16	Ps. 4	Ps. 1,884	Ps. 1,969

15 - PROPERTY, FURNITURE AND EQUIPMENT, NET

This item is made up as follows:

	2019	2018
Furniture and equipment	Ps. 12,401	Ps. 11,586
Property intended for offices	8,767	7,946
Installation costs	7,744	7,197
	28,912	26,729
Less - Accumulated depreciation and amortization	(13,824)	(13,182)
	Ps. 15,088	Ps. 13,547

The depreciation recorded in the results of 2019 and 2018 was Ps. 1,903 and Ps. 2,055, 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 %	2019	2018
Controladora PROSA, S.A. de C.V.	19.73%	\$118	\$109
PAYCLIP INC.	0.07%	101	-
Fondo Chiapas, S.A. de C.V.	11.11%	15	16
Operadora de Fondos Banorte	Various	-	65
Fideicomiso de Coinversión F/2504 (CKD)	Various	32	32
Fideicomiso 73789-Banco Monex	4.88%	5	5
Fideicomiso 11769-Carretera Lerma	4.88%	23	18
Fideicomiso 12040-La Gloria	4.88%	5	8
Fideicomiso Actinver 3650	4.88%	3	2
Fideicomiso F/3937	4.88%	17	-
Fideicomiso F/4280	4.88%	2	-
Others	Various	97	87
		\$418	\$342

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. 1,104 and Ps. 4,389, respectively, as of December 31, 2019 and 2018 as detailed below:

	2019		2018	
	Temporary Differences	Deferred Effect ISR	Temporary Differences	Deferred Effect ISR
Temporary Differences - Assets				
Tax loss carryforwards	Ps. 33	Ps. 10	Ps. 30	Ps. 9
Allowance for loan losses	1	-	1	-
Surplus preventive allowances for credit risks over the net tax limit	17,083	5,125	18,264	5,479
Excess of tax over book value of foreclosed and fixed assets	2,132	635	2,909	870
PTU	492	148	465	139
Fees collected in advance	2,596	779	2,986	896
Accounting provisions	3,577	1,073	4,142	1,243
Financial instruments valuation	-	-	3,871	1,162
Other assets	-	-	-	-
Total deferred assets	Ps. 25,914	Ps. 7,770	Ps. 32,668	Ps. 9,798
Temporary Differences - Liabilities				
Advance contributions to pension fund	Ps. 635	Ps. 190	Ps. 828	Ps. 249
Portfolios acquired	1,133	340	598	179
Capitalizable projects' expenses	18,213	5,464	15,055	4,516
Financial instruments valuation	2,211	663	-	-
Intangible assets	32	9	52	15
Total deferred liabilities	22,224	6,666	16,533	4,959
Deferred tax, net		Ps. 1,104		Ps. 4,839



As explained in Note 26, for 2019 and 2018, and in subsequent years, the applicable ISR rate is 30%.

At December 31, 2019, the tax loss carry forwards prescription is as follows:

Due date	Amount
2028	Ps. 33
	Ps. 33

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, 2019 and 2018, a net amount of Ps. 26 and Ps. 18, respectively, was added to deferred taxes determined at a rate of 21% as per the tax law of the USA.

18 - OTHER ASSETS, NET

This item is made up as follows:

	2019	2018
Net asset forecast from labor obligations and savings fund	Ps. 65	Ps. 55
Payments to amortize	25,593	19,398
Accumulated payment amortization	(4,828)	(3,181)
Goodwill	1,371	1,385
	Ps. 22,201	Ps. 17,657

As of December 31, 2019 and 2018, goodwill is as follows:

	2019	2018
Banorte-Ixe Tarjetas, S.A. de C.V. SOFOM, ER*	Ps. 1,005	Ps. 1,005
Uniteller Financial Services	366	380
	Ps. 1,371	Ps. 1,385

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, 2019 and 2018.

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 2019 and 2018, the Institution generated a liquidity requirement of USD 1,122,418 thousand and USD 1,330,153 thousand, respectively, and held investments in liquid assets of USD 1,565,562 thousand and USD 1,645,364 thousand, representing a surplus of USD 444,987 thousand and USD 322,511 thousand, respectively.



Deposits

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

	2019	2018
Demand deposits		
Non-interest Bearing Checking accounts:		
Cash deposits	Ps. 213,978	Ps. 279,047
Checking accounts in US dollars for individual residents on the Mexican border	2,779	2,908
Demand deposits accounts	78,538	19,494
Interest Bearing Checking accounts:		
Other bank checking deposit	124,928	95,144
Checking accounts in US dollars for individual residents on the Mexican border	1,898	2,035
Demand deposits accounts	13,332	13,490
	435,453	412,118
Time deposits		
General public:		
Fixed-term deposits	30,597	29,103
Retail time deposits	227,673	249,505
Promissory note with interest payable at maturity PRLV primary market for individuals	347	504
Promissory note with interest payable at maturity PRLV primary market for entities	4,103	-
Foreign residents' deposits	6	6
Provision for interest	1,065	1,406
	263,791	280,524
Money market:		
Over the counter promissory notes	15,984	52,346
Provision for interest	52	258
	16,036	52,604
Senior debt	26,907	12,098
Global account of deposit without movement	2,085	1,891
	Ps. 744,272	Ps. 759,235

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:

	2019				2018			
Foreign exchange	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Mexican pesos and UDIS	1.08%	1.15%	1.22%	1.14%	0.76%	0.92%	1.33%	1.13%
Foreign Currency	0.08%	0.08%	0.09%	0.10%	0.02%	0.03%	0.16%	0.07%

Time deposits:

	2019				2018			
Foreign exchange	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
General public								
Mexican pesos and UDIS	6.66%	6.80%	6.71%	6.02%	5.66%	5.94%	6.16%	6.42%
Foreign currency	0.32%	0.38%	0.35%	0.26%	0.17%	0.23%	0.25%	0.29%
Money market								
	8.19%	8.31%	8.25%	7.78%	6.82%	6.25%	7.62%	7.87%



As of December 31, 2019 and 2018, the terms set for these deposits are as follows:

	2019			
	1 to 179 days	6 to 12 months	More than 1 year	Total
General public:				
Fixed-term deposits	Ps. 28,319	Ps. 1,436	Ps. 842	Ps. 30,597
Retail time deposits	219,022	8,185	466	227,673
Promissory note with interest payable at maturity				
PRLV primary market for individuals	345	2	-	347
Promissory note with interest payable at maturity				
PRLV primary market for entities	4,103	-	-	4,103
Foreign residents' deposits	6	-	-	6
Provision for interest	891	160	14	1,065
	252,686	9,783	1,322	263,791
Money market:				
Promissory notes	-	-	15,984	15,984
Provision for interest	-	-	52	52
	-	-	16,036	16,036
	Ps. 252,686	Ps. 9,783	Ps. 17,358	279,827

	2018			
	1 to 179 days	6 to 12 months	More than 1 year	Total
General public:				
Fixed-term deposits	Ps. 26,689	Ps. 1,720	Ps. 694	Ps. 29,103
Retail time deposits	239,371	9,694	440	249,505
Promissory note with interest payable at maturity				
PRLV primary market for individuals	475	17	12	504
Foreign residents' deposits	6	-	-	6
Provision for interest	1,200	193	13	1,406
	267,741	11,624	1,159	280,524
Money market:				
Promissory notes	-	-	52,346	52,346
Provision for interest	-	-	258	258
	-	-	52,604	52,604
	Ps. 267,741	Ps. 11,624	Ps. 53,763	Ps. 333,128

20 - INTERBANK AND OTHER LOANS

The loans received from other banks as of December 31, 2019 and 2018 are as follows:

	Mexican pesos		Denominated in USD		Total	
	2019	2018	2019	2018	2019	2018
Immediately due:						
Domestic banks (Call money)	Ps. 500	Ps. -	Ps. -	Ps. -	Ps. 500	Ps. -
Short-term:						
Banxico	102	101	-	-	102	101
Commercial banking	-	-	-	35	-	35
Development banking	4,037	5,167	11	622	4,048	5,789
Public trusts	4,930	7,181	196	417	5,126	7,598
	9,069	12,449	207	1,074	9,276	13,523
Long-term:						
Commercial banking	-	-	-	15,721	-	15,721
Development banking	-	-	48	1,952	48	1,952
Public trusts	4,097	3,971	709	555	4,806	4,526
	4,097	3,971	757	18,228	4,854	22,199
	Ps. 13,666	Ps. 16,420	Ps. 964	Ps. 19,302	Ps. 14,630	Ps. 35,722



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

The average interest rates are shown below:

Foreign exchange	2019				2018			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
<u>Call money</u>								
Mexican pesos and UDIS	9.82%	14.95%	9.57%	9.83%	7.22%	7.92%	8.60%	9.63%
<u>Other bank loans</u>								
Mexican pesos and UDIS	10.87%	11.03%	10.51%	8.59%	13.70%	11.11%	11.17%	11.04%
Foreign currency	3.28%	3.28%	3.07%	2.86%	3.35%	3.77%	0.98%	0.69%

21 - SUNDRY CREDITORS AND OTHER PAYABLES

This item is made up as follows:

	2019	2018
Cashier and certified checks and other negotiable instruments	Ps. 3,554	Ps. 7,277
Provisions for indemnities	2,171	600
Provisions for other obligations	10,643	8,914
Others	9,897	7,268
	Ps. 26,265	Ps. 24,059

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, 2019 and 2018, related to the defined benefit pension plan, seniority premiums and retiree medical coverage, determined by independent actuaries, is analyzed below:

2019				
	Pension plan	Seniority premiums	Medical services	Total
Projected benefit obligation (PBO)	(Ps. 1,529)	(Ps. 315)	(Ps. 3,463)	(Ps. 5,307)
Fund market value	569	197	2,568	3,334
Funded status	(960)	(118)	(895)	(1,973)
Unrecognized prior service cost	-	-	37	37
Unrecognized actuarial losses	84	1	160	245
Net projected asset	(Ps. 876)	(Ps. 117)	(Ps. 698)	(Ps. 1,691)

2018				
	Pension plan	Seniority premiums	Medical services	Total
Projected benefit obligation (PBO)	(Ps. 1,136)	(Ps. 240)	(Ps. 2,877)	(Ps. 4,253)
Fund market value	601	209	2,432	3,242
Funded status	(535)	(31)	(445)	(1,011)
Unrecognized prior service cost	-	-	73	73
Unrecognized actuarial losses	268	5	536	809
Net projected asset	(Ps. 267)	(Ps. 26)	Ps. 164	(Ps. 129)



Moreover, as of December 31, 2019, a separate fund amounting to Ps. 3,334, (Ps. 3,242 in 2018) 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, 2019, 2018 and 2017, the net periodic pension cost is as follows:

	2019	2018	2017
Service cost	Ps. 53	Ps. 22	Ps. 102
Interest cost	459	459	428
Expected return on plan assets	(343)	(334)	(486)
Amortizations of unrecognized items:			
Profits (actuarial losses)	80	92	136
Cost of the advance reduction/liquidation of obligations	-	-	4
Net periodic pension cost	Ps. 249	Ps. 239	Ps. 184

The rates used in the calculation of the projected benefit obligation and return on plan assets as of December 31, 2019, 2018 and 2017, are shown below:

Concept	2019 Nominal	2018 Nominal	2017 Nominal
Discount rate	9.00%	11.50%	9.25%
Rate of wage increase	4.50%	4.50%	4.50%
Long-term inflation rate	3.50%	3.50%	3.50%
Expected long-term rate of return on plan assets	3.50%	3.50%	3.50%

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

Concept	2019	2018	2017
Defined and projected benefit obligations	(Ps. 336)	(Ps. 297)	(Ps. 261)
Net projected liability	(Ps. 336)	(Ps. 297)	(Ps. 261)

For the years ended December 31, 2019, 2018 and 2017, the net periodic pension cost is as follows:

Concept	2019	2018	2017
Service cost	Ps. 13	Ps. 60	Ps. 11
Cost / (income) for immediate recognition of P/(G)	11	6	7
Net periodic pension cost	Ps. 24	Ps. 66	Ps. 18

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. 161 in 2019 and Ps. 139 in 2018.

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, 2019 and 2018, equivalent to Ps. 3,579 and Ps. 3,025, respectively, which is recorded under "Other assets" and is equivalent to the recorded plan liability.

As of December 31, 2019 and 2018, the PTU provision was Ps. 508 and Ps. 485, respectively.



23 - SUBORDINATED DEBENTURES

As of December 31, 2019 and 2018, the subordinated debentures in circulation are as follows:

	2019	2018
Non-preferred subordinated obligations, non-preferent, perpetual, non-cumulative 5 years callable BANOD19 999999 denominated in USD, with an interest rate of 6.875%.**	Ps. 6,602	Ps. 6,878
Non-preferred subordinated obligations, non preferent, perpetual, non-cumulative 10 years callable BANOE91 999999 denominated in USD, with an interest rate of 7.625%.**	10,375	10,809
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.	5,550	9,825
Preferred subordinated nonconvertible debentures, Q BANORTE 08-U maturing in February 2028, interest at a 4.95% annual rate.	-	2,784
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.	2,264	2,358
Nonpreferred subordinated nonconvertible debentures Q BINTER 15 maturing in February 2025 and interest at an annual interest rate of TIIE to 28 days plus 2.5 points.	1,000	1,000
Preferred subordinated nonconvertible debentures, Q BANORTE 08-U maturing in February 2028, interest at a 4.95% annual rate.	1,772	-
Non-preferred subordinated obligations, non-preferent, perpetual, non-cumulative 5 years callable NC5 Notes denominated in USD, with an interest rate of 6.750%**	11,319	-
Non-preferred subordinated obligations, non preferent, perpetual, non-cumulative 10 years callable NC10 Notes denominated in USD, with an interest rate of 7.50%**	9,433	-
Accrued interest.	153	232
Issuance and placement expenses.	(418)	(326)
	Ps. 48,050	Ps. 33,560

** The above-mentioned emission was registered as a liability and the interest 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. 87 and Ps. 30 in 2019 and 2018, respectively.

24 – TRANSACTIONS AND BALANCES WITH SUBSIDIARIES AND ASSOCIATED COMPANIES

The balances and transactions with subsidiaries and associated companies as of December 31, 2019, 2018 and 2017 are made up as follows:

Institution	Revenues			Accounts receivable		
	2019	2018	2017	2019	2018	2017
Arrendadora y Factor Banorte, S.A. de C.V.	Ps. 872	Ps. 735	Ps. 469	Ps. 10,976	Ps. 10,994	Ps. 6,451
Almacenadora Banorte, S.A. de C.V.	28	35	19	124	198	327
Seguros Banorte, S.A. de C.V.	970	966	815	78	123	105
Pensiones Banorte, S.A. de C.V.	2	3	1	-	-	-
Casa de Bolsa Banorte, S.A. de C.V.	6,791	5,369	2,167	7	86	15
Operadora de Fondos Banorte, S.A. de C.V.	681	589	460	70	59	50
Sólida Administradora de Portafolios, S.A. de C.V.	213	800	852	2,672	2,703	10,810
Total	Ps. 9,557	Ps. 8,497	Ps. 4,783	Ps. 13,927	Ps. 14,163	Ps. 17,758



Institution	Expenses			Accounts payable		
	2019	2018	2017	2019	2018	2017
Grupo Financiero Banorte, S.A.B. de C.V.	Ps. 315	Ps. 594	Ps. 240	Ps. 14,575	Ps. 2,872	Ps. 10,996
Arrendadora y Factor Banorte, S.A. de C.V.	34	33	20	145	124	255
Almacenadora Banorte, S.A. de C.V.	-	1	1	-	-	-
Seguros Banorte, S.A. de C.V.	900	801	720	465	437	310
Pensiones Banorte, S.A. de C.V.	1	-	-	4	1	1
Casa de Bolsa Banorte, S.A. de C.V.	717	1,503	692	1,824	1,017	949
Operadora de Fondos Banorte, S.A. de C.V.	49	27	19	786	381	324
Ixe Servicios, S.A. de C.V.	3	3	2	39	37	34
Sólida Administradora de Portafolios, S.A. de C.V.	4	3	3	156	105	98
Banorte Ahorro y Previsión, S.A. de C.V.	11	22	1	966	148	402
Total	Ps. 2,034	Ps. 2,987	Ps. 1,698	Ps. 18,960	Ps. 5,122	Ps. 13,369

The premiums paid and collected in repurchase operations with Banorte-Ixe Brokerage House and Grupo Financiero Banorte are 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.

As of December 31, 2019 and 2018, the amount of the loans granted to related parties was as follows:

Institution granting the loan	2019	% over the limit	2018	% over the limit
Banco Mercantil del Norte, S.A.	Ps. 11,306	7.9%	Ps. 17,133	15.7%

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

Loan portfolio sales

During June 2018, 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 2014, 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).

Sale of loan portfolio packages between related parties (nominal values)

In February 2003, the Institution sold Ps. 1,925 of its own portfolio (with interest) to its then 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 as of December 31, 2019 and 2018:

Type of portfolio	Mexican pesos			Foreign Currency			Total		
	Aug 02	Dec 18	Dec 19	Aug 02	Dec 18	Dec 19	Aug 02	Dec 18	Dec 19
Performing Loan Portfolio									
Commercial	Ps. 5	Ps. -	Ps. -	Ps. 5	Ps. -	Ps. -	Ps. 10	Ps. -	Ps. -
Mortgage	54	4	4	-	-	-	54	4	4
Total	59	4	4	5	-	-	64	4	4
Past-due loan portfolio									
Commercial	405	185	184	293	1	1	698	186	185
Consumer	81	71	71	-	-	-	81	71	71
Mortgage	1,112	202	190	-	-	-	1,112	202	190
Total	1,598	458	445	293	1	1	1,891	459	446
Total portfolio	1,657	462	449	298	1	1	1,955	463	450
Allowance for loan losses⁽¹⁾									
Commercial	326	185	184	246	1	1	572	186	185
Consumer	77	71	71	-	-	-	77	71	71
Mortgage	669	202	192	-	-	-	669	202	192
Total allowance for loan loss	1,072	458	447	246	1	1	1,318	459	448
Net portfolio	Ps. 585	Ps. 4	Ps. 2	Ps. 52	Ps. -	Ps. -	Ps. 637	Ps. 4	Ps. 2

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

As of December 31, 2019 and 2018, the composition of the Institution's loan portfolio excluding its subsidiaries, including the loan portfolio sold to Sólida, is as follows:

Type of portfolio	Mexican pesos		Foreign Currency		Total	
	Dec 18	Dec 17	Dec 18	Dec 17	Dec 18	Dec 17
Commercial loans	Ps. 393,904	Ps. 427,274	Ps. 63,533	Ps. 62,283	Ps. 457,437	Ps. 489,557
Consumer loans	116,228	111,237	-	-	116,228	111,237
Mortgage loans	170,090	155,804	-	-	170,090	155,804
Performing Loan Portfolio	680,222	694,315	63,533	62,283	743,755	756,598
Commercial loans	4,750	5,602	1,585	1,628	6,335	7,230
Consumer loans	4,339	4,402	-	-	4,339	4,402
Mortgage loans	2,163	1,666	-	-	2,163	1,666
Past-due loan portfolio	11,252	11,670	1,585	1,628	12,837	13,298
Total portfolio	691,474	705,895	65,118	63,911	756,592	769,896
Allowance for loan losses	16,477	17,592	1,055	1,130	17,532	18,722
Net portfolio	Ps. 674,997	Ps. 688,393	Ps. 64,063	Ps. 62,781	Ps. 739,060	Ps. 751,174
Allowance for loan losses					136.57%	140.79%
% of past-due portfolio					1.70%	1.73%



25 – INFORMATION BY SEGMENT

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

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

2019			
	Interest	Fees	Total
	MXP	MXP	MXP
Cash and cash equivalents	Ps. 3,680	Ps. -	Ps. 3,680
Margin securities	291	-	291
Investment in securities	16,857	-	16,857
Securities repurchasing and loans	9,725	-	9,725
Hedging transactions	5,561	-	5,561
Commercial loans	45,457	455	45,912
Mortgage loans	27,852	640	28,492
Consumer loans	16,223	310	16,533
Others	157	-	157
	Ps. 125,803	Ps. 1,405	Ps. 127,208

2018			
	Interest	Fees	Total
	MXP	MXP	MXP
Cash and cash equivalents	Ps. 3,733	Ps. -	Ps. 3,733
Margin securities	256	-	256
Investment in securities	18,974	-	18,974
Securities repurchasing and loans	6,141	-	6,141
Hedging transactions	6,668	-	6,668
Commercial loans	40,340	418	40,758
Mortgage loans	14,399	587	14,986
Consumer loans	26,019	277	26,296
Others	167	-	167
	Ps. 116,697	Ps. 1,282	Ps. 117,979

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



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

	2019			2018			2017		
	MXP	F.E.	Total	MXP	F.E.	Total	MXP	F.E.	Total
Immediately Due and Payable Deposits:									
Checking accounts	Ps.3,628	Ps.41	Ps.3,669	Ps.3,415	Ps. -	Ps.3,415	Ps.1,903	Ps. -	Ps.1,903
Savings accounts	377	-	377	270	-	270	302	-	302
	4,005	41	4,046	3,685	-	3,685	2,205	-	2,205
Time Deposits:									
General public	18,047	47	18,094	15,916	25	15,941	12,073	26	12,099
Money market	3,499	56	3,555	2,345	52	2,397	501	-	501
	21,546	103	21,649	18,261	77	18,338	12,574	26	12,600
Total	Ps.25,551	Ps.144	Ps.25,695	Ps.21,946	Ps.77	Ps.22,023	Ps.14,779	Ps.26	Ps.14,805

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

	2019			2018			2017		
	MXP	F.E.	Total	MXP	F.E.	Total	MXP	F.E.	Total
Call money	Ps. 229	Ps. -	Ps. 229	Ps. 232	Ps. -	Ps. 232	Ps. 114	Ps. -	Ps. 114
Banco de México	22	-	22	13	-	13	5	-	5
Commercial banks	346	285	631	674	-	674	405	23	428
Development banking	1,103	104	1,207	1,215	-	1,215	767	-	767
Provision for interest	6	-	6	8	-	8	11	-	11
Total	Ps. 1,706	Ps. 389	Ps. 2,095	Ps. 2,142	Ps. -	Ps. 2,142	Ps. 1,302	Ps. 23	Ps. 1,325

d. The Intermediation income are as follows:

	2019	2018	2017
Intermediation income:			
Spot foreign currency	(Ps. 5)	(Ps. 119)	(Ps. 130)
Derivatives financial instruments	(854)	1,988	737
Investments in securities	220	(82)	(722)
Valuation	(639)	1,787	(115)
Purchase-sales result, net			
Spot foreign currency	1,120	2,113	Ps. 1,729
Derivatives financial instruments	2,358	(71)	137
Investments in securities	1,721	(30)	350
Total Intermediation income	5,199	2,012	2,216
Total Intermediation income	Ps. 4,560	Ps. 3,799	Ps. 2,101



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

Economic sector	2019				
	Geographical location				
	North	Center	West	South	Total
Agriculture	Ps. 5,180	Ps. 1,233	Ps. 1,302	Ps. 1,106	Ps. 8,821
Mining	38	5,079	-	2	5,119
Manufacturing	15,552	14,984	2,247	2,197	34,980
Construction	6,326	19,963	1,584	4,927	32,800
Public utilities	282	11,402	112	2	11,798
Commerce	24,276	24,795	6,368	12,008	67,447
Transportation	4,706	25,476	425	5,974	36,581
Financial services	32,915	21,979	2,374	2,974	60,242
Communal, social services	7,842	19,519	700	1,445	29,506
Public administration and services	40,760	84,500	16,385	28,253	169,898
Credit card	-	-	-	-	39,700
Consumer	-	-	-	-	76,528
Mortgage	-	-	-	-	170,086
Performing loan portfolio	Ps. 137,877	Ps. 228,930	Ps. 31,497	Ps. 58,888	Ps. 743,506

Economic sector	2018				
	Geographical location				
	North	Center	West	South	Total
Agriculture	Ps.4,507	Ps.1,317	Ps.1,443	Ps.1,535	Ps.8,802
Mining	41	2,359	-	1	2,401
Manufacturing	19,780	14,822	2,334	2,095	39,031
Construction	6,483	27,783	2,051	5,814	42,131
Public utilities	341	9,429	4	2	9,776
Commerce	26,116	25,637	6,117	10,955	68,825
Transportation	4,586	29,080	407	848	34,921
Financial services	33,548	25,605	1,262	3,126	63,541
Communal, social services	3,446	22,228	564	1,722	27,960
Public administration and services	31,990	133,111	12,340	16,807	194,248
Credit card	-	-	-	-	36,657
Consumer	-	-	-	-	72,244
Mortgage	-	-	-	-	155,798
Performing loan portfolio	Ps.130,838	Ps.291,371	Ps.26,522	Ps.42,905	Ps.756,335

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

Economic sector	2019				
	Geographical location				
	North	Center	West	South	Total
Agriculture	Ps. 283	Ps. 39	Ps. 5	Ps. 14	Ps. 341
Mining	-	-	-	-	-
Manufacturing	78	339	158	1,581	2,156
Construction	109	389	10	100	608
Public utilities	-	30	1	3	34
Commerce	489	871	230	333	1,923
Transportation	420	20	11	20	471
Financial services	19	16	1	8	44
Communal, social services	100	316	24	134	574
Credit card	-	-	-	-	2,287
Consumer	-	-	-	-	1,981
Mortgage	-	-	-	-	1,973
Past-due loan portfolio	Ps. 1,498	Ps. 2,020	Ps. 440	Ps. 2,193	Ps. 12,392



Economic sector	2018				
	Geographical location				
	North	Center	West	South	Total
Agriculture	Ps. 86	Ps. 53	Ps. 5	Ps. 18	Ps. 162
Mining	3	-	-	-	3
Manufacturing	91	269	30	1,614	2,004
Construction	57	2,022	13	65	2,157
Public utilities	-	15	-	3	18
Commerce	223	1,014	193	272	1,702
Transportation	435	39	3	40	517
Financial services	8	28	4	9	49
Communal, social services	86	214	30	101	431
Credit card	-	-	-	-	2,151
Consumer	-	-	-	-	2,181
Mortgage	-	-	-	-	1,464
Past-due loan portfolio	Ps. 989	Ps. 3,654	Ps. 278	Ps. 2,122	Ps. 12,839

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

	2019		
	Commercial	Corporate	Total
Commercial	Ps.338,745	Ps.118,447	Ps.457,192
Consumer loans	116,228	-	116,228
Housing mortgage loans	170,086	-	170,086
Total performing loan portfolio	625,059	118,447	743,506
Commercial	3,967	2,184	6,151
Consumer loans	4,268	-	4,268
Housing mortgage loans	1,973	-	1,973
Total past-due loan portfolio	10,208	2,184	12,392
Total loan portfolio	635,267	120,631	755,898
Allowance for loan losses	(17,083)	-	(17,083)
Loan portfolio, net	618,184	120,631	738,815
Acquired collection rights	1,359	-	1,359
Total loan portfolio, net	Ps.619,543	Ps.120,631	Ps.740,174

	2018		
	Commercial	Corporate	Total
Commercial	Ps. 365,369	Ps. 123,931	Ps. 489,300
Consumer loans	111,237	-	111,237
Housing mortgage loans	155,798	-	155,798
Total performing loan portfolio	632,404	123,931	756,335
Commercial	3,129	3,916	7,045
Consumer loans	4,331	-	4,331
Housing mortgage loans	1,463	-	1,463
Total past-due loan portfolio	8,923	3,916	12,839
Total loan portfolio	641,327	127,847	769,174
Allowance for loan losses	(18,264)	-	(18,264)
Loan portfolio, net	623,063	127,847	750,910
Acquired collection rights	2,001	-	2,001
Total loan portfolio, net	Ps. 625,064	Ps. 127,847	Ps. 752,911



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

Product	2019								
	Geographical location						Treasury and other	Foreign	Total
	Monterrey	Mexico City	West	Northwest	South-east				
Non-interest bearing checking accounts	Ps. 61,692	Ps. 106,420	Ps. 28,887	Ps. 34,641	Ps. 37,340	Ps. 1,053		Ps. -	Ps. 270,033
Interest-bearing checking accounts	24,653	47,268	8,317	8,461	22,633	731		-	112,063
Current account Ps. and pre-established	2,877	4,730	1,201	956	1,245	2		-	11,011
Non-interest bearing demand deposits, USD	5,885	8,070	1,412	8,156	1,738	-		-	25,261
Interest bearing demand deposits, USD	4,517	8,756	1,070	3,819	1,353	1		-	19,516
Retail time deposits	46,295	94,811	22,355	21,142	30,770	1,177		-	216,550
Time deposits, USD	3,033	5,546	1,366	1,817	582	-		2,897	15,241
Customers money market	18,363	8,661	3,639	945	1,771	7		-	33,386
Financial intermediaries	-	-	-	-	-	39,325		1,886	41,211
Total Deposits	Ps. 167,315	Ps. 284,262	Ps. 68,247	Ps. 79,937	Ps. 97,432	Ps. 42,296		Ps. 4,783	Ps. 744,272

Product	2018							
	Geographical location							
	Monterrey	Mexico City	West	Northwest	South-east	Treasury and other	Foreign	Total
Non-interest bearing checking accounts	Ps.62,558	Ps.106,646	Ps.28,849	Ps.33,361	Ps.37,669	Ps.1,036	-	Ps.270,119
Interest-bearing checking accounts	8,515	49,643	6,082	5,219	14,013	620	-	84,092
Current account Ps. and pre-established	2,558	4,444	1,027	863	1,126	2	-	10,020
Non-interest bearing demand deposits, USD	6,975	10,827	2,236	8,826	2,462	4	-	31,330
Interest bearing demand deposits, USD	7,641	6,117	915	3,284	975	20	-	18,952
Retail time deposits	42,999	90,927	21,192	19,056	28,845	1,698	-	204,717
Time deposits, USD	3,790	6,877	1,504	2,218	748	-	3,015	18,152
Customers money market	22,227	25,111	6,286	1,751	2,148	-	-	57,523
Financial intermediaries	-	1,884	-	-	-	59,498	2,948	64,330
Total Deposits	Ps. 157,263	Ps. 302,476	Ps. 68,091	Ps. 74,578	Ps. 87,986	Ps. 62,878	Ps. 5,963	Ps. 759,235

26 - INCOME TAXES

The Institution is subject to Income Tax (ISR).

ISR

ISR According to the ISR Law, the rate for 2019, 2018 and 2017 and in 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 income before ISR and PTU is:

	2019	2018	2017
Legal rate	30%	30%	30%
Tax inflation	(2%)	(2%)	(4%)
Non-tax accounting write-offs	2%	2%	2%
Interest on subordinated debentures	(2%)	(1%)	-%
Other entries	(2%)	(2%)	1%
Effective rate	26%	27%	29%

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		
	2019	2018	2017
"O" Series	144,197,415,428	144,197,415,428	137,303,109,559

Paid-in Capital	Historical Amounts		
	2019	2018	2017
"O" Series	Ps. 14,420	Ps. 14,420	Ps. 13,730
Restatement in Mexican pesos through December 2007	4,374	4,374	4,375
	Ps. 18,794	Ps. 18,794	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, 2019, 2018 and 2017, the legal reserve is Ps. 17,165, Ps. 14,682 and Ps. 12,848, respectively, and represents 91%, 78% and 71% of paid-in capital, respectively.

Share-based payments

During 2019, 2018 and 2017, the Institution recorded Ps. 433, Ps. 537 and Ps.576, respectively, in non interest expense as compensation for share-based payments against the paid-in capital.

As of December 31, 2019, 2018 and 2017, the Institution has 9,959,573, 17,061,523 and 19,290,000 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. 106.16, Ps. 104.64 and Ps. 86.04.

During 2019, 2018 and 2017, 7,101,952, 5,391,579 and 15,848,409 shares were exercised, respectively.

Capitalization ratio (Unaudited information)

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, 2019 sent to Banco de México to review is shown below.

- The capitalization ratio of the Institution as of December 31, 2019 was 18.55% of total risk (market, credit and operational) and 23.68% of credit risk, which in both cases exceed the current regulatory requirements.

Integration of Net Equity

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	20,917
2	Retained earnings from prior years	50,883
3	Other elements of comprehensive income (and other allowances)	42,492
4	Equity subject to gradual elimination of the common equity of level 1 (only applicable for companies that are not linked to shares)	N.A.
5	Ordinary shares issued by subsidiaries in third-party ownership (amount allowed in the common equity of level 1)	N.A.
6	Common equity level 1 before regulatory adjustments	114,292
Common equity level 1: regulatory adjustment		
7	Adjustments for prudential valuation	N.A.
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)	8,734
10 (conservative)	Recoverable deferred income taxes that depend on future earnings excluding those that derive from temporary differences (net of payable deferred income tax)	-
11	Result from valuation of instruments for cash flow hedging	(2,287)
12	Reserves pending to constitute	-
13	Receivables generated by securitizations	139
14	Profits and losses caused by changes in the own credit rating on liabilities valued at fair value	N.A.
15	Defined benefit pension plan	(1,930)
16 (conservative)	Investments in own shares	-
17 (conservative)	Reciprocal Investments in the ordinary capital	-
18 (conservative)	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 does not holds more than 10% of the issued share capital (amount that exceeds the threshold of 10%)	-
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%)	807
20 (conservative)	Mortgage service rights (amount that exceeds the 10% threshold)	-
21	Recoverable deferred income taxes from temporary differences (amount that exceeds the 10% threshold, net deferred tax payable)	-
22	Amount exceeding 15% threshold	N.A.
23	Of which: significant investments where the institution has more than 10% in common shares of financial institutions	N.A.
24	Of which: mortgage service rights	N.A.
25	Of which: recoverable deferred income taxes from temporary differences	N.A.



Reference	Common equity level 1 (CET1): securities and allowance	Amount
26	Before regulatory national adjustments	(34)
A	of which: Other elements of comprehensive income (and other allowance)	(34)
27	Regulatory adjustments that apply to Tier 1 common equity due to insufficient additional Tier 1 and Tier 2 equity to cover deductions	-
28	Total regulatory adjustments to common equity level 1	12,365
29	Common equity level 1 (CET1)	101,927
Additional equity level 1: securities		
30	Instruments issued directly that qualify as additional equity of level 1, plus premium	37,728
31	Of which: classified as equity under applicable accounting criteria	-
32	Of which: classified as liability under applicable accounting criteria	N.A.
33	Instruments issued directly subject to gradual elimination of additional equity level 1	-
34	Instruments issued of Tier 1 additional capital and Tier 1 common equity instruments not included in item 5 that were issued by subsidiaries in third party	N.A.
35	Of which: Instruments issued by subsidiaries subject to gradual elimination	N.A.
36	Additional equity level 1 before regulatory adjustments	37,728
Additional equity: regulatory adjustments		
37	Investments in additional equity instruments of Level 1 (amount allowed in the additional level 1)	N.A.
38	Equity investments in Tier 1 additional capital instruments	N.A.
39	Investments in the equity of banks, financial institutions and insurers beyond the scope of regulatory consolidation, net of eligible short positions, where the Institution has no more than 10% of the share capital issued (amount exceeding the threshold of 10%)	N.A.
40	Significant Investments in the equity of banks, financial institutions and insurers beyond the scope of regulatory consolidation, net of eligible short positions, where the Institution owns more than 10% of the share capital issued	N.A.
41	National regulatory adjustments	-
42	Regulatory Adjustments applied to Tier-1 additional capital due to inadequacy of Tier 2 capital to cover deductions	N.A.
43	Total Adjustment to additional capital of level 1	-
44	Additional Capital of Level 1 (AT1)	37,728
45	Equity level 1 (T1 = CET1 + AT1)	139,654
Equity level 2: instruments and allowances		
46	Instruments issued directly that qualify as equity of level 2, plus premium	6,550
47	Instruments issued directly subject to gradual elimination of additional equity level 2	1,772
48	Tier 2 equity instruments and Tier 1 equity instruments and Tier 1 additional capital that have not been included in lines 5 or 34, which have been issued by subsidiaries in third-party ownership (amount allowed in the supplementary capital D E Level 2)	N.A.
49	of which: Instruments issued by subsidiaries subject to gradual elimination	N.A.
50	Allowances	460
51	Equity level 2 before regulatory adjustments	8,783
Equity level 2: regulatory adjustments		
52	Investments in additional equity instruments of Level 2 (amount allowed in the additional level 2)	N.A.
53	Equity Investments in Tier 2 additional capital instruments	N.A.
54	Investments in the equity of banks, financial institutions and insurers beyond the scope of regulatory consolidation, net of eligible short positions, where the Institution has no more than 10% of the share capital issued (amount exceeding the threshold of 10%)	N.A.
55	Significant Investments in the equity of banks, financial institutions and insurers beyond the scope of regulatory consolidation, net of eligible short positions, where the Institution owns more than 10% of the share capital issued	N.A.
56	National regulatory adjustments	-
57	Regulatory adjustments applied to Tier-2	N.A.



Reference	Common equity level 1 (CET1): securities and allowance	Amount
58	Equity level 2 (T2)	8,783
59	Total equity (TC = T1 + T2)	148,438
60	Weighted assets for total risk	800,125
Equity ratios and supplements		
61	Common equity level 1 (as a percentage of weighted assets for total risk)	12.74%
62	Equity level 1 (as a percentage of weighted assets for total risk)	17.45%
63	Total equity (as a percentage of weighted assets for total risk)	18.55%
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)	7.90%
65	of which: equity conservation supplement	2.50%
66	of which: Supplement specific countercyclical banking supplement	0.0005%
67	of which: Supplement of global banks systemically important (G-SIB)	0.90%
68	Common equity level 1 available to cover supplements (as a percentage of weighted assets for total risk)	4.84%
National Minimums (if different from Basel 3)		
69	National minimum reason for CET1 (if it differs from the minimum established by Basel 3)	N.A.
70	National minimum reason for T1 (if it differs from the minimum established by Basel 3)	N.A.
71	National minimum Reason for TC (if it differs from the minimum established by Basel 3)	N.A.
Amounts below the thresholds for deduction (before risk weighting)		
72	Non-significant investments in the capital of other financial institutions	N.A.
73	Significant investments in common shares of financial institutions	N.A.
74	Rights for mortgage services (net of tax deferred earnings in charge)	N.A.
75	Deferred tax asset due to temporary differences (net of deferred tax liability)	6,497
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)	460
77	Limit on the inclusion of provisions in Level 2 capital under standardized methodology	5,242
78	Reserves eligible for inclusion in Level 2 capital with respect to exposures subject to internal qualifications methodology (prior to the application of the limit)	-
79	Limit on the inclusion of reserves in the capital of level 2 under the methodology of internal qualifications	-
Equity instruments subject to gradual elimination (applicable only between January 1, 2019 to January 1, 2022)		
80	Current limit of CET1 instruments subject to gradual elimination	N.A.
81	Amount excluded from the CET1 due to the limit (excess over the limit after amortizations and maturities)	N.A.
82	Current limit of AT1 instruments subject to gradual elimination	-
83	Amount excluded from the AT1 due to the limit (excess over the limit after amortizations and maturities)	-
84	Current limit of AT2 instruments subject to gradual elimination	1,772
85	Amount excluded from T2 due to limit (excess over the limit after amortizations and maturities)	-



Net Capital's Relationship with the Balance Sheet

Table II.1
Balance Sheet figures

Reference of balance sheet items	Balance Sheet figures	Amount presented in the balance sheet
	Assets	1,149,534
BG1	Cash and cash equivalents	61,948
BG2	Margin securities	5,926
BG3	Investments in securities	247,374
BG4	Debtor balances under repurchase in resale agreements	2,016
BG5	Securities lending	-
BG6	Derivatives financial instruments	22,457
BG7	Valuation adjustments for asset hedging	69
BG8	Loan portfolio, net	740,419
BG9	Receivables generated by securitization	139
BG10	Other accounts receivables	28,096
BG11	Foreclosed assets	860
BG12	Property, furniture and equipment	14,443
BG13	Permanent stock investment	2,905
BG14	Long-term assets available for sale	-
BG15	Deferred taxes	1,119
BG16	Other assets	21,763
	Liabilities	1,035,276
BG17	Deposits	742,001
BG18	Interbank and other loans	14,630
BG19	Creditor balances under repurchase and resale agreements	165,581
BG20	Securities lending	-
BG21	Collateral sold or given in guarantee	105
BG22	Derivatives financial instruments	24,973
BG23	Valuation adjustments for financial liabilities coverage	-
BG24	Obligations in securitization operations	-
BG25	Other accounts payable	39,549
BG26	Subordinated debentures	48,050
BG27	Deferred taxes	-
BG28	Deferred credits and advance collections	385
	Stockholders' equity	114,258
BG29	Paid-in capital	20,917
BG30	Other capital	93,341
	Memorandum accounts	1,749,535
BG31	Guarantees granted	-
BG32	Contingent assets and liabilities	50
BG33	Credit commitments	243,391
BG34	Assets in trust or under mandate	460,021
BG35	Financial agent of the federal government	-
BG36	Managed assets in custody	376,241
BG37	Collateral received	207,870



Reference of balance sheet items	Balance Sheet figures	Amount presented in the balance sheet
BG38	Collateral received and sold or given as a pledge	116,266
BG39	Investment banking transactions on account of third parties, (net)	96,100
BG40	Interest accrued but not charged of past due loans	298
BG41	Other registration accounts	249,298

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.
	Asset			
1	Goodwill	8	1,005	BG16: 1,005 (Goodwill)
2	Other intangibles	9	8,734	BG16: 8,734 (Other intangibles)
3	Deferred income tax (recoverable) from tax losses and credits	10	-	
4	Receivables generated by securitization	13	139	BG9: 139 (Receivables generated by securitization transactions)
5	Investments of the pension plan for benefits defined without restricted access and unlimited	15	-	
6	Investments in its own shares	16	-	
7	Mutual Investments in ordinary capital	17	-	
8	Direct Investments in the equity of financial institutions where the Institution has no more than 10% of the shares issued	18	-	
9	Indirect investments in the equity of financial institutions where the Institution has no more than 10% of the shares issued	18	-	
10	Direct investments in the equity of financial institutions where the Institution owns more than 10% of the shares issued	19	-	



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.
11	Indirect investments in the capital of financial institutions where the Institution owns more than 10% of the share capital issued	19	1,547	BG13: 1,547 (Permanent Investment)
12	Deferred income tax (recoverable) from temporary differences	21	N.A.	
13	Reserves recognized as complementary capital	50	460	BG16: 460 (Reserves)
14	Subordinated debt investments	26 - B	-	
15	Investments in multilateral organisms	26 - D	-	
16	Investments in related companies	26 - E	-	
17	Investments in risk capital	26 - F	-	
18	Investments in societies of investment	26 - G	-	
19	Financing for the acquisition of own shares	26 - H	-	
20	Deferred charges and advance payments	26 - J	-	
21	Workers ' participation in deferred earnings (net)	26 - L	-	
22	Investments of the pension plan for defined benefits	26 - N		
23	Investments in clearing houses	26 - P	-	
Liability				
24	Deferred tax (liability) associated to goodwill	8	1,005	BG16: 1,005 (Goodwill)
25	Deferred tax (liability) associated to other intangible	9	8,734	BG16: 8,734 (Goodwill)
26	Liabilities of the pension plan for defined benefits without unrestricted and unlimited access	15	-	



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.
27	Deferred income tax (payable) associated with pension plan for defined benefits	15	-	
28	Deferred income tax (payable) associated with others other than the above	21	-	
29	Subordinated obligations amount complying with Annex 1-R	31	-	
30	Subordinated debentures subject to transitory computing as basic Capital 2	33	-	-
31	Subordinated obligations amount complying with Annex 1-S	46	-	
32	Subordinated debentures subject to transitory computing as complementary capital	47	1,772	BG26: 1,772 (Subordinated debentures)
33	Deferred income tax (in charge) associated with deferred charges and advance payments	26-J	-	
34	Contributed capital that complies with annex 1-Q	1	20,917	BG29; 20,917 (Earned capital)
35	Retained earnings from prior years	2	50,882	BG30; 50,882 (Earned capital)
36	Result from valuation of instruments for cash flow hedging of items accounted at fair value	3	-2,287	BG30; -2,287 (Earned capital)
37	Other elements of capital earned other than previous	3	44,778	BG30; 44,778 (Earned capital)
38	Contributed capital that complies with Annex 1-R	31	-	
39	Contributed capital that complies with Annex 1-S	46	-	
40	Result from valuation of instruments for cash	3, 11	-2,287	BG30; -2,287 (Earned 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.
	flow hedging of items not accounted at fair value			
41	Result from conversions	3, 26 - A	-34	BG30; -34 (Earned capital)
42	Income from non-monetary assets	3, 26 - A	-	-
	Memorandum accounts			
43	Positions in First-Loss Schemes	26 – K	-	-
	Regulatory Concepts not considered in the balance sheet			
44	Reserves pending to constitute	12	-	-
45	Profit or increase the value of the assets by acquisition of positions of securitizations (Originating Institutions)	26 - C	-	-
46	Operations that violate the dispositions	26 - I	-	-
47	Operations with Relevant Related People	26 - M	-	-
48	Abrogated	26 - O, 41, 56	-	-



III. Weighted Assets Subject to Total Risk

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	65,483	5,239
Transactions in local currency with securities in local currency with surcharge and a rate reviewable	5,758	461
Transactions in local currency with real rate or denominated in UDI's	1,268	101
Operations in local currency with performance rate referred to the growth of the General Minimum Wage	-	-
Positions in UDI's or with yield referred to INPC	21	2
Positions in local currency with performance rate referred to the growth of the General Minimum Wage	-	-
Operations in foreign currency with nominal rate	10,284	823
Positions in foreign currency or with yield indexed to an exchange rate	24,738	1,979
Positions in capital instruments or with yield indexed at the cost of a capital instruments group	277	22
Positions in goods	-	-

Table III.2
Weighted Assets subject to credit risk by risk group

Concepto	Risk Weighted Assets	Capital requirement
Group I0A (weighted at 0%)	-	-
Group I0A (weighted at al 10%)	-	-
Group I0A weighted at 20%)	-	-
Groupo I0B (weighted at 20%)	20	2
Group II weighted at 100%)	-	-
Group III (weighted at 20%)	6,655	532
Group III (weighted at 23%)	-	-
Group III (weighted at 50%)	3,595	288
Group III (weighted at 57.5%)	-	-
Group III (weighted at 100%)	5,294	424
Group III (weighted at 115%)	-	-
Group III (weighted at 120%)	-	-
Group III (weighted at 138%)	-	-
Group III (weighted at 150%)	-	-
Group III (weighted at 172.5%)	-	-
Group IV (weighted at 0%)	-	-



Concepto	Risk Weighted Assets	Capital requirement
Group IV (weighted at 20%)	13,331	1,066
Group V (weighted at 10%)	-	-
Group V (weighted at 20%)	20,602	1,648
Group V (weighted at 50%)	7,463	597
Group V (weighted at 115%)	147	12
Group V (weighted at 150%)	16,519	1,321
Grupo VI (weighted at 20%)	-	-
Group VI (weighted at 50%)	43,024	3,442
Group VI (weighted at 75%)	16,903	1,352
Group VI (weighted at 100%)	229,493	18,359
Group VI (weighted at 120%)	-	-
Group VI (weighted at 150%)	-	-
Group VI (weighted at 172.5%)	-	-
Group VII_A (weighted at 10%)	-	-
Group VII_A (weighted at 11.5%)	-	-
Group VII_A (weighted at 20%)	2,755	220
Group VII_A (weighted at 23%)	-	-
Group VII_A (weighted at 50%)	802	64
Group VII_A (weighted at 57.5%)	-	-
Group VII_A (weighted at 100%)	141,204	11,296
Group VII_A (weighted at 115%)	-	-
Group VII_A (weighted at 120%)	-	-
Group VII_A (weighted at 138%)	-	-
Group VII_A (weighted at 150%)	53	4
Group VII_A (weighted at 172.5%)	-	-
Group VII B (weighted at 0%)	-	-
Group VII B (weighted at 20%)	6,985	559
Group VII B (weighted at 23%)	-	-
Group VII B (weighted at 50%)	1,485	119
Group VII B (weighted at 57.5%)	-	-
Group VII B (weighted at 100%)	177,713	14,217
Group VII B (weighted at 115%)	-	-
Group VII B (weighted at 120%)	-	-
Group VII B (weighted at 138%)	-	-
Group VII B (weighted at 150%)	88	7
Group VII B (weighted at 172.5%)	-	-
Group VIII (weighted at 115%)	5,864	469
Group VIII (weighted at 150%)	1,258	101
Group IX (weighted at 10%)	-	-
Group IX (weighted at 50%)	-	-
Group IX (weighted at 100%)	29,391	2,351
Group IX (weighted at 115%)	-	-
Group X (weighted at 1250%)	-	-



Concepto	Risk Weighted Assets	Capital requirement
Securitizations with a Risk Degree of 1 (weighted at 20%)	1,365	109
Securitizations with a Risk Degree of 2 (weighted at 50%)	904	72
Securitizations with a Risk Degree of 3 (weighted at 100%)	40	3
Securitizations with a Risk Degree of 4 (weighted at 350%)	-	-
Securitizations with a Risk Degree of 4, 5 or unqualified (weighted at 1,250%)	-	-
Securitizations with a Risk Degree of 1 (weighted at 40%)	-	-
Securitizations with a Risk Degree of 2 (weighted at 100%)	-	-
Securitizations with a Risk Degree of 3 (weighted at 225%)	-	-
Securitizations with a Risk Degree of 4 (weighted at 650%)	-	-
Securitizations with a Risk Degree of 4, 5 or unqualified (weighted at 1,250%)	-	-

Table III.3
Weighted assets subject to operational risk

Method	Weighted assets by risk	Capital requirement
Alternative standard method	64,812	5,185

Average requirement for market and credit risk in the past 36 months	Average of the annual positive net income of last 36 months
50,633	78,411

IV. 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
5	Level of capital without transience	N.A.
6	Level of security	Credit institution without consolidating subsidiaries
7	Type of instrument	Subordinated debenture
8	Amount recognized in regulatory capital	276,936,300 (Two hundred and seventy-six million, nine hundred and thirty six thousand and three hundred) UDIs, respective to Ps. 1,772,120,368.55 1,962,998,835.09 (One billion seven hundred and seventy-two million one hundred and twenty thousand and three hundred and sixty-five pesos 55/100 M.N.).



Reference	Characteristics	Q BANORTE 08U
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
24	Convertibility conditions	N. A.
25	Convertibility grade	Non-convertible in shares
26	Convertibility rate	N.A.
27	Security convertibility type	Non-convertibles
28	Type of convertibility Financial instrument	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	No
31	Condiciones value decrease	N.A.
32	Grade of value decrease	N.A.
33	Temporality of value decrease	N.A.
34	Temporary value reduction mechanism	N.A.
35	Position of subordination in the event of liquidation	Preferential subordinated debentures
36	Default characteristics	No
37	Description of non-compliance features	N.A.



Reference	Characteristic	D2 IXEGB40 141020
1	Issuer	Ixe Banco, S.A., Institución de Banca Múltiple, Ixe Grupo Financiero
2	Identifier ISIN, CUSIP or Bloomberg	USP59974AB40
3	Legal framework	New York Law
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.Ps. 120,000,000 (One hundred and twenty million dollars 00/100USD)
9	Nominal value	U.S. Ps. 1,000.00 (One thousand dollars 00/100 USD)
9 ^a	Currency	USD dollar
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		
17	Type of yields/Dividends	Fixed
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-convertible
24	Convertibility conditions	N.A.
25	Convertibility grade	Non-convertible in shares
26	Conversion rate	N.A.
27	Security convertibility type	Non-convertible
28	Type of financial instrument of convertibility	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	No
31	Conditions for value decrease	N.A.



Reference	Characteristic	D2 IXEGB40 141020
32	Degree of low value	N.A.
33	Temporality of low value	N.A.
34	Temporary value reduction mechanism	N.A.
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.

Reference	Characteristics	Q BINTER 15
1	Issuer	Banco Interacciones, S.A., Institución de Banca Múltiple, Grupo Financiero Interacciones.
2	Identifier ISIN, CUSIP o Bloomberg	MX0QBI000051
3	Legal framework	LMV, LIC, CIRCULAR 2019/95, LGTOC
Regulatory Treatment		
4	Level of capital with transience	Complementary capital
5	Level of capital without transience	N.A.
6	Level of security	Credit institution without consolidating subsidiaries
7	Type of instrument	Subordinated debenture
8	Amount recognized in regulatory capital	Ps. 1,000,000,000 (One billion pesos 00/100 MXN)
9	Valor nominal del instrumento	Ps. 100.00 (One hundred pesos 00/100 MXN)
9A	Currency	MXN pesos
10	Accounting classification	Liability at amortized cost
11	Date of issuance	26/02/2015
12	Secutity term	Maturity
13	Date of maturity	13/02/2025
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		
17	Type of yields/Dividends	Fixed
18	Interest rate/Dividends	Real (Yield)
19	Clause of cancellation of dividends	Yes
20	Discretion in payment	Discretionary
21	Clause of increase of interest	No



Reference	Characteristics	Q BINTER 15
22	Yields/Dividends	Non-cumulative
23	Security convertibility	Non-convertible
24	Convertibility conditions	N.A.
25	Convertibility grade	Non-convertible in shares
26	Conversion rate	N.A.
27	Security convertibility type	Non convertible
28	Type of financial instrument of convertibility	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	No
31	Conditions for Value Decrease	N.A.
32	Degree of low value	N.A.
33	Temporality of low value	N.A.
34	Temporary value reduction mechanism	N.A.
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.

Referencia	Característica	D2 BANOD19 999999
1	Issuer	Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.
2	identifier ISIN, CUSIP o Bloomberg	USP14008AD19
3	Legal framework	New York Laws
Regulatory treatment		
4	Level of capital with transience	Complementary capital
5	Level of capital without transience	N.A.
6	Level of security	Credit institution without consolidating subsidiaries
7	Type of instrument	Subordinated debenture
8	Amount recognized in regulatory capital	U.S.\$350,000,000 (Trescientos cincuenta millones de Dólares 00/100 USD)
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	06/07/2017
12	Security term	Maturity
13	Date of maturity	Perpetual
14	Clause of advance payment	Perpetual
15	First date of advance payment	Yes
15A	Regulatory or fiscal events	At any time before the expiration date
15B	Settlement price of the advance payment clause	Yes



Referencia	Característica	D2 BANOD19 999999
16	Subsequent dates of payment in advance	Nominal value plus interest accrued at the date of the anticipated amortization
Yields / dividends		
17	Type of yields/Dividends	Fija
18	Interest rate/Dividends	IRUSD0Libor
19	Clause of cancellation of dividends	Sí
20	Discretion in payment	Discrecional
21	Clause of increase of interest	No
22	Yields/Dividends	No acumulables
23	Security convertibility	No convertibles
24	Convertibility conditions	N.A.
25	Convertibility grade	No Susceptibles de Convertirse en Acciones
26	Convertibility rate	N.A.
27	Security convertibility type	No convertibles
28	Type of convertibility Financial instrument	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	No
31	value decrease conditions	N.A.
32	Grade of value decrease	N.A.
33	Temporality of value decrease	N.A.
34	Temporary value reduction mechanism	N.A.
35	Position of subordination in the event of liquidation	Non-Preferential subordinated debentures
36	Default characteristics	Yes
37	Description of non-compliance features	Nonperformance of 30 days in the interest payment, nonperformance in the payment of main in the due date, mercantile contest or it fails.

Reference	Characteristic	D2 BANOE91 999999
1	Issuer	Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.
2	identifier ISIN, CUSIP o Bloomberg	USP14008AE91
3	Legal framework	New York Law
Regulatory treatment		
4	Level of capital with transience	Basic Capital 2
5	Level of capital without transience	N.A.
6	Level of security	Credit institution without consolidating subsidiaries
7	Type of instrument	Subordinated debenture
8	Amount recognized in regulatory capital	U.S.Ps. 550,000,000 (Five hundred and fifty million dollars 00/100 USD)
9	Nominal value	U.S. Ps. 1,000.00 (One thousand dollars 00/100 USD)
9A	Currency	USD dollars
10	Accounting classification	Liability at amortized cost



Reference	Characteristic	D2 BANOE91 999999
11	Date of issuance	04/10/2018
12	Security term	Maturity
13	Date of maturity	Perpetual
14	Clause of advance payment	Yes
15	First date of advance payment	At any time before the expiration 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 time before the expiration date
Yields / dividends		
17	Type of yields/Dividends	Fixed
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
24	Convertibility conditions	N.A.
25	Convertibility grade	Non-convertibles in shares
26	Convertibility rate	N.A.
27	Security convertibility type	Non-convertible
28	Type of convertibility Financial instrument	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	No
31	Value decrease condition	N.A.
32	Grade of value decrease	N.A.
33	Temporality of value decrease	N.A.
34	Temporary value reduction mechanism	N.A.
35	Position of subordination in the event of liquidation	Non-Preferential subordinated debentures
36	Default characteristics	Yes
37	Description of non-compliance features	Nonperformance of 30 days in the interest payment, nonperformance in the payment of main in the due date, mercantile contest or it fails.

Reference	Characteristic	D2 BANOC36 311004
1	Issuer	Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.
2	identifier ISIN, CUSIP o Bloomberg	USP14008AC36
3	Legal framework	New York Law
Regulatory treatment		
4	Level of capital with transience	Complementary capital



Reference	Characteristic	D2 BANOC36 311004
5	Level of capital without transience	N.A.
6	Level of security	Credit institution without consolidating subsidiaries
7	Type of instrument	Subordinated debenture
8	Amount recognized in regulatory capital	U.S.Ps. 500,000,000 (Five hundred million dollars) 00/100 USD)
9	Nominal value	U.S. Ps. 1,000.00 (One thousand dollars 00/100 USD)
9A	Currency	USD dollars
10	Accounting classification	Liability at amortized cost
11	Date of issuance	04/10/2016
12	Security term	Maturity
13	Date of maturity	04/10/2031
14	Clause of advance payment	Yes
15	First date of advance payment	At any time before the expiration 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 time before the expiration date
Yields / dividends		
17	Type of yields/Dividends	Fixed
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
24	Convertibility conditions	N.A.
25	Convertibility grade	Non-convertible in shares
26	Convertibility rate	N.A.
27	Security convertibility type	Non-convertible
28	Type of convertibility Financial instrument	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	Yes
31	Value decrease conditions	Yes
32	Grade of value decrease	7%.
33	Temporality of value decrease	N.A.
34	Temporary value reduction mechanism	N.A.
35	Position of subordination in the event of liquidation	Non-preferential subordinated debentures
36	Default characteristics	Yes



Reference	Characteristic	D2 BANOC36 311004
37	Description of non-compliance features	Nonperformance of 30 days in the interest payment, nonperformance in the payment of main in the due date, mercantile contest or it fails.

Referencia	Característica	D2 BANO64 0999999
1	Issuer	Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.
2	identifier ISIN, CUSIP o Bloomberg	USP1400MAA64
3	Legal framework	New York Law
Regulatory treatment		
4	Level of capital with transience	Complementary capital
5	Level of capital without transience	N.A.
6	Level of security	Credit institution without consolidating subsidiaries
7	Type of instrument	Subordinated debenture
8	Amount recognized in regulatory capital	U.S.\$600,000,000 (Six hundred million dollars 00/100 USD)
9	Nominal value	U.S. \$1,000.00 (One thousand dollar 00/100 USD)
9A	Currency	USD Dollar
10	Accounting classification	Liability at amortized cost
11	Date of issuance	27/06/2019
12	Security term	Maturity
13	Date of maturity	Perpetual
14	Clause of advance payment	Yes
15	First date of advance payment	27/09/2024
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 time before the expiration date
Yields / dividends		
17	Type of yields/Dividends	Fixed
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
24	Convertibility conditions	N.A.
25	Convertibility grade	Non-convertible in shares
26	Convertibility rate	N.A.
27	Security convertibility type	Non-convertible
28	Type of convertibility Financial instrument	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	Yes
31	Value decrease conditions	Yes
32	Grade of value decrease	7%.
33	Temporality of value decrease	N.A.



34	Temporary value reduction mechanism	N.A.
35	Position of subordination in the event of liquidation	Non-preferential subordinated debentures
36	Default characteristics	Yes
37	Description of non-compliance features	Nonperformance of 30 days in the interest payment, nonperformance in the payment of main in the due date, mercantile contest or it fails.

Reference	Characteristic	D2 BANO48 0999999
1	Issuer	Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte.
2	identifier ISIN, CUSIP o Bloomberg	USP1400MAB48
3	Legal framework	New York Laws
Regulatory treatment		
4	Level of capital with transience	Complementary capital
5	Level of capital without transience	N.A.
6	Level of security	Credit institution without consolidating subsidiaries
7	Type of instrument	Subordinated debenture
8	Amount recognized in regulatory capital	U.S.\$500,000,000 (Five hundred million dollar 00/100 USD)
9	Nominal value	U.S. \$1,000.00 (One thousand 00/100 USD)
9A	Currency	USD Dollar
10	Accounting classification	Liability at amortized cost
11	Date of issuance	27/06/2019
12	Security term	Maturity
13	Date of maturity	Perpetual
14	Clause of advance payment	Yes
15	First date of advance payment	27/06/2029
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 time before the expiration date
Yields / dividends		
17	Type of yields/Dividends	Fixed
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
24	Convertibility conditions	N.A.
25	Convertibility grade	Non-convertible in shares
26	Convertibility rate	N.A.
27	Security convertibility type	Non-convertible
28	Type of convertibility Financial instrument	N.A.
29	Instrument issuer	N.A.
30	Value decrease clause (Write Down)	Yes



Reference	Characteristic	D2 BANO48 0999999
31	Value decrease conditions	Yes
32	Grade of value decrease	7%.
33	Temporality of value decrease	N.A.
34	Temporary value reduction mechanism	N.A.
35	Position of subordination in the event of liquidation	Non-preferential subordinated debentures
36	Default characteristics	Yes
37	Description of non-compliance features	Nonperformance of 30 days in the interest payment, nonperformance in the payment of main in the due date, mercantile contest or it fails.

V. Management

Pursuant to the regulations in effect and the requirements of the CNBV, the Institution 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.

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.

VI. Weighters involved in the calculation of the Supplement of contra-cyclical equity of the institutions.

Supplement of contra-cyclical equity of the Institution	
0.13 millions	
Jurisdiction	Ponder
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%
Indic	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%
Singapore	0.00%



Jurisdiction	Ponder
South Africa	0.00%
Sweden	2.00%
Switzerland	0.00%
Turkey	0.00%
Other Jurisdictions	0.00%

28 - FOREIGN CURRENCY POSITION

As of December 31, 2019 and 2018, 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. 18.8642 and Ps. 19.6512 per USD 1.00, respectively, as shown below:

	Thousands of US dollars	
	2019	2018
Assets	8,461,087	7,914,061
Liabilities	8,462,973	8,325,397
Net liability position in US dollars	(1,886)	(411,336)
Net liability position in Mexican pesos	(Ps. 36)	(Ps. 8,083)

29 – POSITION IN UDIS

As of December 31, 2019 and 2018, the Institution holds certain assets and liabilities denominated in UDIS, converted to Mexican pesos based on the current conversion factor of Ps. 6.399018 and Ps. 6.226631, per UDI, respectively, as shown below:

	Thousands of UDIS	
	2019	2018
Assets	1,281,839	2,147,633
Liabilities	652,164	827,501
Net asset position in UDIS	629,675	1,320,132
Net asset position in Mexican pesos	Ps. 4,029	Ps. 8,220

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:

	2019			2018	2017
	Net Income	Weighted share average	Earnings per share	Earnings per share	Earnings per share
EPS continuous operations	Ps. 27,493	Ps. 144,197,415,428	Ps. 0.1907	Ps. 0.1764	Ps. 0.1329
EPS discontinued operations	-	-	-	-	Ps. 0.0006
Net income per share	Ps. 27,493	Ps. 144,197,415,428	Ps. 0.1907	Ps. 0.1764	Ps. 0.1335



31 - RISK MANAGEMENT (Unaudited information)

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 by its acronym in Spanish) (Unaudited information)

Risk management at the Institution is a key element in determining and implementing the Financial Group's strategic planning. The Financial Group's risk management and policies comply with regulations and market best practices.



1. OBJECTIVES, SCOPE AND RISK MANAGEMENT FUNCTIONS

Institution's Risk Management main objectives are:

- To provide clear rules to different business areas, that contribute to minimizing risk and ensuring compliance with the parameters established and approved by the Board of Directors and the Risk Policies Committee (CPR by its acronym in Spanish).
- To establish mechanisms to monitor risk-taking across the Institution, through the use of robust systems and processes.
- To verify the observance of Risk Appetite.
- To estimate and control Institution's capital, under regular and stressed scenarios, aiming to provide coverage for unexpected losses from market movements, credit bankruptcies, and operational risks.
- To implement pricing models for different types of risks.
- To establish procedures for portfolio's optimization and credit portfolio management.
- To update and monitor Contingency Plan in order to restore capital and liquidity levels in case of adverse events.

Moreover, the Institution owns sound methodologies to manage quantifiable risks such as Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Concentration Risk and Counterparty Risk.

Credit Risk: revenue volatility due to constitution of provisions for impaired loans, and potential losses on borrower or counterparty defaults.

Market Risk: revenue volatility due to market changes, which affect the valuation of book positions for active, liabilities or contingent liabilities operations, such as interest rates, spread over yields, exchange rates, price indices, etc.

Liquidity Risk: potential loss by the impossibility of renewing liabilities or securing resources in normal conditions, and by early or forced sale of assets at unusual discounts to meet their obligations.

Operational Risk: loss resulting from inadequate or failed internal processes, employees, internal systems or external events. This definition includes Technology Risk and Legal Risk. Technology Risk, groups all those potential losses from damage, interruption, disruption or failures resulting from use of or reliance on hardware, software, systems, applications, networks and any other information distribution channel, while the Legal Risk involves the potential loss by sanctions for noncompliance with laws and administrative or judicial decisions unfavorable related to Institution's operations.

Concentration Risk: potential loss by high and disproportional exposure to particular risk factors within a single category or among different risk categories.

Likewise, regarding unquantifiable risks, Risk Management's Manual in the Institution establish specific objectives for:

Reputational Risk: potential loss in the performance of Institution's activities, due to an inappropriate or unethical perception of the different stakeholders, internal or external, on their solvency and viability.

1.1. Risk Management – Structure and Corporate Governance

Regarding the structure and organization for a comprehensive Risk Management, the Board of Directors is responsible for authorizing policies and overall strategies such as:

- Institution's Risk Appetite.
- Comprehensive Risk Management Framework.
- Risk exposure limits, risk tolerance levels and mechanisms for corrective actions.
- Contingency Plan and the Contingency Funding Plan.
- The outcome of the internal and regulatory capital adequacy scenarios.



The Board of Directors designates the CPR (Risk Policy Committee) as accountable for managing the risks that the Institution is exposed to, in order to ensure that operations comply with objectives, policies and procedures established by Risk Management.

The CPR also monitors the overall limits of risk exposure approved by the Board of Directors, in addition to approving specific limits for exposure to different types of risk.

The CPR is integrated by members and deputies of the Board, the CEO, the Managing Directors of the Group's Entities, the Risk Managing Director and the Audit Managing Director, the latter participates with voice but no vote.

Moreover, the Assets and Liabilities Committee (ALCO) and the Capital and Liquidity Group, analyze, monitors, and decide regarding interest rate risks in the balance sheet, the financial margin, liquidity and net capital of the Institution.

The Unit for the Comprehensive Risk Management (UAIR by its acronym in Spanish) is in charge of the Risk Management Department (DGAR), and among its functions, is responsible to identify measure, monitor, limit, control, report and disclose the different types of risk to which the Institution is exposed to.

The DGAR reports to CPR, in compliance with the regulation related to its independence from the Business areas.

1.2. Scope and Nature of Institution's Risk Management

The Risk Management function extends to all subsidiaries that comprise the Institution. Depending on the line of business of each of the Businesses, Credit, Concentration, Market, Liquidity and Operational Risks are measured, managed and controlled.

For this purpose, DGAR relies on different information and risk measurement systems, which comply with regulatory standards and align with the best international practices in Risk Management's matters. It's worth mentioning that information and reports contained and produced in the risk systems are constantly backed up following institutional procedures in IT security matters. Furthermore, risk systems enclose transactions susceptible to Credit, Market, Liquidity and Operational Risks, processed through revised models and methodologies, thus generating periodic reports for each one of these risks.

At the Institution, there are policies and procedures for hedging, risk mitigation and compensation strategies for each type of risk in and off balance, all of them enclosed in models, methodologies and procedures for Risk Management. Within these policies, there are certain variables that must be considered for risk mitigation, such as: general features, loan to value, legal terms, instrumentation and hedging level. These policies and procedures also consider collateral execution as a risk compensation mechanism in the case of non-fulfillment by debtors. As part of the strategies and processes for monitoring the coverage or mitigation effectiveness for each type of risk, there are limits for each one of them (Credit, Market, Liquidity and Operational Risks), which are continuously monitored, as well as established procedures for the documentation of excesses and its causes, and the corrective actions implemented to return to acceptable risk levels.

2. CREDIT RISK

Credit risk is the risk of clients, issuers or counterparts not fulfilling their payment obligations. Therefore, proper management is essential to maintain loan quality of the portfolio.

The objectives of Credit Risk Management at the Company are:

- Comply with the Risk Appetite defined by the Board of Directors.
- Improve the quality, diversification and composition of the loan portfolio in order to optimize the risk- reward ratio.
- Provide Executive Management with reliable, timely information to assist decision making regarding funding.
- Provide Business Areas with clear and sufficient tools to support and monitor funding placement.
- Create economic value for shareholders through an efficient Credit Risk Management.
- Define and update the regulatory framework for the Credit Risk Management.
- Comply with the information requirements that the authorities establish regarding Credit Risk Management.



- Perform Risk Management in accordance with the best practices, implementing models, methodologies, procedures and systems based on best practices worldwide.
- Measure Institution's vulnerability to extreme conditions and consider those results for decisions making.

Company's Risk Management policies are:

- Grant and Manage Retail Credit Risk according to best market practices through Parametric Models aimed to identify risk, minimize losses and increase loan origination with quality.
- Grant and Manage Wholesale Loans to companies and other entities, according to best market practices through a credit strategy including Target Markets and Risk Acceptance Criteria, identifying and managing risk through Loan Rating and Early Alerts methodologies.
- Monitor and control asset quality through Loan Classification System, which provides treatment and general actions for defined situations, as well as departments or officers responsible for carrying out such actions.
- Surveillance and Control through Global and Specific Limits, loan rating policies and Credit Risk models that identifies expected and unexpected losses at specific confidence intervals.
- Inform and disclose Credit Risks to risk taking areas, CPR, Board of Directors, Financial Authorities and Investors.
- Define faculties for Credit Risks taking at Institution.

In order to comply with objectives and policies, a series of strategies and procedures have been defined including origination, analysis, approval, management, monitoring, recovery and collections.

2.1. Credit Risk Scope and Methodology

2.1.1. Individual Credit Risk

The Company segments the loan portfolio into two large groups: retail loans and wholesale loans.

The individual Credit Risk for retail loans is identified, measured and controlled through a parametric system (scoring) that includes models for each of the SME (small and medium enterprises) and consumer products (mortgage, auto, payroll, personal loans and credit cards).

Individual risk for wholesale loans is identified, measured and controlled through Objective Markets, Criteria for Risk Acceptance, Early Alerts and Institution's Internal Risk Rating (CIR Banorte).

The Target Markets, Risk Acceptance Criteria and Early Alerts are tools that, together with the Internal Risk Rating, are part of Institution's Loan Strategy and support the estimated level of Credit Risk.

The Target Markets are categories of economic activity by region, backed by economic research and loan behavior analysis as well as by expert opinions, where the Institution is interested in granting loans.

The Risk Acceptance Criteria are parameters that describe different types of risks by industry, in order to estimate the risk taking when granting loans to customers based on their economic activity. The types of risk observed in the Risk Acceptance Criteria are: Financial, Operation, Market, Enterprise's life cycle, Legal and Regulatory Risks, besides credit experience and management quality.

Early Alerts are a set of criteria based on borrower information and indicators, as well as their environment, as a mechanism for timely prevention and identification of a probable deterioration in the loan portfolio, thereby enabling Institution to take prompt preventive actions to mitigate Credit Risk.

Institution's CIR is a borrower's rating methodology which assesses quantitative and qualitative criteria in order to determine credit quality. CIR applies to commercial loans equal to or greater than the equivalent of four million investment units (UDIS) in Mexican pesos equivalent on the qualification date.



2.1.2. Portfolio Credit Risk

The Institution developed a portfolio Credit Risk methodology that, besides including international standards for identifying, measuring, controlling and monitoring, has been adapted to function within the context of the Mexican Financial System.

This Credit Risk methodology provides current value of the entire loan's portfolio at the Institution, that is, the loan exposure, in order to monitor risk concentration levels through risk ratings, geographical regions, economic activities, currency and type of product in order to observe the portfolio's profile and take action to improve diversification, which will maximize profitability with the lowest risk.

The model considers the loan portfolio exposure directly to the balance of each loan, whereas for the financial instruments' portfolio, considers the present value of the instruments and their future cash flows. This exposure is sensible to changes in the market, thereby facilitating estimations under different economic scenarios.

The methodology, besides loan exposure, takes into consideration the probability of default, recovery level associated to each client and the classification of the debtor based on the Merton model. The probability of default is the probability that the debtor will not fulfill his/her debt obligation with the institution according to the originally agreed terms and conditions. The probability of default is based on transition matrixes estimated by the Institution based on the migration of the debtors through different risk rating levels. The recovery ratio is the percentage of total exposure that is estimated to be recovered if the debtor defaults. The classification of the debtor, based on the Merton model, associates the debtor's future behavior to loan and market factors on which his "credit health" depends, as determined by statistical techniques.

The results of this methodology are risk measures such as the expected and unexpected loss at a one-year horizon. The expected loss is the average of credit portfolio's loss distribution, which is used to measure the following year's expected loss due to default or variations in debtors' credit quality. The unexpected loss is an indicator of the loss in extreme scenarios and is measured as the difference between the maximum losses given the distribution of losses, at a specific confidence level that for the Institution is 99.95% and expected loss.

These results are used as a tool for better decision-making in granting loans and in the diversification of the portfolio, according to Institution's strategy. The individual risk identification tools and the portfolio Credit Risk methodology are periodically verified and updated in order to include the application of new techniques that may support or strengthen them.

2.1.3. Credit Risk of Financial Instruments

Credit Risk Management of financial instruments is managed through a series of key pillars with a robust framework of policies for origination, analysis, authorization and management.

Origination policies define the types of eligible negotiable financial instruments, as well as the methodology for assessing Credit Risk of the different types of originators / issuers and counterparts. Credit Risk is allocated through: a risk rating obtained with an internal methodology, evaluations of external rating agencies or a combination of both. Maximum parameters of operation are also defined depending on the type of originator / issuer or counterpart, rating and type of operation.

The Loan Committee authorizes operation lines with financial instruments for clients and counterparties in accordance with authorization policies. The authorization request is submitted by the business area and other areas involved in the operation, with all the relevant information for analysis by the Committee who, if considered appropriate, issues its authorization. Nevertheless, the UAIR is empowered to authorize counterparty credit lines (mainly financial entities) that comply with certain criteria through a parametric methodology approved by the CPR.

In the specific case of derivatives contracts, and in line with best practices, a methodology for calculating potential exposure of credit lines is used, which are analyzed and approved within the Credit Committee and are monitored on daily and monthly basis in the CPR, where guarantee analysis for derivative transaction is held both for clients and financial counterparties.



The National Credit Committee holds the minimum faculty to approve credit lines for derivatives (in case of applying facilities, the UAIR will hold the faculty). For these transactions, the use of derivatives with margin calls shall be privileged in order to mitigate the risk of potential exposure to these transactions.

To determine the lines of credit adversely correlated (Wrong Way Risk "WWR") a potential exposure adjustment is considered.

On an individual level, the risk concentration on financial instruments is managed on a continuous basis, establishing and monitoring maximum parameters of operation for each counterparty or issuer depending on the qualification and type of operation. There are defined risk diversification policies for portfolios, for economic groups and internal groups. Additionally, the concentration of counterparty type or issuer, size of financial institutions and the region in which it operates, are monitored so that an appropriate diversification is obtained and undesired concentrations are avoided.

Credit Risk is measured through a rating associated with the issuer, security or counterparty, which has a previously assigned risk level based on two fundamentals:

1) The probability of nonfulfillment of the issuer, security or counterparty, which is expressed as a percentage between 0% and 100% where the better the rating or lower rate differential compared to the instrument of an equivalent government bond, the lower the probability of non-fulfillment and vice versa.

2) The loss given default that could be experienced with respect of the total of the operation in the event of nonfulfillment, is expressed as a percentage between 0% and 100% where the better the guarantees or credit structures, the smaller the loss given default and vice versa. To mitigate Credit Risk and to reduce the loss given default in the event of non-fulfillment, the counterparties have signed ISDA contracts and agreements to net out, in which credit lines and the use of collateral to mitigate loss in the event of non-fulfillment are implemented.

2.2. Credit Risk Exposure

As of 4Q19 the total amount of the exposure subject to the Standard Method and to the Internal Rating Based Models (for Credit Card) to estimate the Capital Ratio is the following:

Gross Exposures subject to the Standard Method and/or Internal Models (Million pesos)	The Institution
Commercial	58,471
YoY Revenues or Sales < 14 MM UDIS	58,471
States or Municipalities	107,211
Decentralized Federal Government Agencies and State Companies	49,191
Projects with own source of payment	90,412
Financial Institutions	20,599
Mortgage	172,059
Consumer Non-revolving	78,510
Total loans subject to the Standard Method	576,453
Commercial	123,950
YoY Revenues or Sales >= 14 MM UDIS	123,950
Decentralized Federal Government Agencies and State Companies	13,753
Total loans subject to the Internal Basic Model	137,703
Credit cards	41,497
Total loans subject to the Internal Advanced Model	41,497
Total portfolio	756,143

* The Exhibition does not include Letters of Credit and includes accounting adjustments



For transactions subject to Credit Risk, the Institution uses external ratings issued by the rating agencies S&P, Moody's, Fitch, HR Ratings, Verum, DBRS Ratings México and A.M. Best America Latina. Only ratings issues by rating agencies are considered, and are not assigned based on comparable assets.

2.2.1. Exposure to Financial Instruments

As of 4Q19, exposure to Credit Risk for Securities Investments of Banco Mercantil del Norte was Ps. 244,847 million, of which 94.7% is rated higher or similar to A+(mex) on a local scale, placing them in investment grade and the 3 main counterparties other than the Federal Government, State Governments and National Financial Institutions represent 7% of the Tier 1 Capital as of 3Q19. Additionally, the exposure of investments with the same counterparty other than the Federal Government that represents a higher or similar concentration to 5% of the Net Capital as of 3Q19 has higher or similar rating to BBB+(mex) and is comprised of (*average considered term, amount in million pesos and average return to annualized maturity*): market and bond certificates from Pemex to 5 years and 1 month totaling Ps. 12,881 million at 6.0%; and promissory notes, market certificates and certificates of deposits of Pemex to 4 years and 8 months totaling Ps. 15,205 at 4.4%.

For Derivatives operations, the exposure of the 3 main counterparties other than the Federal Government, State Governments and National Financial Institutions represent 2% of the Tier 1 Capital as of 3Q19.

Institution's exposure to counterparty risk from transactions with derivatives is presented below, as well as the netting effect and risk mitigation based on the aggregate of guarantees related to transactions (includes operations with Banxico. Excludes settled transactions through central counterparties).

Position (Million pesos)	4Q19	Promedio 4Q19 Average
Forwards	73	48
FX Swap	(160)	(105)
FX	1	1
Options	(280)	(241)
Swaps with Interest Rates (IRS)	7,642	8,134
Cross Currency Swap (CCIRS)	(6,569)	(6,879)
Credit Default Swaps (CDS)	171	188
Total	879	1,146
Positive Fair Value (<i>Positive Fair Value</i>)	10,621	11,405
Netting Effect*	9,742	10,259
Delivered Guarantees(-) /Received(+)		
Cash	(6,990)	(7,132)
Securities	-	-
Total	(6,990)	(7,132)

* Difference between the positive fair value (not considering the net positions) and the portfolio market value. Transactions performed at the clearing house are not included, as they are not subject to counter party risk.



The following table represents the current and potential levels of exposure at the end and the average of the quarter, respectively:

	Potential Risk		Current Risk	
Counterparties	4Q19	Promedio 4Q19	4Q19	Promedio 4Q19
Financial				
FWD			60	42
FX SWAP	572	643	(160)	(105)
FX			1	1
OPTIONS	1,377	1,466	(203)	(176)
INTEREST RATE SWAP	4,532	4,650	(406)	(386)
CCS	1,730	1,730	(6,580)	(6,892)
CDS	180	197	171	188
Total	8,391	8,686	(7,117)	(7,328)
Clients (Non-Financial)	4Q19	Average 4Q19	4Q19	Average 4Q19
FWD	58	36	13	5
OPTIONS	54	70	(77)	(65)
INTEREST RATE SWAP	8,886	9,342	8,048	8,519
CCS	41	40	11	13
Total	9,039	9,488	7,995	8,472

Based on conditions established in derivative agreements, tolerance levels of exposure are considered according to the rating of involved entities. The following table presents the amount of guarantees to be delivered, in case of a rating downgrade (it's worth noting that with most counterparties we've migrated to zero threshold, thus, guarantees to be delivered do not depend on credit rating but to market movements):

Net Cash Outflows (Million pesos)	4Q19	4Q19 Average
Cash Outflow with 1-notch Downgrade	-	-
Cash Outflow with 2-notch Downgrade	-	-
Cash Outflow with 3-notch Downgrade	-	-

In the following table, the market value is detailed according to the ratings for derivatives' counterparties.

Rating (Million pesos)	MtM 4Q19	4Q19 Average
AAA/AA-	-	-
A+/A-	(6,795)	(6,937)
BBB+/BBB-	(314)	(371)
BB+/BB-	4,156	4,357
B+/B-	-	-
CCC/C	-	-
SC	3,832	4,097
Total	879	1,146



2.3. Credit Collaterals

Collaterals represent the second credit recovery source when its coverage, through the predominant activity of the applicant, is compromised. Collaterals may be real or personal.

The main types of real collaterals are the following:

- Civil Mortgage
- Industrial Mortgage
- Regular Pledge
- Pledge w/o possession transfers
- Pledge / Pledge Bond
- Pledge Bond
- Caution Securities
- Securities Pledge
- Management and Payments Trust
- Development Funds

For assets granted in guarantee, the Company has policies and procedures to monitor and make periodic inspection visits to ensure the existence, legitimacy, value and quality of the guarantees accepted as an alternative credit support. Furthermore, when guarantees are securities, there are policies and procedures to monitor its market's valuation and require additional guarantees if needed.

The covered loan portfolio by type of collateral is as follows:

Collateral Type <i>(Millones de pesos)</i>	Banorte 4T19
Total Loan Portfolio	756,174
Covered Loan Portfolio by type of collateral	
Real Financial Guarantees	15,920
Real Non-Financial Guarantees	433,515
Pari Passu	28,693
First Losses	18,600
Personal Guarantees	19,652
Total Loan Portfolio Covered	516,380

2.4. Expected Loss

As of 4Q19, Institution's total portfolio was Ps. 756,143 million. The expected loss represents 2.2% and the unexpected loss is 3.9% with respect to the total portfolio. The average expected loss is 2.2% during the period October – December 2019.

2.5. Internal Models

2.5.1. Internal Advanced Model for Credit Card

On November 15, 2017, the Institution received the approval from the banking regulator (Comisión Nacional Bancaria y de Valores) to use Internal Rating Based Models (IM) for credit card's reserve constitution and credit risk's regulatory capital requirements with an advanced approach (Document 111-3/706/2017).

These internal models improve credit risk management by estimating risk parameters from the bank's own experience, and have been applied as of February 2018. The aforementioned parameters are:

- Probability of Default. Indicates the probability that a credit card customer defaults on its contractual obligations within the next twelve months after the month being rated. For each loan, there is a score, which is mapped to a Master rating scale.



- Severity of Loss. Measures the intensity of the loss upon default expressed as a percentage of the Default Exposure (DE).

Default Exposure. Is the amount of the debt at the time of default of a loan, considering a time horizon of twelve months after the month being rated.

The next table shows the Credit Card portfolio subject to the Internal Advanced Model, classified by degrees of regulatory risk:

Consumer Revolving Portfolio under Internal Advanced Model						Million pesos	
Risk's Degree*	Accounting Balance	Default Exposure (DE)**	Severity of Loss	PD weighted by DE	Unused credit lines	DE Weighted by exposure	Current DE
A1	17,765	30,552	87.30%	1.03%	45,997	42%	30,552
A2	6,028	9,346	87.30%	2.90%	8,393	35%	9,346
B1	4,183	6,175	87.30%	5.55%	2,069	32%	6,175
B2	539	1,093	87.30%	3.71%	1,619	51%	1,093
B3	4,851	6,042	87.30%	9.17%	772	20%	6,042
C1	1,042	1,574	87.30%	8.06%	980	34%	1,558
C2	3,351	4,540	87.30%	15.10%	1,287	26%	4,445
D	3,176	3,506	87.30%	47.69%	387	9%	1,202
E	1,052	1,078	88.74%	97.71%	196	2%	47
Total Portfolio	41,987	63,905	87.46%	7.92%	61,701	34%	60,460

* The scale Risk's Degrees of the Internal Advanced Model has been mapped in accordance with regulatory risk levels.

** The balances under Default Exposure include Potential Risk as well as Used credit line balance.

The next table shows the difference between expected loss and observed loss resulting from the Internal Advance Model for Credit Cards starting on 1Q19:

Backtesting				
Portfolio	Expected Loss Internal Model (Dec'19)	Observed Loss Jan19-Dec19	Difference Ps. (Observed Loss – Expected Loss)	% Usage
Credit Card	4,588	4,263	(326)	93%
Total Portfolio	4,588	4,263	(326)	93%

2.5.2. Basic Internal Model for Commercial Loans

On November 30, 2018, GFNorte obtained authorization from the banking regulator CNBV (Comisión Nacional Bancaria y de Valores) to use the Internal Model (IM) for Commercial Loans for reserves generation and regulatory capital requirements by credit risk with a basic approach, as per Document 111-3/1472/2018 in the Institution.

Exposures subject to this rating are those pertaining to corporations (other than states, municipalities and financial entities), and individuals (sole proprietorships), both with annual sales higher or equal to 14 million UDIs.



The Internal Model (IM) enhances the overall credit risk management practice by estimating risk parameters through the institution's own experience with such customers. These models have been applied since February 2019 (January figures) at the Institution. The parameter authorized under the Basic Internal Model for Corporations is:

- Probability of Default. Shows the likelihood that a borrower defaults on its contractual obligations within twelve months after the month being rated. There is a score assigned to each borrower, which is in turn mapped against a master rating scale..

A breakdown of risk exposure and expected loss by subsidiary is shown below:

Commercial Loans Portfolio subject to the Internal Basic Model			<i>Million pesos</i>
Subsidiary	Accounting Balance*	Exposure at Default (EAD)**	Expected Loss
Banco Mercantil del Norte	145,926	146,022	1,752
Total Loans*	145,926	146,022	1,752

* The balance includes Letters of Credit in the amount of Ps 8.89 billion and excludes accounting adjustments of Ps 14 million in Banorte and Ps 143 million in Arrendadora y Factor Banorte.

** EAD balances include both potential risk as well as used balance risk.

2.6. Risk Diversification

In December 2005, the CNBV issued "General Dispositions Applicable to Credit Institutions regarding to Risk Diversification". These guidelines state that the institutions must carry-out an analysis of their borrowers and/or loans to determine the amount of "Common Risk"; also, the institutions must have the necessary information and documentation to prove that the person or group of persons represent common risk in accordance with the assumptions established in those Rules.

In compliance with the risk diversification regulation in asset and liability operations, **the Institution** submits the following information:

Tier 1 as of 3Q19	143,514
<i>(Million pesos)</i>	
I. Loans with individual balance greater than 10% of basic equity:	
<u>Loan Operations</u>	
Number of loans	-
Total amount of loans	-
% in relation to Tier 1	0%
<u>Money Market Operations</u>	
Number of loans	-
Total amount of loans	-
% in relation to Tier 1	0%
<u>Overnight Operations</u>	
Number of loans	-
Total amount of loans	-
% in relation to Tier 1	0%
II. Loans with individual balance greater than 10% of basic equity:	40,274

3. MARKET RISK

Institution's objectives regarding Market Risk are:

- Comply with the Desired Profile Risk defined by the Group's Board of Directors.
- Maintain an adequate monitoring on Market Risk.
- Maintain the Senior Management adequately informed in time and form.



- Quantify exposure to Market Risk through the use of various methodologies.
- Define maximum risk levels the Institution is willing to maintain.
- Measure the Institution's vulnerability to extreme market conditions and consider such results when making decisions.

Institution's Market Risk Policies are:

- New products subject to market risk must be evaluated and approved through the new products' guidelines approved by the CPR.
- The Board of Directors is the entitled body to approve global limits and market risk's appetite metrics, as well as their amendments.
- The CPR is the entitled body to approve models, methodologies and specific limits, as well as their amendments.
- Market risk models will be valid by and independent area, which is different from the one that develop and manage them.
- Market risk inputs and models will be valid as per a properly approved policy by the CPR.

3.1 Market Risk Methodology

Market Risk Management is controlled through a series of fundamental pillars, highlighting the use of models and methodologies such as potential loss commonly known as "expected shortfall", Back Testing and Stress Testing, which are used to measure the risk of traded products and portfolios in the financial markets. It is noteworthy that based on Basel requirements referred in the document "Minimum Capital Requirements for Market Risk", Banorte implemented during January the calculation of expected shortfall, thus substituting the calculation of VaR. In addition, it was implemented the valuation of derivatives by OIS curves and curves adjusted for collateral following international standards.

The result shows that the Bank's expected shortfall, using a 97.5% confidence level, is on average Ps 67.8 million.

Risk management is supported by a framework of policies and manuals through which the implementation and monitoring on market risk limits, the disclosure of the aforementioned risk metrics and its tracking regarding the established limits, are set.

Key risk ratios are disclosed in monthly reports to the Risk Policy Committee and through a daily report to top executives at the Institution, related to the Market Risk risk-taking

3.2. Market Risk Exposure

Exposure of the Institution's financial portfolios to Market Risk is quantified using the standard methodology in the industry known as Value at Risk (VaR).

The VaR model considers a one day horizon base, and considers a non-parametric historical simulation with a 97.5% confidence level and 500 historical observations on risk factors. Furthermore, it considers all the positions (money market, treasury, equities, FX and derivatives for trading purposes) classified for accounting purposes as trading assets, both on and off the balance sheet.

The average VaR of the portfolio for 4Q19 was Ps. 67.8 million (Ps. 6.7 million higher than the average VaR from last quarter).

The result shows that the Bank's potential loss, con un nivel de confianza de 97.5%, es en average Ps 67.8 mi.

VaR (Million pesos)	4Q18 Average
VaR the Institution	67.8
Net Capital the Institution	148,438
VaR / Net Capital the Institution	0.05%



VaR by risk factor for the Institution's portfolio had the following behavior during the fourth quarter of the year:

Risk Factor (Million pesos)	4Q19	4Q19 Average
Rates	38.5	57.8
FX	48.3	41.6
Equity	29.4	34.4
Diversification Effect VaR	(58.7)	(66.1)
Bank's Total VaR	57.5	67.7

VaR for 4Q19 was Ps. 57.6 million. The contribution to VaR for each risk factor is:

Risk Factor (Million pesos)	4Q19	4Q19 Average
Domestic Rates	18.2	31.1
Foreign Rates	10.0	11.6
FX	15.8	11.6
Equity	13.5	13.4
Bank's Total VaR	57.5	67.7

VaR by risk factor is determined by simulating 500 historical scenarios to each risk factor and assessing instruments by their main risk factor. It is important to note that all positions classified as trading were considered, positions classified as held to maturity and available for sale were excluded.

The proportion by market risk factor excluding the diversification effect is:

Risk Factor	4Q18
Rates	43%
FX	31%
Equity	26%

3.3. Sensitivity Analysis and Stress Testing under extreme conditions

Since VaR indicates the potential losses under normal market conditions, the Institution complements its risk analysis enforcing tests under extreme conditions known as Stress Testing. This is presented to the Risk Policy Committee on monthly basis with the main objective of assessing the impact on the Institution's positions of extreme movements in risk factors.

3.4. Backtesting

In order to validate the effectiveness and accuracy of the VaR, a monthly Back testing analysis is presented to the Risk Policy Committee. Through this analysis, it is possible to compare losses and gains observed with respect to the estimated Value at Risk and if necessary make the required adjustments to the parameter.

4. BALANCE AND LIQUIDITY RISK

Institution's Balance and Liquidity Risk objectives are:

- Comply with the Risk Appetite defined by the Group's Board of Directors.
- Give proper monitoring of Balance and Liquidity Risk.
- Assessing through the use of different methodologies, Balance and Liquidity Risk exposure.
- Measure Institution's vulnerability to extreme market conditions and consider such results for decision making.
- Maintain Senior Management properly informed in a timely manner on Balance and Liquidity Risk exposure and on any limits' and risk profile's deviation.
- Monitor the institution's coverage policy and review it at least annually.
- Maintain a sufficient level of liquid assets eligible to guarantee the institution's liquidity even under stress conditions



Institution's Liquidity Risk Policies are:

- Establishment of specific global limits of Balance and Liquidity Risk Management.
- Measurement and monitoring of Balance and Liquidity Risk.
- Information and disclosure of Liquidity Risk to risk-taking areas, CPR, Board of Directors, Financial Authorities and to public investors

4.1. Liquidity Risk Methodology and Exposure

Balance and Liquidity risk is managed through a series of fundamental pillars that include the use of key indicators such as the Liquidity Coverage Ratio (LCR), re-price gaps and liquidity, as well as stress testing. The latter, based on a framework of policies and manuals, including a funding contingency plan, and a contingency plan to preserve solvency and liquidity. Similarly, is enhanced with monitoring limits and Risk Appetite metrics of Balance and Liquidity Risk. The disclosure of metrics and indicators and their compliance with the established limits and the Risk Appetite are reviewed through monthly reports to the CPR, weekly reports to the capital and liquidity management group and quarterly reports to the Board of Directors.

4.2. Profile and Funding Strategy

The composition and evolution of the Bank's funding during the quarter is shown in the following table:

Funding Source (Million pesos)	3Q19	4Q19	Var vs. 3Q19
Demand Deposits			
Local Currency ⁽¹⁾	355,205	393,386	10.7%
Foreign Currency ⁽¹⁾	46,698	44,778	(4.1%)
Demand Deposits	401,903	438,164	9.0%
Time Deposits – Retail			
Local Currency ⁽²⁾	223,547	216,685	(3.1%)
Foreign Currency ⁽²⁾	12,156	12,351	1.6%
Core Deposits	637,606	667,200	4.6%
Money Market			
Local Currency ⁽³⁾	49,694	50,791	2.2%
Foreign Currency ⁽³⁾	24,493	24,010	(2.0%)
Banking Sector Deposits	711,793	742,001	4.2%

1. Includes balance of the Global Deposits without Movement.
2. Includes eliminations among subsidiaries.
3. Money Market and Time Deposits

4.3. Liquidity Coverage Ratio (LCR)

The LCR measures Liquidity Risk through the relationship between Liquid Assets and Net Cash Outflows in the next 30 days, under a regulatory stress scenario.

The LCR is an indicator designed to ensure that the institution has sufficient liquidity to meet its short term obligations, under an extreme scenario using exclusively high quality liquid assets as source of funding.



The following table presents the average evolution of LCR components in 4Q19.

LCR Components (Million pesos)	Bank and Sofomes	
	Unweighted amount (Average)	Weighted amount (Average)
COMPUTABLE LIQUID ASSETS		
1 Total Computable Liquid Assets	No aplica	108,195
CASH DISBURSEMENTS		
2 Unsecured retail financing	370,185	24,931
3 Stable financing	241,756	12,088
4 Less stable financing	128,430	12,843
5 Unsecured wholesale financing	217,874	66,106
6 Operational Deposits	171,226	38,100
7 Non-Operational Deposits	41,149	22,506
8 Unsecured debt	5,499	5,499
9 Secured wholesale financing	260,082	19,211
10 Additional Requirements:	312,745	21,509
11 Disbursements related to derivatives and other guarantee requirements	63,056	7,343
12 Disbursements related to losses from debt financing	0	0
13 Credit and liquidity lines	249,689	14,165
14 Other contractual financing obligations	927	113
15 Other contingent financing liabilities	0	0
16 TOTAL CASH DISBURSEMENTS	No aplica	131,869
CASH INFLOWS		
17 Cash Inflows for secured operations	125,953	17,971
18 Cash Inflows for unsecured operations	43,545	27,937
19 Other Cash Inflows	4,177	4,177
20 TOTAL CASH INFLOWS	173,675	50,085
	Adjusted Amount	
21 TOTAL COMPUTABLE LIQUID ASSETS	No aplica	108,195
22 TOTAL NET CASH DISBURSEMENTS	No aplica	81,784
23 LIQUID COVERAGE RATIO	No aplica	133.49%

During 4Q18, the average LCR for the 91 days in the quarter for the Bank and Sofomes was 133.49%, and at the end of 4Q19 the LCR was 113.85%. The aforementioned levels are above the Risk Appetite and the regulatory minimum standards.

These results show that the Institution can meet all of its short-term obligations in a crisis scenario ¹.

4.4. Evolution of LCR Components

The evolution of the LCR components comparing 3Q19 and 4Q19 is presented in the following table.

LCR Component (Million pesos)	3Q19	4Q19	Var vs. 3Q19
Liquid Assets	102,261	103,080	0.8%
Cash Inflows	65,649	44,610	(32.0%)
Cash Outflows	135,498	135,147	(0.3%)

¹ The Liquidity Coverage Ratio information is preliminary and is subject to Banco de Mexico's affirmation.



The Liquid Assets that compute in the LCRs for the Bank and Sofomes between 3Q19 and 4Q19 are distributed as follows:

Type of Asset (Million pesos)	3Q18	4Q18	Var vs. 3Q18
Total	102,261	103,080	0.8%
Level I	94,421	95,218	0.8%
Level II	7,841	7,862	0.3%
Level II A	4,133	4,126	(0.2%)
Level II B	3,708	3,736	0.7%

Liquid assets increased in the quarterly comparison in 3Q19 and 4Q19, due to a growth in the deposits for monetary regulation and auctions with Banco de Mexico.

4.5. LCR Result's Main Causes

Variations in the LCR between 3Q19 and 4Q19 are mainly due to the increase in cash outflows related to the funding exchange market conditions, as well a decrease in the balances of liquidity management accounts of the treasury due to balance optimization strategies.

4.6. Liquidity Risk in foreign currency

For Liquidity Risk quantification and monitoring, in the specific case of the foreign currency denominated portfolio, the Insitution uses the criteria established by Banco de México for the assessment of the foreign currency Liquidity Coefficient.

The Liquidity Coefficient in foreign currencies should be interpreted as the ability of the institution to meet its liquidity mismatches with liquid assets, both in foreign currency.

4.7. Exposure to Derivatives and possible Margin calls

The Insitution applies the regulatory methodology to determine cash outflows for derivatives. At the end of 4Q18, estimated outflows for derivatives were as follows:

Derivatives Cash Outflows (Million pesos)	3Q19	4Q19	Var vs. 3Q19
Net cash outflows at market value and for potential future exposure	4,767	4,767	0.0%
Cash outflows for a 3 notch credit rating downgrade	0	0	0%

The former measurement shows that potential outflows for derivatives may represent a liquidity requirement up to Ps. 4,767 million, stable vs. 3Q19.



4.8. Liquidity Gaps

As part of the liquidity analysis for the Bank, 30 day liquidity gaps for the Institution's assets and liabilities (obligations) are analyzed. Results for the Bank at the end of 4Q19 are presented in the following table.

Concept (Million pesos)	3Q19	4Q19	Var vs. 3Q19
Cumulative 30 day Gap	(72,313)	(67,420)	(6.8%)
Liquid Assets	95,094	78,466	(17.5%)

Mismatch among inflows and outflows (gaps) for the next 30 days are covered with liquid assets. In addition, a more granular breakdown of the liquidity gaps is presented, remaining as follows for 4Q18:

Concept (Million pesos)	1 day	7 days	1 month	3 months	6 months	12 months
Natural Gap	(31,758)	1,011	(36,673)	(1,082)	(9,624)	10,100
Accumulated Gap	(31,758)	(30,747)	(67,420)	(68,502)	(78,126)	(68,026)

4.9. Stress Testing under liquidity extreme conditions

As part of its Liquidity Risk management, the Institution performs tests under extreme liquidity circumstances with internal scenarios, to assess the Bank's liquidity adequacy under adverse conditions from the environment as well as by the bank's intrinsic conditions. A total of 9 scenarios, based on 3 sources of risk (systemic, idiosyncratic and combined) with 3 levels of severity (moderate, medium and severe) are used.

4.10. Contingency Funding Plan

In order to comply with comprehensive liquidity management practices, and to ensure its operation in adverse situations in terms of Liquidity, the Institution has implemented a contingency funding plan, which incorporates elements to identify possible liquidity problems and defines alternate funding sources available to deal with contingencies.

4.11. Balance Risk

Interest rate risk entails estimating its impact on the financial margin. Financial margin is the difference between interest income and costs associated to interest bearing liabilities (interest expense). Depending on the balance's structure, variations in interest rates may have either a positive or negative impact in the rate scenarios.

Given that financial margin follows the flow structure of assets and liabilities in the balance sheet, the model used is a repricing model by brackets in which all assets and liabilities are distributed in different bands depending on their repricing characteristics and/or tenure. Once categorized by re-pricing structure, the impact that each of these bands have on these metrics can be estimated..

4.11.1. Financial Margin Sensitivity



Financial Margin sensitivity is a metric that takes into consideration a twelve-month period. Only the bands with duration lower than 1 year are impacted by interest rate simulated fluctuations, and consider a parallel and symmetric shift for both active and passive interest rates. Relevant considerations behind margin sensitivity calculations are:

- All financial assets and liabilities in the balance sheet are considered. The separate book for trading is not included.
- This metrics takes into consideration all balance sheet behavior models, such as mortgage prepayments and deposit survival.
- The balance sheet is regarded as static and constant through time. Neither organic growth nor interest rate structure or changes in product's mixture are considered.

The following table shows Financial Margin Sensitivity for Banorte Bank:

Margin Sensitivity <i>(Million pesos)</i>	3Q19	4Q19	Var vs. 3Q19
Domestic currency balance	219	554	152.8%
Foreign currency balance	424	362	(14.6%)

At the end of 4Q19, local currency balance sensitivity for a 100bps shift in reference rates, changed from Ps 219 million in 3Q19 to Ps 554 million. Foreign currency balance sensitivity for a 100bps shift in reference rates changed from Ps 424 million to Ps 362 million. The calculation does not consider the positive effect of lower rates on the Negotiable Position that would be recorded under Trading Income.

5. OPERATIONAL RISK

The Institution has a formal Operational Risk department headed by the "Deputy Managing Director of Financial and Operational Risk", reporting directly to the Chief Risk Officer.

Operational Risk is defined as the potential loss due to failures or deficiencies in internal controls, errors in operation processing and storing or in data transmitting, as well as to adverse administrative and judicial rulings, fraud or theft (this definition includes Technological and Legal Risk).

The objectives of Operational Risk Management are: a) Enable and support the organization to reach its institutional objectives through prevention and management of operational risks; b) To ensure that the existing operational risks and the required controls are properly identified, assessed and in line with the risk strategy established by the organization; and c) To ensure that operational risks are properly quantified in order to adequately allocate capital per Operational Risk.

Pillars in Operational Risk Management

5.1. Policies, Objectives and Guidelines

As part of the Institutional regulations, there are documented policies, objectives, guidelines, methodologies and responsible areas in Operating Risk management.

The Operational Risk Management Directors maintains close communication and coordination with the Regulatory Comptrollership in order to facilitate effective Internal Control in which proper procedures and controls are established for mitigating Operating Risk among the processes, and provide monitoring through the Internal Audit Department.



The Regulatory Comptrollership, as part of the Internal Control System, carries out the following activities to mitigate risk: a) Internal control validations; b) Institutional regulations management and control; c) Monitoring of operating processes' internal control by means of control indicators reports, that are reported by the process comptrollers in the various areas; d) Money Laundering Prevention process management; e) Control and monitoring of the regulatory provisions; and f) Analysis and assessment of the operating processes and projects with the participation of the responsible Directors of each process in order to ensure adequate internal control.

5.2. Quantitative and Qualitative Measuring Tools

5.2.1 Operational Losses Database

In order to record operating loss events, the Institution owns a system 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:

Type of Events	Description
Internal Fraud	Losses derived from a type of action intended to defraud; unlawfully assets appropriation; or sidestep regulations, laws or company policies (excluding diversity/discrimination events) in which at least one company party is involved.
External Fraud	Losses derived from a type of action intended to defraud; unlawfully assets appropriation; or sidestep the laws, caused by a third party
Labor Relations and Safety in the Workplace	Losses caused by acts incompatible with the legislation or labor agreements regarding hygiene or safety, the payment of personal damage claims, or cases associated with diversity/discrimination
Customers, Products & Business Practices	Losses caused by involuntary noncompliance or negligence of a professional obligation to specific customers (including fiduciary and adjustment requirements), or due to the nature or design of a product
Natural Disasters and Other Events	Losses caused by damage or harm to material assets as a consequence of natural disasters or other events
Incidences in the Business and Systems Failures	Losses caused by incidences in the business and systems failures
Process Execution, Delivery and Management	Losses caused by errors in operations processing or management, as well as relations with commercial counterparties and suppliers

This historical Database provides the statistics of the operational events in which the institution has incurred to determine their trends, frequency, impact and distribution. Moreover, the Database will enable, in the future, to own enough information to estimate capital requirements as per Advances Models.

5.2.2. Legal and Fiscal Contingencies Database

For recording and monitoring legal, administrative and tax issues that may arise from adverse ruling, an internal system called "Legal Risk Issues Monitoring System" (SMARL by its acronym in Spanish) 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, legal and fiscal contingencies are estimated by the attorneys that process the cases, determining its risk level based on an internal methodology. This allows to constitute necessary reserves in a determined term (according to lawsuit's term) to face such Contingencies.

5.3. Risk Management Model

The Institution has defined objectives, which are achieved through different plans, programs and projects. Compliance with such objectives may be adversely affected due to operating risks, therefore it is imperative to provide a methodology for managing them within the organization. Consequently, Operating Risk Management is now an institutional policy defined and supported by senior management.



To perform Operating 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 Regulatory Comptrollership with the support of Process Comptrollership, are processed in order to eliminate or mitigate them (seeking to reduce their severity or frequency) and if the case, defining tolerance levels. Currently, work is being performed on developing a new Institution Operating Risk Management Model and the technological tools needed to implement it.

5.4. Required Capital Calculation

In accordance with the current Capitalization for Operational Risk Regulations, the Institution has adopted the Alternative Basic Model, which is estimated and reported periodically to the authorities; the assets subject to operational risk are disclosed in the corresponding note regarding the Rules for capital requirements.

5.5. Information and Reporting

The information generated by the Database and the Management Model is processed periodically to report to the Risk Policies Committee and the Board of Directors regarding the main operating events that were detected, the trends, identified risks and their mitigating strategies. Reporting is also performed regarding the status of the main Operating Risk mitigation initiatives implemented by the various areas of the organization.

5.6. Operational Risk Disclosure

Regarding the disclosure for Operational Risk, the cumulative operational losses for the last 12 months, represents 1.8% of the Net Interest Margin.

5.7. Technological Risk

Technological Risk is defined as 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 in the rendering of banking services to the customers. This risk forms an inherent part of Operating Risk, which is why its management is handled collectively throughout the entire organization.

To address the Operating Risk associated with information integrity, and "Integrity Committee" has been created. Its objectives are to align security and information control efforts under a prevention focus, to define new strategies, policies, processes or procedures and to provide solutions to information security issues that affect or may affect the Institutional patrimony.

The functions established by the CNBV for Technology Risk Management are performed by the Institution under regulatory and Integrity Committee guidelines.

To address the Operating Risk caused by high impact external events, the Institution has a Business Continuity Plan (BCP) and Disaster Recovery Plan (DRP) based on a same-time data replication system at an alternate computer site. All the above, covers the backup and recovery of the Institution's critical applications in the event or any relevant operating contingency.

5.8. Legal Risk

Legal Risk is defined as the potential loss from failure to comply with the applicable legal and administrative provisions, the issuance of indisputable unfavorable court rulings and the application of penalties regarding the operations that the institution performs.

The Legal Risk must be measured as an inherent part of Operating Risk in order to understand and estimate its impact. Therefore, those legal issues which result in actual operating losses of the SMARL system are later recorded in the SCERO a database of operational events.

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.



6. SECURITIZATIONS EXECUTED BY THE INSTITUTION

The main objective of the securitization operations carried out by the Bank, is to transfer risks and benefits of certain financial assets to third parties.

The Institution has accomplished the following securitizations:

- On October 11, 2006, Fincasa Hipotecaria (Fincasa), now merged with the Institution, held the irrevocable trust for the issuance of market certificates No. 563, issuer code FCASACB, whose underlying assets are mortgages originated and transferred by Fincasa.
- On November 5, 2007, the Institution held the irrevocable trust for the issuance of market certificates No. 477, issuer code BNTECB, whose underlying assets are loans originated and transferred by the Institution to federal entities, states and municipalities, as well as trusts in which any of such entities act as trustees.

In accordance with criteria C-1, "Recognition and Disposal of Financial Assets", these assets were written off from the Institution's balance sheet as a sale, given that conditions for the risk's and benefit's transfer inherent in the ownership of the financial assets were met. The Institution is not responsible for assumed or retained risks with respect to trust assets its sole responsibility is the fulfillment of its obligations in the trust agreement and administration contract.

The Institution is responsible that each of the assigned loans meets the eligibility criteria, at the time of their respective assignment. If the trust, the common representative, the financial guarantor, identify any non-eligible loans, they may require the Institution to replace such loan or if replacement is not possible, to make payment for the "non-replaced ineligible loan" in question. If the Institution identifies any non-eligible loan, it must notify and replace or make the corresponding payment.

Particularly in Trust 477, operations with derivatives are carried out, specifically swaps, in order to reduce exposure to exchange rate and interest rate risks. The Institution assumes the counterparty risk generated by these operations, however these operations are only carried out with institutions of recognized solvency. The Trust's policy is to only carry out derivative instrument operations for the sole purpose of coverage, never for speculation.

The Institution's Board of Directors has no pre-determined policies for the issuance of securitizations, authorization for any new issuance must be requested.

The Institution does not participate in securitizations of third party positions.

There are several risk factors for securitizations that may affect trusts. If these risks materialize, payment to market certificates' holders could be adversely affected. The main risks which these financial instruments are exposed to are credit, market, liquidity and operational risk, which have been detailed in previous sections.

To monitor the quality of Credit Risk exposure of financial instruments arising from securitized assets, the Institution estimates expected loss within one-year time horizon. Likewise, in order to monitor exposure to market risk, the value at risk is calculated with a one-day time horizon and a 99% confidence level, for these instruments.

The Institution is the settlor and trustee of trusts for the securitizations carried out. At the same time, it acts as underwriter on each issue, offering bonds to investors. Additionally, the Institution also carries out the duties of administrator in each of the trusts.

On the other hand, the Institution also acts as an investor by acquiring titles of market certificates issued by the trusts set up for securitizations. By 4Q19, the Institution had the following position in securities and securitization amounts carried out by the same Institution:

Securitization (Million pesos)	The Institution	
	Securities	Amount
91_BNTECB_07	50,763,776	1,569
91_BNTECB_07-2	563,059	14
97_FCASACB_06U	-	-



The following shows the proportion of securities held by the Institution, in relation to the total issued for each series:

Securitization (Million pesos)	Issued Securities	The Institution
91_BNTECB_07	52,313,776	97.0%
91_BNTECB_07-2	1,113,059	50.6%
97_FCASACB_06U	1,351,386	0.0%

Ratings assigned by each rating agency at the end of the quarter for each market certificate issued by the aforementioned trusts are as follows:

Securitization	Standard & Poor's		Fitch Ratings		Moody's		HR Ratings		Verum		Best		DBRS	
	Local	Glob al	Local	Glob al	Local	Glob al	Loc al	Glob al	Loc al	Glob al	Loc al	Glob al	Loc al	Glob al
91_BNTECB_07					Aa3. mx	Baa 3	HR AA A							
91_BNTECB_07-2					A3.m x	Ba3	HR AA +							
97_FCASACB_06U	mx A+		BB B (me x)											

As of 4Q19 the amounts of the underlying assets of each securitization were:

Securitization (Million pesos)	Amount		
	Performing	Past-Due	Total
91_BNTECB_07			
91_BNTECB_07-2	2,036	-	2,036
97_FCASACB_06U	88	118	206

There are no impaired assets in trust 477.

Securitization exposure broken down by Credit Risk Weight is shown below:

Concept (Million pesos)	Balance	Capital Requirement
Securitized with Risk Level 1 (weighted 20%)	0	0
Securitized with Risk Level 2 (weighted 50%)	1,459	58
Securitized with Risk Level 3 (weighted 100%)	14	1
Securitized with Risk Level 3 (weighted 350%)	0	0
Securitized with Risk Level 5, 6 or not rated (weighted 1250%)	0	0

No securitization position is recorded in memorandum accounts and no maintained securitization position is deducted from basic capital.

Securitizations trusts 563 and 477 consider early amortization provisions. The institution has not made revolving securitizations or re-securitizations operations during the quarter.



6.1. Applied Accounting Policies

All securitization operations carried out by the Institution were recognized as sales in accordance with criterion C-1, "Recognition and Disposal of Financial Assets". This is because, despite retaining the contractual rights to receive cash flows from financial assets, a contractual obligation is assumed to pay such cash flows to a third party. In addition, an analysis of the transfer of these assets concluded that the entity substantially transfers all the risks and benefits inherent with ownership of the financial assets. Registration of profits from sales conforms to the provisions in paragraph 31 of criterion C-1, which states:

- a) Eliminate transferred financial assets at the last book value;
- b) Recognition for the consideration received in the operation;
- c) Recognition of profit or loss in the income statement, for the difference between the book value of eliminated financial assets, and the sum of (i) compensation received (recognized at fair value) and (ii) the effect (gain or loss) by cumulative valuation recognized in equity.

The BORHIS and GEM Trusts issued certificates in favor of the institution, as holders of rights in last place under the trust agreement. These certificates provide the right to receive a percentage of the distributions and in general to the corresponding proportions of the remnant that may be in the trust after full payment of the bonds. Valuation of the certificates is based on the method of net present value of remaining cash flows expected over the lifespan of the securitization. Remaining cash flows, depending on the type of securitization, are determined as follows:

- a) BORHIS: the sum of the cash flow to receive from the securitized loan portfolio, less the cash flow to pay off the market certificates, less the monthly administration expenses plus the income from sales of foreclosed properties, if the case.
- b) GEM: the sum of the cash flow to receive from the securitized loan portfolio, less the cash flow to pay off the stock certificates, fewer expenses for Administration, plus or less the change in the reserve's interest.

Remaining flows are discounted with the B1 banking curve, which takes into consideration the trust's Credit Risk. The most important assumptions in the valuation of the certificates are the following:

- a) Non-compliance rate: cash flows to be received from loan portfolios are adjusted by a determined percentage of the outstanding portfolio amount that is estimated to fall into non-compliance. That percentage is estimated using historical performance information of this portfolio. This percentage is applied to flows greater than 12 months.
- b) Prepayment rate: cash flows to be received from the loan portfolio are adjusted by a determined percentage of the outstanding portfolio amount estimated to be prepaid. That percentage is estimated using historical performance information of this portfolio.
- c) Portfolio term: is estimated using WAM (Weighted Average Maturity) of the securitized portfolio.
- d) Portfolio interest rate: is estimated using WAC (Weighted Average Coupon) of the securitized portfolio.
- e) Portfolio payment dates: loan portfolio payment dates are considered to be the same as those of the stock certificates.
- f) Reserve to be rated: the current value of the remaining flows is reduced by the amount of the reserve to be rated. This reserve corresponds to the non-compliance risk for cash flows in the first 12 months.
- g) General account: the current value of the remaining flows are added to the amount of cash or cash equivalents deposited in the general account, collection account and if the case, in the expense reserve account, in case of total payment of the stock certificates, these assets would be distributed to the certificate holders.
- h) General terms of stock certificates: estimated to be in accordance with prices published by Valmer.

Regarding the policies for recognizing obligations in balance sheet of the agreements that may require financial support from the Institution in case of asset's securitization: all amounts due under the stock certificates of the different existing securitizations, will be charged to the trust estate. If, for any reason, the liquid assets of the trust net worth are not sufficient to ensure payment of the amounts due under the stock certificates, holders will not have the right to claim payment from the Institution, the Trust, the common representative, the placement agent, the guarantor or guarantors in the case, or anyone else. The stock certificates have not been guaranteed or endorsed by any of the persons involved in the issuance thereof, therefore none of them are obligated to make payments to the certificate holders, with the exception, in the case of a trust, where payments may be charged to the trust in accordance with the trust agreement.

Note: The complimentary information regarding Risk Management in order to comply with Article 88 from the CUB, is available in the Risk Management Note on the Quarterly Report for the Institution.



33 - MEMORANDUM ACCOUNTS

	2019	2018
Contingent assets and liabilities	Ps. 50	Ps. 193
Credit commitments	243,391	269,658
Assets in trust or mandate	460,021	458,795
Managed assets in custody	376,241	446,162
Collateral received	207,870	237,642
Collateral received and sold or given as a pledge	116,266	159,301
Investment banking transactions on account of third parties (net)	96,100	68,035
Interest accrued but not charged of past due loans	298	634
Other registration accounts	249,298	226,303
	Ps.	
	1,749,535	Ps. 1,866,723

34 - COMMITMENTS

As of December 31, 2019 and 2018, the Institution had the following contingent obligations and commitments:

- Other contingent obligations and opening of credits totaling Ps. 243,441 (Ps. 269,851 in 2018), which are recorded in memorandum accounts (unaudited).
- The Institution takes on lease properties where its branches are located, as well as some of its administrative offices, which consider an annual increase in the amount of the rent calculated based on the National Index of Consumer Prices. The Lease terms range from one to fifteen years, for which, as of December 31, 2019, the commitments for payment of rents are as follows:

Year	Amount
2020	Ps. 1,756
2021	1,826
2022	1,899
2023	1,975
2024 to 2033	26,019
Total	\$33,475

- In addition, the Institution also takes in lease some equipment for operation, mainly computer equipment, electronic and utility vehicles. At December 31, 2019, the commitments for payment of rents are the following:

Year	Amount
2020	Ps. 1,139
2021	1,185
2022	1,232
2023	1,282
2024 to 2033	16,004
Total	\$20,842

35 – CONTINGENCIES

As of December 31, 2019, 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, 2019, the Institution has recorded a reserve for contentious matters of Ps. 973 (Ps. 648 in 2018).



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 2019 and 2018, the amount of contributions to the IPAB payable by the Institution for fees amounted to Ps.3,297 and Ps. 3,149, respectively.

37 - NEW ACCOUNTING GUIDELINES

As of December 31, 2019, CINIF has issued the following NIFs and improvements to current NIFs which could generate accounting changes.

Accord with the resolution amending published on November 4, 2019 that modifies the general provisions applicable to credit institutions published on December 15, 2019 the NIFs issued by the CINIF, referred in paragraph 3 of criteria A-2, will be applicable beginning January 1, 2021.

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 NIFs 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 January 1, 2021 are:

- NIF B-17, "Determination of Fair Value".
- NIF C-3, "Accounts Receivable".
- NIF C-9, "Provisions, Contingencies and Commitments".
- 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".
- NIF D-5, "Leases".



Independent Auditors' Review Report to the Board of Directors and Stockholders of Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries (Subsidiary of Grupo Financiero Banorte, S.A.B. de C.V.)

Introduction

We have reviewed the accompanying unaudited condensed consolidated interim statement of financial position of Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries (the "Institution") as of March 31, 2020 and the related unaudited condensed consolidated interim statements of income, condensed consolidated interim statements of changes in stockholders' equity and condensed consolidated interim statements of cash flows for the three-month periods ended March 31, 2020, and a summary of significant condensed accounting policies and other explanatory notes for such period. The Institution is responsible for the preparation and presentation of these unaudited condensed consolidated interim financial statements in accordance with the accounting principles prescribed by the Mexican National Banking and Securities Commission (the "Commission") through the "General Provisions applicable to Credit Institutions" in Circular A-1, "Basic Framework of the Accounting Criteria Applicable to Banking Institutions" and the Circular A-2, "Application of Particular Accounting Standards" (collectively, the Accounting Criteria), which refer to Mexican Financial Reporting Standards ("MFRS") B-9, "Interim Financial Reporting". Our responsibility is to express a conclusion on these unaudited condensed consolidated interim financial statements based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity." A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying condensed consolidated interim financial information is not prepared, in all material respects, in accordance with the accounting criteria prescribed by the Commission through the "General Provisions applicable to Credit Institutions".



Other Matters

As mentioned in Note 3, on February 27, 2020, we expressed an unqualified opinion on the consolidated financial statements of Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries as of and for the year ended December 31, 2019. Such consolidated financial statements are not included in this report, except for the condensed consolidated interim statement of financial position for comparative purposes. For a comprehensive understanding, the accompanying unaudited condensed consolidated interim financial statements, should be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2019.

Our review also comprehended the translation of the Mexican peso amounts into U.S. dollar amounts and, in our conclusion, such translation has been made in conformity with the basis stated in Note 3. The accompanying unaudited condensed consolidated interim financial statements have been translated into English for the convenience of readers.

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



C.P.C. Héctor García Garza

Registration in the General Administration
of Federal Tax Audit Num. 15255
Monterrey, N.L., México

June 28, 2020



**BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
(SUBSIDIARY OF GRUPO FINANCIERO BANORTE, S.A.B. DE C.V.)
UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENTS OF FINANCIAL POSITION
AS OF MARCH 31, 2020 (UNAUDITED) AND DECEMBER 31, 2019**
In millions of Mexican pesos (Ps) and in millions of U.S. dollars (US) (See Note 3)

ASSETS	March 31, 2020	March 31, 2020	December 31, 2019
CASH AND CASH EQUIVALENTS (Note 5)	US 3,776	Ps. 88,668	Ps. 62,282
MARGIN SECURITIES	413	9,701	5,926
INVESTMENT IN SECURITIES (Note 6)			
Trading securities	3,405	79,968	75,169
Securities available for sale	6,686	157,021	152,630
Securities held to maturity	839	19,711	19,593
	10,930	256,700	247,392
DEBTOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS (Note7)	82	1,930	2,016
DERIVATIVE FINANCIAL INSTRUMENTS (Note 8)			
For trading purposes	2,084	48,940	22,295
For hedging purposes	55	1,291	162
	2,139	50,231	22,457
VALUATION ADJUSTMENTS FOR FINANCIAL ASSETS HEDGING	3	66	69
PERFORMING LOAN PORTFOLIO (Note 9)			
Commercial loans			
Business loans	12,281	288,409	266,442
Financial institutions' loans	1,022	24,011	20,595
Government loans	6,866	161,246	170,155
Consumer loans	4,948	116,200	116,228
Mortgage loans			
Medium and residential	7,245	170,143	166,921
Low-income housing	-	8	9
Loans acquired from INFONAVIT or FOVISSSTE	131	3,075	3,156
TOTAL PERFORMING LOAN PORTFOLIO	32,493	763,092	743,506
PAST-DUE LOAN PORTFOLIO (Note 9)			
Commercial loans			
Business loans.	285	6,700	6,147
Financial institutions' loans	-	4	4
Government loans	1	35	-
Consumer loans	171	4,018	4,268
Mortgage loans			
Medium and residential	78	1,834	1,786
Low-income housing	-	-	-
Loans acquired from INFONAVIT or FOVISSSTE	10	235	187
TOTAL PAST-DUE LOAN PORTFOLIO	545	12,826	12,392
LOAN PORTFOLIO	33,038	775,918	755,898
(Minus) ALLOWANCE FOR LOAN LOSSES (Note 10)	(764)	(17,932)	(17,083)
LOAN PORTFOLIO, net	32,274	757,986	738,815
ACQUIRED COLLECTION RIGHTS	54	1,261	1,359
TOTAL LOAN PORTFOLIO, net	32,328	759,247	740,174
RECEIVABLES GENERATED BY SECURITIZATIONS	7	161	139
OTHER ACCOUNTS RECEIVABLE, net	3,545	83,264	29,410
FORECLOSED ASSETS, net	35	818	860
PROPERTY, FURNITURE AND EQUIPMENT, net	646	15,167	15,088
PERMANENT STOCK INVESTMENTS (Note 11)	20	468	418
DEFERRED TAXES AND PROFIT SHARING, net (Note 12)	185	4,352	1,104
OTHER ASSETS (Note 13)			
Deferred charges, advance payments and intangibles	968	22,728	21,978
Other short-term and long-term assets	6	146	223
TOTAL ASSETS	US 55,083	Ps. 1,293,647	Ps. 1,149,536

See accompanying notes to these unaudited condensed consolidated interim financial statements.



LIABILITIES AND STOCKHOLDERS' EQUITY	March 31, 2020	March 31, 2020	December 31, 2019
DEPOSITS (Note 14)			
Demand deposits	US 19,240	Ps. 451,842	Ps. 435,453
Time deposits			
General public	11,734	275,566	261,705
Money market	1,145	26,894	18,122
Senior debt	1,505	35,355	26,907
Global account deposit without movement	94	2,213	2,085
	33,718	791,870	744,272
INTERBANK AND OTHER LOANS (Note 15)			
Immediately due	213	5,000	500
Short-term loans	355	8,332	9,276
Long-term loans	179	4,197	4,854
	747	17,529	14,630
CREDITOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS (Note 7)	7,481	175,685	162,684
COLLATERAL SOLD OR PLEDGED			
Repurchase or resale agreements (creditor balance) (Note 7)	1	16	105
DERIVATIVE FINANCIAL INSTRUMENTS (Note 8)			
For trading purposes	2,153	50,574	20,752
For hedging purposes	447	10,487	4,221
	2,600	61,061	24,973
OTHER ACCOUNTS PAYABLE			
Income taxes	102	2,402	1,513
Employee profit sharing	27	639	508
Creditors from settlements of transactions	1,277	29,983	9,397
Creditors from cash collateral received	312	7,331	2,493
Sundry creditors and other payables	1,483	34,824	26,265
	3,201	75,179	40,176
SUBORDINATED DEBENTURES (Note 16)	2,488	58,423	48,050
DEFERRED CREDITS AND ADVANCED COLLECTIONS	9	221	386
TOTAL LIABILITIES	50,245	1,179,984	1,035,276
STOCKHOLDERS' EQUITY (Note 19)			
PAID-IN CAPITAL			
Common stock	800	18,794	18,794
Additional paid-in capital	99	2,336	2,123
	899	21,130	20,917
OTHER CAPITAL			
Capital reserves	738	17,330	17,330
Retained earnings from prior years	3,304	77,595	50,883
Result from valuation of securities available for sale	(120)	(2,824)	1,885
Result from valuation of instruments for cash flow hedging	(169)	(3,965)	(2,287)
Cumulative foreign currency translation adjustment	8	177	(34)
Remeasurement of employee benefits	(84)	(1,963)	(1,930)
Net income	262	6,180	27,493
	3,939	92,530	93,340
NONCONTROLLING INTEREST	-	3	3
TOTAL STOCKHOLDERS' EQUITY	4,838	113,663	114,260
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	US 55,083	Ps. 1,293,647	Ps. 1,149,536

See accompanying notes to these unaudited condensed consolidated interim financial statements.

Act. José Marcos Ramírez Miguel
Chief Executive Officer

Eng. Rafael Arana de la Garza
Chief Financial and Operations Officer

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.

**BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
(SUBSIDIARY OF GRUPO FINANCIERO BANORTE, S.A.B. DE C.V.)
UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENTS OF INCOME
FOR THE THREE MONTHS ENDED MARCH 31, 2020 AND 2019**

In millions of Mexican pesos (Ps) and in millions of U.S. dollars (US) (See Note 3)

	March 31, 2020	March 31, 2020	March 31, 2019
Interest income (Note 17)	US 1,276	Ps. 29,978	Ps. 32,643
Interest expense	(531)	(12,462)	(15,712)
NET INTEREST INCOME	745	17,516	16,931
Allowance for loan losses	(181)	(4,262)	(3,700)
NET INTEREST INCOME AFTER ALLOWANCE FOR LOAN LOSSES	564	13,254	13,231
Commission and fee income	246	5,782	5,303
Commission and fee expense	(91)	(2,135)	(1,951)
Intermediation income (Note 17)	45	1,048	934
Other operating income	1	31	1,820
Non-interest expense	(414)	(9,718)	(9,341)
	(213)	(4,992)	(3,235)
OPERATING INCOME	351	8,262	9,996
Equity in earnings of unconsolidated subsidiaries and associated companies	1	29	14
INCOME BEFORE INCOME TAX	352	8,291	10,010
Current income tax	(110)	(2,576)	(2,176)
Deferred income taxes	20	465	(472)
	(90)	(2,111)	(2,648)
NET INCOME	US 262	Ps. 6,180	Ps. 7,362

See accompanying notes to these unaudited condensed consolidated interim financial statements.

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(SUBSIDIARY OF GRUPO FINANCIERO BANORTE, S.A.B. DE C.V.)
UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2020 AND 2019**
In millions of Mexican pesos (Ps) and in millions of U.S. dollars (US) (See Note 3)

	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	Result from valuation of instruments for cash flow hedging
Balances, January 1, 2019	Ps. 18,794	Ps. 1,184	Ps. 14,847	Ps. 53,133	Ps. (1,994)	Ps. (3,430)
TRANSACTIONS APPROVED BY STOCKHOLDERS:						
Transfer of prior year's result	-	-	-	24,834	-	-
Share-based payments payable in stock options	-	271	-	-	-	-
Effect due liquidation of the subsidiary Banorte USA	-	-	-	-	-	-
Effect due to fusion with Bank Interactions	-	-	-	(18)	-	-
Total transactions approved by stockholders	-	271	-	24,816	-	-
COMPREHENSIVE INCOME:						
Net income	-	-	-	-	-	-
Result from valuation of securities available for sale	-	-	-	-	2,059	-
Effect of subsidiaries, affiliates and mutual funds	-	-	-	1	-	-
Cumulative foreign currency translation adjustment	-	-	-	-	-	-
Result from valuation of instruments for cash flow hedging	-	-	-	-	-	348
Remeasurement of employee benefits	-	-	-	(9)	-	-
Interest on subordinated obligations	-	-	-	(319)	-	-
Total comprehensive income	-	-	-	(327)	2,059	348
Noncontrolling interest	-	-	-	-	-	-
Balances, March 31, 2019	18,794	1,455	14,847	77,622	65	(3,082)
Balances, January 1, 2020	18,794	2,123	17,330	50,883	1,885	(2,287)
TRANSACTIONS APPROVED BY STOCKHOLDERS:						
Transfer of prior year's result	-	-	-	27,493	-	-
Share-based payments payable in stock options	-	213	-	-	-	-
Total transactions approved by stockholders	-	213	-	27,493	-	-
COMPREHENSIVE INCOME:						
Net income	-	-	-	-	-	-
Result from valuation of securities available for sale	-	-	-	-	(4,709)	-
Effect of subsidiaries, affiliates and mutual funds	-	-	-	(3)	-	-
Cumulative foreign currency translation adjustment	-	-	-	-	-	-
Result from valuation of instruments for cash flow hedging	-	-	-	-	-	(1,678)
Remeasurement of employee benefits	-	-	-	(9)	-	-
Interest on subordinated obligations	-	-	-	(769)	-	-
Total comprehensive income	-	-	-	(781)	(4,709)	(1,678)
Noncontrolling interest	-	-	-	-	-	-
Balances, March 31, 2020	Ps. 18,794	Ps. 2,336	Ps. 17,330	Ps. 77,595	(Ps. 2,824)	(Ps.3,965)

See accompanying notes to these unaudited condensed consolidated interim financial statements.



OTHER CAPITAL						
	Cumulative foreign currency translation adjustment	Remeasurements of employee benefits	Net income	Total controlling interest	Non controlling interest	Total stockholders' equity
Balances, January 1, 2019	Ps. 1,659	(Ps. 628)	Ps. 24,834	Ps. 108,399	Ps. 3	Ps. 108,402
TRANSACTIONS APPROVED BY STOCKHOLDERS:						
Transfer of prior year's result	-	-	(24,834)	-	-	-
Share-based payments payable in stock options	-	-	-	271	-	271
Effect due liquidation of the subsidiary Banorte USA	(1,661)	-	-	(1,661)	-	(1,661)
Effect due to fusion with Bank Interactions	-	-	-	(18)	-	(18)
Total transactions approved by stockholders	(1,661)	-	(24,834)	(1,408)	-	(1,408)
COMPREHENSIVE INCOME:						
Net income	-	-	7,362	7,362	-	7,362
Result from valuation of securities available for sale	-	-	-	2,059	-	2,059
Effect of subsidiaries, affiliates and mutual funds	-	-	-	1	-	1
Cumulative foreign currency translation adjustment	(11)	-	-	(11)	-	(11)
Result from valuation of instruments for cash flow hedging	-	-	-	(1,678)	-	348
Remeasurement of employee benefits	-	(124)	-	(133)	-	(133)
Interest on subordinated obligations	-	-	-	(319)	-	(319)
Total comprehensive income	(11)	(124)	7,362	9,307	-	9,307
Noncontrolling interest	-	-	-	-	-	-
Balances, March 31, 2019	(13)	(752)	7,362	116,298	3	116,301
Balances, January 1, 2020	(34)	(1,930)	27,493	114,257	3	114,260
TRANSACTIONS APPROVED BY STOCKHOLDERS:						
Transfer of prior year's result	-	-	(27,493)	-	-	-
Share-based payments payable in stock options	-	-	-	213	-	213
Total transactions approved by stockholders	-	-	(27,493)	213	-	213
COMPREHENSIVE INCOME:						
Net income	-	-	6,180	6,180	-	6,180
Result from valuation of securities available for sale	-	-	-	(4,709)	-	(4,709)
Effect of subsidiaries, affiliates and mutual funds	-	-	-	(3)	-	(3)
Cumulative foreign currency translation adjustment	211	-	-	211	-	211
Result from valuation of instruments for cash flow hedging	-	-	-	(1,678)	-	(1,678)
Remeasurement of employee benefits	-	(33)	-	(42)	-	(42)
Interest on subordinated obligations	-	-	-	(769)	-	(769)
Total comprehensive income	211	(33)	6,180	(810)	-	(810)
Noncontrolling interest	-	-	-	-	-	-
Balances, March 31, 2020	Ps. 177	(Ps.1,963)	Ps. 6,180	Ps. 113,660	Ps. 3	Ps. 113,663

See accompanying notes to these unaudited condensed consolidated interim financial statements.

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**BANCO MERCANTIL DEL NORTE, S.A.,
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(SUBSIDIARY OF GRUPO FINANCIERO BANORTE, S.A.B. DE C.V.)
UNAUDITED CONDENSED CONSOLIDATED INTERIM STATEMENTS OF CASH FLOWS
FOR THE THREE MONTHS ENDED MARCH 31, 2020 AND 2019**
In millions of Mexican pesos (Ps) and in millions of U.S. dollars (US) (See Note 3)

	March 31, 2020	March 31, 2020	March 31, 2019
Net income	US 262	Ps. 6,180	Ps. 7,362
Items not requiring (generating) resources:			
Real estate, furniture and equipment depreciations	16	385	369
Provisions	64	1,496	2,550
Current and deferred income tax	90	2,111	2,648
Equity in earnings of unconsolidated subsidiaries and associated companies	(1)	(29)	(14)
	431	10,143	12,915
OPERATING ACTIVITIES:			
Changes in margin securities	(161)	(3,775)	(2,050)
Changes in investments in securities	(597)	(14,018)	3,706
Changes in debtor balances under repurchase and resale agreements	4	85	402
Changes in asset position of derivatives	(1,134)	(26,642)	4,294
Change in loan portfolio	(816)	(19,170)	9,904
Changes in acquired collection rights	4	97	136
Changes in receivables generated by securitizations	(1)	(23)	(24)
Change in foreclosed assets	2	42	(32)
Change in other operating assets	(2,315)	(54,357)	(11,358)
Change in deposits	2,028	47,599	(22,008)
Change in interbank and other loans	123	2,899	(2,090)
Change in creditor balances under repurchase and sale agreements	554	13,000	8,611
Collateral sold or pledged	(4)	(89)	6
Change in liability position of derivative financial instruments	1,270	29,823	(4,734)
Change in subordinated debentures	442	10,373	(234)
Change in other operating liabilities	1,384	32,471	2,365
Change in hedging instruments related to operations	147	3,459	(1,161)
Income tax paid	(191)	(4,491)	(1,499)
Net cash flows generated by (used in) operating activities	1,170	27,426	(2,851)
INVESTING ACTIVITIES:			
Proceeds on disposal of property, furniture and equipment	16	386	101
Payments for acquisition of property, furniture and equipment	(35)	(815)	(593)
Proceeds on disposal of Subsidiaries and associated companies	(2)	(37)	3
Net cash flows used in investing activities	(21)	(466)	(489)
FINANCING ACTIVITIES:			
Payment of interest on subordinated obligations	(33)	(769)	(319)
Net cash flows used in financing activities	(33)	(769)	(319)
Net increase (decrease) in cash and cash equivalents	1,116	26,191	(3,659)
Effects from changes in the value of cash and cash equivalents	8	195	(11)
Cash and cash equivalents at the beginning of the period	2,652	62,282	75,233
Cash and cash equivalents at the end of the period	US 3,776	Ps. 88,668	Ps. 71,563

See accompanying notes to these unaudited condensed consolidated interim financial statements.

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**BANCO MERCANTIL DEL NORTE, S.A.,
INSTITUCIÓN DE BANCA MÚLTIPLE, GRUPO FINANCIERO BANORTE AND SUBSIDIARIES
(SUBSIDIARY OF GRUPO FINANCIERO BANORTE S.A.B. DE C.V.)
NOTES TO UNAUDITED CONDENSED CONSOLIDATED INTERIM FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2020 AND 2019 (UNAUDITED) AND AS OF DECEMBER 31, 2019**
In millions of Mexican pesos (Ps) and in millions of U.S. dollars (US) (See Note 3)

1 - ACTIVITY AND REGULATORY ENVIRONMENT

Banco Mercantil del Norte, S.A., Institución de Banca Múltiple, Grupo Financiero Banorte and Subsidiaries (the Institution or Banorte) 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 main activity of its subsidiaries is the execution of financial operations such as the administration of funds for the withdrawal (until October 17, 2016, date on which the splitting of the Institution took effect), the issuance of credit cards and the provision of multiple banking services in the United States of America.

The main regulating aspect compel the Institution to maintain a minimum capitalization index for market and credit 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 with all of the above as of March 31, 2020.

The Institution is a 98.26% owned subsidiary 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, in the United States of America.

The Institution's unaudited condensed consolidated interim financial statements have been approved by the Board of Directors at their April 23, 2020 meeting and through June 28, 2020 as it relates to Note 27 by the Institutions CEO and CFO, in accordance with the responsibility assigned to them.

2 - SIGNIFICANT EVENTS

On March 25, 2020, the CNBV announced certain special temporary accounting criteria applicable to banking institutions in connection with their mortgages, credit cards, automobile, personal, payroll and SME loans. These measures include, among others: (i) permitting borrowers of said credits to defer the payment of principal and/or interests of their loans for a period of four months, with the possibility to extend it for two additional months, without requiring banks to create loan-loss provisions for these deferrals, and (ii) allowing to freeze the balances of existing loans that were in good standing as of February 28, 2020, without interest charges, without considering such loans as non-performing. We implemented a debtor relief program in response to these measures.

On March 31, 2020, the CNBV issued a recommendation to banks, advising them to: (i) refrain from paying dividends to their shareholders or implementing any other mechanisms that result in a transfer of economic benefits to the shareholders, including the distribution of reserves, or assuming an irrevocable commitment to pay any dividends or benefits with respect to the year ended December 31, 2019 and for the three months ended March 31, 2020, in case of financial groups, this recommendation is also applicable to the holding company and other entities of the group, and (ii) refrain from repurchasing shares or any other mechanism aimed to reward shareholders. These measures aim to strengthen banking institutions against potential losses resulting from the COVID-19 pandemic and will enable them to have more resources to support the local economy during the pandemic.



3 - BASIS OF PRESENTATION AND PREPERATION

Presentation of unaudited condensed consolidated interim financial statements

The unaudited condensed consolidated interim financial statements as of March 31, 2020 and for the three months ended March 31, 2020 (Unaudited) and for the year ended December 31, 2019, which are accompanied, have been prepared in accordance with the accounting criteria established by the Commission, which refer to Mexican Financial Reporting Standards ("MFRS") B-9, "Interim Financial Reporting". This interim condensed consolidated report does not include all the notes of the type normally included in an annual financial consolidated report. Accordingly, this interim condensed consolidated report is to be read in conjunction with the audited consolidated financial statements as of and for the year ended December 31, 2019.

Monetary unit of the unaudited condensed consolidated interim financial statements

The unaudited condensed consolidated interim financial statements and the corresponding explanatory notes as of March 31, 2020 and for the three months ended March 31, 2020 and 2019 include balances and transactions in Mexican pesos and purchasing power of such dates.

Consolidation of financial statements

The accompanying unaudited condensed consolidated interim financial statements include those of the Institution and its subsidiaries mentioned below, and all significant unaudited condensed consolidated interim intercompany balances and transactions have been eliminated.

As of March 31, 2020 (Unaudited) and December 31, 2019, the Institution's consolidated subsidiaries and its equity ownership is as follows:

	March 31, 2020	December 31, 2019
Administradora de Servicios Profesionales Especializados, S.A. de C.V.	99.99%	99.99%
Casa Servicios Administrativos, S.A. de C.V.	99.60%	99.60%
Bonds Finance Company Limited*	100.00%	100.00%
Fideicomiso BONY 469	100.00%	100.00%
Inmobiliaria Interorbe, S.A. de C.V.	99.99%	99.99%
Inmobiliaria Mobinter, S.A. de C.V.	99.99%	99.99%
Inmobiliaria Interdiseño, S.A. de C.V.	99.99%	99.99%
Estrategia en Finanzas & Infraestructura, S.A. de C.V.	99.99%	99.99%
Fideicomiso de coinversión FCICK16-1	97.50%	97.50%
Banorte Financial Services, INC.	100.00%	100.00%

* 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.

Conversion of Financial Statements of Banorte Financial Services, INC. (indirect foreign subsidiary)

In order to consolidate the financial statements of Banorte Financial Services, INC., they are first adjusted to 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 for the year-end rate for assets and liabilities, historical rate for non-monetary assets and liabilities as well as stockholders' equity, and the weighted average rate of the period for income, costs and expenses. The conversion effects are presented in the Institution's stockholders' equity.

Application of Special Accounting Criteria

In view of the fact that the Institution is carrying out a process of corporate restructuring, the Commission, based on Article 175 of the "General provisions applicable to credit institutions" and in accordance with the Article 72 of the



"General provisions applicable to credit auxiliary entities" authorized to Banorte, Sólida and AyF a special accounting criteria through the official letter 320-1/15576/2018.

Those criteria authorized the Institution to recognize the result from valuation of Corporación GEO, S.A.B. de C.V. (GEO), URBÍ Desarrollos Urbanos S.A.B. de C.V. (URBÍ) and Desarrolladora Homex, S.A.B. de C.V. (HOMEX) shares, classified as available for sale which previously was recognized in the stockholder's equity at the date of issuance of the aforementioned official letter, directly against the heading "Retained earnings from prior years" and not against the "Net income" as established in paragraph 46 of the NIF B-2, "Investments in securities."

If the authorized Special Accounting Criteria were not applied, the amounts that would have been recognized and presented in the unaudited condensed consolidated interim statement of financial position and unaudited condensed consolidated interim income statement as of January 1, 2019 in the items affected would be:

Statement of financial position	Figures Without Special Accounting Criteria	Figures with Special Accounting Criteria	Variation
Retained earnings from prior years	Ps. 53,806	Ps. 53,133	Ps. (673)
Net income	24,161	24,834	673
Total stockholders' equity	108,402	108,402	-
Total liabilities and stockholders' equity	Ps. 1,180,492	Ps. 1,180,492	Ps. -

Income statement	Figures Without Special Accounting Criteria	Figures with Special Accounting Criteria	Variation
Brokerage revenues	Ps. 3,126	Ps. 3,799	(Ps. 673)
Operating income	33,324	33,997	673
Net income	Ps. 24,161	Ps. 24,834	Ps. 673

Comprehensive income

This is the change in stockholders' equity during the period, for items other than distributions and activity in contributed common stock and is comprised of the net income of the period, plus other comprehensive income (loss) items of the same period, which are presented directly in stockholders' equity without affecting the unaudited condensed consolidated interim Income Statements, in accordance with the accounting practices established by the Commission. In 2020 and 2019, comprehensive income includes the net income of the period, 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, Commission special accounting criteria and the result from valuation of cash flow hedging instruments.

Explanation for translation into English

The accompanying unaudited condensed consolidated interim financial statements have been translated from Spanish into English for the convenience of users. These unaudited condensed consolidated interim financial statements are presented on the basis of accounting practices prescribed by the Commission. Certain accounting practices applied by the Institution may not conform to Mexican Financial Reporting Standards ("MFRS" or individually referred to as *Normas de Información Financiera* or "NIFs") or other accounting principles generally accepted outside of Mexico.

The unaudited condensed consolidated interim financial statements are stated in millions of Mexican pesos ("Ps.") the currency of the country in which the Institution is incorporated and has its principal operations. The translations of Mexican pesos into U.S. dollars ("US") are included solely for the convenience of the readers and have been made at the rate of Ps. 23.4847 per one U.S. dollar according to the closing exchange rate of March 31, 2020, as issued by Banco de México. Such translation should not be construed as representations that the Mexican peso amounts have been, could have been, or could in the future, be converted into U.S. dollars at this rate or at any other rate, if at all.



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 unaudited condensed consolidated interim 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 MFRS, as 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 Institution 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, 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 recorded 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 recorded, recording 20% during the year 2019, 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	Annual application 20%	Gradual recognition as of March 31, 2020 (Unaudited)
Corporate Bonds	Ps. 183.0	Ps. 36.6	Ps. 155.5

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 2019, 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	Annual application 20%	Gradual recognition as of March 31, 2020 (Unaudited)
Corporate Bonds	Ps. 2,727.8	Ps. 485.5	Ps. 2,244.1

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 unaudited condensed consolidated interim statement of financial position as of March 31, 2020, had the aforementioned option not been applied in the affected items are:



Concept	Amount
Other assets and short and long term	Ps. 39,494
Total of assets	1,531,991
Retained earnings from prior years	125,907
Reimbursement for benefits to employees	(2,077)
Total stockholders' equity	197,279
Total liabilities and stockholders' equity	Ps. 1,729,059

(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 Institution.

Recognition of the effects of inflation in unaudited condensed consolidated interim 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 2020 and 2019 was 15.03% and 15.71%, respectively. Therefore, the Mexican economy is considered as non-inflationary. However, assets, liabilities and stockholders' equity as of March 31, 2020 (Unaudited) and December 31, 2019 include the restatement effects recorded up through December 31, 2007.

The cumulative Mexican inflation over the three month period ended March 31, 2020 (Unaudited) and for the year ended December 31, 2019 was 9.51% and 15.03%, respectively.

The Mexican inflation rates for the three month period ended March 31, 2020 (Unaudited) and for the year ended December 31, 2019 were 1.57% and 2.77%, 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 unaudited condensed consolidated interim statement of financial position date.

Margin securities

Margin securities on cash in transactions with derivative financial instruments in recognized markets are recorded at nominal value.

The cash is intended to ensure the compliance with the obligations corresponding to derivatives held in recognized markets and correspond to the initial margin, to partial or total settlements, additional contributions or withdrawals, returns generated by the account itself, as well as commissions that correspond to charge in the validity of the corresponding contracts.

Partial or total settlements deposited and withdrawn by the clearing house due to fluctuations in the prices of derivatives must be recognized within the margin account, affecting as a counterpart a specific account that may be of a debtor or creditor nature, and that it will reflect the effects of the derivative valuation prior to its liquidation. The counterpart of a debtor or creditor nature will represent an advance received, or, a financing granted by the clearing house prior to the liquidation of the derivative.

The amount of margin accounts granted and received in cash in derivative transactions not carried out in recognized markets or exchanges will be presented under other accounts receivable, while the account payable generated by the receipt of cash collateral it will be presented in other accounts payable.



Collaterals granted in such operations, other than restricted cash must remain in the same area from which they originate. The payable account, which represents the obligation of the assignee to return to the transferor the collateral other than cash that has been sold must be presented in the unaudited condensed consolidated interim statement of financial position, on collaterals sold or given as collateral. The amount of the collateral other than cash on which the right to sell or give as guarantee has been granted shall be presented in memorandum accounts in a specific item.

As of March 31, 2020 and December 31, 2019, the Institution maintained standardized derivative and future operations, so cash collateral (cash margin calls) were recognized to ensure compliance with the obligations corresponding to the operations held in markets recognized for the purpose to mitigate the default risk.

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.

If, in a subsequent period, the fair value of debt classified as available for sale were to be increased and such reversal of the impairment effect may be objectively related to an event occurring after the impairment were to be recognized in the results of the year, the loss due to impairment shall be reversed in the results of the year.

The loss due to impairment recognized in the income statement of securities classified as available for sale shall not be reversed.

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.

General valuation standards

Upon the sale of trading securities, the valuation results 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 statement of financial position 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 unaudited condensed consolidated interim 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 unaudited condensed consolidated interim statement of financial position 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 the unaudited condensed consolidated interim off statement of financial position 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 unaudited condensed consolidated interim statement of financial position 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 unaudited condensed consolidated interim statement of financial position 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 to 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 unaudited condensed consolidated interim income statement in "Intermediation income" and the corresponding unaudited condensed consolidated interim statement of financial position 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 unaudited condensed consolidated interim statement of financial position and to anticipate interest and exchange rate fluctuations, thereby protecting the stockholders' 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 "Intermediation income".
- 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 performing 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 valued under the Black-Scholes model, 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 begins 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 Value at Risk (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 Risk Policies 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 completely 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: 90 calendar days after interest payment overdue, or 30 calendar days after principal payment overdue.
- 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 are renewed with single payment of principal at maturity, regardless of whether the payment of interest is periodic or at maturity; it is considered that there is sustained payment of credit when: The accredited has covered at least 20% 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 unaudited condensed consolidated interim statement of financial position 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

Internal methodology of rating credit card and other revolving credits.

On November 15, 2017, the Institution received approval from the banking regulator to use Internal Models (IM) for credit card rating for reserves and regulatory capital generation by credit risk with an advanced focus (Document 111-3/706/2017).

These internal models improve overall credit risk management by estimating risk parameters from the bank's own experience based on January 2018 data, and have been applied as of February 2018.

The internal methodology describes that the determination of the rating and estimation of the reservation of the credit card consumption portfolio and other revolving credits are considered as the following credit risk parameters:

$$R_i = P_{li} * SP * E_{li}$$

Where:

R_i = Loan reserves to record for E_{li} credit

P_{li} = Probability of default for E_{li} credit

SP_i = Severity of the loss for E_{li} credit

E_{li} = Exposure to default for i –ésimo credit

For the determination of the reserve is necessary to use the probability of default, the severity of the loss and the exposure to breach, agree to the following:

1. Probability of default of the Internal Model

The probability of default (PI) measures how likely it is that an accredited leave to comply with their contractual obligations and is assigned with the information in the following table according to their risk level previously determined by the internal model of Credit Card.

Risk level	PI
A-01	0.00646233
A-02	0.00668129
A-03	0.00770357
A-04	0.00899237



Risk level	PI
B-01	0.01008105
B-02	0.01538093
B-03	0.01962636
B-04	0.02590753
C-01	0.03379690
C-02	0.04619679
C-03	0.06073381
C-04	0.08180872
D-01	0.11804428
D-02	0.17143767
D-03	0.30358352
D-04	0.71565748
E	1

2. Severity of the loss

Severity of Loss. Measures the intensity of the loss upon default expressed as a percentage of the Exposure at Default (EAD), once considered collateral values and the costs associated regarding the settlement (judicial, administrative collection, and deed in lieu, among others).

Clasificación	Overdue payments	SP
Payed	0 – 3	87.16%
Unpaid	4	87.16%
	5	90.30%
	6 and more	100%

3. Probability of Default

Probability of Default (PD) shows the likelihood that a borrower defaults on its contractual obligations within twelve months after the month being rated. Default is defined when loans present 90 or more days past-due.

The credit conversion factor (FCC) assignment to estimate the EI is performing according to the following table:

Delay	Factor
01	1.8475
02	2.0624
03	1.2974
04	1.1693
05	1.2167
06	1.0985
11	1.2583
12	1.1074
13	1.0398
14	1.0790
15	1.0247
21	1.1145
22	1.0907
23	1.0385
24	1.0161
25	1.0241
31	1.0129
32	1.0086
33	1.0053
5	0.6549



Delay segment in defined in the internal model.

The value of the Factor assigned to each segment proceeds to rate the exposure to non-compliance.

When the accountant balance is greater than zero: $EI = \text{Factor\_Arbol} * \text{Accountant balance}$

When the accountant balance is less or equal than zero and the limit credit is empty: $EI = 0.6549 * \text{Credit limit}$.

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.

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 credit 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.

Internal models ratings for reserves and regulatory capital constitution

Applicable Portfolio

The Institution owns a Rating Internal Model for Revolving Consumer portfolio for the constitution of reserves and capital under an Advanced Approach, estimating the three parameters required for its calculation: Probability of Default (PD), Severity of Loss (SL) and Exposure at Default (EAD). Additionally, owns a Rating Internal Model for Corporations portfolio, for the constitution of reserves and capital under a Basic Approach, estimating only the Probability of Default (PD) parameter.

The exposures considered in the Commercial Loans portfolio are those pertaining to corporations (other than states, municipalities and financial entities), and individuals (sole proprietorships), both with annual sales higher or equal to 14 million UDIs.

The methodology used by the Institution in the estimation of the parameters and the calculation of reserves and capital, follows the guidelines established by the banking regulator CNBV (Comisión Nacional Bancaria y de Valores), in relation to the general provisions applicable to Credit Institutions stipulated in the Single Bank Circular (Circular Única de Bancos or CUB).

On November 15, 2017, the Institution received approval from the banking regulator CNBV to use Internal Models (IM) for credit card rating for reserves and regulatory capital generation by credit risk with an advanced focus (Document 111-3/706/2017).

Likewise, on November 30, 2018, GFNorte obtained authorization from the banking regulator CNBV (Comisión Nacional Bancaria y de Valores) to use the Internal Model (IM) for Commercial Loans for reserves generation and regulatory capital requirements by credit risk with a Basic Approach, as per Document 111-3/1472/2018 in Banco Mercantil del Norte, and on March 1, 2019 for Arrendadora y Factor Banorte, Sólida Administradora de Portafolios, as per Documents 111-1/160/2019 and 111-1/161/2019 respectively.

Internal Models used by the Institution, like the Standard Models, have an expected loss approach for the next twelve months.



Internal Models grant a comprehensive credit risk management, considering the portfolio's own risk in such a way that the resulting models show greater predictability, derived from the use of specific attributes for each of the segments.

One of the purposes of internal estimations is to calculate Reserves and Capital Requirements for Credit Card and Commercial Loans Portfolios, which must be rated in accordance with the General Provisions Applicable to Credit Institutions described in the Single Bank Circular.

Internal Rating Process

Commercial Loans

For the Commercial Loans portfolio the estimation of the Probability of Default (PD) is performed using the Internal Model with Basic Approach, considering internal and external variables.

Once PD is determined, Severity of Loss (SL) and the Exposure at Default (EAD) are considered under the Standard Method, and once the above factors have been obtained, the Expected Loss (EL) is computed as follows:

$$EL = PD * SL * EAD$$

Credit Cards Portfolio

In the Credit Card portfolio, the Rating System scale allows the Institution to have a better credit risk management when considering the portfolio's own risk, in order to continuously monitor customers and to prevent or mitigate adverse events.

Its main purpose is to segregate population into homogeneous subsets (buckets), so that the resulting models show greater predictability, derived from the use of specific attributes for each of the segments.

Internal Models' Variable Estimation

Probability of Default

Probability of Default (PD) shows the likelihood that a borrower defaults on its contractual obligations within twelve months after the month being rated. Default is defined when loans present 90 or more days past-due.

For its estimation, information from internal and external variables is used with which a score is obtained, which is mapped to a master rating measuring risk level.

Severity of Loss

Severity of Loss. Measures the intensity of the loss upon default expressed as a percentage of the Exposure at Default (EAD), once considered collateral values and the costs associated regarding the settlement (judicial, administrative collection, and deed in lieu, among others).

The estimation of the Severity of Loss (SL) implies calculating present value of flows at default date, granting a comparable measure for loans with different recovery periods.

Exposure at Default

Exposure at Default (EAD) is the amount of the debt at the time of default of a loan. It is estimated on a conversion factor basis, which considers the relationship between balance and the unused credit line.

In the particular case of the Commercial Loan portfolio, Severity of Loss (SL) and Exposure at Default (EAD) are used in accordance with those established on the CUB for Standard Models.

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 unaudited condensed consolidated interim 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 unaudited condensed consolidated interim 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 unaudited condensed consolidated interim 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, obtained in accordance with accounting criteria issued by the Commission.

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, 2019, there were no reserves other than 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 equipment 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.

Income 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 unaudited condensed consolidated interim statement of financial position under the "Deferred taxes, net" line.

Intangible assets

Intangible assets are recognized in the unaudited condensed consolidated interim statement of financial position 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 March 31, 2020 (Unaudited) and December 31, 2019.

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.

Derived from the entry into force of the New MFRS D-3, "Employee Benefits" (MFRS D-3), the Institution adopted the transitory third article published by the Commission to gradually recognize in the stockholder's equity the changes by reformulation referred to in MFRS D-3. In this way, the Institution gradually recognizes in a period of 5 years, as of 2016, the initial balance of actuarial gains or losses in other comprehensive income, as well as, the initial balance of the improvements to the plan in retained earnings from prior years.

At the end of March 31, 2020 (Unaudited), actuarial earning / losses were generated in all benefits these amounts are integrated into the other comprehensive income account and will be recycled to results during the future working life of the workers according to the benefit.

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 or 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 MFRS 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 unaudited condensed consolidated interim statement of financial position, 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 Institution that are considered as irrevocable commercial loans not disposed by the borrowers. It includes the lines of credit granted 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

As of March 31, 2020 (Unaudited) and December 31, 2019, cash and cash equivalents are as follows:

	2020	2019
Cash	Ps. 26,681	Ps. 23,841
Banks	61,899	38,370
Other deposits and available funds	88	71
	Ps. 88,668	Ps. 62,282

"Banks" is represented by cash in Mexican pesos and US dollars converted at the exchange rate issued by Banco de México of Ps. 23.4847 and Ps. 18.8642 as of March 31, 2020 (Unaudited) and December 31, 2019, respectively, and is made up as follows:

	Mexican pesos		USD		Total	
	2020	2019	2020	2019	2020	2019
Call money	Ps. 5,355	Ps. 3,413	Ps. -	Ps. -	Ps. 5,355	Ps. 3,413
Deposits with foreign credit institutions	-	-	6,947	503	6,947	503
Domestic banks	8,807	2,828	-	-	8,807	2,828
Banco de México	39,711	31,074	1,079	552	40,790	31,626
	Ps. 53,873	Ps. 37,315	Ps. 8,026	Ps. 1,055	Ps. 61,899	Ps. 38,370



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 March 31, 2020 (Unaudited), and December 31, 2019, the Institution had made monetary regulation deposits of Ps. 29,680 and Ps. 33,122, respectively.

As of March 31, 2020 (Unaudited) and December 31, 2019, the total sum of restricted cash and cash equivalents is Ps. 35,100 and Ps. 33,122, 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.

The exchange rates used for the conversion of gold and silver coins (Centenarios and Troy ounces, respectively) was Ps. 929.35 and Ps. 400.53, per unit, respectively, in 2019; and Ps. 702.80 and Ps. 392.85, per unit, respectively, in 2019.

6 - INVESTMENT IN SECURITIES

a. Trading securities

As of March 31, 2020 (Unaudited) and December 31, 2019, trading securities are as follows:

	2020			2019	
	Acquisition cost	Accrued interest	Valuation increase (decrease)	Book value	Book value
Government securities	Ps. 77,418	Ps. 613	Ps. 65	Ps. 78,096	Ps. 71,471
Unrestricted	(865)	-	-	(865)	(835)
D Bonds	-	-	-	-	(199)
M Bonds	(66)	-	-	(66)	(2)
BPA	(716)	-	-	(716)	(86)
CETES	(63)	-	-	(63)	(548)
UDIBONOS	(20)	-	-	(20)	-
Restricted	78,283	613	65	78,961	72,306
D Bonds	28,932	102	3	29,037	10,649
M Bonds	307	5	3	315	1,158
BPA	48,922	506	59	49,487	59,416
CEBUR	-	-	-	-	381
CETES	102	-	-	102	605
UDIBONOS	20	-	-	20	97
Bank securities	244	-	1	245	241
Unrestricted	(1,815)	-	-	(1,815)	-
Promissory notes	(1,815)	-	-	(1,815)	-
Restricted	2,059	-	1	2,060	241
Other bank securities	239	-	1	240	241
Promissory notes	1,820	-	-	1,820	-
Private securities	1,399	4	224	1,627	3,457
Unrestricted	1,399	4	224	1,627	3,457
Shares	128	-	93	221	258
Shares SI	32	-	-	32	2
CEBUR – Corporate	1,239	4	131	1,374	1,359
EUROBONDS	-	-	-	-	1,838
	Ps. 79,061	Ps. 617	Ps. 290	Ps. 79,968	Ps. 75,169

During the three months ended March 31, 2020 (Unaudited), the Institution recognized a loss of (Ps. 119) related to the fair value impacts of these financial instruments.



b. Securities available for sale

As of March 31, 2020 (Unaudited) and December 31, 2019, securities available for sale are as follows:

	2020			2019	
	Acquisition cost	Accrued interest	Valuation increase (decrease)	Book value	Book value
Government securities	Ps. 130,377	Ps. 1,171	Ps. (1,555)	Ps. 129,993	Ps. 124,401
Unrestricted	38,817	427	(1,071)	38,173	36,417
BPA	(100)	-	-	(100)	-
BREMs	7,778	17	-	7,795	7,786
CEBUR – Government	426	-	1	427	429
CEBUR – Municipality	141	1	1	143	147
CETES	575	-	-	575	613
Eurobonds– Government	29,997	409	(1,073)	29,333	27,442
Restricted	91,560	744	(484)	91,820	87,984
M Bonds	1,404	31	(126)	1,309	537
BPA	49,380	473	87	49,940	54,680
CEBUR – Government	3,460	14	(6)	3,468	3,351
CETES	3	-	-	3	48
Eurobonds– Government	34,490	204	(427)	34,267	29,368
M Bonds	2,823	22	(12)	2,833	-
Bank securities	6,103	32	77	6,212	6,700
Unrestricted	6,103	32	77	6,212	6,700
CEBUR –Development bank	1,679	23	38	1,740	1,759
CEBUR – Bank	1,615	5	14	1,634	1,319
CEDES	1,180	3	-	1,183	1,956
Structured notes	501	-	22	523	479
Others	1,128	1	3	1,132	1,187
Private securities	23,465	229	(2,878)	20,816	21,529
Unrestricted	21,616	164	(2,369)	19,411	19,954
Shares	118	-	16	134	170
Investment funds	4,284	-	98	4,382	4,305
CEBUR – BORHIS	11	-	(3)	8	8
CEBUR – Corporate	6,769	24	(401)	6,392	6,370
Eurobonds - Private	10,434	140	(2,079)	8,495	9,101
Restricted	1,849	65	(509)	1,405	1,575
Eurobonds - Private	1,849	65	(509)	1,405	1,575
	Ps. 159,945	Ps. 1,432	(Ps. 4,356)	Ps. 157,021	Ps. 152,630

As of March 31, 2020 (Unaudited) and December 31, 2019, there are Ps. 93,225 and Ps. 89,559, respectively, in restricted securities available for sale, mainly associated with securities repurchasing transactions.

c. Securities held to maturity

As of March 31, 2020 (Unaudited) and December 31, 2019, securities held to maturity are as follows:



Medium and long-term debt instruments:

	2020			2019
	Acquisition cost	Accrued interest	Book value	Book value
Government securities	Ps. 16,264	Ps. 250	Ps. 16,514	Ps. 16,364
Unrestricted	816	4	820	813
M Bonds	243	4	247	245
CETES specials	573	-	573	568
Restricted	15,448	246	15,694	15,551
M Bonds	12,561	239	12,800	12,654
CEBUR Municipality	2,887	7	2,894	2,897
Private securities	3,192	5	3,197	3,229
Unrestricted	1,314	0	1,314	1,314
CEBUR – BORHIS	2	-	2	2
Others	1,312	-	1,312	1,312
Restricted	1,878	5	1,883	1,915
CEBUR – Corporate	1,878	5	1,883	1,915
	Ps. 19,456	Ps. 255	Ps. 19,711	Ps. 19,593

As of March 31, 2020 (Unaudited) and December 31, 2019, there are Ps. 17,577 and Ps. 17,466, respectively, in restricted trading securities associated mainly with repurchasing operations.

7 - DEBTOR BALANCES UNDER REPURCHASE AND RESALE AGREEMENTS

As of March 31, 2020 (Unaudited) and December 31, 2019, the debtor and creditor balances in repurchase transactions consist of:

Acting as seller of securities

Instrument	2020	2019
CETES	Ps. 3,465	Ps. 156
CETES with taxes	40	-
CEBUR	-	3,732
Eurobonds	-	19,310
Bonds UMS (Fix)	19,690	-
Bonds IPAB (BPAG28)	19,568	25,770
Quarterly IPAB bonds (BPAG91)	65,356	73,852
Semi-annual IPAB bonds (BPAT182)	14,317	13,543
Development bonds	29,038	7,607
Government bonds	16,809	14,064
UDIBONOS	2,833	97
Government securities	171,116	158,131
Financial Institution Negotiable Instruments	240	245
Bank securities	240	245
CEBUR – Municipality	2,848	2,850
CEBUR – Corporate	1,481	1,458
Private securities	4,329	4,308
	Ps. 175,685	Ps. 162,684

With the Institution acting as the vendor, accrued premiums were charged to the results of operations for the three months ended March 31, 2020 (Unaudited) and for the year ended December 31, 2019 of Ps. 4,591 and Ps. 31,841, respectively, and recorded under “interest expenses”.

During 2019, 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

Instrument	2020				2019			
	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
CEBUR – Government	Ps. 3,876	Ps. 3,876	Ps. -	Ps. -	Ps. 3,690	Ps. 3,784	Ps. -	Ps. 94
CEBUR – Development bank	2,700	2,700	-	-	2,571	2,571	-	-
Government UMS								
Bonds (Fix)	1,907	-	1,907	-	1,871	-	1,871	-
Bonds IPAB	1,836	1,836	-	-	2,760	2,760	-	-
Quarterly IPAB Bonds	13,206	13,218	-	12	42,017	41,880	145	8
Semi-annual IPAB	2,403	2,403						
Bonds								
M Bonds	-	-	-	-	24,921	24,921	-	-
D Bonds	9,092	9,093	3	4	4,500	4,500	-	-
CETES (Fix)	1,260	1,260	-	-	12,158	12,161	-	3
Government securities	36,280	34,386	1,910	16	94,488	92,577	2,016	105
Securitized bank								
certificates	15,237	15,237	-	-	8,676	8,676	-	-
CEDES	9,849	9,849	-	-	10,613	10,613	-	-
Bank bonds	-	-	-	-	-	-	-	-
Others	10	10	-	-	17	17	-	-
Bank securities	25,096	25,096	-	-	19,306	19,306	-	-
CEBUR – Municipality	4,753	4,733	20	-	2,399	2,399	-	-
CEBUR in UDIS	674	674	-	-	1,500	1,500	-	-
Short-term CEBUR	1,500	1,500	-	-	437	437	-	-
Private securities	6,927	6,907	20	-	4,336	4,336	-	-
	Ps. 68,303	Ps. 66,389	Ps. 1,930	Ps. 16	Ps. 118,130	Ps. 116,219	Ps. 2,016	Ps. 105

With the Institution in its capacity as purchaser, accrued interest was charged to the results of operations for the three months ended March 31, 2020 (Unaudited) and for the year ended December 31, 2019 of Ps. 1,730 and Ps. 2,717, respectively, and reported under “interest income”.

During 2019, repurchase transactions carried out by the Institution in its capacity as purchaser ranged in term from 1 to 364 days.

8 - DERIVATIVE FINANCIAL INSTRUMENTS

The transactions carried out by the Institution involving derivative financial instruments correspond mainly to futures, swaps and options contracts. These transactions are entered into in order to hedge various financial risks as well as for trading purposes.

As of March 31, 2020 (Unaudited) and December 31, 2019, the Institution has evaluated the effectiveness of derivative transactions for hedging purposes and has concluded that they are highly effective.

As of March 31, 2020 (Unaudited) and December 31, 2019, the Institution's derivatives positions held for trading purposes are as follows:

Asset position	2020	2019
Forward	Ps. 306	Ps. 96
Foreign currency forwards	306	96
Options	2,641	652
Interest rate options	251	262
Foreign currency options	2,390	-
Stock options	-	390
Swaps	45,993	21,547
Interest rate swaps	31,506	17,186
Foreign currency swaps	13,695	4,190
Credit swaps	792	171
Total trading	48,940	22,295



Swaps	1,291	162
Interest rate swaps	47	-
Exchange rate swaps	1,244	162
Total hedging	1,291	162
Total position	Ps.50,231	Ps. 22,457

Liability position	2020	2019
Forward	Ps. 408	Ps. 176
Foreign currency forwards	408	176
Options	2,994	930
Interest rate options	229	200
Foreign currency options	2,765	730
Swaps	47,172	19,646
Interest rate swaps	26,828	12,715
Foreign currency swaps	20,344	6,931
Total trading	50,574	20,752

Options	1,223	-
Foreign currency options	1,223	-
Swaps	9,264	4,221
Interest rate swaps	446	273
Foreign currency swaps	8,818	3,948
Total hedging	10,487	4,221
Total position	Ps. 61,061	Ps. 24,973

The following are notional bonds in different currencies, depending on the type of product, by March 31, 2020 (Unaudited):

Trading instruments

Instrument	MXN	USD	EUR	CHF
Foreign currency forwards	Ps. 12,076	Ps. 511	Ps. -	Ps. -
Interest rate options	80,705	1,815	-	225
Stock options	-	-	-	-
Foreign currency swaps (receiving leg)	72,241	2,855	254	260
Foreign currency swaps (paying leg)	67,121	3,530	253	-
Interest rate swaps (receiving leg)	972,373	17,867	-	-
Interest rate swaps (paying leg)	972,373	17,867	-	-
Credit Default Swaps	-	-	-	-

Hedging instruments

	MXN	USD	EUR	CHF	GBP
Interest rate options	Ps. -	Ps. -	Ps. -	Ps. 225	Ps. -
Foreign currency swaps (receiving leg)	17,377	-	-	475	-
Foreign currency swaps (paying leg)	9,185	588	207	-	128
Interest rate swaps (receiving leg)	36,256	-	-	-	-
Interest rate swaps (paying leg)	36,256	-	-	-	-

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

Transactions carried out for hedging purposes have maturities from 2019 to 2031 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 derivatives portfolio as of March 31, 2020 (Unaudited) is US 1,469,172 thousand, and Ps. 439,200, while as of December 31, 2019 it was US 879,631 thousand and Ps.6,800.

As of March 31, 2020 (Unaudited) and December 31, 2019, the collateral given was comprised of cash.

As of March 31, 2020 (Unaudited) and December 31, 2019, 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 March 31, 2020 (Unaudited), there are 121 hedge files related to hedging transactions. Their effectiveness ranges between 85% and 100%, well within the range established by the accounting standards of 80% to 100%. Furthermore, there is no overhedging on any of the derivatives and as of March 31, 2020 (Unaudited) and December 31, 2019, there are no ineffective portions that are recorded at the market value that the Institution has to record in earnings.

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.

9 - LOAN PORTFOLIO

As of March 31, 2020 (Unaudited) and December 31, 2019, the loan portfolio by loan type is as follows:

	Performing loan portfolio		Past-due loan portfolio		Total	
	2020	2019	2020	2019	2020	2019
Commercial loans						
Denominated in domestic currency						
Commercial	Ps. 212,056	Ps. 204,805	Ps. 4,703	Ps. 4,563	Ps. 216,759	Ps. 209,368
Rediscounted portfolio	6,314	6,760	-	-	6,314	6,760
Denominated in USD						
Commercial	68,900	53,912	1,997	1,584	70,897	55,496
Rediscounted portfolio	1,139	965	-	-	1,139	965
Loans to financial institutions	24,011	20,595	4	4	24,015	20,599
Consumer loans						
Credit card	38,707	39,700	2,384	2,287	41,091	41,987
Other consumer loans	77,493	76,528	1,634	1,981	79,127	78,509
Mortgage loans						
Denominated in domestic currency	173,126	169,983	2,058	1,960	175,184	171,943
Denominated in USD		103		13		116
Denominated in UDIS	100	-	11	-	111	-
Government loans	161,246	170,155	35	-	161,281	170,155
Total loan portfolio	Ps. 763,092	Ps. 743,506	Ps. 12,826	Ps. 12,392	Ps. 775,918	Ps. 755,898



As of March 31, 2020 (Unaudited) and December 31, 2019, the balance of deferred loan origination fees was Ps. 2,449 and Ps. 2,498, respectively and the amount recorded in results for the three months ended March 31, 2020 (Unaudited) and December 31, 2019 was Ps. 358 and Ps. 1,208, respectively. Furthermore, the deferred balance of costs and expenses associated with initial loan grant is Ps. 2,226 and Ps. 2,770 as of March 31, 2020 (Unaudited) and December 31, 2019, respectively, and the amount recorded in results for the periods was Ps. 291 and Ps. 1,282, respectively. 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 unaudited condensed consolidated interim statements of financial positions as well as in interest income and interest expenses, respectively, in the unaudited condensed consolidated interim statements of income.

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.

As of March 31, 2020 (Unaudited) and 2019, the balance of fully reserved past-due loans that were written off was Ps. 3,884 and Ps. 15,753, respectively.

During the three months ended March 31, 2020 (Unaudited) and December 31, 2019, revenues from recoveries of previously written-off loan portfolios were Ps. 565 and Ps. 2,006, respectively.

10 - ALLOWANCE FOR LOAN LOSSES

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

Risk category	March 31, 2020 (Unaudited)						Total
	Loan portfolio	Companies	Government	Financial institutions loans	Consumer portfolio	Mortgage portfolio	
Risk A1	Ps. 637,812	Ps. 950	Ps. 440	Ps. 68	Ps. 700	Ps. 223	Ps. 2,381
Risk A2	48,141	145	228	5	272	29	679
Risk B1	24,108	53	8	2	721	18	802
Risk B2	16,772	41	13	6	558	27	645
Risk B3	23,571	106	438	5	550	15	1,114
Risk C1	12,207	155	74	2	596	84	911
Risk C2	9,552	97	126	-	818	167	1,208
Risk D	14,885	1,960	16	2	2,546	495	5,019
Risk E	6,435	1,745	-	-	2,892	96	4,733
Unclassified	(1,701)	-	-	-	-	-	-
	Ps. 791,782	Ps. 5,252	Ps. 1,343	Ps. 90	Ps. 9,653	Ps. 1,154	Ps. 17,492
Less: Recorded allowance							17,932
Reserve supplement*							Ps. 440



2019							
Risk category	Required allowances for losses						
	Loan portfolio	Companies	Government	Financial institutions' loans	Consumer portfolio	Mortgage portfolio	Total
Risk A1	Ps. 628,235	Ps. 856	Ps. 529	Ps. 67	Ps. 623	Ps. 220	Ps. 2,295
Risk A2	35,967	151	77	9	303	30	570
Risk B1	31,131	59	86	-	844	17	1,006
Risk B2	12,931	57	4	-	379	28	468
Risk B3	25,448	111	366	10	836	15	1,338
Risk C1	8,514	95	90	-	266	78	529
Risk C2	9,616	94	101	-	864	163	1,222
Risk D	14,140	1,974	-	2	2,182	491	4,649
Risk E	6,346	991	-	-	3,208	87	4,286
Unclassified	(1,611)	-	-	-	-	-	-
	Ps. 770,717	Ps. 4,388	Ps. 1,253	Ps. 88	Ps. 9,505	Ps. 1,129	Ps. 16,363
Less: Recorded allowance							17,083
Reserve supplement*							Ps. 720

*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 March 31, 2020 (Unaudited) and December 31, 2019, the amount of the rating base for loan portfolios includes Ps. 15,712 and Ps. 14,573, respectively, for granted guarantors and loan acquisitions, which were recorded in memorandum accounts. Ps. 301 and Ps. 276, respectively, were also added for loans to related parties.

As of March 31, 2020 (Unaudited) and December 31, 2019, the estimated allowance for loan losses is determined based on portfolio balances at those dates and represents 140% and 138%, 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 March 31, 2020 (Unaudited) and December 31, 2019.

Movements in allowance for loan losses

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

	2020 (Unaudited)	2019
Balance at the beginning of the year	Ps. 17,083	Ps. 18,264
Increase charged to results	4,827	17,112
Discounts and write-offs	(4,276)	(18,250)
Others	298	(43)
Year-end balance	Ps. 17,932	Ps. 17,083



11 - PERMANENT STOCK INVESTMENTS

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

	Share %	2020 (Unaudited)	2019
Controladora PROSA, S.A. de C.V.	19.73%	Ps. 136	Ps. 118
PAYCLIP INC.	2.06%	139	101
Fideicomiso de Coinversión F/2504 (CKD)	-	-	32
Fideicomiso 73789-Banco Monex	-	-	5
Fideicomiso 11769-Carretera Lerma	-	-	23
Fideicomiso 12040-La Gloria	-	-	5
Fideicomiso Actinver 3650	-	-	3
Fideicomiso F/3937	-	-	17
Fideicomiso F/4280	-	-	2
Trans Unión de México S.A. SIC	4.9%	49	-
Sociedades de Inversión	Various	15	15
Dun & Bradstreet S.A. SIC	4.9%	13	-
Inversiones de Fideicomiso FCICK16-1	Various	39	-
Inversiones de Estrategia en Finanzas	Various	32	-
Others	Various	45	97
		Ps. 468	Ps. 418

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

12 - 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 unaudited condensed consolidated interim statement of financial position accounts, the Institution has recognized a recoverable net deferred tax asset of Ps. 4,352 and Ps. 1,104, respectively, as of March 31, 2020 (Unaudited) and December 31, 2019, respectively, as detailed below:

	2020 (Unaudited)		2019	
	Temporary Differences	Deferred Effect ISR	Temporary Differences	Deferred Effect ISR
Temporary Differences - Assets				
Tax loss carryforwards	Ps. -	Ps. -	Ps. 33	Ps. 10
Allowance for loan losses	-	-	1	-
Surplus preventive allowances for credit risks over the net tax limit	17,932	5,380	17,083	5,125
Excess of tax over book value of foreclosed and fixed assets	1,439	448	2,132	635
PTU	622	186	492	148
Fees collected in advance	2,541	762	2,596	779
Accounting provisions	3,659	1,098	3,577	1,073
Financial instruments valuation	8,910	2,673	-	-
Tax loss	33	10	-	-
Total deferred assets	35,136	10,557	25,914	7,770
Temporary Differences - Liabilities				
Advance contributions to pension fund	559	168	635	190
Portfolios acquired	1,112	334	1,133	340
Capitalizable projects' expenses	18,980	5,694	18,213	5,464
Financial instruments valuation	-	-	2,211	663
Intangible assets	36	9	32	9
Total deferred liabilities	Ps. 20,687	Ps. 6,205	Ps. 22,224	Ps. 6,666
Deferred tax, net		Ps. 4,352		Ps. 1,104

The applicable tax rate is 30% for all presented and subsequent periods.



13 - OTHER ASSETS

Other assets include the following items:

	2020 (Unaudited)	2019
Net asset forecast from labor obligations and savings fund	Ps. 62	Ps. 65
Payments to amortize	26,747	25,593
Accumulated payment amortization	(5,396)	(4,828)
Goodwill	1,461	1,371
	Ps. 22,874	Ps. 22,201

Goodwill has not been amortized since 2007 and is subject to annual impairment tests. No impairment to goodwill was identified as of March 31, 2020 (Unaudited) and December 31, 2019.

14 - DEPOSITS

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

	2020 (Unaudited)	2019
Demand deposits		
Non-interest bearing checking accounts:		
Cash deposits	Ps. 206,260	Ps. 213,978
Checking accounts in US dollars for individual residents on the Mexican border	3,226	2,779
Demand deposits accounts	78,530	78,538
Interest bearing checking accounts:		
Savings accounts	147,254	124,928
Checking accounts in US dollars for individual residents on the Mexican border	2,255	1,898
Demand deposits accounts	14,317	13,332
	451,842	435,453
Time deposits		
General public:		
Fixed-term deposits	32,240	30,597
Retail time deposits	243,111	227,673
Promissory note with interest payable at maturity PRLV primary market for individuals	329	347
Promissory note with interest payable at maturity PRLV primary market for entities	4,468	4,103
Foreign residents deposits	7	6
Provision for interest	718	1,065
	280,873	263,791
Money market:		
Over the counter promissory notes	21,474	15,984
Provision for interest	113	52
	21,587	16,036
Senior debt	35,355	26,907
Global account of deposit without movement	2,213	2,085
	Ps. 791,870	Ps. 744,272

The funding rates that 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).



15 - INTERBANK AND OTHER LOANS

The loans received from other banks as of March 31, 2020 (Unaudited) and December 31, 2019 are as follows:

	Mexican pesos		Denominated in USD		Total	
	2020	2019	2020	2019	2020	2019
Immediately due						
Domestic banks (Call money)	Ps. 5,000	Ps. 500	Ps. -	Ps. -	Ps. 5,000	Ps. 500
Short-term:						
Banxico	200	102	-	-	200	102
Development banking	3,864	4,037	8	11	3,872	4,048
Public trusts	3,973	4,930	261	196	4,234	5,126
Interest provision	26	-	-	-	26	-
	8,063	9,069	269	207	8,332	9,276
Long-term:						
Development banking	-	-	58	48	58	48
Public trusts	3,271	4,097	868	709	4,139	4,806
	3,271	4,097	926	757	4,197	4,854
	Ps. 16,334	Ps. 13,666	Ps. 1,195	Ps. 964	Ps. 17,529	Ps. 14,630

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

16 - SUBORDINATED DEBENTURES

As of March 31, 2020 (Unaudited) and December 31, 2019, the subordinated debentures in circulation are as follows:

	2020	2019
Non-preferred subordinated obligations, non-preferred, perpetual, non-cumulative 5 years callable BANOD19 999999 denominated in USD, with an interest rate of 6.875%. **	Ps. 8,220	Ps. 6,602
Non-preferred subordinated obligations, non preferred, perpetual, non-cumulative 10 years callable BANOE91 999999 denominated in USD, with an interest rate of 7.625%. **	12,917	10,375
Non-preferred subordinated non-convertible 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.	2,818	2,264
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.	6,909	5,550
Non-preferred subordinated non-convertible debentures Q BINTER 15 maturing in February 2025 and interest at an annual interest rate of TIIE to 28 days plus 2.5 points.	-	1,000
Preferred subordinated nonconvertible debentures, Q BANORTE 08-U maturing in February 2028, interest at a 4.95% annual rate.	1,799	1,772
Non-preferred subordinated obligations, non-preferred, perpetual, non-cumulative 5 years callable NC5 Notes denominated in USD, with an interest rate of 6.750%**	14,091	11,319
Non-preferred subordinated obligations, non preferred, perpetual, non-cumulative 10 years callable NC10 Notes denominated in USD, with an interest rate of 7.50%**	11,742	9,433
Accrued interest.	325	153
Issuance and placement expenses.	(398)	(418)
	Ps. 58,423	Ps. 48,050

The debt issuance costs related to these debentures are amortized using the straight-line method over the term of the debt. The amortization charged to results is Ps. 16 and Ps. 87 for the three months ended in March 31, 2020 (Unaudited) and 2019, respectively.



17 - INFORMATION BY SEGMENT

The main operations and balances per concept and/or business segment in the condensed consolidated interim statements of financial position and the statements of comprehensive income are comprised as follows:

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

	March 31, 2020 (Unaudited)					
	Interest		Fees		Total	
	MXP	Foreign Exchange	MXP	Foreign Exchange	MXP	Foreign Exchange
Cash and cash equivalents	Ps. 694	Ps. -	Ps. -	Ps. -	Ps. 694	Ps. -
Margin securities	40	-	-	-	40	-
Investment in securities	3,964	-	-	-	3,964	-
Securities repurchasing and loans	1,730	-	-	-	1,730	-
Hedging transactions	1,240	-	-	-	1,240	-
Commercial loans	10,437	-	108	-	10,545	-
Mortgage loans	4,271	-	167	-	4,438	-
Consumer loans	7,201	-	83	-	7,284	-
Other	43	-	-	-	43	-
	Ps. 29,620	Ps. -	Ps. 358	Ps. -	Ps. 29,978	Ps. -

	March 31, 2019					
	Interest		Fees		Total	
	MXP	Foreign Exchange	MXP	Foreign Exchange	MXP	Foreign Exchange
Cash and cash equivalents	Ps. 1,030	Ps. -	Ps. -	Ps. -	Ps. 1,030	Ps. -
Margin securities	93	-	-	-	93	-
Investment in securities	4,471	-	-	-	4,471	-
Securities repurchasing and loans	2,717	-	-	-	2,717	-
Hedging transactions	1,502	-	-	-	1,502	-
Commercial loans	11,902	-	94	-	11,996	-
Mortgage loans	3,891	-	155	-	4,046	-
Consumer loans	6,675	-	75	-	6,750	-
Other	38	-	-	-	38	-
	Ps. 32,319	Ps. -	Ps. 324	Ps. -	Ps. 32,643	Ps. -

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

	March 31, 2020 (Unaudited)			March 31, 2019		
	MXP	Foreign Exchange	Total	MXP	Foreign Exchange	Total
Immediately Due and Payable						
Deposits:						
Checking accounts	Ps. 1,069	Ps. -	Ps. 1,069	Ps. 865	Ps. -	Ps. 865
Savings accounts	92	-	92	77	-	77
	1,161	-	1,161	942	-	942
Time Deposits:						
General public	3,847	-	3,847	4,865	6	4,871
Money market	468	-	468	1,018	-	1,018
	4,315	-	4,315	5,883	6	5,889
Total	Ps. 5,476	Ps. -	Ps. 5,476	Ps. 6,825	Ps. 6	Ps. 6,831



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

	March 31, 2020 (Unaudited)			March 31, 2019		
	MXP	Foreign Exchange	Total	MXP	Foreign Exchange	Total
Call money	Ps. 80	Ps. -	Ps. 80	Ps. 41	Ps. -	Ps. 41
Banco de México	3	-	3	2	-	2
Commercial banks	19	-	19	267	-	267
Development banking	245	-	245	310	-	310
Other agencies	2	-	2	2	-	2
Total	Ps. 349	Ps. -	Ps. 349	Ps. 622	Ps. -	Ps. 622

d. The trading results for the three months ended March 31, 2020 (Unaudited) and 2019, are as follows:

	2020	2019
Trading results:		
Spot foreign currency	Ps.1,219	(Ps. 5)
Derivatives financial instruments	(1,237)	521
Investments in securities	(119)	68
Valuation	(137)	585
Purchase-sales result, net		
Spot foreign currency	(Ps. 862)	Ps. 101
Derivatives financial instruments	1,742	82
Investments in securities	305	166
	1,185	349
Total trading results	Ps.1,048	Ps. 934

18 - INCOME TAXES

The Institution is subject to Income Tax (ISR). Pursuant to the 2014 ISR Law the rate for March 31, 2020 (Unaudited) and December 31, 2019 was 30% and will continue at the same rate for subsequent years.

Reconciliation of the accounting and income tax 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 is:

	March 31, 2020 (Unaudited)	December 31, 2019
Legal rate	30%	30%
Tax inflation	(2%)	(2%)
Non-tax accounting items	1%	2%
Interests obligations	(5%)	(2%)
Other	2%	(2%)
Effective rate	26%	26%



19 - STOCKHOLDERS' EQUITY

The Institution's shareholders' common stock as of March 31, 2020 (Unaudited) and December 31, 2019 is comprised as follows:

	Number of shares with a nominal value of Ps. 0.10	
	March 31, 2020	December 31, 2019
	Paid-in Capital	Paid-in Capital
"O" Series	144,197,415,428	144,197,415,428

	Historical Amounts	
	March 31, 2020 (Unaudited)	December 31, 2019
"O" Series	Ps. 14,420	Ps. 14,420
Restatement in Mexican pesos through December 2007	4,374	4,374
	Ps. 18,794	Ps. 18,794

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 March 31, 2020 (Unaudited) and December 31, 2019, the legal reserve is Ps. 17,165 and represents 91% of paid-in capital, respectively.

Share-based payments

During 2020 (Unaudited) and 2019, the Institution recorded Ps. 46 and Ps. 433, respectively, in administration expenses as compensation for share-based payments against paid-in capital.

As of March 31, 2020 (Unaudited) and December 31, 2019, the Institution has 11,776,461 and 9,959,573 shares of the Financial Group 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. 88.68 and 106.16.

During 2020 (Unaudited) and 2019, 1,289,512, and 5,391,579 shares were granted, 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 March 31, 2020 (Unaudited) sent to Banco de México to review is shown below.

- The Institution's capitalization ratio as of March 31, 2020 (Unaudited) was 18.97% of total risk (market, credit and operational), and 24.14% of credit risk, which in both cases exceed the current regulatory requirements.



The amount of net capital, divided by basic and complementary capital, is detailed below (these figures may differ from those in the basic financial statements):

Net capital as of March 31, 2020	
Tier 1 common equity prior to regulatory adjustments.	Ps. 113,483
Goodwill (net of applicable deferred income taxes)	1,005
Other intangibles different from mortgage service right (net of applicable deferred income taxes)	9,058
Result from valuation of instruments for cash flow hedging	(3,965)
Benefits on the remainder in securitization transactions	161
Defined benefit pension plan	(1,963)
Substantial investments in ordinary shares of banks, financial institutions and insurers outside the scope of the regulatory consolidation, net of the short-term demandable positions, where the Institution owns over 10% of the capital stock issued (amount over the 10% threshold)	1,592
National regulatory adjustments	177
Total regulatory adjustments to Tier 1 common equity	12,678
Tier 1 common equity (CET1)	100,805
Additional Tier 1 equity (AT1)	46,969
Tier 1 Equity (T1 = CET1 + AT1)	46,969
Capital instruments issued directly, subject to gradual elimination of Tier 2 equity reserves	1,800
Reserves	484
Tier 2 equity (T2)	9,194
Total capital (TC = T1 + T2)	Ps. 156,968

Assets subject to risk are detailed below:

Assets subject to market risk

Concept	Positions weighted by risk	Capital requirement
Nominal interest rate securities transactions in Mexican pesos	Ps. 47,668	Ps. 3,821
Floating rate securities transactions in Mexican pesos	6,771	542
Real interest rate or UDI denominated securities transactions in Mexican pesos	2,094	168
UDIS or inflation indexed (INPC) securities transactions	31	2
Nominal interest rate foreign exchange denominated securities transaction in Mexican pesos	9,185	735
Positions in foreign exchange or exchange rate indexed securities transactions	9,924	794
Positions in shares or whose yield is indexed to the price of a share or group of shares	214	17
Total	Ps. 75,887	Ps. 6,079



Assets subject to credit risk

Concept	Risk Weighted Assets	Capital requirement
Group III (weighted at 20%)	9,737	779
Group III (weighted at 50%)	4,150	332
Group III (weighted at 100%)	2,620	210
Group IV (weighted at 20%)	13,034	1,043
Group V (weighted at 20%)	19,869	1,589
Group V (weighted at 50%)	8,534	683
Group V (weighted at 115%)	147	12
Group V (weighted at 150%)	11,752	940
Group VI (weighted at 50%)	42,733	3,419
Group VI (weighted at 75%)	17,089	1,367
Group VI (weighted at 100%)	253,723	20,298
Group VII_A (weighted at 20%)	4,586	367
Group VII_A (weighted at 50%)	929	74
Group VII_A (weighted at 100%)	152,371	12,190
Group VII_A (weighted at 150%)	19	1
Group VII_B (weighted at 20%)	6,359	509
Group VII_B (weighted at 50%)	1,642	131
Group VII_B (weighted at 100%)	201,751	16,140
Group VII_B (weighted at 150%)	84	7
Group VIII_B (weighted at 115%)	5,455	436
Group VIII_B (weighted at 115%)	1,669	134
Group IX (weighted at 100%)	29,739	2,379
Securizations with a Risk Degree of 1 (weighted at 20%)	1,386	111
Securizations with a Risk Degree of 2 (weighted at 50%)	937	75

Assets subject to operational risk:

	Risk Weighted Assets	Capital requirement
Standard method	Ps. 65,882	Ps. 5,271
Average of market and credit risk of the last 36 months	Average of positive net annual income of the last 36 months	
Total	Ps. 51,902	Ps. 80,205

Management

Pursuant to the regulations in effect and the requirements of the CNBV, the Institution 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 based off of the risk position, supported by strategy or transaction simulations of the various areas of business operation in order to determine their consumption.



20 - FOREIGN CURRENCY POSITION

As of March 31, 2020 (Unaudited) and December 31, 2019, 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. 23.4847 and Ps. 18.8642 per USD 1.00, respectively, as shown below:

	Thousands of US dollars	
	March 31, 2020	December 31, 2019
Assets	9,537,103	8,461,087
Liabilities	9,964,080	8,462,973
Net liability position in US dollars	(426,977)	(1,886)
Net liability position in Mexican pesos	(Ps. 10,027)	(Ps. 36)

21 - POSITION IN UDIS

As of March 31, 2020 (Unaudited) and December 31, 2019, the Institution holds certain assets and liabilities denominated in UDIS, converted to Mexican pesos based on the current conversion factor of Ps. 6.499170 and Ps. 6.399018, per UDI, respectively, as shown below:

	Thousands of UDIS	
	March 31, 2020	December 31, 2019
Assets	Ps. 1,129,943	Ps. 1,281,839
Liabilities	656,308	652,164
Net asset position in UDIS	473,635	629,675
Net asset position in Mexican pesos	Ps. 3,078	Ps. 4,029

22 - 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 for the three months ended March 31, 2020 (Unaudited) and December 31, 2019 are shown below:

	March 31, 2020			December 31, 2019
	Net income	Weighted share average	Earnings per share	Earnings per share
UPA continuous operations	6,180	144,197,415,428	Ps. 0.0429	Ps. 0.1907
Net income per share	6,180	144,197,415,428	Ps. 0.0429	Ps. 0.1907

23 - COMPREHENSIVE RISK MANAGEMENT

Risk management at the Institution is a key element in determining and implementing the Group's strategic planning. The Institution's risk management and policies comply with regulations and market's best practices.



1. OBJECTIVES, SCOPE AND RISK MANAGEMENT FUNCTIONS

The Institution's risk management main objectives are:

- To provide clear rules to different business areas, that contribute to minimizing risk and ensuring compliance with the parameters established and approved by the Board of Directors and the Risk Policies Committee (CPR by its acronym in Spanish).
- To establish mechanisms to monitor risk-taking across Institution, through the use of robust systems and processes.
- To verify the observance of Risk Appetite.
- To estimate and control Institution capital, under regular and stressed scenarios, aiming to provide coverage for unexpected losses from market movements, credit bankruptcies, and operational risks.
- To implement pricing models for different types of risks.
- To establish procedures for portfolio's optimization and credit portfolio management.
- To update and monitor Contingency Plan in order to restore capital and liquidity levels in case of adverse events.

Moreover, Institution owns sound methodologies to manage quantifiable risks such as Credit Risk, Market Risk, Liquidity Risk, Operational Risk, Concentration Risk and Counterparty Risk.

Credit Risk: revenue volatility due to constitution of provisions for impaired loans, and potential losses on borrower or counterparty defaults.

Market Risk: revenue volatility due to market changes, which affect the valuation of book positions for active, liabilities or contingent liabilities operations, such as: interest rates, spread over yields, exchange rates, price indices, etc.

Liquidity Risk: potential loss by the impossibility of renewing liabilities or securing resources in normal conditions, and by early or forced sale of assets at unusual discounts to meet their obligations.

Operational Risk: loss resulting from inadequate or failed internal processes, employees, internal systems or external events. This definition includes Technology Risk and Legal Risk. Technology Risk, groups all those potential losses from damage, interruption, disruption or failures resulting from use of or reliance on hardware, software, systems, applications, networks and any other information distribution channel, while the Legal Risk involves the potential loss by sanctions for noncompliance with laws and administrative or judicial decisions unfavorable related to Institution operations.

Concentration Risk: potential loss by high and disproportional exposure to particular risk factors within a single category or among different risk categories.

Likewise, regarding unquantifiable risks, the Risk Management's Manual in Institution establish specific objectives for:

Reputational Risk: potential loss in the performance of the Institution's activities, due to an inappropriate or unethical perception of the different stakeholders, internal or external, on their solvency and viability.

1.1. Risk Management – Structure and Corporate Governance

Regarding the structure and organization for a comprehensive Risk Management, the Board of Directors is responsible for authorizing policies and overall strategies such as:

- Institution Risk Appetite.
- Comprehensive Risk Management Framework.
- Risk exposure limits, risk tolerance levels and mechanisms for corrective actions.
- Contingency Plan and the Contingency Funding Plan.
- The outcome of the internal and regulatory capital adequacy scenarios.

The Board of Directors designates the CPR (Risk Policy Committee) as accountable for managing the risks that Institution is exposed to, in order to ensure that operations comply with objectives, policies and procedures established by Risk Management.



The CPR also monitors the overall limits of risk exposure approved by the Board of Directors, in addition to approving specific limits for exposure to different types of risk.

The CPR is integrated by members and deputies of the Board, the CEO, the Managing Directors of the Group's Entities, the Risk Managing Director and the Audit Managing Director, the latter participates with voice but no vote.

Moreover, the Assets and Liabilities Committee (ALCO) and the Capital and Liquidity Group, analyze, monitors, and decide regarding interest rate risks in the unaudited condensed consolidated interim statement of financial position, the financial margin, liquidity and net capital of the Institution.

The Unit for the Comprehensive Risk Management (UAIR by its acronym in Spanish) is in charge of the Risk Management Department (DGAR), and among its functions, is responsible to identify measure, monitor, limit, control, report and disclose the different types of risk to which the Institution is exposed to.

The DGAR reports to CPR, in compliance with the regulation related to its independence from the Business areas.

1.2. Scope and Nature of GFNorte's Risk Management

The Risk Management function extends to all subsidiaries that comprise Institution. Depending on the line of business of each of the Businesses, Credit, Concentration, Market, Liquidity and Operational Risks are measured, managed and controlled.

For this purpose, DGAR relies on different information and risk measurement systems, which comply with regulatory standards and align with the best international practices in Risk Management's matters. It's worth mentioning that information and reports contained and produced in the risk systems are constantly backed up following institutional procedures in IT security matters. Furthermore, risk systems enclose transactions susceptible to Credit, Market, Liquidity and Operational Risks, processed through revised models and methodologies, thus generating periodic reports for each one of these risks.

At Institution, there are policies and procedures for hedging, risk mitigation and compensation strategies for each type of risk in and off balance, all of them enclosed in models, methodologies and procedures for Risk Management. Within these policies, there are certain variables that must be considered for risk mitigation, such as: general features, loan to value, legal terms, instrumentation and hedging level. These policies and procedures also consider collateral execution as a risk compensation mechanism in the case of non-fulfillment by debtors. As part of the strategies and processes for monitoring the coverage or mitigation effectiveness for each type of risk, there are limits for each one of them (Credit, Market, Liquidity and Operational Risks), which are continuously monitored, as well as established procedures for the documentation of excesses and its causes, and the corrective actions implemented to return to acceptable risk levels.

2. CREDIT RISK

Credit risk is the risk of clients, issuers or counterparts not fulfilling their payment obligations. Therefore, proper management is essential to maintain loan quality of the portfolio.

The objectives of Credit Risk Management at the Institution are:

- Comply with the Risk Appetite defined by the Board of Directors.
- Improve the quality, diversification and composition of the loan portfolio in order to optimize the risk- reward ratio.
- Provide Executive Management with reliable, timely information to assist decision making regarding funding.
- Provide Business Areas with clear and sufficient tools to support and monitor funding placement.
- Create economic value for shareholders through an efficient Credit Risk Management.
- Define and update the regulatory framework for the Credit Risk Management.
- Comply with the information requirements that the authorities establish regarding Credit Risk Management.
- Perform Risk Management in accordance with the best practices, implementing models, methodologies, procedures and systems based on best practices worldwide.
- Measure Institution's vulnerability to extreme conditions and consider those results for decisions making.



The Institution's Risk Management policies are:

- Grant and Manage Retail Credit Risk according to best market practices through Parametric Models aimed to identify risk, minimize losses and increase loan origination with quality.
- Grant and Manage Wholesale Loans to companies and other entities, according to best market practices through a credit strategy including Target Markets and Risk Acceptance Criteria, identifying and managing risk through Loan Rating and Early Alerts methodologies.
- Monitor and control asset quality through Loan Classification System which provides treatment and general actions for defined situations, as well as departments or officers responsible for carrying out such actions.
- Surveillance and Control through Global and Specific Limits, loan rating policies and Credit Risk models that identifies expected and unexpected losses at specific confidence intervals.
- Inform and disclose Credit Risks to risk taking areas, CPR, Board of Directors, Financial Authorities and Investors.
- Define faculties for Credit Risks taking at Institution.

In order to comply with objectives and policies, a series of strategies and procedures have been defined including origination, analysis, approval, management, monitoring, recovery and collections.

2.1. Credit Risk Scope and Methodology

2.1.1. Individual Credit Risk

The Institution segments the loan portfolio into two large groups: retail loans and wholesale loans.

The individual Credit Risk for retail loans is identified, measured and controlled through a parametric system (scoring) that includes models for each of the SME (small and medium enterprises) and consumer products (mortgage, auto, payroll, personal loans and credit cards).

Individual risk for wholesale loans is identified, measured and controlled through Objective Markets, Criteria for Risk Acceptance, Early Alerts and Banorte's Internal Risk Rating (CIR Banorte).

The Target Markets, Risk Acceptance Criteria and Early Alerts are tools that, together with the Internal Risk Rating, are part of Banorte's Loan Strategy and support the estimated level of Credit Risk.

The Target Markets are categories of economic activity by region, backed by economic research and loan behavior analysis as well as by expert opinions, where Banorte is interested in granting loans.

The Risk Acceptance Criteria are parameters that describe different types of risks by industry, in order to estimate the risk taking when granting loans to customers based on their economic activity. The types of risk observed in the Risk Acceptance Criteria are: Financial, Operation, Market, Enterprise's life cycle, Legal and Regulatory Risks, besides credit experience and management quality.

Early Warnings are a set of criteria based on borrower information and indicators, as well as their environment, as a mechanism for timely prevention and identification of a probable deterioration in the loan portfolio, thereby enabling Institution to take prompt preventive actions to mitigate Credit Risk.

Banorte's CIR is a borrower's rating methodology which assesses quantitative and qualitative criteria in order to determine credit quality. CIR applies to commercial loans equal to or greater than the equivalent of four million investment units (UDIS) in Mexican pesos equivalent on the qualification date, or borrowers whose annual sales or income are the greater or equal to 14 million (UDIS) (only for business enterprises).

2.1.2. Portfolio Credit Risk

The Institution developed a portfolio Credit Risk methodology that, besides including international standards for identifying, measuring, controlling and monitoring, has been adapted to function within the context of the Mexican Financial System.



This Credit Risk methodology provides current value of the entire loan's portfolio at the Institution, that is, the loan exposure, in order to monitor risk concentration levels through risk ratings, geographical regions, economic activities, currency and type of product in order to observe the portfolio's profile and take action to improve diversification, which will maximize profitability with the lowest risk.

The model considers the loan portfolio exposure directly to the balance of each loan, whereas for the financial instruments' portfolio, considers the present value of the instruments and their future cash flows. This exposure is sensible to changes in the market, thereby facilitating estimations under different economic scenarios.

The methodology, besides loan exposure, takes into consideration the probability of default, recovery level associated to each client and the classification of the debtor based on the Merton model. The probability of default is the probability that the debtor will not fulfill his/her debt obligation with the institution according to the originally agreed terms and conditions. The probability of default is based on transition matrixes estimated by the Institution based on the migration of the debtors through different risk rating levels. The recovery ratio is the percentage of total exposure that is estimated to be recovered if the debtor defaults. The classification of the debtor, based on the Merton model, associates the debtor's future behavior to loan and market factors on which his "credit health" depends, as determined by statistical techniques.

The results of this methodology are risk measures such as the expected and unexpected loss at a one-year horizon. The expected loss is the average of credit portfolio's loss distribution, which is used to measure the following year's expected loss due to default or variations in debtors' credit quality. The unexpected loss is an indicator of the loss in extreme scenarios and is measured as the difference between the maximum losses given the distribution of losses, at a specific confidence level that for the Institution is 99.95% and expected loss.

These results are used as a tool for better decision-making in granting loans and in the diversification of the portfolio, according to Banorte's strategy. The individual risk identification tools and the portfolio Credit Risk methodology are periodically verified and updated in order to include the application of new techniques that may support or strengthen them.

2.1.3. Credit Risk of Financial Instruments

Credit Risk Management of financial instruments is managed through a series of key pillars with a robust framework of policies for origination, analysis, authorization and management.

Origination policies define the types of eligible negotiable financial instruments, as well as the methodology for assessing Credit Risk of the different types of originators / issuers and counterparts. Credit Risk is allocated through: a risk rating obtained with an internal methodology, evaluations of external rating agencies or a combination of both. Maximum parameters of operation are also defined depending on the type of originator / issuer or counterpart, rating and type of operation.

The Loan Committee authorizes operation lines with financial instruments for clients and counterparties in accordance with authorization policies. The authorization request is submitted by the business area and other areas involved in the operation, with all the relevant information for analysis by the Committee who, if considered appropriate, issues its authorization. Nevertheless, the UAIR is empowered to authorize counterparty credit lines (mainly financial entities) that comply with certain criteria through a parametric methodology approved by the CPR.

In the specific case of derivatives contracts, and in line with best practices, a methodology for calculating potential exposure of credit lines is used, which are analyzed and approved within the Credit Committee and are monitored on daily and monthly basis in the CPR, where guarantee analysis for derivative transaction is held both for clients and financial counterparties.

The National Credit Committee holds the minimum faculty to approve credit lines for derivatives (in case of applying facilities, the UAIR will hold the faculty). For these transactions, the use of derivatives with margin calls shall be privileged in order to mitigate the risk of potential exposure to these transactions.

To determine the lines of credit adversely correlated (Wrong Way Risk "WWR") a potential exposure adjustment is considered.



On an individual level, the risk concentration on financial instruments is managed on a continuous basis, establishing and monitoring maximum parameters of operation for each counterparty or issuer depending on the qualification and type of operation. There are defined risk diversification policies for portfolios, for economic groups and internal groups. Additionally, the concentration of counterparty type or issuer, size of financial institutions and the region in which it operates are monitored so that an appropriate diversification is obtained and undesired concentrations are avoided.

Credit Risk is measured through a rating associated with the issuer, security or counterparty which has a previously assigned risk level based on two fundamentals:

- 1) The probability of nonfulfillment of the issuer, security or counterparty, which is expressed as a percentage between 0% and 100% where the better the rating or lower rate differential vs. the instrument of an equivalent government bond, the lower the probability of non-fulfillment and vice versa.
- 2) The loss given default that could be experienced with respect of the total of the operation in the event of non-fulfillment, is expressed as a percentage between 0% and 100% where the better the guarantees or credit structures, the smaller the loss given default and vice versa. To mitigate Credit Risk and to reduce the loss given default in the event of non-fulfillment, the counterparties have signed ISDA contracts and agreements to net out, in which credit lines and the use of collateral to mitigate loss in the event of non-fulfillment are implemented.

2.2. Credit Risk Exposure

As of March 31, 2020 (Unaudited) the total amount of the exposure subject to the Standard Method and Internal Models (Advanced Internal Model for Credit Cards and Basic Internal Model for Corporations) to estimate the Capital Ratio is the following:

Gross Exposures subject to the Standard Method and/or Internal Models <i>(Million pesos)</i>	Banorte
Commercial	61,794
Annual Revenues or Sales < 14 MM UDIS	61,794
States or Municipalities	104,404
Decentralized Federal, State and Municipal Government Agencies and State Companies	42,938
Projects with own source of payment	95,163
Financial Institutions	24,015
Mortgage	175,295
Consumer Non-Revolving	51,708
Total Loans subject to the Standard Method	555,318
Commercial	138,224
Annual Revenues or Sales >=14 MM UDIS	138,224
Federal, State and Municipal Government	
Decentralized Agencies, with annual income or Sales >= 14 MM UDIS	13,939
Total Loans subject to the Basic Internal Model	152,163
Credit Cards	27,419
Total Loans subject to Advanced Internal Model	41,090
Total Portfolio	68,509

For transactions subject to Credit Risk, the Institution uses external ratings issued by the rating agencies S&P, Moody's, Fitch, HR Ratings, Verum, DBRS Ratings México and A.M. Best America Latina. Only ratings issues by rating agencies are considered, and are not assigned based on comparable assets.



2.2.1. Exposure to Financial Instruments

As of March 31, 2020 (Unaudited), exposure to Credit Risk for Securities Investments of Banco Mercantil del Norte was Ps 254,193 billion, of which 96.0% is rated higher or similar to A+(mex) on a local scale, placing them in investment grade and the 3 main counterparties other than the Federal Government, State Governments and National Financial Institutions represent 8% of the Tier 1 Capital as of December 2019. Additionally, the exposure of investments with the same counterparty other than the Federal Government that represents a higher or similar concentration to 5% of the Net Capital as of December 2019 has higher or similar rating to BBB+(mex) and is comprised of (*average considered term, amount in million pesos and average return to annualized maturity*): market and bond certificates from Pemex to 3 years and 11 months totaling Ps. 12.15 billion at 9.5%.

For derivative operations, the exposure of the 3 main counterparties other than the Federal Government, State Governments and National Financial Institutions represent 5% of the Tier 1 Capital as of December 2019.

Banorte's exposure to counterparty risk from transactions with derivatives is presented below, as well as the netting effect and risk mitigation based on the aggregate of guarantees related to settle transactions (includes operations with Banxico. Excludes settled transactions through central counterparties).

Position (Million pesos)	1Q20	1Q20 Average
Forwards	Ps. (272)	Ps. (103)
FX Swaps	49	173
FX	20	4
Options	(1,586)	(846)
Interest Rates Swaps (IRS)	9,401	8,421
Cross Currency Swap (CCIRS)	(14,208)	(9,191)
Cross Default Swap (CCIRS)	792	374
Total	(5,804)	(1,168)
Positive Fair Value (Positive Market Value)	16,031	13,194
Netting Effect*	21,835	14,362
Delivered Guarantees(-) /Received(+)		
Cash	(18,747)	(11,384)
Securities	0	0
Total	(18,747)	(11,384)

* Difference between the positive market value (not considering the net positions) and the portfolio market value. Transactions performed at the clearing house are not included, as they are not subject to counter party risk.

The following table represents the current and potential levels of exposure at the end and the average of the quarter, respectively:



(Million pesos)	Potential Risk		Current Risk	
Financial Counterparties	1Q20	1Q20 Average	1Q20	1Q20 Average
FWD			(169)	(61)
FX SWAP	830	897	49	173
FX			20	4
OPTIONS	2,756	1,872	(1,499)	(781)
INTEREST RATE SWAP	4,103	4,061	(2,163)	(1,473)
CCS	5,092	3,087	(14,229)	(9,209)
CDS	803	383	792	374
Total	6,443	5,663	(17,199)	(10,973)
Clients (Non-Financial)	1Q20	1Q20 Average	1Q20	1Q20 Average
FWD	27	35	(103)	(42)
OPTIONS	81	73	(87)	(65)
INTEREST RATE SWAP	12,486	10,799	11,564	9,894
CCS	27	21	22	18
Total	12,561	10,892	11,396	9,805

Based on conditions established in derivative agreements, tolerance levels of exposure are considered according to the rating of involved entities. The following table presents the amount of guarantees to be delivered, in case of a rating downgrade. It's worth noting that with most counterparties we've migrated to zero threshold, thus, guarantees to be delivered do not depend on credit rating but to market movements:

Net Cash Outflows (Million pesos)	1Q20	1Q20 Average
Cash Outflow with 1-notch Downgrade	-	-
Cash Outflow with 2-notch Downgrade	-	-
Cash Outflow with 3-notch Downgrade	-	-

In the following table, the derivatives' market value is detailed according to the counterparties' ratings.

Rating (Million pesos)	MtM 1Q20	1Q20 Average
AAA/AA-	(1)	-
A+/A-	(11,496)	(7,400)
BBB+/BBB-	(2,616)	(1,985)
BB+/BB-	2,794	3,441
B+/B-	-	-
CCC/C	-	-
SC	5,515	4,776
Total	(5,804)	(1,168)



2.3. Credit Collaterals

Collaterals represent the second credit recovery source when its coverage, through the predominant activity of the applicant, is compromised. Collaterals may be real or personal.

The main types of real collaterals are the following:

- Civil Mortgage
- Industrial Mortgage
- Regular Pledge
- Pledge w/o possession transfers
- Pledge / Pledge Bond
- Pledge Bond
- Caution Securities
- Securities Pledge
- Management and Payments Trust
- Development Funds

For assets granted in guarantee, the Institution has policies and procedures to monitor and make periodic inspection visits to ensure the existence, legitimacy, value and quality of the guarantees accepted as an alternative credit support. Furthermore, when guarantees are securities, there are policies and procedures to monitor its market's valuation and require additional guarantees if needed.

The covered loan portfolio by type of collateral is as follows:

Collateral Type <i>(Million pesos)</i>	Banorte 1Q20
Total Loan Portfolio	776,051
Covered Loan Portfolio by type of collateral	
Real Financial Guarantees	20,417
Real Non-Financial Guarantees	434,082
Pari Passu	28,715
First Losses	18,179
Personal Guarantees	21,671
Total Loan Portfolio Covered	523,064

2.4. Expected Loss

As of March 31, 2020 (Unaudited), Banco Mercantil del Norte's total portfolio was Ps. 775,990 billion. The expected loss represents 2.2% and the unexpected loss is 4.3% with respect to the total portfolio. The average expected loss is 2.2% during the period January– March 2020.

2.5. Internal Models

2.5.1. Internal Advanced Model for Credit Card

On November 15, 2017, the Institution received approval from the banking regulator (Comisión Nacional Bancaria y de Valores) to use Internal Models (IM) for credit card rating for reserves and regulatory capital constitution for credit risk with an advanced focus (Document 111-3/706/2017).

These internal models improve overall credit risk management by estimating risk parameters from the bank's expertise and have been applied as of February 2018 (based on January 2018 data). The aforementioned parameters are:



- **Probability of Default.** Indicates the probability that a credit card customer defaults on its contractual obligations within the next twelve months after the month being rated. For each loan, there is a score, which is mapped to a Master rating scale.
- **Severity of Loss.** Measures the intensity of the loss upon default expressed as a percentage of the Default Exposure (DE).
- **Default Exposure.** Is the amount of the debt at the time of default of a loan, considering a time horizon of twelve months after the month being rated.

The next table shows the Credit Card portfolio subject to the Internal Advanced Model, classified by degrees of regulatory risk:

Consumer Revolving Portfolio under Internal Advanced Model							<i>Million pesos</i>
Risk Degree*	Accounting Balance	Default Exposure (DE)**	Severity of Loss	PD weighted by DE	Unused credit lines	DE weighted by exposure	Current DE
A1	16,809	30,330	87.30%	1.06%	52,462	45%	30,330
A2	5,129	8,115	87.30%	3.35%	6,650	37%	8,115
B1	4,582	6,062	87.30%	4.95%	1,643	24%	6,062
B2	424	802	87.30%	4.75%	1,078	47%	802
B3	2,373	3,128	87.30%	8.23%	771	24%	3,113
C1	4,204	5,473	87.30%	9.17%	1,195	23%	5,441
C2	3,153	3,960	87.30%	17.29%	643	20%	3,815
D	3,441	3,771	87.30%	47.67%	393	9%	1,100
E	973	983	88.75%	98.31%	218	1%	15
Total Portfolio	41,088	62,624	87.46%	8.20%	65,053	34%	58,793

* The scale in Risk Degree of the Internal Advanced Model has been mapped in accordance with regulatory risk levels.

** The balances under Default Exposure include Potential Risk as well as used credit line balance.

The next table shows the difference between expected loss and observed loss resulting from the Internal Advance Model for Credit Cards from 1Q20:

Backtesting				
Portfolio	Expected Loss Internal Model*	Observed Loss*	Difference Ps (Observed Loss – Expected Loss)	% NCL Coverage
Credit Card	4,515	4,812	298	107%
Total Portfolio	4,515	4,812	298	107%

* Expected and Observed Loss is equal to the last twelve months average.

2.5.2. Basic Internal Model for Corporations

On November 30, 2018, GFNorte obtained authorization from the banking regulator CNBV (Comisión Nacional Bancaria y de Valores) to use the Internal Model (IM) for Commercial Loans for reserves generation and regulatory capital requirements by credit risk with a basic approach, as per Document 111-3/1472/2018 in Banco Mercantil del Norte, and on March 1, 2019 for Arrendadora and Factor Banorte, Sólida Administradora de Portafolios, as per Documents 1111/160/2019 and 111-1/161/2019, respectively.

Exposures subject to this rating are those pertaining to corporations (other than states, municipalities and financial entities), and individuals (sole proprietorships), both with annual sales higher or equal to 14 million UDIs.



The Internal Model (IM) enhances the overall credit risk management practice by estimating risk parameters through the institution's own experience with such customers. These models have been applied since February 2019 (January figures) at Banco Mercantil del Norte, and starting in March 2019 (with February figures) at Arrendadora and Factor Banorte, and Sólida Administradora de Portafolios. The parameter authorized under the Basic Internal Model for Corporations is:

- Probability of Default. Shows the likelihood that a borrower defaults on its contractual obligations within twelve months after the month being rated. There is a score assigned to each borrower, which is in turn mapped against a master rating scale.

The following table shows the portfolio which is subject to the Internal Model for Corporations, classified by risk level:

Commercial Loans subject to the Basic Internal Model			Million Pesos
Subsidiary	Accounting Balance	Default Exposure (DE)**	Expected Loss
Banco Mercantil del Norte	161,580	161,797	2,612
Cartera Total*	161,580	161,797	2,612

* The balance includes Letters of Credit in the amount of Ps 9.40 billion and excludes accounting adjustments of Ps 15 million in Banorte and Ps 142 million in Arrendadora and Factor Banorte.

** DE balances includes both potential risk as well as used balance.

2.6. Risk Diversification

In December 2005, the CNBV issued "General Provisions Applicable to Credit Institutions related to Risk Diversification". These guidelines state that institutions must perform an analysis of their borrowers and/or loans to determine the amount of "Common Risk"; also, institutions must have the necessary information and documentation to prove that the person or group of people represent a common risk in accordance with the assumptions established in those rules.

In compliance with risk diversification regulation on active and passive operations, **Banco Mercantil del Norte** submits the following information:

Tier 1 as of December 31, 2019 (Million pesos)		139,655
I. Loans with individual balance greater than 10% of basic equity:		
<u>Loan Operations</u>		
Number of loans		-
Total amount of loans		-
% in relation to Tier 1		-%
<u>Money Market Operations</u>		
Number of loans		-
Total amount of loans		-
% in relation to Tier 1		-%
<u>Overnight Operations</u>		
Number of loans		-
Total amount of loans		-
% in relation to Tier 1		-%
II. Maximum amount of credit with the 3 largest debtors and common risk groups		42,149



3. MARKET RISK (BANK AND BROKERAGE HOUSE)

The Institution objectives regarding Market Risk are:

- Comply with the Desired Profile Risk defined by the Group's Board of Directors.
- Maintain an adequate monitoring on Market Risk.
- Maintain the Senior Management adequately informed in time and form.
- Quantify exposure to Market Risk through the use of various methodologies.
- Define maximum risk levels the Institution is willing to maintain.
- Measure the Institution's vulnerability to extreme market conditions and consider such results when making decisions.

The Institution Market Risk Policies are:

- New products subject to market risk must be evaluated and approved through the new products' guidelines approved by the CPR.
- The Board of Directors is the entitled body to approve global limits and market risk's appetite metrics, as well as their amendments.
- The CPR is the entitled body to approve models, methodologies and specific limits, as well as their amendments.
- Market risk models will be valid by and independent area, which is different from the one that develop and manage them.
- Market risk inputs and models will be valid as per a properly approved policy by the CPR.

3.1 Market Risk Methodology

Market Risk Management is controlled through a series of fundamental pillars, highlighting the use of models and methodologies such as Potential Loss commonly known as "expected shortfall" Back Testing, Sensibility Analysis and Stress Testing, which are used to measure the risk of traded products and portfolios in the financial markets. It is noteworthy that based on Basel requirements referred in the document "Minimum Capital Requirements for Market Risk", Banorte implemented during January the estimation of expected shortfall, thus substituting the estimation of VaR. In addition, it was implemented the valuation of derivatives by OIS curves and curves adjusted by collateral following international standards.

Risk management is supported by a framework of policies and manuals through which the implementation and monitoring on market risk limits, the disclosure of the aforementioned risk metrics and its tracking regarding the established limits, are set.

Key risk ratios are disclosed in monthly reports to the Risk Policy Committee and through a daily report to top executives at the Institution, related to the Market Risk risk-taking.

3.2. Market Risk Exposure

Exposure of the Institution's financial portfolios to Market Risk is quantified using the methodology denominated expected shortfall which is the average of losses once VaR is surpassed.

The expected shortfall model considers a one day horizon base, and considers a non-parametric historical simulation with a 97.5% confidence level and 500 historical observations on risk factors. Furthermore, it considers all the positions (money market, treasury, equities, FX and derivatives) classified for accounting purposes as trading assets, both on and off the unaudited condensed consolidated interim statement of financial position.

The average expected shortfall of the portfolio for 1Q20 (Unaudited) was Ps. 98.7 million (Ps. 30.9 million lower than the average expected shortfall from last quarter).

The result shows that the Institution's expected shortfall, using a 97.5% confidence level, is on average Ps 98.7 million.



Expected Shortfall (Million Pesos)	1Q20 Average
Total Expected Shortfall	98.7
Net Capital	156,968
Expected Shortfall/Net Capital	0.06%

Expected shortfall by risk factor behavior during the first quarter of the year is as follows:

Risk Factor (Million Pesos)	1Q20	1Q20 Average
Rates	81.9	74.5
FX	68.5	59.8
Equity	81.5	67.8
Diversification Effect	(119.4)	(103.4)
Bank's Expected Shortfall	112.5	98.7

Expected shortfall for 1Q20 (Unaudited) was Ps. 112.5 million. The contribution to the Institution's expected shortfall for each risk factor is:

Risk Factor (Million Pesos)	1Q20	1Q19 Average
Domestic Rates	13.0	30.7
Foreign Rates	20.6	10.2
FX	27.9	15.2
Equity	51.0	42.6
Bank's Expected Shortfall	112.5	98.7

Expected shortfall by risk factor is determined by simulating 500 historical scenarios to each risk factor and assessing instruments by their main risk factor. It is important to note that all positions classified as trading were considered, positions classified as held to maturity and available for sale were excluded.

The proportion by market risk factor excluding the diversification effect is:

Risk Factor	1Q19
Rates	37%
FX	30%
Equity	33%

3.3. Sensitivity Analysis and Stress Testing under extreme conditions

Complementary to expected shortfall and for strengthening risk analysis, Banorte tests under extreme conditions, also known as Stress Testing. This is presented to the Risk Policy Committee on monthly basis with the main objective of assessing the impact on the Institution's positions of extreme movements in risk factors.

3.4. Backtesting

In order to validate the effectiveness and accuracy of the expected shortfall, a monthly Back testing analysis is presented to the Risk Policy Committee. Through this analysis, it is possible to compare losses and gains observed with respect to the estimated expected shortfall and if necessary make the required adjustments to the parameter.

4. BALANCE AND LIQUIDITY RISK



The Institution Balance and Liquidity Risk objectives are:

- Comply with the Risk Appetite defined by the Group's Board of Directors.
- Give proper monitoring of Balance and Liquidity Risk.
- Assessing through the use of different methodologies, Balance and Liquidity Risk exposure.
- Measure Institution's vulnerability to extreme market conditions and consider such results for decision making.
- Maintain Senior Management properly informed in a timely manner on Balance and Liquidity Risk exposure and on any limits' and risk profile's deviation.
- Monitor the institution's coverage policy and review it at least annually.
- Maintain a sufficient level of liquid assets eligible to guarantee the institution's liquidity even under stress conditions

The Institution Liquidity Risk Policies are:

- Establishment of specific global limits of Balance and Liquidity Risk Management.
- Measurement and monitoring of Balance and Liquidity Risk.
- Information and disclosure of Liquidity Risk to risk-taking areas, CPR, Board of Directors, Financial Authorities and to public investors

4.1. Liquidity Risk Methodology and Exposure

Balance and Liquidity risk is managed through a series of fundamental pillars that include the use of key indicators such as the Liquidity Coverage Ratio (LCR), re-price gaps and liquidity, as well as stress testing. The latter, based on a framework of policies and manuals, including a funding contingency plan, and a contingency plan to preserve solvency and liquidity. Similarly, is enhanced with monitoring limits and Risk Appetite metrics of Balance and Liquidity Risk. The disclosure of metrics and indicators and their compliance with established limits and desired Risk Appetite is performed through monthly reports to the CPR, weekly reports to the capital and liquidity management group, and quarterly reports to the Board of Directors.

4.2. Profile and Funding Strategy

The composition and evolution of the Bank's funding during the quarter is shown in the following table:

Funding Source (Million pesos)	4Q19	1Q20	Var vs. 4Q19
Demand Deposits			
Local Currency ⁽¹⁾	393,386	403,689	2.6%
Foreign Currency ⁽¹⁾	44,778	51,181	14.3%
Demand Deposits	438,164	454,870	3.8%
Time Deposits – Retail			
Local Currency ⁽²⁾	216,685	213,451	(1.5%)
Foreign Currency ⁽²⁾	12,351	13,142	6.4%
Core Deposits	667,200	681,462	2.1%
Money Market			
Local Currency ⁽³⁾	50,791	75,868	49.4%
Foreign Currency ⁽³⁾	24,010	31,794	32.4%
Banking Sector Deposits	742,001	789,125	6.4%

1. Includes balance of the Global Deposits without Movement.
2. Includes eliminations among subsidiaries.
3. Money Market and Time Deposits

4.3. Liquidity Coverage Ratio (LCR)

The LCR measures Liquidity Risk through the relationship between Liquid Assets and Net Cash Outflows in the next 30 days, under a regulatory stress scenario.



The LCR is an indicator designed to ensure that the institution has sufficient liquidity to meet its short term obligations, under an extreme scenario using exclusively high quality liquid assets as source of funding.

The following table presents the average evolution of LCR components in 1Q20.

LCR Components (Million of pesos)	Bank and Sofomes	
	Unweighted amount (Average)	Weighted amount (Average)
COMPUTABLE LIQUID ASSETS		
1 Total Computable Liquid Assets	NA	106,915
CASH DISBURSEMENTS		
2 Unsecured retail financing	400,503	28,103
3 Stable financing	238,953	11,948
4 Less stable financing	161,550	16,155
5 Unsecured wholesale financing	233,330	72,906
6 Operational Deposits	172,632	38,581
7 Non-Operational Deposits	56,158	29,786
8 Unsecured debt	4,539	4,539
9 Secured wholesale financing	240,574	18,412
10 Additional Requirements:	339,065	23,589
11 Disbursements related to derivatives and other guarantee requirements	70,786	8,781
12 Disbursements related to losses from debt financing	0	0
13 Credit and liquidity lines	268,278	14,808
14 Other contractual financing obligations	2,333	248
15 Other contingent financing liabilities	0	0
16 TOTAL CASH DISBURSEMENTS	Not applicable	143,258
CASH INFLOWS		
17 Cash Inflows for secured operations	98,549	17,188
18 Cash Inflows for unsecured operations	49,030	31,159
19 Other Cash Inflows	5,464	5,464
20 TOTAL CASH INFLOWS	153,043	53,811
		Adjusted Amount
21 TOTAL COMPUTABLE LIQUID ASSETS	Not applicable	106,915
22 TOTAL NET CASH DISBURSEMENTS	Not applicable	89,446
23 LIQUID COVERAGE RATIO	Not applicable	120.12%

During 1Q20, the average LCR for the 91 days in the quarter for the Bank and Sofomes was 120.12%, and at the end of 1Q20 the LCR was 125.26%. The aforementioned levels are above the Risk Appetite and the regulatory minimum standards. These results show that Banorte can meet all of its short-term obligations in a crisis scenario ¹.

4.4. Evolution of LCR Components

The evolution of the LCR components comparing 4Q19 and 1Q20 is presented in the following table.

LCR Component (Million of pesos)	4Q19	1Q20	Var vs. 4Q19
Liquid Assets	103,080	114,567	11.1%
Cash Inflows	44,610	69,743	56.3%
Cash Outflows	135,147	161,208	19.3%

¹ The Liquidity Coverage Ratio information is preliminary and is subject to Banco de Mexico's affirmation.



The Liquid Assets that compute in the LCRs for the Bank and Sofomes between 4Q19 and 1Q20 are distributed as follows:

Type of Asset <i>(Million of pesos)</i>	4Q19	1Q20	Var vs. 4Q19
Total	103,080	114,567	11.1%
Level I	95,218	108,655	14.1%
Level II	7,862	5,912	(24.8%)
Level II A	4,126	2,515	(39.0%)
Level II B	3,736	3,398	(9.1%)

Liquid assets decreased in the quarterly comparison in 4Q19 and 1Q20, due to the federal government securities exchange in foreign currency as part of a long term repo operation, deposit requirements, and expiration of instruments Level IIA.

4.5. LCR Result's Main Causes

Variations in the LCR between 4Q19 and 1Q20 are mainly due to the decrease in cash outflows related to the funding exchange market conditions, as well a funding substitution strategies, while available liquidity remains stable when comparing both quarters.

4.6. Liquidity Risk in foreign currency

For Liquidity Risk quantification and monitoring, in the specific case of the foreign currency denominated portfolio, Banorte uses the criteria established by Banco de México for the assessment of the foreign currency Liquidity Coefficient.

The Liquidity Coefficient in foreign currencies should be interpreted as the ability of the institution to meet its liquidity mismatches with liquid assets, both in foreign currency.

4.7. Exposure to Derivatives and possible Margin calls

Banorte applies the regulatory methodology to determine cash outflows for derivatives. At the end of 1Q19, estimated outflows for derivatives were as follows:

Derivatives Cash Outflows <i>(Million of Pesos)</i>	4Q19	1Q20	Var vs. 4Q20
Net cash outflows at market value and for potential future exposure	4,767	4,517	(5.2%)
Cash outflows for a 3 notch credit rating downgrade	0	0	0%

The former measurement shows that potential outflows for derivatives may represent a liquidity requirement up to Ps 4.52 billion, stable vs. 4Q19.

4.8. Liquidity Gaps

As part of the liquidity analysis for the Bank, 30 days liquidity gaps for the Institution's assets and liabilities (obligations) are analyzed. Results for the Bank at the end of 1Q20 are presented in the following table.

Concept <i>(Million of pesos)</i>	4Q19	1Q20	Var vs. 4Q19
Cumulative 30 day Gap	(67,420)	(61,440)	(8.9%)
Liquid Assets	78,466	74,116	(5.5%)



Mismatch among inflows and outflows (gaps) for the next 30 days are covered with liquid assets. In addition, a more granular breakdown of the liquidity gaps is presented, remaining as follows for 1Q20:

Concept (Million of pesos)	1 day	7 days	1 month	3 months	6 months	12 months
Natural Gap	(40,142)	9,562	(30,860)	6,514	11,542	25,166
Accumulated Gap	(40,142)	(30,580)	(61,440)	(54,926)	(43,384)	(18,218)

4.9. Stress Testing under liquidity extreme conditions

As part of its Liquidity Risk management, Banorte performs tests under extreme liquidity circumstances with internal scenarios, to assess the Bank's liquidity adequacy under adverse conditions from the environment as well as by the bank's intrinsic conditions. A total of 9 scenarios, based on 3 sources of risk (systemic, idiosyncratic and combined) with 3 levels of severity (moderate, medium and severe) are used.

4.10. Contingency Funding Plan

In order to comply with comprehensive liquidity management practices, and to ensure its operation in adverse situations in terms of Liquidity, Banorte has implemented a contingency funding plan, which incorporates elements to identify possible liquidity problems and defines alternate funding sources available to deal with contingencies.

4.11. Balance Risk

Interest rate risk entails estimating its impact on the financial margin as well as on equity's economic value. Financial margin is the difference between interest income and costs associated to interest bearing liabilities (interest expense). Depending on the balance's structure, variations in interest rates may have either a positive or negative impact in the rate scenarios. On the other side, economic value measures variations on equity flows due to changes on interest rate structure.

Given that both financial margin and equity's economic value follows the flow structure of assets and liabilities in the unaudited condensed consolidated interim statement of financial position, the model used to estimate those metrics is a re-pricing model by brackets in which all assets and liabilities are distributed in different bands depending on their re-pricing characteristics and/or tenure. Once categorized by re-pricing structure, the impact that each of these bands have on these metrics can be estimated.

4.11.1. Financial Margin Sensitivity

Financial Margin sensitivity is a metric that takes into consideration a twelve-month period. Only the bands with duration lower than 1 year are impacted by interest rate simulated fluctuations, and consider a parallel and symmetric shift for both active and passive interest rates. Relevant considerations behind margin sensitivity calculations are:

- All financial assets and liabilities in the unaudited condensed consolidated interim statement of financial position are considered. The book for trading is monitored separately.
- This metrics takes into consideration all unaudited condensed consolidated interim statement of financial position behavior models, such as mortgage prepayments and deposit survival.
- The unaudited condensed consolidated interim statement of financial position is regarded as static and constant through time. Neither organic growth nor structural or mix changes are considered.

The following table shows Financial Margin Sensitivity for Banorte:

Margin Sensitivity (Million of Pesos)	4Q19	1Q20
Local Currency Balance	554	462
Foreign Currency Balance	362	570



At the end of 1Q20, local currency balance sensitivity for a 100bps increase in domestic interest rates, changed from Ps 554 million on 4Q19 to Ps 462 million. Foreign currency balance sensitivity for a 100bps increase in foreign interest rates changed from Ps 362 million on 4Q19 to Ps 570 million. It is important to note that positions on the financial markets immunize, through Trading Income, any effect due to lower rates on Balance

5. OPERATIONAL RISK

The Institution has a formal Operational Risk department headed by the “Deputy Managing Director of Financial and Operational Risk”, reporting directly to the Chief Risk Officer.

Operational Risk is defined as the potential loss due to failures or deficiencies in internal controls, errors in operation processing and storing or in data transmitting, as well as to adverse administrative and judicial rulings, fraud or theft (this definition includes Technological and Legal Risk).

The objectives of Operational Risk Management are: a) Enable and support the organization to reach its institutional objectives through prevention and management of operational risks; b) To ensure that the existing operational risks and the required controls are properly identified, assessed and in line with the risk strategy established by the organization; and c) To ensure that operational risks are properly quantified in order to adequately allocate capital per Operational Risk.

Pillars in Operational Risk Management

5.1. Policies, Objectives and Guidelines

As part of the Institutional regulations, there are documented policies, objectives, guidelines, methodologies and responsible areas in Operating Risk management.

The Operational Risk Management Directors maintains close communication and coordination with the Regulatory Comptrollership in order to facilitate effective Internal Control in which proper procedures and controls are established for mitigating Operating Risk among the processes, and provide monitoring through the Internal Audit Department.

The Regulatory Comptrollership, as part of the Internal Control System, carries out the following activities to mitigate risk: a) Internal control validations; b) Institutional regulations management and control; c) Monitoring of operating processes' internal control by means of control indicators reports, that are reported by the process comptrollers in the various areas; d) Money Laundering Prevention process management; e) Control and monitoring of the regulatory provisions; and f) Analysis and assessment of the operating processes and projects with the participation of the responsible Directors of each process in order to ensure adequate internal control.

5.2. Quantitative and Qualitative Measuring Tools

5.2.1 Operational Losses Database

In order to record operating loss events, the Institution owns a system 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:

Type of Events	Description
Internal Fraud	Losses derived from a type of action intended to defraud; unlawfully assets appropriation; or sidestep regulations, laws or company policies (excluding diversity/discrimination events) in which at least one company party is involved.
External Fraud	Losses derived from a type of action intended to defraud; unlawfully assets appropriation; or sidestep the laws, caused by a third party
Labor Relations and Safety in the Workplace	Losses caused by acts incompatible with the legislation or labor agreements regarding hygiene or safety, the payment of personal damage claims, or cases associated with diversity/discrimination
Customers, Products & Business Practices	Losses caused by involuntary noncompliance or negligence of a professional obligation to specific customers (including fiduciary and adjustment requirements), or due to the nature or design of a product



Natural Disasters and Other Events	Losses caused by damage or harm to material assets as a consequence of natural disasters or other events
Incidences in the Business and Systems Failures	Losses caused by incidences in the business and systems failures
Process Execution, Delivery and Management	Losses caused by errors in operations processing or management, as well as relations with commercial counterparties and suppliers

This historical Database provides the statistics of the operational events in which the institution has incurred to determine their trends, frequency, impact and distribution. Moreover, the Database will enable, in the future, to own enough information to estimate capital requirements as per Advances Models.

5.2.2. Legal and Fiscal Contingencies Database

For recording and monitoring legal, administrative and tax issues that may arise from adverse ruling, an internal system called “Legal Risk Issues Monitoring System” (SMARL by its acronym in Spanish) 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, legal and fiscal contingencies are estimated by the attorneys that process the cases, determining its risk level based on an internal methodology. This allows to constitute necessary reserves in a determined term (according to lawsuit’s term) to face such contingencies.

5.3. Risk Management Model

The Institution has defined objectives, which are achieved through different plans, programs and projects. Compliance with such objectives may be adversely affected due to operating risks, therefore it is imperative to provide a methodology for managing them within the organization. Consequently, Operating Risk Management is now an institutional policy defined and supported by senior management.

To perform Operating 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 Regulatory Comptrollership with the support of Process Comptrollership, are processed in order to eliminate or mitigate them (seeking to reduce their severity or frequency) and if the case, defining tolerance levels. Currently, work is being done on developing a new Institution Operating Risk Management Model and the technological tools needed to implement it.

5.4. Required Capital Calculation

In accordance with the current Capitalization for Operational Risk Regulations, the Institution has adopted the Alternative Basic Model, which is estimated and reported periodically to the authorities; the assets subject to operational risk are disclosed in the corresponding note regarding the Rules for capital requirements.

5.5. Information and Reporting

The information generated by the Database and the Management Model is processes periodically to report to the Risk Policies Committee and the Board of Directors regarding the main operating events that were detected, the trends, identified risks and their mitigating strategies. Reporting is also done regarding the status of the main Operating Risk mitigation initiatives implemented by the various areas of the organization.

5.6. Operational Risk Disclosure

Regarding the disclosure for Operational Risk, the cumulative operational losses for the last 12 months, represents 1.6% of the Net Interest Margin.



5.7. Technological Risk

Technological Risk is defined as 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 in the rendering of banking services to the customers. This risk forms an inherent part of Operating Risk, which is why its management is handled collectively throughout the entire organization.

To address the Operating Risk associated with information integrity, and "Integrity Committee" has been created. Its objectives are to align security and information control efforts under a prevention focus, to define new strategies, policies, processes or procedures and to provide solutions to information security issues that affect or may affect the Institutional patrimony.

The functions established by the CNBV for Technology Risk Management are performed by the Institution under regulatory and Integrity Committee guidelines.

To address the Operating Risk caused by high impact external events, GFNorte has a Business Continuity Plan (BCP) and Disaster Recovery Plan (DRP) based on a same-time data replication system at an alternate computer site. All the above, covers the backup and recovery of the Institution's critical applications in the event or any relevant operating contingency.

5.8. Legal Risk

Legal Risk is defined as the potential loss from failure to comply with the applicable legal and administrative provisions, the issuance of indisputable unfavorable court rulings and the application of penalties regarding the operations that the institution performs.

The Legal Risk must be measured as an inherent part of Operating Risk in order to understand and estimate its impact. Therefore, those legal issues which result in actual operating losses of the SMARL system are later recorded in the SCERO a database of operational events.

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.

6. SECURITIZATIONS PERFORMED BY GFNORTE

The main objective of the securitization operations carried out by the Institution, is to transfer risks and benefits of certain financial assets to third parties.

Banorte has accomplished the following securitizations:

- On October 11, 2006, Fincasa Hipotecaria (Fincasa), now merged with Institution, held the irrevocable trust for the issuance of market certificates No. 563, issuer code FCASACB, whose underlying assets are mortgages originated and transferred by Fincasa.
- On November 5, 2007, Banorte held the irrevocable trust for the issuance of market certificates No. 477, issuer code BNTECB, whose underlying assets are loans originated and transferred by Banorte to federal entities, states and municipalities, as well as trusts in which any of such entities act as trustees.

In accordance with criterion C-1 Recognition and Disposal of Financial Assets, these assets were written off from the Institution's unaudited condensed consolidated interim statement of financial position as a sale, given that conditions for the risk's and benefit's transfer inherent in the ownership of the financial assets were met. The Institution is not responsible for assumed or retained risks with respect to trust assets, its sole responsibility is the fulfillment of its obligations in the trust agreement and administration contract.



The Institution is responsible that each of the assigned loans meets the eligibility criteria, at the time of their respective assignment. If the trust, the common representative, the financial guarantor, identify any non-eligible loans, they may require Banorte to replace such loan or if replacement is not possible, to make payment for the "non-replaced ineligible loan" in question. If Banorte identifies any non-eligible loan, it must notify and replace or make the corresponding payment.

Particularly in Trust 477, operations with derivatives are carried out, specifically swaps, in order to reduce exposure to exchange rate and interest rate risks. The Institution assumes the counterparty risk generated by these operations, however these operations are only carried out with institutions of recognized solvency. The Trust's policy is to only carry out derivative instrument operations for the sole purpose of coverage, never for speculation.

The Institution's Board of Directors has no pre-determined policies for the issuance of securitizations, authorization for any new issuance must be requested.

The Institution does not participate in securitizations of third party positions.

There are several risk factors for securitizations that may affect trusts. If these risks materialize, payment to market certificates' holders could be adversely affected. The main risks which these financial instruments are exposed to are credit, market, liquidity and operational risk, which have been detailed in previous sections.

To monitor the quality of Credit Risk exposure of financial instruments arising from securitized assets, the Institution estimates expected loss within one-year time horizon. Likewise, in order to monitor exposure to market risk, the value at risk is calculated with a one-day time horizon and a 99% confidence level, for these instruments.

Banco Mercantil del Norte is the settlor and trustee of trusts for the securitizations carried out. At the same time it acts as underwriter on each issue, offering bonds to investors. Additionally, the Institution also carries out the duties of administrator in each of the trusts.

On the other hand, Banorte also acts as an investor by acquiring titles of market certificates issued by the trusts set up for securitizations. By March 31, 2020 (Unaudited), Banorte had the following position in securities and securitization amounts carried out by the same Institution:

Securitization (Million of pesos)	Banorte	
	Securities	Amount
91_BNTECB_07	50,763,776	1,480
91_BNTECB_07-2	563,059	16
97_FCASACB_06U	-	-

The following shows the proportion of securities held by Banorte, in relation to the total issued for each series:

Securitization (Million of pesos)	Issued Securities	Banorte
91_BNTECB_07	52,313,776	97.0%
91_BNTECB_07-2	1,113,059	50.6%
97_FCASACB_06U	1,351,386	0.0%

Ratings assigned by each rating agency at the end of the quarter for each market certificate issued by the aforementioned trusts are as follows:

Securitization	Standard & Poor's		Fitch Ratings		Moody's		HR Ratings		Verum		Best		DBRS	
	Local	Global	Local	Global	Local	Global	Local	Global	Local	Global	Local	Global	Local	Global
91_BNTECB_07					Aa3.mx	Baa3	HR AAA							
91_BNTECB_07-2					A3.mx	Ba3	HR AA+							
97_FCASACB_06U	mxBBB		BBB (mex)											



As of March 31, 2020 the amounts of the underlying assets of each securitization were:

Securitization (Million of pesos)	Amount		
	Performing	Past-Due	Total
91_BNTECB_07	Ps 2,002	Ps -	Ps 2,002
91_BNTECB_07-2			
97_FCASACB_06U	Ps 88	Ps 115	Ps 203

There are no impaired assets in trust 477.

Securitization exposure broken down by Credit Risk Weight is shown below:

Concept (Million of Pesos)	Balance	Capital Requirement
Securitized with Risk Level 1 (weighted 20%)	-	-
Securitized with Risk Level 2 (weighted 50%)	1,480	59
Securitized with Risk Level 3 (weighted 100%)	16	1
Securitized with Risk Level 4 (weighted 350%)	-	-
Securitized with Risk Level 5, 6 or not rated (weighted 1250%)	-	-

No securitization position is recorded in memorandum accounts and no maintained securitization position is deducted from basic capital.

Securitizations trusts 563 and 477 consider early amortization provisions. The institution has not made revolving securitizations or re-securitizations operations during the quarter.

6.1. Applied Accounting Policies

All securitization operations carried out by the Institution were recognized as sales in accordance with criterion C-1 Recognition and Disposal of Financial Assets. This is because, despite retaining the contractual rights to receive cash flows from financial assets, a contractual obligation is assumed to pay such cash flows to a third party. In addition, an analysis of the transfer of these assets concluded that the entity substantially transfers all the risks and benefits inherent with ownership of the financial assets. Registration of profits from sales conforms to the provisions in paragraph 31 of criterion C-1, which states:

- Eliminate transferred financial assets at the last book value;
- Recognition for the consideration received in the operation;
- Recognition of profit or loss in the income statement, for the difference between the book value of eliminated financial assets, and the sum of (i) compensation received (recognized at fair value) and (ii) the effect (gain or loss) by cumulative valuation recognized in equity.

The BORHIS and GEM Trusts issued certificates in favor of the institution, as holders of rights in last place under the trust agreement. These certificates provide the right to receive a percentage of the distributions and in general to the corresponding proportions of the remnant that may be in the trust after full payment of the bonds. Valuation of the certificates is based on the method of net present value of remaining cash flows expected over the lifespan of the securitization. Remaining cash flows, depending on the type of securitization, are determined as follows:

- BORHIS: the sum of cash flows to be received from the securitized loan portfolio, minus cash flow to be paid to securitized portfolios, minus the monthly administration expenses, plus the income from sales of foreclosed properties, if applicable.
- GEM: is the sum of cash flows to be received from securitized loan portfolios, minus the cash flow to be paid to stock certificates, minus monthly management expenses, plus or minus the change in the interest reserve.

Remaining flows are discounted with the B1 banking curve, which takes into consideration the trust's Credit Risk. The most important assumptions in the valuation of the certificates are the following:

- Non-compliance rate: cash flows to be received from loan portfolios are adjusted by a determined percentage of the outstanding portfolio amount that is estimated to fall into non-compliance. That percentage is estimated using historical performance information of this portfolio. This percentage is applied to flows greater than 12 months.



- b) Prepayment rate: cash flows to be received from the loan portfolio are adjusted by a determined percentage of the outstanding portfolio amount estimated to be prepaid. That percentage is estimated using historical performance information of this portfolio.
- c) Portfolio term: is estimated using WAM (Weighted Average Maturity) of the securitized portfolio.
- d) Portfolio interest rate: is estimated using WAC (Weighted Average Coupon) of the securitized portfolio.
- e) Portfolio payment dates: loan portfolio payment dates are considered to be the same as those of the stock certificates.
- f) Reserve to be rated: the current value of the remaining flows is reduced by the amount of the reserve to be rated. This reserve corresponds to the non-compliance risk for cash flows in the first 12 months.
- g) General account: the current value of the remaining flows are added to the amount of cash or cash equivalents deposited in the general account, collection account and if the case, in the expense reserve account, in case of total payment of the stock certificates, these assets would be distributed to the certificate holders.
- h) General terms of stock certificates: estimated to be in accordance with prices published by Valmer.

Regarding the policies for recognizing obligations in unaudited condensed consolidated interim statement of financial position of the agreements that may require financial support from the Institution in case of asset's securitization: all amounts due under the stock certificates of the different existing securitizations, will be charged to the trust estate. If, for any reason, the liquid assets of the trust net worth are not sufficient to ensure payment of the amounts due under the stock certificates, holders will not have the right to claim payment from the Institution, the Trust, the common representative, the placement agent, the guarantor or guarantors in the case, or anyone else. The stock certificates have not been guaranteed or endorsed by any of the persons involved in the issuance thereof, therefore none of them are obligated to make payments to the certificate holders, with the exception, in the case of a trust, where payments may be charged to the trust in accordance with the trust agreement.

Note: The complimentary information regarding Risk Management in order to comply with Article 88 from the CUB, is available in the Risk Management Quarterly Report for the Institution.

24 - MEMORANDUM ACCOUNTS

	2020	2019
Contingent assets and liabilities	Ps. 79	Ps. 50
Credit commitments	254,795	243,391
Assets in trust or mandate	429,851	460,021
Managed assets in custody	401,255	376,241
Collateral received	160,559	207,870
Collateral received and sold or given as a pledge	66,285	116,266
Investment banking transactions on account of third parties (net)	87,728	96,100
Interest accrued but not charged of past due loans	294	298
Other registration accounts	265,945	249,298
	Ps. 1,666,791	Ps. 1,749,535

25 - CONTINGENCIES

As of March 31, 2020 (Unaudited), 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 unaudited condensed consolidated interim financial position. As of March 31, 2020 (Unaudited), the Institution has recorded a reserve for contentious matters of Ps. 969 (Ps. 973 in 2019).



26 - NEW ACCOUNTING GUIDELINES

As of March 31, 2020 CINIF has issued the following NIFs and improvements to current NIFs, which could lead to certain accounting changes for the Institution:

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

On April 8, 2020, the CNBV issued a number of temporary regulatory measures aimed to enable banks to continue granting loans to their customers in a high volatility environment while mitigating the impact of COVID-19. These temporary measures will be effective from April 1, 2020 to March 31, 2021 and include, enabling banks to use their capital conservation buffer without triggering any sanctions or corrective measures.

Additionally, the CNBV extended through January 1, 2022 the effective date of certain new standards, for which the Institution is in the process of evaluating the impacts on its consolidated financial statements. The new standards which will be applicable to lending institutions as of January 1, 2022 are as follows:

- NIF B-17, "Determination of Fair Value".
- NIF C-2, "Investment in financial instruments".
- NIF C-3, "Accounts receivable".
- NIF C-9, "Provisions, contingencies and commitments".
- NIF C-10, "Derivative financial instruments and hedging relationships".
- NIF C-16, "Impairment of financial instruments receivable".
- NIF C-19, "Financial instruments payable".
- NIF C-20, "Financial instruments receivable principal and interest".
- NIF D-1, "Revenue from contracts with customers".
- NIF D-2, "Costs for contracts with customers".
- NIF D-5, "Leases".
- NIF B-5 "Financial information by segments".
- NIF B-12 "Compensation of financial assets and financial liabilities".
- NIF C-2 "Investment in financial instruments".
- NIF C-10 "Derivative and hedging financial instruments".
- NIF C-13 "Related parties".
- NIF C-14 "Transfer and derecognition of financial assets".
- NIF C-22 "Cryptocurrencies"
- NIF B-11 "Long-lived assets held for sale and discontinued operations"

To date, the Institution's management is in the process of analyzing the impacts that these NIFs may have on the unaudited condensed consolidated interim financial statements.

27 - SUBSEQUENT EVENTS

Application of Special Accounting Criteria – SARS-CoV2 Contingency (COVID-19)

On March 25, 2020, in response to the public health emergency declaration due to the COVID-19 pandemic by Mexico's General Health Council, the Commission issued Special Accounting Criteria ("SAC"), applicable to the Institution for the period from February 28, 2020 through June 27, 2020. The SAC authorized the Institution to consider those performing loans as of February 28, 2020 whose payment of principal and interest were deferred as part of a structured program not be considered as restructured loans as originally established in Criteria B-6 "Loan Portfolio" ("Criteria B-6") and therefore should be maintained within the performing portfolio for the period agreed in that program for purposes of establishing the allowance for credit losses.



In view of the negative impact of the COVID-19 virus, among other measures, safety and health protocols to prevent contagion at the work place were enacted, limited gatherings and group events; home-office was promoted and customers and employees were encouraged to use our digital channels. In addition, the Institution's management decided to support its borrowers through the implementation of various structured support programs as follows:

Loan type	Deferral payment	Interest	Collection charges	Credit bureau impact	Extending timeline	Past-due
Credit card	4 months	No	No	No	NA	No
Payroll	4 months	No	No	No	Yes	No
Personal	4 months	No	No	No	Yes	No
Auto	4 months	No	No	No	Yes	No
Mortgage	4 months	No	No	No	Yes	No
SMS	4 months	No	No	No	Yes	No

As of May 31, 2020 (Unaudited), the details of the application of the support programs giving effects to the special accounting criteria is as follows:

Statement of financial position	Figures with COVID support	Loan portfolio and Allowance For Loan Losses effect	Figures without COVID support
PERFORMING LOAN PORTFOLIO			
Commercial loans	Ps. 481,828	Ps. -	Ps. 481,828
Consumer loans	114,078	(93)	113,985
Mortgage loans	175,520	(6)	175,514
TOTAL PERFORMING LOAN PORTFOLIO	771,426	(99)	771,327
PAST-DUE LOAN PORTFOLIO			
Commercial loans	6,995	-	6,995
Consumer loans	4,471	93	4,564
Mortgage loans	2,396	6	2,402
TOTAL PAST-DUE LOAN PORTFOLIO	13,862	99	13,961
LOAN PORTFOLIO	785,288	-	785,288
(Minus) ALLOWANCE FOR LOAN LOSSES	(17,989)	(465)	(18,454)
LOAN PORTFOLIO, net	767,299	(465)	766,834
TOTAL ASSETS	1,344,068	(465)	1,343,603
Allowance for Loan Losses	6,813	465	8,278
NET INCOME	10,819	(465)	10,354
TOTAL STOCKHOLDERS' EQUITY	123,239	(465)	122,774
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	Ps. 1,344,068	(Ps. 465)	Ps. 1,343,603

As of May 31, 2020 (Unaudited), the balance of loans subject to support programs is Ps.144,363.

The extent to which the COVID-19 pandemic affects results of operations, including higher levels of non-performing loans and leading to the recognition of additional allowances for impairment losses, will depend on its duration and the level of continued disruption to Mexican, regional and global economic activity that at the date remains uncertain.



ISSUER
Banco Mercantil del Norte, S.A., Institución de Banca Múltiple,
Grupo Financiero Banorte, acting through its Cayman Islands Branch
Principal Office
Avenida Revolución 3000 Sur
Colonia Primavera
C.P. 64830
Monterrey, N.L., México

LEGAL ADVISORS
To the Issuer

As to Mexican law:
White & Case, S.C.
Torre del Bosque, P.H.
Blvd. Manuel Ávila Camacho No. 24
Col. Lomas de Chapultepec
11000 Ciudad de México
México

As to U.S. federal and New York law:
White & Case LLP
1221 Avenue of the Americas
New York, New York 10020-1095
United States of America

As to Cayman Islands law:
Maples and Calder
P.O. Box 309
Ugland House
Grand Cayman KY1-1104,
Cayman Islands

To the Initial Purchasers

As to Mexican law:
Ritch, Mueller, Heather y Nicolau, S.C.
Torre Virreyes
Av. Pedregal 24
Piso 10
Col. Molino del Rey
11040 Ciudad de México
México

As to U.S. federal and New York law:
Cleary Gottlieb Steen & Hamilton LLP
One Liberty Plaza
New York, New York 10006-1470
United States of America

AUDITOR
Galaz, Yamazaki, Ruiz Urquiza, S.C.
Member of Deloitte Touche Tohmatsu Limited
Av. Juárez 1102
Piso 40
Col. Centro
64000, Monterrey, Nuevo León
México

TRUSTEE, PAYING AGENT, TRANSFER AGENT AND REGISTRAR
The Bank of New York Mellon
240 Greenwich Street, Floor 7 East
New York, New York
10286



U.S.\$500,000,000

**Banco Mercantil del Norte, S.A.,
Institución de Banca Múltiple, Grupo Financiero Banorte,
acting through its Cayman Islands Branch**

8.375% Perpetual 10-Year Callable Subordinated Non-Preferred Non-Cumulative Tier 1 Capital
Notes

OFFERING MEMORANDUM

July 9, 2020

Global Coordinator

Goldman Sachs & Co. LLC

Joint Book-Running Managers

**Goldman Sachs & Co.
LLC**

BofA Securities

Credit Suisse

MUFG