

**4Q19**

**Risk Management Report  
December 31<sup>st</sup>, 2019**

Contact: [investor@banorte.com](mailto:investor@banorte.com)

[investors.banorte.com](http://investors.banorte.com)

+52 (55) 1670 2256

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# Risk Management

Risk management at Grupo Financiero Banorte is a key element in determining and implementing the Group's strategic planning. The Group's risk management and policies comply with regulations and market's best practices.

## 1. OBJECTIVES, SCOPE AND RISK MANAGEMENT FUNCTIONS

### GFNorte'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 GFNorte, through the use of robust systems and processes.
- To verify the observance of Risk Appetite.
- To estimate and control GFNorte'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, GFNorte 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 GFNorte'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 GFNorte 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:

- GFNorte'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 GFNorte 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 GFNorte 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 GFNorte. 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 GFNorte, 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 counterparties not fulfilling their payment obligations. Therefore, proper management is essential to maintain loan quality of the portfolio.

The objectives of Credit Risk Management at GFNorte 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.

GFNorte's Credit 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 Warnings 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 Portfolio Credit Risk models that identify expected and unexpected losses at specific confidence levels.
- 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

GFNorte 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 Target Markets, Risk Acceptance Criteria, Early Warnings and GFNorte's Internal Risk Rating (CIR Banorte).

The Target Markets, Risk Acceptance Criteria and Early Warnings are tools that, together with the Internal Risk Rating, are part of GFNorte'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 GFNorte 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, and Enterprise's life cycle, Legal and Regulatory Risks, besides credit experience and management quality.

Early Warnings are a set of criteria based on borrower's 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 the 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 on the rating date, or borrowers whose annual sales or income are greater or equal to 14 million UDIs (in case of being enterprises).

### **2.1.2 Portfolio Credit Risk**

GFNorte 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 GFNorte, 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 GFNorte based on the migration of the debtors through different risk rating levels. The recovery rate is the percentage of total exposure that is expected to be recovered if the debtor defaults. The classification 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 mean 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 loss given the loss distribution, at a specific confidence level which for GFNorte's 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 GFNorte's strategy. The individual risk identification tools and the portfolio Credit Risk methodology are periodically reviewed 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 quality of different types of issuers and counterparties. Credit quality is allocated through: a rating obtained with an internal methodology, evaluations of external rating agencies or a combination of both. Maximum parameters of operation are also defined based on the type of issuer or counterparty, 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, counterparty credit lines (mainly to financial entities) that comply with certain criteria may be approved through a parametric methodology approved by the CPR.

In the specific case of derivatives contracts, and in line with best practices, a methodology for estimating potential exposure to lines is used, which are analyzed and approved within the Credit Committee and are monitored on daily basis and reported monthly in the CPR, where guarantee analysis for derivative transaction is held both for clients and financial counterparties.

The correspondent Credit Committee holds the minimum faculty to approve derivative lines for clients (when applicable, a fast track process has been approved by the CPR). For these transactions, the use of derivatives lines with margin calls shall be privileged in order to mitigate the risk of potential exposure to these transactions.

To determine adversely correlated lines (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 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 fundamentals:

- 1) 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 vs. the instrument of an equivalent government bond, the lower the probability of default 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 December 31<sup>st</sup>, 2019, the total amount of the exposure subject to the Standard Method and the Internal Models (Advanced Internal Model for Credit Cards and Basic Internal Model for Business Enterprises) to estimate the Capital Ratio is the following:

Gross Exposures subject to the Standard Method and Internal Models (Million pesos)	Banorte	Arrendadora y Factor*	Sólida	Total Portfolio
Commercial	58,471	1,255	25	59,751
YoY Revenues or Sales < 14 MM UDIS	58,471	1,255	25	59,751
States or Municipalities	107,211	200	0	107,411
Decentralized Federal Government Agencies and State Companies	49,191	5,506	0	54,697
Projects with own source of payment	90,412	0	100	90,512
Financial Institutions	20,599	565	0	21,164
Mortgage	172,059	0	0	172,059
Consumer Non-Revolver	78,510	9	1,489	80,007
<b>Total Loans subject to the Standard Method</b>	<b>576,453</b>	<b>7,535</b>	<b>1,614</b>	<b>585,602</b>
Commercial	123,950	25,611	110	149,671
YoY Revenues or Sales >= 14 MM UDIS	123,950	25,611	110	149,671
Federal, State and Municipal Government Decentralized Agencies, with annual income or Sales >= 14 MM UDIS	13,753	0	0	13,753
<b>Total Loans subject to the Basic Internal Model</b>	<b>137,703</b>	<b>25,611</b>	<b>110</b>	<b>163,424</b>
Credit Card	41,987	0	0	41,987
<b>Total Loans subject to Advanced Internal Model</b>	<b>41,987</b>	<b>0</b>	<b>0</b>	<b>41,987</b>
<b>Eliminations and Accounting Records</b>				<b>(15,596)</b>
Not Rated				<b>31</b>
<b>Total Loans</b>				<b>775,448</b>

\* Excludes Pure Leasing

\*\* The exposure does not take into account Letters of Credit and it has 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 Loan Portfolio

GFNorte's Credit Risk loan portfolio as of 4Q19 shows a total exposure of Ps 775.45 billion, up 3.8%, that is Ps 28.37 billion higher vs. the previous quarter, and (Ps 15.01) billion decline (1.9%) vs. the previous year.

Variations per product of GFNorte's total portfolio are:

Product / Segment (Million pesos)	Total Loan			Var. vs. 3Q19		Var. vs. 4Q18	
	4Q18	3Q19	4Q19	Ps	%	Ps	%
Government	197,377	157,826	173,992	16,167	10.2%	(23,384)	(11.8%)
Commercial	177,241	172,231	176,892	4,661	2.7%	(349)	(0.2%)
Mortgage	157,262	168,093	172,059	3,967	2.4%	14,797	9.4%
Corporate	140,726	127,345	130,510	3,165	2.5%	(10,216)	(7.3%)
Payroll	54,648	53,930	53,069	(861)	(1.6%)	(1,579)	(2.9%)
Credit Card	38,808	41,500	41,987	486	1.2%	3,179	8.2%
Auto Loans	24,393	26,159	26,938	780	3.0%	2,546	10.4%
<b>Total Loans</b>	<b>790,455</b>	<b>747,084</b>	<b>775,448</b>	<b>28,365</b>	<b>3.8%</b>	<b>(15,007)</b>	<b>(1.9%)</b>



Subsidiary (Million pesos)	Loans		Distressed Portfolio		Total	Total Reserves
	Performing	Past-due	Performing	Past-due		
Banorte*	728,661	6,459	1,001	5,933	742,054	16,876
Arrendadora y Factoraje	32,719	5	83	339	33,146	424
Sólida	1,653	45	0	25	1,723	131
Accounting Records**	(1,475)	0	0	0	(1,475)	207
<b>Total Loans</b>	<b>761,558</b>	<b>6,509</b>	<b>1,084</b>	<b>6,298</b>	<b>775,448</b>	<b>17,639</b>

\* Banorte' s total loans include eliminations for (Ps 14.09) billion.

\*\* Includes portfolio from trust FCICK 16-1 for Ps 31.0 million.

Total reserves of Ps 17.64 billion include rating reserves of Ps 17.43 billion and accounting records (to provision 100% of past due interests, valuation, negative debts in the Credit Bureau, and those registered in recoveries) of Ps 207 million.

GFNorte's performing, past-due and distressed portfolios in 4Q19 grouped by sector and subsidiary are detailed in the following two tables:

Sector (Million pesos)	Loans		Distressed		Total Loans	Reserves		4Q19 Charge offs	Days Past-Due**
	Performing	Past-Due	Performing	Past-Due		4Q19	Var vs. 3Q19		
Government Services*	173,988	4	0	0	173,992	1,327	99	0	41
Commerce	80,920	39	256	600	81,814	931	41	95	229
Manufacturing	46,579	47	284	1,888	48,797	1,280	4	165	354
Transportation	44,061	19	163	2,176	46,418	1,470	127	70	634
	37,114	10	56	630	37,810	524	(0.2)	18	405
<b>Top 5 Sectors</b>	<b>382,661</b>	<b>119</b>	<b>758</b>	<b>5,293</b>	<b>388,832</b>	<b>5,533</b>	<b>272</b>	<b>346</b>	
Other Sectors	91,100	102	326	1,004	92,532	1,049	(547)	232	
Mortgage	170,086	1,973	0	0	172,059	1,128	11	453	
Consumer	117,680	4,314	0	0	121,994	9,721	(252)	3,085	
Accounting Records	31	0	0	0	31	207	0	0	
<b>Total Loans</b>	<b>761,558</b>	<b>6,509</b>	<b>1,084</b>	<b>6,298</b>	<b>775,448</b>	<b>17,639</b>	<b>(517)</b>	<b>4,117</b>	

\* Includes Financial, Real Estate and Other Services

\*\* Days past due from Non-Performing Loans.

\*\*\* Includes portfolio from trust FCICK 16-1 for Ps 31.0 million.

Sector/Subsidiary (Million pesos)	Banorte*	AyF	Sólida	Accounting Record	Total Loans
Government	170,155	5,706	0	(1,869)	173,992
Services**	76,140	5,312	0	363	81,814
Commerce	43,075	5,722	0		48,797
Manufacturing	37,137	9,280	0		46,418
Transportation	34,544	3,267	0		37,810
<b>Top 5 Sectors</b>	<b>361,051</b>	<b>29,287</b>	<b>0</b>	<b>(1,506)</b>	<b>388,832</b>
Remaining***	381,003	3,859	1,723	31	386,616
<b>Total Loans</b>	<b>742,054</b>	<b>33,146</b>	<b>1,723</b>	<b>(1,475)</b>	<b>775,448</b>

\* Banorte' s total loans include eliminations for (Ps 14.09) billion.

\*\* Includes Financial and Real Estate services

\*\*\* Remaining includes the portfolio from trust FCICK 16-1 for Ps 31.0 million

As of 4Q19, GFNorte's performing, past due and distressed portfolios grouped by federal entity and subsidiary are detailed in the following two tables:

Federal Entities <i>(Million pesos)</i>		Loans		Distressed		Total Loans	Total Reserves
		Performing	Past-Due	Performing	Past-Due		
1	Ciudad de México	243,603	1,576	280	1,221	246,681	4,289
2	Nuevo León	108,272	661	117	2,302	111,351	2,924
3	Estado de México	59,015	788	143	600	60,545	1,649
4	Jalisco	43,970	362	99	300	44,731	900
5	Baja California Sur	23,093	102	2	17	23,213	316
6	Tamaulipas	22,706	263	47	84	23,100	532
7	Sinaloa	21,084	148	20	335	21,587	450
8	Coahuila	20,351	144	25	52	20,572	418
9	Veracruz	19,712	269	43	135	20,159	530
10	Chihuahua	18,702	175	26	226	19,129	520
<b>Top 10</b>		<b>580,506</b>	<b>4,488</b>	<b>802</b>	<b>5,272</b>	<b>591,068</b>	<b>12,529</b>
Other Federal Entities		182,527	2,021	282	1,025	185,855	4,903
Accounting Records		(1,475)	0	0	0	(1,475)	207
<b>Total Loans</b>		<b>761,558</b>	<b>6,509</b>	<b>1,084</b>	<b>6,298</b>	<b>775,448</b>	<b>17,639</b>

\* Banorte's total loans include eliminations for (Ps 14.09) billion.

\*\* Includes the portfolio from trust FCICK 16-1 for Ps 31.0 million.

As of 4Q19, GFNorte's performing, past due and distressed portfolios grouped by term are detailed below:

Remaining Term <i>(Million pesos)</i>	Portfolio		Distressed		Total Loans	Total Reserves
	Performing	Past-Due	Performing	Past-Due		
0 - 1 years	120,896	2,521	210	3,429	127,056	7,660
1 - 5 years	180,969	2,002	746	2,194	185,911	6,752
5 - 10 years	99,247	160	35	311	99,754	634
> 10 years	327,549	1,775	10	0	329,334	1,830
<b>Banorte*</b>	<b>728,661</b>	<b>6,459</b>	<b>1,001</b>	<b>5,933</b>	<b>742,054</b>	<b>16,876</b>
Arrendadora y Factor	32,719	5	83	339	33,146	424
Sólida	1,653	45	0	25	1,723	131
Accounting Records**	(1,475)	0	0	0	(1,475)	207
<b>Total Loans</b>	<b>761,558</b>	<b>6,509</b>	<b>1,084</b>	<b>6,298</b>	<b>775,448</b>	<b>17,639</b>

\* Banorte's total loans include eliminations for (Ps 14.09) billion.

\*\* Includes the portfolio from trust FCICK 16-1 for Ps 31.0 million.

The total distressed portfolio is Ps 7.38 billion. Below is the quarterly balance of loan loss provisions for this portfolio:

Loan Loss Provisions for Distressed Portfolio (Million pesos)	4Q19			
	Banorte	Arrendadora y Factor	Sólida	GFNorte
<b>Initial Loan Loss Provisions</b>	<b>3,399</b>	<b>202</b>	<b>15</b>	<b>3,616</b>
Charged to results	520	5	0	524
Loans' write offs	168	0	0	168
FX changes	(33)	0	0	(33)
Adjustments in Credit Risk	385	5	0	389
Sale of Portfolios	(388)	0	0	(388)
Received in lieu of payment	0	0	0	0
Write-offs, charge-offs and discounts	(485)	0	0	(485)
<b>Final Loan Loss Provisions</b>	<b>3,046</b>	<b>206</b>	<b>15</b>	<b>3,268</b>
<b>Loan Recoveries</b>	<b>37</b>	<b>0</b>	<b>0</b>	<b>37</b>

### 2.2.2 Exposure to Financial Instruments

As of December 31st, 2019, exposure to Credit Risk for Securities Investments of Banco Mercantil del Norte was Ps 244.85 billion, of which 94.7% is rated higher or equal 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 September 2019. Additionally, exposure of investments with the same counterparty other than the Federal Government that represents a higher or equal concentration to 5% of the Net Capital as of September 2019 has higher or equal rating to BBB+ (mex) and is comprised of (*weighted average, amounts in pesos and weighted average return to annualized maturity*): market and bond certificates from Pemex to 4 years and 8 months totaling Ps 15.21 billion 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 September 2019.

Exposure to Credit Risk for Securities Investments of Casa de Bolsa Banorte was Ps 184.95 billion, of which 99.3% is rated higher or equal 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 92% of the Equity as of September 2019. Additionally, the exposure of investments with the same counterparty other than the Federal Government that represents a higher or equal concentration to 5% of the Equity as of September 2019 has a higher or equal rating to A-(mex) and are comprised of (*weighted average term, amounts in pesos and weighted average return to annualized maturity*): certificates of deposit and market certificates of HSBC Mexico for 1 year totaling Ps 11.13 billion at 7.7%; certificates of deposit and market certificates of Scotiabank Inverlat for 1 year and 5 months totaling Ps 8.36 billion at 7.6%; certificates of deposit and market certificates of Banco Santander Mexicano for 11 months totaling Ps 7.71 billion at 7.6%; certificates of deposit and market certificates of BBVA Mexico for 1 year and 8 months totaling Ps 4.11 billion at 7.6%; certificates of deposit and market certificates of Banobras for 5 months totaling Ps 3.21 billion at 7.5%; market certificates of Mexico City Government for 27 years and 9 months totaling Ps 2.43 billion at 7.8%; market certificates of FEFA for 2 years and 9 months totaling Ps 2.38 billion at 7.7%; certificates of deposit and market certificates of Banco del Bajío for 1 year totaling Ps 1.88 billion at 7.7%; certificates of deposit and market certificates of Banco Multiva for 5 months for Ps 1.12 billion at 7.9%; market certificates of Banco Inbursa for 2 years and 11 months totaling Ps 1.02 billion at 7.7%; market certificates of Banamex for 4 months totaling Ps 951 million at 7.6%; market certificates of Banco Compartamos for 3 years and 3 months totaling Ps 884 million at 8.0%; certificates of deposit of Banca Mifel for 6 months totaling Ps 866 million at 7.9%; market certificates of Consubanco for 1 year and 3 months totaling Ps 866 million at 8.8%; certificates of deposit of Banco Invex for 3 months totaling Ps 810 million at 7.8%; Deutsche Bank bonds for 3 years and 5 months for Ps 663 million at 9.4%; market certificates of CFE for 6 months totaling Ps 623 million at 7.9%; market certificates of Nafinsa for 11 months totaling Ps 617 million at 7.5%; market certificates of Bancomext for 6 months totaling Ps 414 million at 7.4%; market certificates of PEMEX for 2 years and 10 months for Ps 323 million at 7.6%, and fiduciary market certificates of INFONACOT for 1 year and 7 months for Ps 252 million at 7.7%.

There are no Derivatives operations.

Arrendadora y Factor Banorte had no exposure to Securities Investments or to Derivatives.

Sólida Administradora de Portafolios had no exposure to Securities Investments nor to Derivatives.

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 guarantees related to settled transactions (includes operations with Banxico. Excludes settled transactions through central counterparties).

Position (Million Pesos)	4Q19	4Q19 Average
Forwards	73	48
FX Swaps	(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
<b>Total</b>	<b>879</b>	<b>1,146</b>
Positive Fair Value (Positive Market Value)	10,621	11,405
Netting Effect*	9,742	10,259
<b>Delivered Guarantees (-) /Received (+)</b>		
Cash	(6,990)	(7,132)
Securities	0	0
<b>Total</b>	<b>(6,990)</b>	<b>(7,132)</b>

\* 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	
	4Q19	4Q19 Average	4Q19	4Q19 Average
<b>Financial Counterparties</b>				
<b>FWD</b>			60	42
<b>FX SWAP</b>	572	643	(160)	(105)
<b>FX</b>			1	1
<b>OPTIONS</b>	1,377	1,466	(203)	(176)
<b>INTEREST RATE SWAP</b>	4,532	4,650	(406)	(386)
<b>CCS</b>	1,730	1,730	(6,580)	(6,892)
<b>CDS</b>	180	197	171	188
<b>Total</b>	<b>4,610</b>	<b>4,936</b>	<b>(7,117)</b>	<b>(7,327)</b>
<b>Clients (Non-Financial)</b>				
<b>FWD</b>	58	36	13	5
<b>OPTIONS</b>	54	70	(77)	(65)
<b>INTEREST RATE SWAP</b>	8,886	9,342	8,048	8,519
<b>CCS</b>	41	40	11	13
<b>Total</b>	<b>9,013</b>	<b>9,459</b>	<b>7,996</b>	<b>8,472</b>

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 have migrated to zero threshold, thus, guarantees to be delivered do not depend on credit rating but on market movements:

<b>Net Cash Outflows (Million pesos)</b>	<b>4Q19</b>	<b>4Q19 Average</b>
Cash Outflow with 1-notch Downgrade	0	0
Cash Outflow with 2-notch Downgrade	0	0
Cash Outflow with 3-notch Downgrade	0	0

In the following table, the market value of derivatives is detailed according to the counterparties' ratings:

<b>Rating (Million Pesos)</b>	<b>MoM 4Q19</b>	<b>4Q19 Average</b>
<b>AAA/AA-</b>	0	0
<b>A+/A-</b>	(6,795)	(6,937)
<b>BBB+/BBB-</b>	(314)	(371)
<b>BB+/BB-</b>	4,156	4,357
<b>B+/B-</b>	0	0
<b>CCC/C</b>	0	0
<b>SC</b>	3,832	4,097
<b>Total</b>	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 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 (Million Pesos)	4Q19			
	Banorte	Arrendadora y Factor**	Sólida	GFNorte*
<b>Total Loan Portfolio</b>	<b>756,174</b>	<b>33,146</b>	<b>1,723</b>	<b>775,448</b>
Covered Loan Portfolio by type of collateral				
Real Financial Guarantees	15,920	0	0	15,920
Real Non-Financial Guarantees	433,515	5,019	235	438,769
Pari Passu	28,693	0	0	28,693
First Losses	18,600	0	0	18,600
Personal Guarantees	19,652	2,886	0	22,538
<b>Total Loan Portfolio Covered</b>	<b>516,380</b>	<b>7,904</b>	<b>235</b>	<b>524,519</b>

\* Total Loans includes eliminations and accounting records for (Ps 15.60 billion).

\*\* Excludes Pure Leasing

## 2.4 Expected Loss

As of December 31<sup>st</sup>, 2019, Banco Mercantil del Norte's total portfolio was Ps 756.14 billion. The expected loss represents 2.2% and the unexpected loss is 3.9% of the total portfolio. The average expected loss is 2.2% for the period October-December 2019.

Regarding Casa de Bolsa Banorte, the credit exposure of investments is Ps 184.95 billion and the expected loss represents 0.03% of the exposure. The average expected loss is 0.03% between October-December 2019.

The total portfolio of Arrendadora y Factor Banorte, including pure leasing is Ps 35.90 billion. The expected loss represents 0.8% and the unexpected loss is 6.2% of the total portfolio. The average expected loss is 0.9% for the period October-December 2019.

The total portfolio of Sólida Administradora de Portafolios was Ps 1.72 billion. The expected loss represents 12.1% and the unexpected loss 11.1% of the total portfolio. The average expected loss is 11.1% for the period October-December 2019.

## 2.5 Internal Models

### 2.5.1 Internal Advanced Model for Credit Card

On November 15<sup>th</sup>, 2017, GF Banorte 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 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 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 Exposure at Default (EAD).
- Exposure at Default. Is the amount of the debt at the time of default, 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 Level*	Accounting Balance	Exposure at Default (EAD)**	Severity of Loss	PD factored by EAD	Unused credit lines	EAD factored by Exposure	Current EAD	
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	
<b>Total Portfolio</b>	<b>41,987</b>	<b>63,905</b>	<b>87.46%</b>	<b>7.92%</b>	<b>61,701</b>	<b>34%</b>	<b>60,460</b>	

\* The scale of Risk Level for the Internal Advanced Model has been mapped in accordance with regulatory risk levels.

\*\* The balances under Exposure at Default 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 1Q19.

Backtesting				
Portfolio	Expected Loss Internal Model*	Observed Loss*	Difference Ps (Observed Loss – Expected Loss)	% Use
Credit Card	4,588	4,263	(326)	93%
<b>Total Portfolio</b>	<b>4,588</b>	<b>4,263</b>	<b>(326)</b>	<b>93%</b>

\* Expected and Observed Loss is equal to the last twelve months' average.

## 2.5.2 Basic Internal Model for Commercial Loans

On November 30<sup>th</sup>, 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<sup>st</sup>, 2019 for Arrendadora y Factor Banorte, Sólida Administradora de Portafolios, as per Documents 111-1/160/2019 y 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 y 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 Commercial Loans, classified by risk level:

Commercial Loans subject to the Basic Internal Model Grupo Financiero Banorte				Million Pesos
Risk Level	Accounting Balance	Exposure at Default (EAD)*	PD weighted by EAD	
1	34,433	34,435	0.37%	
2	77,140	77,210	0.49%	
3	41,751	41,773	0.63%	
4	11,831	11,832	1.80%	
5	2,544	2,545	4.31%	
6	292	292	7.70%	
7	241	241	14.62%	
8	498	498	27.41%	
9	218	218	54.02%	
Default	2,831	2,831	100.00%	
<b>Total</b>	<b>171,778</b>	<b>171,874</b>	<b>2.46%</b>	

\* EAD balances include both potential risk as well as used balance risk.

A breakdown of risk exposure and expected loss by subsidiary is shown below:

Commercial Loans Portfolio subject to the Internal Basic Model				Million Pesos
Subsidiary	Accounting Balance	Exposure at Default (EAD)**	Expected Loss	
Banco Mercantil del Norte	145,926	146,022	1,752	
Arrendadora y Factor Banorte	25,742	25,742	102	
Sólida Administradora de Portafolios	110	110	0.1	
<b>Total Loans*</b>	<b>171,778</b>	<b>171,874</b>	<b>1,854</b>	

\* The balance includes Letters of Credit in the amount of Ps 8.21 billion and excludes accounting adjustments of Ps 14 million in Banorte and Ps 132 million in Arrendadora y Factor Banorte.

\*\* EAD balances include both potential risk as well as used balance risk.

The following table shows the difference between expected loss estimated by the Internal Model for Commercial Loans, and the real loss observed in the following 12 months. Because the model was just recently authorized, the table shows estimations obtained during the parallel model runs period.

Backtesting			Million Pesos
Period	Expected Loss with Internal Model	Observed Loss	% Coverage (Expected Loss / Observed Loss)
4Q18	1,774	747	237%

## 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** presents the following information (million pesos):

<b>Tier 1 Capital as of September 30, 2019</b>		<b>143,514</b>
<b>I. Loans with individual balance greater than 10% of Tier 1 Capital:</b>		
<u>Loan Operations</u>		
Number of loans		0
Total amount of loans		0
% in relation to Tier 1		0%
<u>Money Market Operations</u>		
Number of loans		0
Total amount of loans		0
% in relation to Tier 1		0%
<u>Overnight Operations</u>		
Number of loans		0
Total amount of loans		0
% in relation to Tier 1		0%
<b>II. Maximum amount of credit with the 3 largest debtors and common risk groups:</b>		<b>40,274</b>

In compliance with risk diversification regulation on active and passive operations, **Arrendadora y Factor Banorte** presents the following information (million pesos):

<b>Equity as of September 30, 2019</b>		<b>5,672</b>
<b>I. Loans with individual balance greater than 10% of Equity:</b>		
<u>Loan Operations</u>		
Number of loans		5
Total amount of loans		8,551
% in relation to Equity		151%
<u>Money Market Operations</u>		
Number of loans		0
Total amount of loans		0
% in relation to Equity		0%
<u>Overnight Operations</u>		
Number of loans		0
Total amount of loans		0
% in relation to Equity		0%
<b>II. Maximum amount of credit with the 3 largest debtors and common risk groups:</b>		<b>6,482</b>

In compliance with risk diversification regulation on active and passive operations, **Sólida Administradora de Portafolios** presents the following information (million pesos):

<b>Equity as of September 30, 2019</b>	<b>3,083</b>
<b>I. Loans with individual balance greater than 10% of Equity (group level):</b>	
<u>Loan Operations</u>	
Number of loans	0
Total amount of loans	0
% in relation to Equity	0%
<u>Money Market Operations</u>	
Number of loans	0
Total amount of loans	0
% in relation to Equity	0%
<u>Overnight Operations</u>	
Number of loans	0
Total amount of loans	0
% in relation to Equity	0%
<b>II. Maximum amount of credit with the 3 largest debtors and common risk groups:</b>	<b>344</b>

### 3. MARKET RISK (BANK AND BROKERAGE HOUSE)

GFNorte'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.

GFNorte'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.

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 balance sheet.

The average expected shortfall of the Bank's portfolio for 4Q19 was Ps 67.8 million (Ps 6.7 million higher than the average expected shortfall from last quarter).

The result shows that the Bank's expected shortfall, using a 97.5% confidence level, is on average Ps 67.8 million.

<b>Expected Shortfall Million Pesos</b>	<b>Average 4Q19</b>
Total Expected Shortfall	67.8
Net Capital	148,438
<b>Expected Shortfall/Net Capital</b>	<b>0.05%</b>

Expected shortfall by risk factor behavior during the fourth quarter of the year:

<b>Risk Factor Million Pesos</b>	<b>4Q19</b>	<b>Average 4Q19</b>
Rates	38.5	57.8
FX	48.3	41.6
Equity	29.4	34.4
Diversification Effect	(58.7)	(66.1)
<b>Bank's Expected Shortfall</b>	<b>57.6</b>	<b>67.8</b>

Expected shortfall for 4Q19 was Ps 57.6 million. The contribution to the Bank's Expected shortfall for each risk factor is:

<b>Risk Factor Million Pesos</b>	<b>4Q19</b>	<b>Average 4Q19</b>
Domestic Rates	18.2	31.1
Foreign Rates	10.0	11.6
FX	15.8	11.6
Equity	13.5	13.4
<b>Bank's Expected Shortfall</b>	<b>57.6</b>	<b>67.8</b>

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 average proportion by market risk factor excluding the diversification effect is:

<b>Risk Factor</b>	<b>4Q19</b>
Rates	43%
FX	31%
Equity	26%

### **3.2.1 Sensitivity Analysis and Stress Testing under extreme conditions**

With the purpose of complementing and strengthening risk analysis, Banorte 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.

### 3.2.2 Back testing

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 necessarily make the required adjustments to the parameter.

### 3.2.3 Expected Shortfall of Casa de Bolsa

The expected shortfall average in 4Q19 was Ps 45.7 million, Ps 7.7 million higher vs. 3Q19.

The result shows that potential loss for Casa de Bolsa, using a 97.5% confidence level, is on average Ps 45.7 million:

<b>Expected Shortfall Million Pesos</b>	<b>Average 4Q19</b>
Total Expected Shortfall	45.7
Net Capital	3,445
<b>Expected Shortfall/Net Capital</b>	<b>1.33%</b>

The expected shortfall by risk factor for Casa de Bolsa Banorte portfolio behavior during the fourth quarter of the year was:

<b>Risk Factor (Million Pesos)</b>	<b>4Q19</b>	<b>Average 4Q19</b>
Rates	42.8	45.9
FX	0.0	0.0
Equity	0.0	1.2
Diversification effect	0.0	(1.4)
<b>Casa de Bolsa Expected Shortfall</b>	<b>42.8</b>	<b>45.7</b>

Expected shortfall at the end of 4Q19 was Ps 42.8 million.

The expected shortfall by risk factor is determined by simulating 500 historical scenarios and performing a grouping of instruments by their main risk factor. It is important to note that all positions classified as trading were considered, excluding the held-to-maturity position and available for sale.

Concentration by Market Risk factor is mainly in interest rates

### 3.2.4 Sensitivity Analysis and Stress Testing under extreme conditions

Complementing the potential losses methodology with the purpose of enhancing risk analysis, Casa de Bolsa Banorte complements its risk analysis enforcing tests under extreme conditions known as Stress Testing. This is presented to the Risk Policy Committee on a monthly basis with the main objective of assessing the impact on the Institution's positions of extreme movements in risk factors

### 3.2.5 Back testing

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 necessarily make the required adjustments to the parameter.

## 4. BALANCE AND LIQUIDITY RISK

GFNorte'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.
- Follow-up on 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.

GFNorte'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 established limits and desired established risk profile 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)	3Q19	4Q19	Change vs. 3Q19
Demand Deposits			
Local Currency <sup>(1)</sup>	355,205	393,386	10.7%
Foreign Currency <sup>(1)</sup>	46,698	44,778	(4.1%)
<b>Demand Deposits</b>	<b>401,903</b>	<b>438,164</b>	<b>9.0%</b>
Time Deposits – Core			
Local Currency <sup>(2)</sup>	223,547	216,685	(3.1%)
Foreign Currency	12,156	12,351	1.6%
<b>Core Deposits</b>	<b>637,606</b>	<b>667,200</b>	<b>4.6%</b>
Money Market			
Local Currency <sup>(3)</sup>	49,694	50,791	2.2%
Foreign Currency <sup>(3)</sup>	24,493	24,010	(2.0%)
<b>Banking Sector Deposits</b>	<b>711,793</b>	<b>742,001</b>	<b>4.2%</b>

1. Includes balance of the Global Deposits without Movement.
2. Includes eliminations among subsidiaries.
3. Money Market & 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)
<b>COMPUTABLE LIQUID ASSETS</b>		
1 Total Computable Liquid Assets	NA	108,195
<b>CASH DISBURSEMENTS</b>		
<b>2 Unsecured retail financing</b>	<b>370,185</b>	<b>24,931</b>
3 Stable financing	241,756	12,088
4 Less stable financing	128,430	12,843
<b>5 Unsecured wholesale financing</b>	<b>217,874</b>	<b>66,106</b>
6 Operational Deposits	171,226	38,100
7 Non-Operational Deposits	41,149	22,506
8 Unsecured debt	5,499	5,499
<b>9 Secured wholesale financing</b>	<b>260,082</b>	<b>19,211</b>
<b>10 Additional Requirements:</b>	<b>312,745</b>	<b>21,509</b>
11 Disbursements related to derivatives and other guarantee requirements	63,056	7,343
12 Disbursements related to losses from debt financing	0	0
13 Lines of credit and liquidity	249,689	14,165
14 Other contractual financing obligations	927	113
15 Other contingent financing liabilities	0	0
<b>16 TOTAL CASH DISBURSEMENTS</b>	<b>NA</b>	<b>131,869</b>
<b>CASH INFLOWS</b>		
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
<b>20 TOTAL CASH INFLOWS</b>	<b>173,675</b>	<b>50,085</b>
		<b>Adjusted amount</b>
<b>21 TOTAL COMPUTABLE LIQUID ASSETS</b>	<b>NA</b>	<b>108,195</b>
<b>22 TOTAL NET CASH DISBURSEMENTS</b>	<b>NA</b>	<b>81,784</b>
<b>23 LIQUID COVERAGE RATIO</b>	<b>NA</b>	<b>133.49%</b>

During 4Q19, the 91-day average LCR 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 Banorte can meet all of its short-term obligations in a crisis scenario<sup>1</sup>.

#### 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%)

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)	3Q19	4Q19	Var. vs. 3Q19
<b>Total</b>	<b>102,261</b>	<b>103,080</b>	<b>0.8%</b>
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 remained relatively stable in the quarterly comparison in 3Q19 and 4Q19, presenting a slightly negative variation regarding Liquid Assets Level II A.

#### 4.5 LCR Result's Main Causes

Variations in the LCR between 3Q19 and 4Q19 are mainly due to a decrease in available liquidity derived by the maturity of issued bonds and dividends payment to Grupo Financiero Banorte.

#### 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 4Q19, 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 measurement shows that potential outflows for derivatives may represent a liquidity requirement up to Ps 4.77 billion, stable vs. 3Q19.

<sup>1</sup> The Liquidity Coverage Ratio information is preliminary and is subject to Banco de Mexico's affirmation.



## 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 4Q19:

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, 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. 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 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 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:

<b>Margin Sensitivity</b> <i>(Million pesos)</i>	<b>3Q19</b>	<b>4Q19</b>	<b>Change vs. 3Q19</b>
Local 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 registered under Trading Income.

#### **4.12 Subsidiaries**

Balance and Liquidity Risk Management processes for the Bank and its Sofomes are centralized in GFNorte's Credit and Risk Management General Direction. To monitor Sofomes' liquidity, an analysis of the balance sheet structural behavior is conducted, as well as funding diversification. Furthermore, a liquidity gap analysis is performed. Specifically for the Brokerage House, regulatory liquidity requirements are monitored.

The following table shows the composition of the gap indicators for the Bank's subsidiaries and Sofomes at the end of 4Q19.

<b>Liquidity Ratio</b> <i>(Million Pesos)</i>	<b>Casa de Bolsa Banorte</b>	<b>Arrendadora y Factor</b>	<b>Sólida</b>
Cumulative 30 days Gap	2,688	2,519	(30)
Liquid assets	3,445	142	156

## 5. OPERATIONAL RISK

GFNorte 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 by Operational Risk.

### 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:

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 GFNorte'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**

GFNorte 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 applicable, define 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 Standardized Approach (ASA) Model, which is estimated and reported periodically to the authorities.

### **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 done regarding the status of the main Operating Risk mitigation initiatives implemented by the various areas of the organization.

### **5.6 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.

## 5.7 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 Group, is to transfer risks and benefits of certain financial assets to third parties.

GFNorte has carried out the following securitizations:

- On October 11<sup>th</sup>, 2006, Fincasa Hipotecaria (Fincasa), now merged with Banorte, 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<sup>th</sup>, 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 states, municipalities, and their decentralized agencies, 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 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 regarding the 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 be notified and replace it or make the corresponding payment.

Trust 477 has derivatives operations, particularly swap contracts, 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' assets. If these risks materialize, payment to market certificates' holders could be adversely affected. The main risks to 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, the Institution also acts as an investor by acquiring titles of market certificates issued by the trusts set up for securitizations. As of December 31<sup>st</sup>, 2019 Grupo Financiero Banorte holds the following Securities and amounts in securitizations carried out by GFNorte:

Securitization (Million pesos)	Banorte		Seguros Banorte		Total GFNorte	
	Securities	Ps	Securities	Ps	Securities	Ps
91_BNTECB_07	50,763,776	1,459	500,000	15	51,263,776	1,474
91_BNTECB_07-2	563,059	14	-	-	563,059	14
97_FCASACB_06U	-	-	-	-	-	-

The following shows the proportion of Securities held by Grupo Financiero Banorte, for each series:

Securitization (Million pesos)	Issued Securities	Banorte	Seguros Banorte	Total GFNorte	Total Clients
91_BNTECB_07	52,313,776	97.0%	1.0%	98.0%	2.0%
91_BNTECB_07-2	1,113,059	50.6%	0.0%	50.6%	49.4%
97_FCASACB_06U	1,351,386	0.0%	0.0%	0.0%	100.0%

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 AA+							
91_BNTECB_07-2					A3.mx	Ba3	HR AA							
97_FCASACB_06U	mxCCC		BBB-	(mex)										

As of December 31<sup>st</sup>, 2019 the amounts of the underlying assets of each securitization were:

Securitization (Million pesos)	Performing	Amount Past-Due	Total
91_BNTECB_07			
91_BNTECB_07-2	Ps. 2,036	Ps. 0	Ps. 2,036
97_FCASACB_06U	Ps. 88	Ps. 118	Ps. 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 4 (weighted 350%)	0	0
Securitized with Risk Level 5, 6 or not rated (weighted 1250%)	0	0

\*Excludes the position in Seguros Banorte

No securitization position is registered in memorandum accounts and no maintained securitization position is deducted from Tier 1 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 MBS (Mortgage-Backed Securities) and S&M (States & Municipalities) 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) MBS: 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. At the end of the period, the certificate related to securitization FCASACB 06U shows a fair market value of zero, since no remaining cash flows are expected to be received.
- b) S&M: 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 trusts' Credit Risks. 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 is 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.

## 7. POSITION IN SHARES:

At the end of December 31<sup>st</sup>, 2019, Banco Mercantil del Norte held shares amounting to Ps 5.12 billion, with gains of Ps 670 million accumulated during the year.

During the fourth quarter, accumulated revenues from sales and settlements were Ps 308.3 million.

The capital requirement for Market Risk was Ps 43 million, and the regulatory Net Capital deductions reached Ps 715.7 million.

Institution	Type of Trading	Accounting Classification	Capitalization Treatment	Market Value 4Q19	Gains / Losses Accum.	Profit / Loss Sales / Purchases
Banorte	Public Trading	Negotiation	Market Risk	5.4	(21.6)	0
Banorte	Public Trading	Available for Sale	Market Risk	1.6	(13.2)	0
Banorte	Public Trading	Negotiation	Credit Risk	259.9	122.7	0
Banorte	Public Trading	Negotiation	Capital Deduction	221.6	120.9	0
Banorte	Public Trading	Available for Sale	Capital Deduction	494.5	249.5	126.0
Banorte	w/o Public trading	Available for Sale	Market and Credit Risk	4,133.6	211.7	182.3
			<b>Total</b>	<b>5,116.6</b>	<b>670.0</b>	<b>308.3</b>

As of December 31<sup>st</sup>, 2019 a position of Ps 572.8 million is held in Casa de Bolsa Banorte.

During the quarter, there were gains for Ps 23.2 million from sales and settlements.

Regarding Market Risk Capital Requirement, the amount was Ps 171.6 million of the total position in shares of Banorte.

Institution	Type of Trading	Accounting Classification	Capitalization Treatment	Market Value 4Q19	Gains / Losses Accum.	Profit / Loss Sales / Purchases
Casa de Bolsa Banorte	Public	Negotiation	Market Risk	572.8	333.2	23.2
			<b>Total</b>	<b>572.8</b>	<b>333.2</b>	<b>23.2</b>