

## **Equator Principles Annual Report Term: January 1st - December 31st, 2014**

### **Introduction**

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

The EPs were created in 2003 by EPFIs (Equator Principles Financial Institutions) in consultation with the International Finance Corporation (IFC); during the first ten years of operation, 80 global and local banks from 35 countries were added<sup>1</sup> The EPs apply globally to all industrial sectors. According to these principles, only projects in compliance with the established social and environmental standards are able to receive financing.

In 2012 Banorte became the second Mexican bank to adopt the EPs, on the basis that they offer important benefits to the institution, its customers and its stakeholders. Banorte recognizes that its function as a financial institution provides it with the opportunity to promote efficient environmental management and socially responsible development<sup>2</sup> in the projects that it finances.

This document serves as a report on the implementation of the EPs in Banorte from January 1<sup>st</sup> to December 31<sup>st</sup>, 2014, according to Principle 10 (Reporting and Transparency) and Annex B (Minimum Reporting Requirements) of the Equator Principles III-2013.

### **Implementation of the Equator Principles at Banorte**

#### **Adoption of the Equator Principles and its insertion in the processes**

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

The SEMS outlines a process of identification, allocation, evaluation and management of social and environmental risks associated with the provision of credit, based on the guidelines of the EPs, the IFC Performance Standards and The World Bank Group Environmental, Health and Safety Guidelines.

Thus, the objective of the SEMS and the EPs is to analyze the environmental and social risk of the loan portfolio of the Corporate Finance, Commercial Banking, Government Banking and Structured Financing, in order to ensure that projects that receive financing or advisory from Banorte are developed in a socially responsible manner, reflect the application of strict environmental management practices which cause the least amount of harm possible<sup>3</sup>.

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

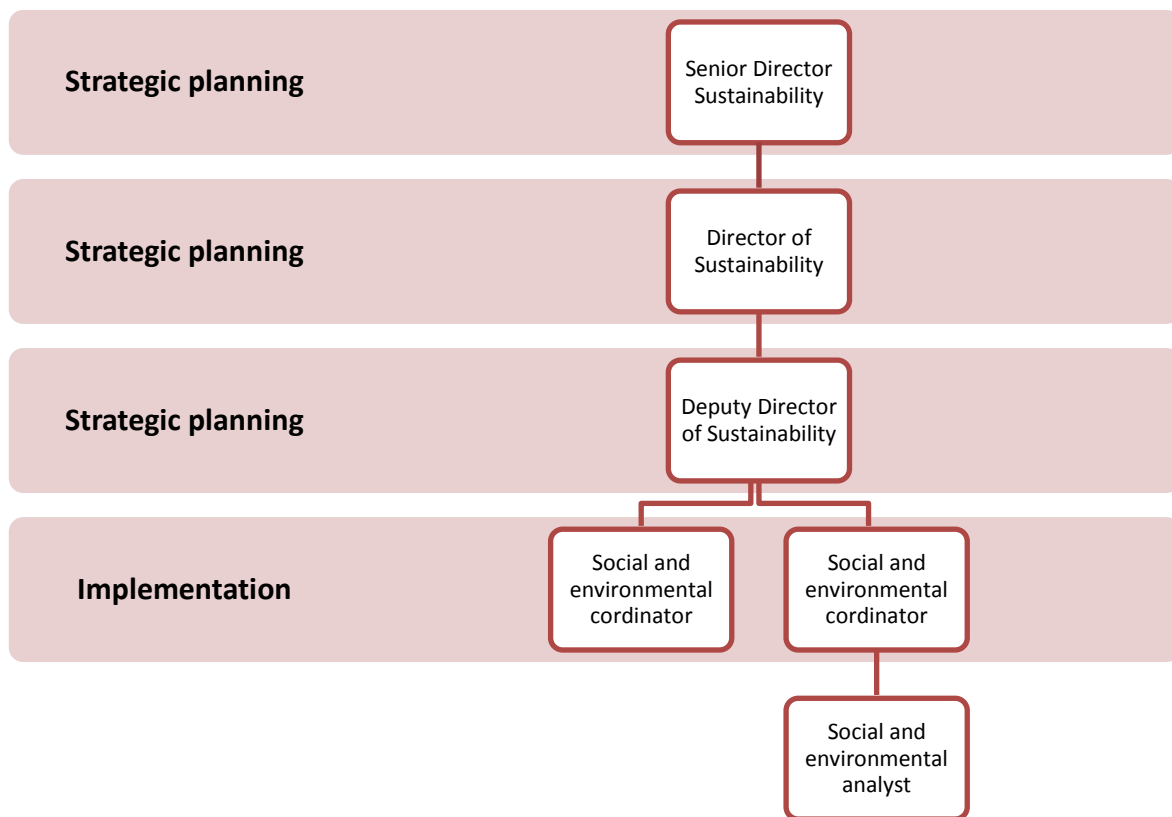
<sup>2</sup> [http://www.equator-principles.com/resources/equator\\_principles\\_III.pdf](http://www.equator-principles.com/resources/equator_principles_III.pdf)

<sup>3</sup> [http://www.equator-principles.com/resources/equator\\_principles\\_III.pdf](http://www.equator-principles.com/resources/equator_principles_III.pdf)

### Administrative structure of the Equator Principles

The implementation of the SEMS and the EPs is in charge of the leadership of Sustainability department, who created the Social and Environmental Coordination (Coordinación Socio-ambiental: CSA) in order to successfully administrate and operate the system. In 2012, Banorte hired the University of the Environment (Universidad del Medio Ambiente), as an external consultant, to manage the CSA. However, in mid-2014, the Social Responsibility and Sustainability department decided to create an internal structure in order to respond to the needs of SEMS and the EPs.

Consequently, in 2014, Banorte commenced a recruitment process for CSA's personnel with an emphasis placed on hiring professionals with education, experience, competence and specialized skills related to social and environment issues. In September, the first Coordinator was named.



Graphic 1. Administrative Structure of the Equator Principles

### Social and Environmental Risk Management System and the Equator Principles

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

## Identification of social and environmental risks

The process begins with the identification of potential social and environmental risks. This is achieved by analyzing the characteristics of potential investments proposed by the credit officers based on information provided by the Selective Credit Alliance System (Sistema Alianza Crédito Selectivo: SACS), by telephone or through questionnaires<sup>4</sup> prepared by the SEMS (in case of the Government Banking and Structured Finance). The characteristics include customer activity, credit destination, financial product, amount of the credit, and the corresponding deadlines.

## Categorization of social and environmental risks

The categorization stage involves the determination of the credit risk associated with a project or investment, based on the nature, scale and stage of the project and the level of environmental and social risks and impacts, which will determine whether further evaluation is necessary. The risk is classified in the following categories: low risk (C), medium risk (B) or high risk (A).

The determination of the social and environmental risk is made based on the initial risk evaluation, which is automatically provided to a potential loan by SACS, according to a predetermined matrix that relates the purpose of the loan. Thus, once the potential risks for the proposed loan are identified, the Social and Environmental Coordinator will then confirm or reassign the level of risk.

The projects that require evaluation are selected based on their compliance with the criteria established by the SEMS; the criteria includes:

- Exclusion List: Economic activities or operations that are prohibited as defined in the chapter on Credit Philosophy in the Credit Manual of Banorte.
- Sensitive Industries: Industrial sectors whose activities have been identified for their high social or environmental risk (construction, agribusiness, food production, forestry, energy, infrastructure, manufacturing, mining, chemicals, oil and gas and tourism).
- Characteristics of the loan:  
*Amount of the loan*: In the case of a loan for above 1 million dollars the IFC Performance Standards are applied; for a loan above 10 million dollars the EPs will apply.  
*Purpose of the loan*: Project Finance or working capital of two or more years.
- Additional social and environmental risks: The project is less than 5 km away from places considered as cultural or natural heritage, indigenous communities and/or in case the project induces the resettlement of populations.

## Evaluation of social and environmental risks

The evaluation of social and environmental risk consists of the verification of compliance with projects to be financed under the current national regulatory framework and the international guidelines on social and environmental issues for the financial sector, taking into consideration the characteristics of the project and the social and environmental risk assigned by the CSA (A and B priority).

Loans over 1 million dollars will be evaluated by the IFC Performance Standards, and loans over 10 million dollars will be analyzed under the Equator Principles framework. Thus, CSA will require that investment officers obtain the necessary information to conduct due diligence<sup>5</sup> that ensure compliance.

<sup>4</sup> See Appendix 2. Questionnaire for Government Banking also see Annex 3. Questionnaire for Structured Finance

<sup>5</sup> See Appendix 4. Due Diligence

The evaluation of the social and environmental risks includes recommendations for both the Credit Committee and the customer regarding the social and environmental viability of the project and improvements in social and environmental performance.

### **Management of social and environmental risks**

The risk management stage consists of the monitoring of the environmental and social performance of the loans that are selected for the evaluation. It includes mainly the loans analyzed projects under the EPs framework.

During this stage, the CSA establishes continuous contact with the executives and analysts in order to supervise the delivery of the required documents and reports in order to carry out the annual review of the projects, to communicate the status of the projects and compliance with the relevant legislation and area of opportunity for improvement of social and environmental performance.

In the same way, the CSA offers continuous advisory to the credit department (executives and analysts) and to the support the client's compliance. If possible, it will make an on-site inspection.

### **Review of the implementation of the Equator Principles**

As part of the Banorte's SEMS process, the Director and Deputy Director of the Social Responsibility and Sustainability department, in partnership with the CSA, continuously monitor the SEMS operation and the EP implementation and conduct an annual review of the results attained and the objectives achieved with respect to implementation. This review will also consider the feedback of the Credit Department.

### **Training of the Equator Principles staff**

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

Also, the CSA is responsible for the awareness and training regarding the determination, objectives, responsibilities, scope and operation of SEMS and EP for the following departments: Corporate Finance and Commercial Banking, Government Banking and Structured Finance. In 2014, the CSA trained and evaluated 465 executives and analysts through an online course. The instruction of the investment team is reinforced during daily operation, through personal contact at the time of investment analysis.

**Report of results of the Equator Principles of 2014**

Since June 2013, the SEMS and EP operations have taken into account the Equator Principles III - 2013 for "Non-Designated Countries" like Mexico, in the region of the Americas. Regarding to the provision of credit from January 1st to December 31st, 2014, the EP application produced the results detailed below.

**Project Finance Advisory Services**

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

**Bridge loans**

Due to their nature, the information about the bridge loans is not subject to specific reporting requirements of the report<sup>6</sup>.

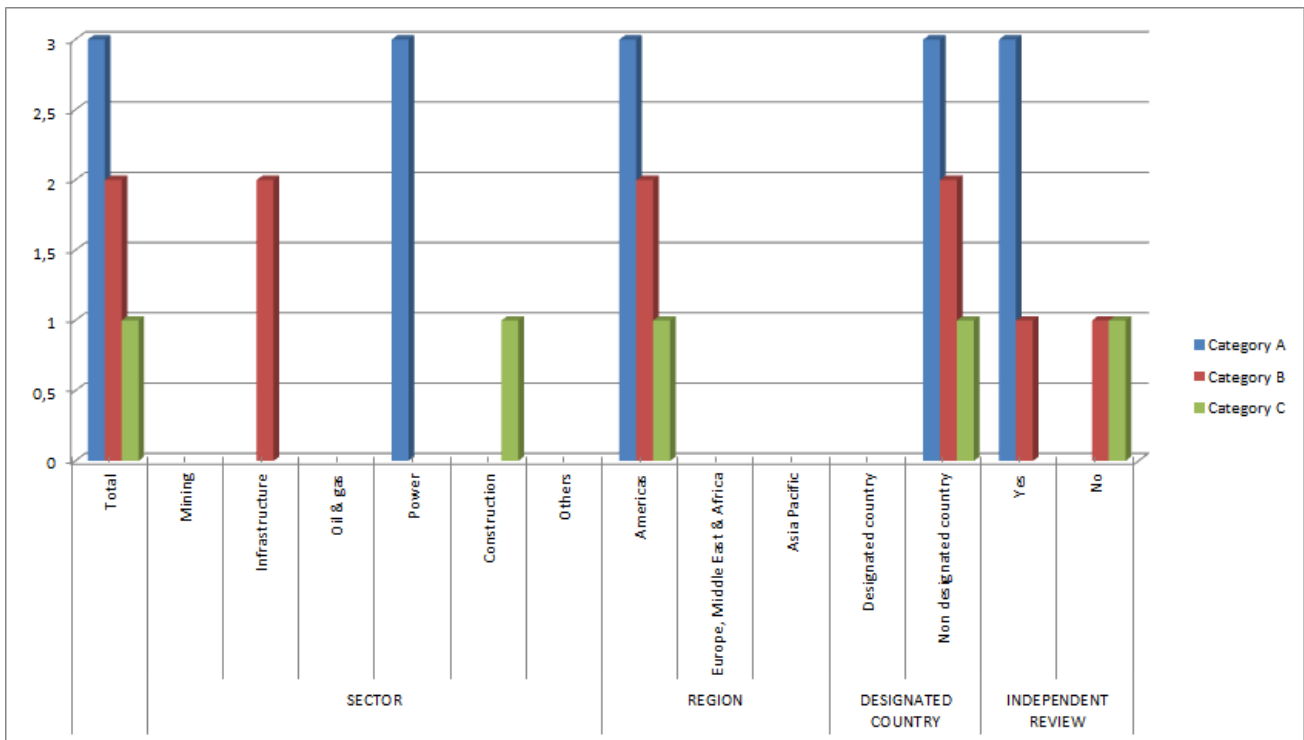
**Project Finance**

| <b>CATEGORY</b>                         | <b>A</b> | <b>B</b> | <b>C</b> |
|---|----------|----------|----------|
| <b>Total</b>                            | 3        | 2        | 1        |
| <b>SECTOR</b>                           |          |          |          |
| <b>Mining</b>                           |          |          |          |
| <b>Infrastructure</b>                   |          | 2        |          |
| <b>Oil &amp; gas</b>                    |          |          |          |
| <b>Power</b>                            | 3        |          |          |
| <b>Construction</b>                     |          |          | 1        |
| <b>Others</b>                           |          |          |          |
| <b>REGION</b>                           |          |          |          |
| <b>Americas</b>                         | 3        | 2        | 1        |
| <b>Europe, Middle East &amp; Africa</b> |          |          |          |
| <b>Asia Pacific</b>                     |          |          |          |
| <b>DESIGNATED COUNTRY</b>               |          |          |          |
| <b>Designated country</b>               |          |          |          |
| <b>Non designated country</b>           | 3        | 2        | 1        |
| <b>INDEPENDENT REVIEW</b>               |          |          |          |
| <b>Yes</b>                              | 3        | 1        |          |
| <b>No</b>                               |          | 1        | 1        |

Table 1. 2014 Project Finance

The majority of Project Finance are category A with potential significant adverse environmental and social risks and/or impacts that are diverse, irreversible or unprecedented. These three projects have an independent review. Only two loans are category B and one are category C. Most of projects correspond to the power industry and infrastructure.

<sup>6</sup> [http://www.equator-principles.com/resources/equator\\_principles\\_spanish\\_2013.pdf](http://www.equator-principles.com/resources/equator_principles_spanish_2013.pdf)



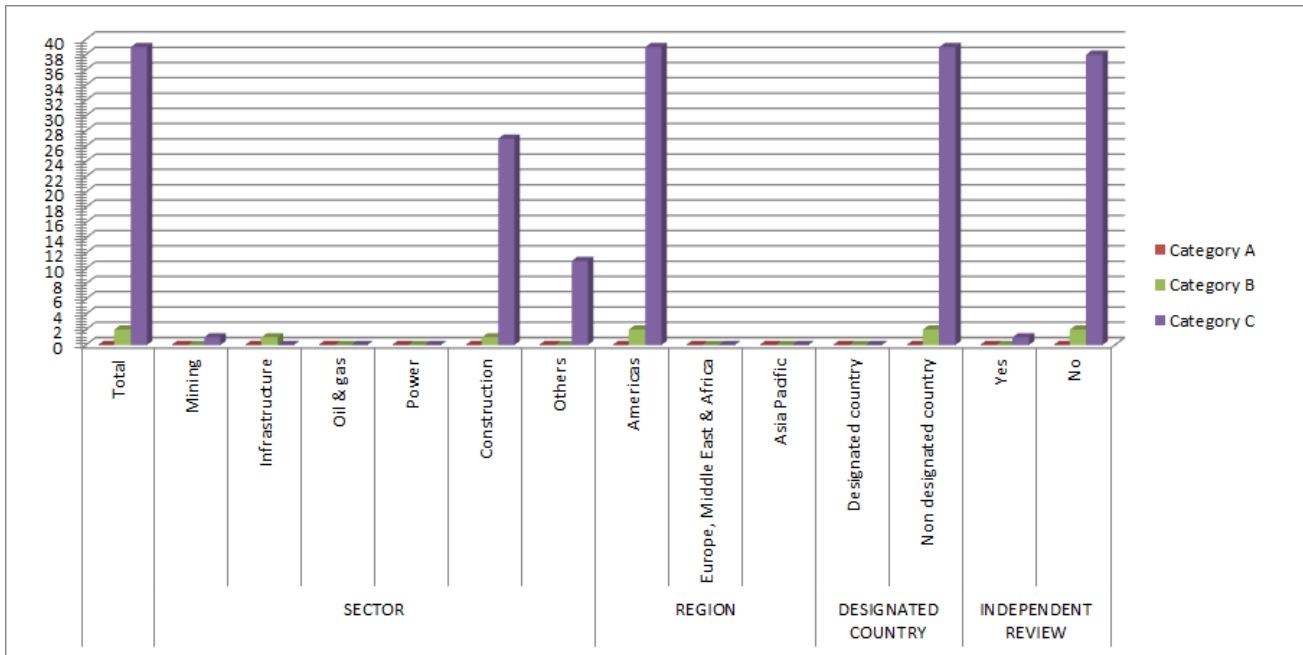
Graphic 2. Total number of project finance transactions that reached financial close in 2014.

### Project-Related Corporate Loans

| CATEGORY                     | A | B | C  |
|------------------------------|---|---|----|
| <b>Total</b>                 |   | 2 | 39 |
| <b>SECTOR</b>                |   |   |    |
| Mining                       |   |   | 1  |
| Infrastructure               |   | 1 |    |
| Oil & gas                    |   |   |    |
| Power                        |   |   |    |
| Construction                 |   | 1 | 27 |
| Others                       |   |   | 11 |
| <b>REGION</b>                |   |   |    |
| Americas                     |   | 2 | 39 |
| Europe, Middle East & Africa |   |   |    |
| Asia Pacific                 |   |   |    |
| <b>DESIGNATED COUNTRY</b>    |   |   |    |
| Designated country           |   |   |    |
| Non designated country       |   | 2 | 39 |
| <b>INDEPENDENT REVIEW</b>    |   |   |    |
| Yes                          |   |   | 1  |
| No                           |   | 2 | 38 |

Table 2. 2014 Project-Related Corporate Loans

The majority of Project-Related Corporate Loans are category C with minimal or no adverse environmental and social risks and/or impacts. Only two loans are category B. Almost all the projects correspond to the construction industry.



Graphic 3. Total number of Project-Related Corporate Loans transactions that reached financial close in 2014.

### Project Name Reporting for Project Finance

| No. | Project Name | Host Country | Sector         | Participating EPFIs | Year of Financial Close |
|-----|--------------|--------------|----------------|---------------------|-------------------------|
| 1   |              | Mexico       | Power          |                     | 2014                    |
| 2   |              | Mexico       | Power          |                     | 2014                    |
| 3   |              | Mexico       | Power          |                     | 2014                    |
| 4   |              | Mexico       | Infrastructure |                     | 2014                    |
| 5   |              | Mexico       | Infrastructure |                     | 2014                    |
| 6   |              | Mexico       | Construction   |                     | 2014                    |

Table 3. 2014 Project Name Reporting for Project Finance

We cannot disclose 'Project Name Reporting for Project Finance' data for 6 applicable transactions (3 classified in category A, 2 in category B, and 1 in category C) from January 1st to December 31st, 2014, as disclosure would violate applicable local laws and regulations.

In particular, Article 142 of the Law on Credit Institutions, stating that the information and documentation relating to operations and services shall be confidential. So credit institutions in protecting the right to privacy of its customers and users, they can only give news or information the owner, their representatives and when requested by the judicial authority, the National Banking and Securities Commission, Bank of Mexico, the Institute for Protection of Bank Savings and the Commission for the Protection and Defense of Financial Services Users.

## Conclusion

The adoption and implementation of the EPs by Banorte has represented an important challenge and has brought great satisfaction. During this period, we consolidated the operation of the SEMS with the assimilation of the EPs, which currently is reflected in the improvement of the analysis of the social and environmental risk, tools and methodologies employed.

We are very motivated and confident about the strategies set out for the coming year, which will contribute to the strengthening of our system and its processes and improvement in the application of the EPs, in order to ensure that the projects that we finance are executed in a socially and environmentally responsible manner.

## Hyperlink to Data and Implementation Reporting

<http://www.banorte.com/portal/personas/informacion.web?grupo=13&elemento=1184>

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## Appendix 1. Exclusion list of Banorte

### 03.02 Prohibited Risk Situations

**Current from: 10/07/2013 Preview Version.**

The most recent changes are in blue.

#### 03.02 Prohibited Risk Situations.

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

- a. Production or activities that involve forced labor <sup>(1)</sup> or child labor exploitation.
- b. Production or commerce of any product or activity considered as illegal, all in the current legal framework.
- c. Any business related to pornography and prostitution.
- d. Wildlife crime regulated by the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES).
- e. Production or trade of radioactive material (including warehousing and treatment of radioactive wastes.) asbestos, polychlorinated biphenyl (PCB) and others chemical products that have been prohibited internationally.
- f. Production and trade of pharmaceutical or pesticide and herbicides that has been prohibited internationally.
- g. Production or trade of harmful substances that destroy ozone, which have been prohibited internationally.
- h. Sea fishing using nets more than 2.5 km long.
- i. Commercial forestry at commercial level in primary tropical rainforest.
- j. Any other activity that is in violation of environmental, health or industrial safety laws.

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

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

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

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

For the case of SOFOL (Limited Scope Financial Institutions) mortgage loans, the prior authorization of the Risk Policy Committee is required, due to the "zero limit" according to the

number [1.1.5.3.2.2. Specific Limit for Credit Risk for SOFOL Mortgages \(Límite Específico de Riesgo de Crédito para Sofoles Hipotecarias\)](#) in the Risks Manual.

Transaction with applicants, whose credit score, which is determined by the Credit Bureau (Buró de Crédito) has one the following characteristics:

- Suspension of payments or bankruptcy, except expired procedures (1).
- Fraud, except when the Credit Bureau and/or the creditor determine that the fraud is not attributable to the client (2).
- Prevention Code 78, business receptors of credit cards that result in losses for the institution.
- Bankruptcy to 2,000 UDI.
- Observation Code UP. Account that result in bankruptcy. Amount superior to 2,000 UDI.
- Prevention Code 86; Client that have guarantees that support their line of credit, without authorization of the guarantor.

(1) The Codes that determine Suspension of Payments or Bankruptcy are:

- Prevention Code 80. Client declared to be Bankrupt, Suspension or Payments or Insolvency.

(2) The Codes that determine Fraud are:

- Prevention Code 82. Client that results in a loss to the guarantor by proven fraud.
- Observation Code FD. Fraudulent Account.
- MOP 99. Fraud committed by the consumer.

**Appendix 2. Questionnaire for Government Banking**
**Equator Principles - Banorte**
**PE002 Format- Social & environmental risk determination**
**Government Finance**

Folio # (If available)  Date

Client Data

CASB (If available)  requested amount

Eligibility criteria for analysis of Equator Principles

Is it a new project?  Yes  No *(Restructuring is not eligible)*

Total Cost of Capital

The project to be financed is of high intensity in carbon emission or it belongs to one of the following sectors<sup>7</sup>:

- Production of cement & lime
- Thermal power plants
- Iron & Steel Industry
- Foundry
- Melting & refining of metals
- Other (high intensity carbon emission)

Please contact the CSA and include details about the fate of the finance if affirmative response to question 1 and the total capital > \$10 million USD, or if the project is of high carbon intensity or at least one option is selected in question 3

<sup>7</sup> All projects which are expected to emit more than 100,000 tons of CO<sub>2</sub> equivalent per year, require an **analysis of alternatives** for technically and financially feasible options aiming to reduce greenhouse gas emissions.

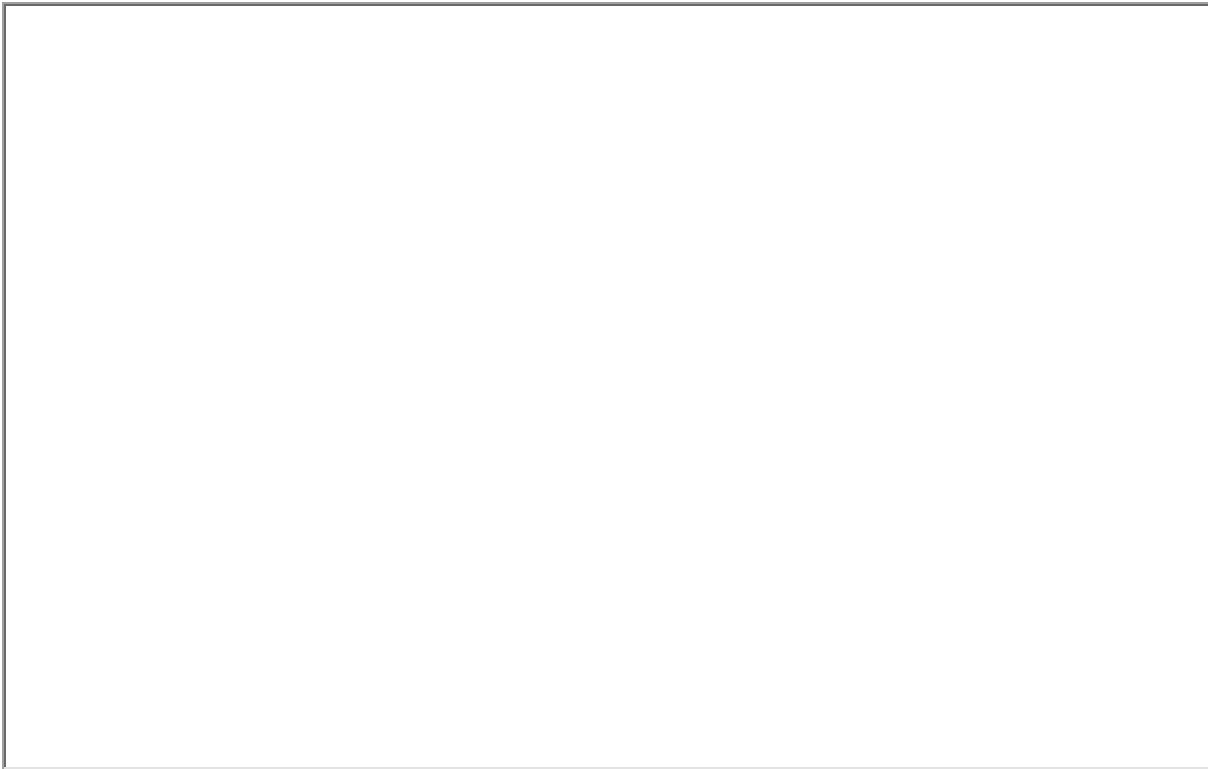
Destination of the financing (Please include industry activity, location & time limit for the details submitted):

Questionnaire answered by:

Social & Environmental Coordinator Observations

Potential Risk Level (If apply):       A       B       C

Justification/Comments:



Social & Environmental Coordinator:

**Appendix 3. Questionnaire for Structured Finance**

**Equator Principles - Banorte**  
**PE003 Format – Social & environmental risk determination**  
**Structured Finance**

Folio (If available)  Date

Client Data

CASB (If available)  requested amount

Total Cost of Capital

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

Financial criteria

The financing is an advisory service, whose total amount of investment is \$10 million USD or more.

Yes  No

Is it a funding project with a total investment of USD \$10 million or more?

Yes  No

The financing is a business loan and complies with the following five criteria:

- Related to a single project
- Total amount of financing is USD \$100 million more
- The initial exposure of Banorte is at least USD \$50 million.
- The term of the loan is at least two years
- The borrower has the cash operating control (direct or indirect) on the project

The financing is a temporary credit with a duration of less than two years, with the intention of being refinanced by a project loan for a business loan related to a project, and it is anticipated that this will comply with any of the criteria listed in questions 1 to 3?

Yes       No

Non-financial criteria – climate change:

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

- Production of cement & lime
- Thermal power plants
- Iron & Steel Industry
- Foundry
- Melting & refining of metals
- Other (high intensity carbon emission)

Details of the project (Description, location, website, certifications, etc.):

Questionnaire answered by:

Social & Environmental Coordinator Observations

Potential Risk Level (If apply):  A  B  C

Justification/Comments:

Social & Environmental Coordinator:



**Appendix 4. Due diligence procedure****Equator Principles  
PE001 Format – Due diligence**Folio (If available)  Date Client Data CASB (If available)  requested amount **General description of the project****Social & environmental risk categorization assigned to the project** High  Medium  Low  Exclusion**Documentation submitted****Social & Environmental performance references of the client**

a) Does the customer have an established environmental and/ or social responsibility policy?

 Yes  No

b) Does the customer have an established environmental, quality and/or process certification?

 Yes  No

c) Does the customer have any acknowledgment of their social &amp; environmental performance?

 Yes  No

d) Does the customer have a record of negative social &amp; environmental performance?

 Yes  No

e) Does the client have of negative record with respect to any other relevant matter?

 Yes  No

f) Has the customer incurred any fine and or sanctions related to social &amp; environmental issues?

Yes No

g) Are there any environmental requirements to be met by the customer according to credit/legal checklists?

 Yes No

### **Compliance with the Equator Principles**

of determining the compliance with the Equator Principles.

Principle 2: Environmental and Social Assessment

Principle 3. Applicable Environmental and Social Standards

Principle 4: Environmental and Social Management System and Equator Principles Action Plan

Principle 5: Stakeholder Engagement

Principle 6: Grievance Mechanism

Principle 7: Independent Review

Principle 8: Covenants

To be evaluated in the phase B of the project

Principle 9: Independent Monitoring & Reporting

To be evaluated in the phase C of the project

Principle 10 : Reporting and Transparency

**Conclusions and recommendations of the Social and Environmental Coordination (CSA)**

**Prepared by:**



**Name of the Coordinator**  
**Social & Environmental Coordinator**  
Social Responsibility & Sustainability  
E-mail  
5268.9000 Ext. 3235 RED 8555.3235

**Review of documentation**

To be held prior to the financing.

Date of review:

Date of next review:

Performed by:

Permissions

List of delivered and pending permission.

Opinion delivered by a lawyer concerning the permissions obtained and pending to deliver

Reports

Environmental Impact Statement (Manifestación de Impacto Ambiental: MIA) & Environmental and Social Management Plan.

Independent Review Report

Monitoring

Absence of Threat

Confirmation of Compliance

Conditions Prior to Funding

Conditions Prior to Completion

Covenants

Agreements

|  |
|--|
|  |
|--|

Limitations

|  |
|--|
|  |
|--|

Recommendations of the Social & Environmental Coordinator

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|--|
|  |
|--|

**Monitoring**

To be held with the frequency determined by the Social & Environmental Coordinator (maximum each year).

Review date:

Date of next review:

Performed by:

Cases of non-compliance

Reporting Requirements (Obligations)

Reports prior to the closure

Reports Prior to the Completion of the Project

Operating Reports

Explanation of Social or Environmental Claims

Explanation of Environmental Pollutants

Explanation of Elements of Health and Safety at work

Explanation of social complaints or significant protest

Others

Recommendations of the Social & Environmental Coordinator