



nacional financiera
Banca de Desarrollo

ANNUAL REPORT 2018

BOARD OF DIRECTORS AND COMMISSIONERS ON DECEMBER 31, 2018

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Chairman of the Directive Board

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Deputy Secretary of Finance and Public Credit

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ROCÍO NAHLE GARCÍA

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Banco de México

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General Director
National Council on Science and Technology

DEPUTIES

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Head of the Development Banking Unit
Secretariat of Finance and Public Credit

GABRIEL YORIO GONZÁLEZ

Head of the Public Credit Unit
Secretariat of Finance and Public Credit

TO BE APPOINTED

Chairman of the Entrepreneur National Institution

ALBERTO MONTOYA MARTÍN DEL CAMPO

Deputy Secretary of Energy
Secretariat of Energy

HÉCTOR DESENTIS MONTALBÁN

Director of Promotion Financial Intermediaries
Banco de México

TO BE APPOINTED

Head of Insurance, Pension and
Social Security
Secretariat of Finance and Public Credit

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JOSÉ MANUEL LÓPEZ CAMPOS

Chairman of the Confederation of National Chambers of Commerce, Service and Tourism (CONCANACO-SERVYTUR)

DEPUTIES

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Chairman of the Mexican Chamber of Construction (CMIC)

ENRIQUE GUILLÉN MONDRAGÓN

National Chairman of the National Chamber of the Transformation Industry (CANACINTRA)

GUSTAVO ADOLFO DE HOYOS WALTHER

Chairman of the Employers Confederation of the Mexican Republic (COPARMEX)

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Financial Director América Móvil, S.A.B. de C.V.

JOSÉ SALVADOR MARTÍNEZ CERVANTES

Independent Professional

COMMISSIONERS

HOLDER SERIES "A"

TO BE APPOINTED

Delegate and Principal Public Commissioner of Finance
Secretariat of Public Service

DEPUTY SERIES "A"

BRIGITTE CORNEJO JIMÉNEZ

Deputy Delegate and Deputy Public Commissioner of Finance
Secretariat of Public Service

HOLDER SERIES "B"

ARACELI ESPINOSA ELGUEA

Professor and Researcher of the Management and Business Academic Department of the Instituto Tecnológico Autónomo de México (ITAM)

DEPUTY SERIES "B"

IGNACIO NÚÑEZ ANTA

Comptroller and Manager of Grupo Financiero Anáhuac

SECRETARY OF THE DIRECTIVE BOARD

LÁZARO JIMÉNEZ GARCÍA

Secretary of the Directive Board

PERLA LILIANA DE LA PEÑA AMANTE

Prosecretary of the Directive Board

**OFFICER
ATTENDING
SESSIONS
OF THE DIRECTIVE
BOARD ON
DECEMBER 31, 2018**

**EUGENIO FRANCISCO DOMINGO NÁJERA
SOLÓRZANO**

General Director (CEO)

CATALINA BONNEFOI MONROY

Deputy General Director of Development
Finance

RAÚL SOLÍS WOLFOWITZ

Deputy General Director of Investment Banking

PEDRO GUERRA MENÉNDEZ

Deputy General Director of Treasury and
Financial Markets

**PEDRO A. ARGÜELLES RODRÍGUEZ
MONCADA**

Deputy General Director of Credit

TONATIUH SALINAS MUÑOZ

Regional Advertising and Institutional Relations
Deputy General Director

TOMÁS TRUEBA ZEPEDA

Deputy General Director of Legal and Fiduciary
Affairs

FEDERICO BALLÍ GONZÁLEZ

Deputy General Director of Finance and
Management

ADRIANA COVARRUBIAS DEL PERAL

Technical Coordinator of the CEO

LÁZARO JIMÉNEZ GARCÍA

Secretary of the Directive Board

PERLA LILIANA DE LA PEÑA AMANTE

Prosecretary of the Directive Board

CONTENTS

ECONOMIC ENVIRONMENT	8
PROMOTION	14
Credit and Guarantees to Private Sector Program	15
Productive Chains Program	15
Sector-based Program	15
Alternative Channels	18
Private Sector Credit Portfolio Balances	20
Business Training and Technical Assistance Program	20
Regional Promotion Network and Institutional Relations	24
INVESTMENT BANKING	29
Structured and Corporate Credits	30
Financial Advisory Services	32
Government Banking	32
Investment Programs	32
Sustainable Projects	33
INTERNATIONAL	34
Project Management	35
International Cooperation	37
Financial Agent	40
TREASURY AND MARKETS	42
Treasury	43
Markets	44
Investment Funds	47
Cetesdirecto	47

LEGAL AND FIDUCIARY OPERATIONS	48
Corporate and Business	49
Governmental Regulations.....	51
Legal and Collecting Disputes and Credit Department.....	52
Fiduciary Operations	53
OPERATIONS SUPPORT	54
Quality Management and Organizational Culture.....	55
Human Capital Development	55
Internal Comptroller	56
Internal Auditing.....	62
Computing.....	64
FINANCIAL RESULTS	65
INTERNAL CONTROL	68
ANNEX A	
Nacional Financiera important figures	70
ANNEX B	
“Report on Consolidated Financial Statements with Subsidiaries, as of December 31, 2018.”	73
ANNEX C	
Directory of Regional and Overseas Offices	78

ECONOMIC ENVIRONMENT

During 2018, the performance of global economic activity was positive; such expansion phase lasted for nine consecutive years after the 2008-2009 crisis.

Based on the figures available to date, the estimated economic growth rate was 3.7%, two tenths lower than the initial forecasts, and a tenth below the value observed in 2017.

The developed world, after having synchronized its cycles, showed divergences once again throughout the year, in great measure as a consequence of the economic policy actions of some countries, political decisions in others, and delayed events in general which still have not been resolved.

The growth rate of this group of economies, weighed by its participation

in their Gross Domestic Product (GDP) was 2.3%, that is, a tenth less than the growth rate of 2017. The developed countries had smaller growth rates in comparison to the previous year, except the economy of the United States of America (USA), which was bolstered by the tax stimulus. Thus, the USA grew by 2.9% vs 2.2% in 2017; the Eurozone grew by 1.9% vs 2.4%, Japan grew by 0.9% vs 1.9%; Canada grew 2.1% vs 3.0% and the United Kingdom, under the Brexit effect, grew 1.4% vs 1.8%.

The emerging and developing economies had a yearly advance of 4.6%, down from the 4.7% observed the

previous year, and lower than the prior forecast of 4.9%. The disparity among this group of countries was bigger in comparison with the developed countries. The countries that grew more in 2018 than in 2017 were as follows: Chile, 4.0% vs 1.5%; Peru, 3.9% vs 2.5%; Bolivia, 4.3% vs 4.2%; Brazil, 1.3% vs 1.1%; India, 7.3% vs 6.9%; Thailand, 4.2% vs 3.9%; Indonesia, 5.2% vs 5.1%; Hungary, 4.6% vs 4.1%; Poland, 5.0% vs 4.8%, and Russia, 1.7% vs 1.5%. On the other hand, the countries with growth rates below 2017 results were headed by China with 6.6% down from 6.8% (this is its smaller growth rate since 1991 [3.8%]), followed by South Africa with 0.7% vs 1.3%; South Korea, 2.7% vs 3.1%; Argentina, -2.4% vs 2.9% and Venezuela, -15.0% vs -10.5% (both are estimates in the absence of official information).

The labor markets kept improving significantly, with some exceptions. Unemployment rates in several countries dropped to levels not seen in years, even decades. For example, in the USA, 2.88 million jobs were created by the end of the year, which was reflected on an unemployment rate of 3.9%, the lowest for a year since 1969. Likewise, the unemployment rate reached 8.2% in the Eurozone, 2.4% in Japan, and 4.2% in the United Kingdom, their lowest rates since 2008, 1992 and 1974, respectively.

On the other hand, the dynamism of the world economy observed during the first quarter, which later began to slow down on the second quarter, brought greater inflationary pressures, which diluted gradually during the last months of the year in the face of the drastic drop of oil and associated fuels prices. The annual inflation in USA, as measured by the Consumer Price Index published by the Bureau of Labor Statistics, finished the year at 1.9%, down from 2.1% in 2017, while the core inflation, that is, discounting energy and food prices, rose from 1.8% to 2.2% due to the price increase on medical services, among other factors.

The economic slowdown that started being noticeable during the second semester of the year was reflected in a lower annual inflation in other places such as Japan, from 1.0% to 0.3% and the United Kingdom, from 3.0% to 2.1%. On the other hand, although other countries and regions finished with higher inflation rates in comparison to 2017, in others the inflation decreased during the last months of the year, such as in the Eurozone, from 1.4% to 1.6%, and Canada from 1.8% to 1.9%. Moreover, performance was more disperse in the emergent

economies, particularly due to the effects of the general appreciation of the United States Dollar (hereafter, dollar). Likewise, inflation rose in these countries as follows: Brazil from 2.95% to 3.75%; Chile, from 2.30% to 2.60%; Peru, from 1.36% to 2.19%; China, from 1.8% to 1.9%; Russia, from 2.5% to 4.3%; India, from 3.58% to 3.80%; Colombia, from 4.09% to 3.18%; South Africa, from 4.7% to 4.5%; Poland, from 2.1% to 1.1%, and South Korea, from 1.9% to 1.3%.

In keeping with the normalization process of its monetary policy, the U.S Federal Reserve System or Fed increased in 100 base points (bp) the target range for the federal funds rate, that is, 25 bp in each of the meetings held on March, June, September and December, raising the roof of the range to 2.50%, the highest level since the 4.25% of December 2007, when the target was exceptional. Nevertheless, at the time of unveiling their economic estimates for the next three years, the Fed reduced the federal funds rate associated with their growth, inflation and unemployment rate expectations for 2019, indicating that, although their strategy of raising rates will continue, the rhythm thereof will be slower.

Other central banks that made changes to their monetary policy during 2018 appear in the following table:

Central Bank	Level at the end of 2018 (%)	Variation on 2018 (PP)
United States	2.50	100
United Kingdom	0.75	25
Canada	1.75	75
Mexico	8.25	100
Argentina	60.00	3,125
Brazil	6.50	-50
India	6.50	50
Turkey	24.00	1,600
Indonesia	6.00	175

MEXICAN ECONOMY

Due to the aforementioned external adverse environment and the uncertainty caused by the renegotiation process of the North American Free Trade Agreement (NAFTA) that led to the United States-Mexico-Canada Agreement (USMCA), the federal electoral process and the impasse of the change of government, the production of final goods and services reached 2.0% during 2018, according to preliminary data published by the National Institute of Statistics and Geography (INEGI) at the end of January 2019 and thus the rhythm of growth of the Mexican economy dropped by a tenth of a percentage point compared to 2017. Primary activities grew 2.4% (3.2% in 2017), secondary activities grew 0.2% (having dropped 0.3% in 2017) and tertiary activities grew 2.8% (compared with 3.1% the prior year).

Regarding the demand, the economy continued being driven by private consumption, which until past November had an accrued increase of 2.4%. Analyzed by source, the consumption of national goods and services grew 2.2%; goods increased by 1.6% and services by 2.8%; while the consumption of imported goods increased by 3.5%.

Total investment, also until November, had an accrued advance of 1.3% compared to the same period in 2017. Analyzed by components, construction advanced 0.19%, investment in nationally sourced machinery



and equipment shrunk by -4.4%, while imports of such grew 7.8%.

Throughout 2018 the export sector displayed greater dynamism by growing 10%, in spite of imports advancing by 10.4%; both in terms of dollars.

In 2018 unemployment rate closed at 3.35% with a slight increase compared to the previous months, and a yearly average of 3.33%

The number of workers insured by the Mexican Social Security Institute (IMSS), taking into account both permanent and urban eventual workers, totaled 19,827,419 by the end of

Throughout 2018 the export sector displayed greater dynamism by growing

10%



December, that is, 643,228 jobs were created during the year with a percentage advance of 3.4%.

Remunerations measured by the Daily Wages Associated with Workers Insured by the IMSS grew by 5.38% yearly in nominal terms by yearend closing, while its real ex-ante variation (that is, compared to the inflation prospects for 12 months) had a positive growth of 1.48%.

Family remittances from abroad continued to be an important factor for the Mexican Economy and they reached a new historical maximum in 2018 by totaling 33,481 million dollars (MD), an increase of 10.5% compared to the levels observed in 2017. The value in pesos of the aforementioned remittances reached 645,513 million, which represented an increase in comparison to the value accrued in 2017, of 12.9% in nominal terms and 7.61% in real terms.

During 2018, the annual general inflation decreased in comparison to the levels observed by the end of

2017 due to decreases in the core (underlying) and non-core (not underlying) inflation. The annual general inflation dropped from 6.77% in December 2017 to 4.83% by the end of 2018.

Three moments can be distinguished in the inflation trajectory: an accelerated drop between January and May that saw the lowest level of the year: 4.51%; from this point there was an ascending trend that caused the annual inflation to rise to 5.02% in September, and then, there was a new drop until inflation reached the aforementioned closing level.

The behavior of fuel prices explains in good measure the ups and downs of inflation: LP gas prices dropped -9.3% between January and April, then increased 21% between April and October, and then dropped again 4.7% between October and December. On the other hand, gasoline prices increased 16.6% between January and November, and dropped 1.63% in December. Agri-food products prices contributed to stop the ascending trend of inflation during part of

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the year, and unfavorable climate conditions drove the increase of tomato, green tomato and serrano pepper prices, by 78.3%, 120.2% and 99.9% respectively. Thus the non-core inflation was 8.40% for 2018, down from 12.62% observed in 2017.

Moreover, the annual core inflation dropped from 4.87% at the end of 2017 to 3.68% on December 2018. This decrease was caused by lower inflation of goods and services. The annual inflation for goods dropped from 6.17% to 3.92% and the annual inflation for services dropped from 3.76% to 3.47%.

Lastly, in regards to monetary policy, Banco de México (Banxico) decided to adjust their reference rate upwards by 25 bp in four separate occasions at the meetings of February, June, November and December until reaching 8.25%, its highest level since the end of 2008. The aim of the central bank's actions was to prevent second order effects in the formation of prices and deterioration in the medium and long term inflation expectations, given the materialization of some risks, as well as the increase in the exchange rate and the prices of gas and gasoline during the second quarter. The monetary policy adjustments by the Fed were also a relevant factor.

In November and December, there were changes in the Board of Governors of the Central Bank. Guillermo del Cueto left his position as deputy governor for health reasons and Manuel Ramos Francia finished his eight year term, which started on January 2010, as deputy governor. They were replaced by Gerardo

Esquivel and Jonathan Heath, respectively, as of January 1, 2019.

After the negotiations to update NAFTA were suspended, the meetings restarted in August and concluded on September 30, 2018. On November 30, 2018, the leaders of the three countries

signed the United States-Mexico-Canada Agreement (USMCA) at the G20 summit held on Buenos Aires, Argentina. Nevertheless, the ratification of the agreement by the houses of representatives of the three countries, and its enactment, is still pending.

The new Mexican President was formally installed on December 1st, 2018, and, through the Secretary of the Finance and Public Credit, submitted the 2019 Economic Program to the Mexican Congress on December 15 for its discussion and approval, of which the following items stand out:

Federal Income LAW

- 2019 Federal Income Law: 5.81 trillion pesos, an increase of 535.0 billion pesos more than the amount approved in 2018, with an actual growth of 6%; 1.45 trillion pesos in oil income, 3.29 trillion pesos in tax income, 120.0 billion pesos in non-tax income, 821.0 billion pesos in income from agencies and companies, and 539.0 billion pesos in debt issuance. Moreover, the net external debt totals 5.40 billion dollars.

Federal Expenses Budget

- 2019 Federal Expenses Budget (FEB): the total net expenses of the public sector will have an actual increase of 6.1% compared with the 2018 approved budget, that is, a fixed increase of 330.8 billion pesos, thus, it will reach 5.77 trillion pesos. Programmable expenses of 4.12 trillion pesos (4.08 trillion pesos actual expenses minus payment deferrals of 36.0 billion pesos). Adding to programmable expenses of 1.69 trillion pesos.

Priority projects

- The priority projects of the central sector include the following standouts: Tren Maya -railway project- (6.0 billion pesos), modernization and refurbishing of airport and connectivity infrastructure (18.0 billion pesos) Sembrando Vida -rural development program- (15.0 billion pesos), Pension para el Bienestar de las Personas Adultas Mayores -senior citizens pension program- (100,000 billion pesos).

GDP of 24.94 trillion pesos

- Economic Policy General Criteria (EPGC - 2019 variables) GDP growth of 2.0% (1.5-2.5%), nominal GDP of 24.94 trillion pesos, 3.9% deflator, 3.4% inflation, an average and a closing exchange rate of 20.00 pesos per dollar, 8.3% end of period CETE rate, current account of -2.2% of the GDP, oil price of 55 dollars per barrel and a production of 1.84 million oil barrels.

Public balance of -2.0%

- A public balance of -2.0% of the GDP was also considered, with a primary balance of 1.0%, financial requirements for the public sector of -2.5% and historic balance of the financial requirements for the public sector of 45.3% of the GDP.





PROMOTION

Nacional Financiera, through its different credit and guarantees programs, funneled resources in 2018 of 553.742 billion pesos, of which 55.0% corresponded to Second-Tier loans, 42.1% to credits through the Guarantees Program and 2.9% to First-Tier private operations.

CREDIT AND GUARANTEES TO PRIVATE SECTOR PROGRAM

The variety of products offered by the institution through its Productive Chains, Traditional Discount, Micro-Business Financing and Equipment programs, as well as its Guarantees Scheme and the credit guaranteed by the latter, allowed to funnel resources to the private sector for the amount of 553.742 billion pesos, which supported 509,250 beneficiaries, including 137,046 companies and 372,204 microcredits, of which 40.5% (206,000) were clients supported for the first time in the past five years.

The micro, small and medium beneficiaries totaled 99.7%.

Based on the size of the supported companies, it is estimated that 1,018,500 jobs in the country have been preserved.

Resources were funneled through the Second Tier for the amount of 304.397 billion pesos, Productive Chains issued credits for the amount of 206.494 billion pesos, Micro-business and Equipment contributed with 23.374 billion pesos and Traditional Discount contributed with 74.529 billion pesos.

The Guarantees Program stimulates granting credit to small and medium sized enterprises (SMEs), since Nafin assumes part of the risk over any financing granted by Financial Intermediaries (FIs). During the period from January to December 2018, a total of 233.037 billion pesos (including guarantees financing and guaranteed credit) was funneled. Thus, the balance at the closing of the period, taking in consideration any guaranteed credit, was 118.799 billion pesos, 9.0% higher in comparison to the closing of December 2017. The Nafin Guarantee coverage for this balance is 67.3%

PRODUCTIVE CHAINS PROGRAM

By the end of 2018, through the Productive Chains Program, 206.494 billion pesos had been granted, producing a balance of 47.370 billion pesos. During 2018 and within this program, the Federal Government agencies and entities registered accounts payable for 338.017 billion pesos, 29% of which were paid early. This allowed to support 3,929 suppliers that exercised the benefit of early payment through financial factoring.

The main indicators of the program during 2018 were as follows:

- More than 460 First-Order Companies (EPO, in Spanish) in operation, benefitting more than 20 thousand suppliers.
- More than 2.3 million papers were operated.

During 2018, the promotion activity continued developing and registered in total 52 new chains and 187 chains in the promotion and implementation stages.

The main results of the Program, compared to the same period the year before, are as follows:

- Private sector operations increased by 2.784 billion pesos, which equates to 2%.
- The private sector balance increased to 4.855 billion pesos, which equates to 11%.
- The Federal Government balance grew to 4.716 billion pesos, which equates to 48%.
- The number of new EPOs registered increased by 30%.

SECTOR-BASED PROGRAMS

Nacional Financiera offers programs to service MSMEs of sectors or economic activities with limited access to financing, and programs to promote job creation and contribute to the servicing of strategic or priority sectors. During 2018 these programs

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reached a balance of 32.548 billion pesos, which implies a growth of 33.4% in comparison to the previous year. During 2018, 33,326 credits for the amount of 23.796 billion pesos (authorized amount) were granted during 2018.¹ Per line of action, the main results were as follows:

i. Financial Inclusion. 10,702 credits for the amount of 10.481 billion pesos were granted. The following stand out:

- Support Program for Women Entrepreneurs:** A program that includes gender perspective in the credit offer to MSMEs, to promote competitiveness and growth of businesses run by women of the country. 5,782 credits for the amount of 8.540 billion pesos were granted (actual granted 8.444 billion pesos).
- Credit for Young People (Crédito Joven) Program:** A program that grants credit to young individuals aged between 18 and 35 years old who wish to start their own business or grow their current business. 2,949 credits for the amount of 1.505 billion pesos were granted (actual granted 1.501 billion pesos).
- Radio Broadcaster Companies Financing Program:** A financing program for radio broadcaster companies, aimed to financing the compensation payment for their licenses. The first 57 credits in the amount of 175 million pesos were granted.

ii. Regional Development. 1,442 credits for the amount of 2.684 billion pesos were granted, which mainly include the following program:

- Programs of Economic Impulse and Promotion to Employment:** These programs are operated in

State	Granted Credits	Placed Amount (Million Pesos)
Nuevo León	323	688
Aguascalientes	149	279
Sinaloa	138	254
Chihuahua	96	187
Durango	94	162
Baja california	68	155
Michoacán*	80	126
Tamaulipas	76	107
Zacatecas	59	105
Oaxaca*	72	95
Hidalgo	39	85
Jalisco	44	81
Guerrero*	53	74
San Luis Potosí	34	55
Querétaro	26	42
Campeche y Tabasco*	58	129
Chiapas*	18	33
State of Mexico	4	14
Guanajuato	8	7
Sonora	2	6
Puebla	1	1
Total	1,442	2,684

*It operates under the "Impulso Suroeste" program, together with the strategy of Special Economic Areas.

¹ Credit amounts granted in the Sector-Based Programs take into consideration the amount of the authorized credit.

coordination with the governments of the participating states to support their priority economic activities and contribute to regional development and job creation. 1,442 credits were granted for the amount of 2.684 billion pesos.

The states of Baja California, Campeche, Chihuahua and Tabasco began to operate under the Programs of Economic Impulse and Promotion to Employment, during 2018. Likewise, there were portfolio expansions in Aguascalientes, Jalisco, Michoacán, San Luis Potosí, Oaxaca, Sinaloa, Tamaulipas and Zacatecas.



iii. Suppliers Development. 1,611 credits for the amount of 3.104 billion pesos were granted. The following stand out:

- **Building Sector Support Program:** This program supports the sector companies dedicated to the development of commercial infrastructure. 1,260 credits were granted for the amount of 2.524 billion pesos.
- **Assistance Program for the Leather and Footwear Sector and its Supply Chain:** This program supports the productive chain of the leather and footwear sector with financing to drive technological development and operational and administrative modernization. 234 credits were granted for the amount of 354 million pesos.

iv. Modernization and Equipment. 1,780 credits were granted for the amount of 3.876 billion pesos (authorized amount).

- **Micro and Small Carriers:** Program aimed at carriers for the purchase of new or seminew units with the purpose of fostering the renewal of the federal trucking fleet. 465 credits were granted for the amount of 873 million pesos.
- **Come to Eat (Ven a Comer) Program:** A financing program aimed at restaurant companies for working capital, equipment and modernization of facilities. 609 credits were granted for the amount of 951 million pesos.

- **Gasoline Station Companies Program:** A program that supports gasoline station companies with financing for the necessary investments for their modernization, in the face of new competition conditions in the energy industry. 78 credits were granted for the amount of 221 million pesos.

v. Economic Reactivation. 478 credits were granted for the amount of 586 million pesos (authorized amount). The following stand out:

- **Support Program for Companies Affected by Earthquakes:** This program was implemented after the earthquakes of September 7 and 19 of 2017 to contribute to the recovery of the affected areas, through financing of MSMEs and individuals with business activities for the investments required to reestablish their productive capacity and preserve jobs. 474 credits were granted for the amount of 582 million pesos in Mexico City, Guerrero, Puebla, Chiapas, Morelos and Oaxaca.

vi. Sustainable Financing. 8,313 credits were granted for the amount of 487 million pesos.

- The **Eco-Business Credit for Energy Efficiency Program**, in its “massive” and “individualized” modes, supports micro and small companies for the acquisition and/or replacement of efficient equipment, aiming to generate electricity savings. 6,223 credits were granted for the amount of 431 million pesos.

Alternative Channels

This program provides advice to MSMEs and entrepreneurs through the Customer Service Center and the Promoters Network for the affiliation process of suppliers to the Productive Chains Program and for the procedures to obtain sector-based financing. Likewise, it provides training, technical support and specialized advice for the operation of electronic products to EPOs and FIs. Moreover, it develops the entrepreneur capital market through investment in innovation and high-impact projects with direct investment and investment funds.

Sector-Based Programs Advertising

This program develops and implements promotion and sales strategies of some Sector-Based Programs through the Promoters Network, with the Impulso Económico (Economic Impulse), Emergentes (Emergent), Crédito Joven (Credit for Young People), Businesswomen and Building programs among the standouts.

The SMEs service indicators in the sector-based programs take into consideration the efficiency indexes, with the following results:

- 95% of SMEs are serviced within five natural days (from the assignment of cases).
- After the SME confirms its interest in financing, 97% of the dossiers are prepared in 10 natural days.
- After their preparation, 99% of the dossiers are sent to the counter of the financial intermediary within the following five natural days.

Likewise, a contribution to the balance of sector-based programs of 6.681 billion pesos was achieved.

Promotion of Factoring

This activity generates and implements strategies of promotion and affiliation to the Factoring Programs in Productive Chains and Financing of Suppliers, jointly with the clients of the Alternative Channels Directorate, by using the Promoters Network and assorted media such as telephone campaigns through the Customer Service Center, e-mails, events and information desks, among others.

The main results during 2018 were as follows:

- Affiliation of 3,114 new suppliers to the Productive Chains Program.
- 91% of the suppliers that published recorded operations.

Likewise, it contracts and manages the Customer Service Center. The main results at the end of 2018 are as follows:

- Service to 255,263 calls, 78% of which corresponds to users of the Productive Chains Program.
- The Productive Chains suppliers carried out discounts of their bills through the telephone for the amount of 30.507 billion pesos, which represents 13% of the total operated in the Program.
- 5,629 applications were serviced through the Entrepreneur Support Network, of which 59% required training services and the remaining 41% required financing. Out of the 2,300 applications corresponding to financing.

Administration of Electronic Products

Controls the Administration and Documental Management Platforms, as well as Nafinet, a platform that electronically operates the Productive Chains, Financing to Distributors and Electronic Credit products, and provides training, specialized advice and technical support to FIs, EPOs and internal areas. Likewise, it performs the documental review of the dossiers of affiliation to Productive Chains and certain Sector-Based Programs.

Some of the volumes of the Platforms include the following:

- Supervision and follow-up to more than 9,438 average daily operations (Chains and Credit at Fixed and Variable Rates, Emergent and Microcredits) with daily average amounts of more than 1.039 billion pesos.
- Servicing and support to more than 94 banking and non-banking financial intermediaries for credit operations and queries.

- Funds dispersal to SMEs and financial intermediaries by a monthly average of 892 million pesos on account of the EPOs, through the Productive Chains
- Implementation of 20 Productive Chains.

Entrepreneur Capital

Promotes direct or indirect investment projects through investment funds. It consists of six portfolios: Conacyt-Nafin Fund, Seed Capital Joint Investment Fund, Ecosystem of Entrepreneur Capital Inadem-Nafin, Crowdfunding Project, Mexico Ventures Fund, and IMPI-FUMEC Patenting Support Program. These portfolios are managed and operated through participation in the Management Boards and Stockholder Meetings of the companies, Investment Committees of the Funds, and follow-up meetings with the Contributing Organizations.

The main results are as follows:

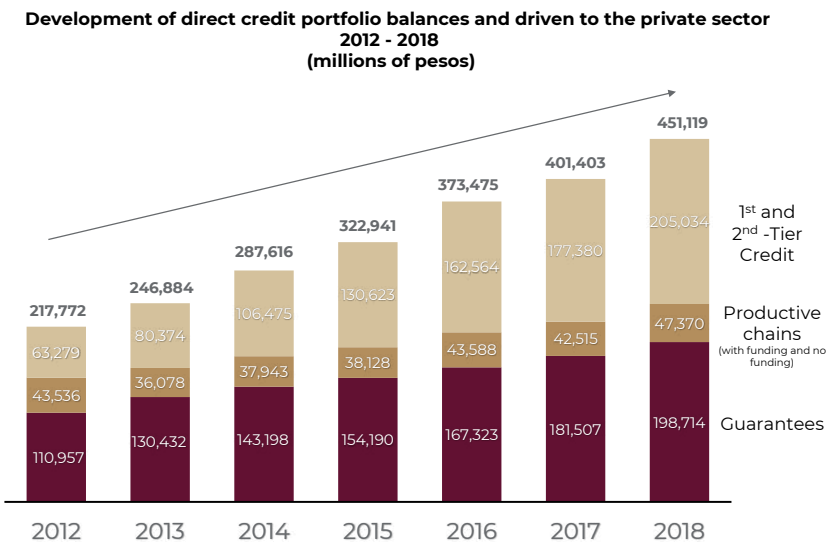
- **Conacyt-Nafin Fund.** The total investment of the program was 224 million pesos in 43 companies. The program is presently in the stage of disinvestment. Disinvestment in 14 companies for the amount of 86 million pesos has been negotiated. 8 million pesos were recovered in 2018 from five companies in the process of disinvestment. On the other hand, the Conacyt obtained the authorization of the Angel Investment Fund from the corresponding committees and the contract was executed in September 2018. It is presently being implemented.
- **Seed Capital Joint Investment Fund.** 430 million pesos in capital have been committed to 11 investment funds which have supported 92 companies, 16 of which received direct support for the amount of 76 million pesos, and there have been three successful disinvestments for the amount of 23.4 million pesos. The formalization of the special contributor Prosoft, for the amount of 130 million pesos, was one of the more relevant operations carried out during the second quarter of 2018.
- **Ecosystem of Entrepreneur Capital INADEM-Nafin.** The total amount of the program is estimated at 5.829 billion

pesos (public and private resources) with a participation of the Entrepreneur Capital Trust Fund for the amount of 1.879 billion pesos, to support 40 investment funds, which in turn have invested in 209 companies.

- **Mexico Ventures Fund.** There are four funds in operation with resources for the amount of 475 million pesos. In 2018 there were investments for the amount of 33.6 million pesos.
- **IMPI-FUMEC-Nafin Patenting Support Program.** In 2018 four patents were selected during the participation in the Call for Patents Workshop: a hovercraft, open architecture exoskeleton, hybrid system for heat generation and conservation and organic frogs breeding system.
- **Crowdfunding Project.** The second stage of the Crowdfunding Industry Diagnosis was performed in 2018, jointly with the Asociación de Plataformas de Fondo Colectivo (Afico), the Multilateral Investments Fund of the Inter-American Development Bank (BID-FOMIN) and the National Institute of Entrepreneurship (Inadem). This stage includes the analysis of 10 new platforms recently incorporated to the Afico, the updated analysis of the seven platforms of the previous stage, and the implications of the Fintech Law and its provisions for all the affiliated platforms.

PORTFOLIO BALANCES OF PRIVATE SECTOR CREDITS

At the end of December 2018, the total balance of the private sector credits portfolio, including guaranteed credits, had increased to 451.119 billion pesos, which represents an increase of 26.489 billion pesos (12.4%) compared with the same period the previous year. Of this amount, the Guarantees Program contributed 44%, the traditional credit contributed 45%, and the productive chains, the remaining 11%. In accordance with its mission of assisting the smallest companies of the country, 77% of the portfolio balance for the private sector was concentrated on MSMEs.



BUSINESS TRAINING AND TECHNICAL ASSISTANCE PROGRAM

Due to the restrictions arising from the electoral processes, the initial estimate was to support 80,000 beneficiaries with the 2018 Training and Technical Assistance Program. Nevertheless, this estimate increased to 99,000 beneficiaries given the evolution observed, and the actual number was 143,495 MSMEs entrepreneurs and/or business owners who received or attended courses, workshops, conferences, internships and/or work meetings and technical assistance, conducted both in Mexico City's Enterprise Development Center (Cedem) and at the mobile offices, public and private entities facilities associated with Nafin, and the e-learning (online) platform.

	Beneficiaries		
	Annual estimate 2018 1/	Performed Jan-Dec 2018	Progress
In-person ^{2/}	41,500	71,745	172.9%
Online ^{3/}	50,000	55,585	111.2%
Mobile Office	7,500	16,165	215.5%
Total of trained people	99,000	143,495	144.9%

1/As a result of the electoral process 80,000 beneficiaries were estimated to be supported according to the annual program of 2018. Nevertheless, due to the evolution observed, such estimate was of 99,000 beneficiaries.

2/It includes Technical Assistance Beneficiaries.

3/Number are accrued and for 2018 such numbers were estimated by "Active users who have taken the courses."

In the framework of the Program's strategy, the following actions have been performed during fiscal year 2018:

- A strategy was designed for the "2018 Business Diagnosis", which consists of:
 - » Application of diagnostics to companies in the e-learning platform, with the support of a net consultant.
 - » The consultant advises the company with the results of the diagnosis and the written authorization of the entrepreneur. The consultant makes two phone calls; the first call one month after the business owner completes the diagnosis, and the second call takes place two months after.
 - » In these calls the consultant points out opportunity areas for the business; for example having a mission or vision, how to promote the products or services, etc. and concludes by recommending other training subjects. During 2018, 3,057 beneficiaries, 891 entrepreneurs and 2,166 business owners performed the self-diagnosis.
- The following online and in-person courses were updated: "Regime of fiscal incorporation", "Products and services for your company", "SME products and services for promoters", "My business has a trademark", "Choose your type of corporation to start your business", "20 steps to begin or improve your restaurant" and "Correctly calculate your costs". In addition, the new online course "Iniciativa Mujer (Woman Initiative)" was incorporated.
- A new mechanism for the distance homologation of the Consultants Network was incorporated, which saves them time and costs by preventing travel, and keeps them updated in regards to the business contents of the Program. 14 homologations of assorted courses and workshops were performed by the end of the period.
- 201 collaboration agreements with public and private organizations for conducting training courses and providing technical assistance were executed.
- A new training concept called Jornada Pyme 2018, which consists of 8-hour practical workshops, was implemented. The Net consultants, based on their experience and the needs of business owners and entrepreneurs, develop contents of their own and give them according to a methodology established by the Business Development and Technical Assistance Directorate. At the end of 2018, 18 Jornadas Pyme events with the following subjects have been performed: "Sales for SMEs", "Digital Marketing", "Legal solutions for SMEs", "The success of your company is a family business", "How to obtain a bank credit", "Creativity and Innovation", "Business Simulator", "Business leadership and productivity", "Efficient use of energy in SMEs" and "Innovative and sustainable tourism business entrepreneurship", among others. These Jornadas Pyme 2018 were conducted during the Nafinsa Business Development and Credit Week events, organized in coordination with the State Representatives Network and public and private organizations, where free information about financing and training was provided. During 2018 five events took place in Chihuahua, Coahuila, Querétaro, Tamaulipas and Durango, respectively, with an average of 500 beneficiaries per week.
- From September 10-14, 2018, Nafin participated in the National Entrepreneur Week organized by the Secretariat of Economy, giving five master conferences in subjects such as "The role of women in family businesses", "Megatrends", "25 ways to finance companies", "Entrepreneurship" and "Digital marketing". Likewise, the Mobile Office organized 17 events, including conferences and group dynamics, with subjects such as "Family businesses challenges" and "Business lottery", among others, with an attendance of approximately 1,000 beneficiaries.
- From October 1-7 2018, Nafin participated in the 11th National Financial Education Week organized by the National Commission for the Protection and Advocacy of Financial Services Users (Condusef), with 17 master conferences in eight Mexico's states, in subjects such as: "The Mexican Financial System", "Grow your own emotional and economic wealth", "Balanced scorecard", "Finances for entrepreneurs" and

| NACIONAL FINANCIERA

“Cryptocurrencies”, among others. Likewise there were 19 Mobile Office events, including conferences and group dynamics, such as “Lego Serious Play” “Business Marathon”, “Business Coffee”, etc. Approximately 2,000 beneficiaries were serviced at such events.

- The “Collaborative Economy Workshop” aimed at informing about the opportunity areas of collaborative businesses in the financial, tourism, transportation and services sectors in Mexico was designed. The workshop was conducted in five occasions in Mexico City, Estado de México, Nuevo León and Oaxaca, respectively, and 112 beneficiaries received trained with a general level of satisfaction of 93%.
- The pilot project to implement corporate governance in 15 Mexican family companies was instrumented in 2017, within the scope of the Corporate Governance (CG) area and in collaboration with the Latin American Development Bank (CAF, in Spanish) and the Foundation for Sustainable Development in Mexico (Fundes, in Spanish). Out of these companies, nine were formally registered in 2017 and the six remaining concluded the project in 2018.
- The workshop “The Role of Corporate Governance in the Business Process” aimed at 39 members of Nacional Financiera, was implemented within the aforementioned area and jointly with the CAF. The workshop aims to strengthen the institutional abilities in regards to the importance of CG in companies, with a vision of risk management. The acceptance level reached 92%.
- Likewise, the 12th CG Workshop aimed at Non-Banking Financial Intermediaries (IFNBs, in Spanish) took place in Mexico City on October 10-11, 2018, with 57 individuals and 27 IFNBs in attendance and an acceptance level of 92%. The 13th CG Workshop aimed at family business took place in Mexico City on November 7-8, 2018 with 47 individuals and 23 companies in attendance and an acceptance level of 94%.

- From 2013 to 2018, the CG area has supported 342 companies and 807 business owners that have attended 13 CG workshops. There was also support for 368 business owners that attended the “Corporate Governance in Family Business” master conference.
- In regards to energy efficiency, the Corporate Ecoefficiency in Financial Institutions course was implemented in February 2018, jointly with the CAF. The 2-day course had 17 attendants from the following institutions:
 - » National Banking and Securities Commission (CNBV), National Commission on Energy Efficiency (Conuee), Trust Funds for Rural Development (FIRA) and Nacional Financiera. The course had a satisfaction level of 96%.
- Six meetings were organized in regards to the exchange of good practices and internships, with 141 attendants and a satisfaction level of 96.8%. The following were the beneficiary institutions:

1. Corporación Financiera de Desarrollo (Cofide).
2. Universidad Autónoma de Occidente, Los Mochis campus.
3. Universidad Veracruzana.
4. Collaboration project with Panama.
5. Unidad Profesional Interdisciplinaria de Ingeniería y Ciencias Sociales y Administrativas (UPIICSA).
6. 4th International Best Practices Program for Development Banking: The Nafinsa Model.

- **Ongoing participation in interinstitutional committees:**
 - » National Productivity Committee. Coordinated by the Secretariat of Finance and Public Credit (SHCP), it aims to promote support for business establishments in order to raise awareness about the importance and benefits of formalization through financial education courses.
 - » Financial Education Committee. Coordinated by the Condusef, it supports and reinforces actions regarding financial inclusion and education.
- In regards to the servicing channels, the following stands out:
 - » The in-person channel has 32 business development courses.
 - » The three Nafinsa Mobile Offices visited 31 states and 116 localities, through 124 routes, providing 1,201 courses for 16,165 beneficiaries.
 - » 3,230 in-person courses were provided to 71,745 beneficiaries through the Cedem in Mexico City and the national network of 52 consultants.² Out of all the courses, 252 events correspond to the Regime of Fiscal Incorporation (RIF, in Spanish) for 4,661 beneficiaries.
 - » The online platform: www.nafintecapacita.com has 32 courses of business development and 55,585 active users (accrued) that have attended 121,240 courses.
 - » From January to December 11,484 online courses were concluded. It is worth mentioning that for 2018 the accrued number of beneficiaries represents all who had started a course in the platform.³



² The sum of beneficiaries includes the in-person training actions such as workshops, conferences, work meetings and/or internships and technical assistance.

³ The beneficiaries counted in fiscal year 2017 represented all the users that logged in the platform to get informed and/or take the training courses, and to query materials of interest through communities, news, forums and chats, among others. The users that have started a course and continue logging in all the platform's services will be counted in fiscal year 2018. Only the measuring criterion changes.

REGIONAL PROMOTION NETWORK AND INSTITUTIONAL RELATIONS

The credit and guarantees granted to the private sector at the close of 2018 amounted to 553,742 billion pesos, providing support to a total of 509,250 beneficiaries, which include 137,046 companies, and 372,204 microcredits. Out of all beneficiaries, 99.7% were micro, small and medium companies. In the regional classification the Central region stands out with a participation of 51%.

OPERATION FOR PROMOTION OF PRIVATE SECTOR BY SECOND FLOOR, FIRST FLOOR AND GUARANTEES Regional Classification (Millions of pesos - Number of Enterprises)								
Credit and Guarantees Jan-Dec 2017			Credit and Guarantees Jan-Dec 2018			Percentage Variation 2018/2017		
Amount	Enterprise		Amount	Enterprise		Amount	Enterprise	
546,534	565,531	TOTAL	553,742	509,250		1.3		(10.0)
28,882	33,204	NORTH WEST	29,260	34,784		1.3		4.8
9,165	12,109	B. California	10,037	13,325		9.5		10.0
1,698	1,800	B. California Sur	1,752	3,928		3.2		118.2
9,742	5,386	Sinaloa	8,252	7,791		(15.3)		44.7
8,277	13,909	Sonora	9,219	9,740		11.4		(30.0)
100,969	73,473	NORTH EAST	106,507	69,435		5.5		(5.5)
12,662	13,760	Coahuila	11,423	14,927		(9.8)		8.5
10,581	9,373	Chihuahua	12,266	7,232		15.9		(22.8)
3,903	5,274	Durango	4,190	5,119		7.3		(2.9)
66,254	27,503	Nuevo León	70,393	24,258		6.2		(11.8)
7,569	17,563	Tamaulipas	8,234	17,899		8.8		1.9
85,985	108,684	WEST CENTRAL REGION	85,501	103,661		(0.6)		(4.6)
4,486	3,655	Aguascalientes	4,119	4,789		(8.2)		31.0
3,122	3,068	Colima	3,341	2,507		7.0		(18.3)
16,993	16,139	Guanajuato	16,009	15,140		(5.8)		(6.2)
40,110	28,925	Jalisco	41,268	25,268		2.9		(12.6)
8,091	19,889	Michoacán	7,829	16,941		(3.2)		(14.8)
1,734	3,156	Nayarit	1,816	3,946		4.8		25.0
8,666	27,669	San Luis Potosí	8,409	28,103		(3.0)		1.6
2,782	6,183	Zacatecas	2,710	6,967		(2.6)		12.7
290,194	223,965	CENTER	288,237	193,017		(0.7)		(13.8)
202,803	62,125	Mexico City	195,187	46,560		(3.8)		(25.1)
2,352	13,174	Guerrero	2,737	19,611		16.4		48.9
6,713	16,093	Hidalgo	6,375	15,244		(5.0)		(5.3)
51,082	69,367	Mexico	54,947	50,336		7.6		(27.4)
3,797	20,059	Morelos	3,771	18,439		(0.7)		(8.1)
8,571	6,452	Querétaro	9,273	5,781		8.2		(10.4)
13,725	29,273	Puebla	14,799	31,555		7.8		7.8
1,151	7,422	Tlaxcala	1,149	5,491		(0.2)		(26.0)
40,504	126,205	SOUTH -SOUTHEAST	44,237	108,353		9.2		(14.1)
3,248	10,970	Campeche	3,893	5,879		19.9		(46.4)
4,707	24,517	Chiapas	3,579	20,853		(24.0)		(14.9)
3,096	8,474	Oaxaca	3,250	11,166		5.0		31.8
4,009	16,011	Quintana Roo	4,233	9,777		5.6		(38.9)
5,663	6,825	Tabasco	8,462	7,286		49.4		6.8
13,512	48,685	Veracruz	14,647	45,401		8.4		(6.7)
6,269	10,723	Yucatán	6,174	7,991		(1.5)		(25.5)

The Regional Promotion and Institutional Relations Deputy General Directorate is the main sales channel of Nacional Financiera products and services in the 32 states of the country, by promoting the programs and assisting the administrative areas in the implementation thereof.

The aims of the Promotion and Institutional Representation activities developed during fiscal year 2018 were as follows:

- Promote the activities of Nacional Financiera at state level.
- Promote Nacional Financiera's products and services portfolio for assorted business segments.
- Establish local alliances for the promotion of institutional products in support of SMEs.
- Identify the requirements and needs of business sectors and state governments.
- Generate business for the institution with a focus on regional development.

The results reported by the Regional Promotion and Institutional Relations Deputy General Directorate (DGA) in favor of the country's regional and sectorial development by yearend closing were as follows:

- The Nacional Financiera brand was positioned in most of the country's states, through the design of the routes travelled by the three Nafinsa's Mobile Offices. Likewise, the communication lines with municipal authorities were expanded through the processing of the appropriate licenses for the installation of the Mobile Offices and the local promotion of Nacional Financiera's training offer in 106 municipalities of 31 states.
- During fiscal year 2018, the institution entered into 23 collaboration agreements through the Regional Development and Institutional Relations Deputy General Directorate or its regional directorates and state representatives. The institution may enter into collaboration agreements with business organizations, the educational sector and state and municipal governments. The purpose of entering into these agreements is to "Combine efforts

between "THE PARTIES" to provide financing access guidance and information to affiliated micro, small and medium companies, and information about training programs and courses developed by "NAFIN" to be provided by electronic means and/or in-person."

- The State Representatives Network participated in the organization of 262 promotional events, and the promotion and invitation thereto. The aforementioned events covered the country's 32 states with the aim to promote the Mujer Pyme and Crédito Joven (Credit for Young People) products. It is worth mentioning that 34 out of the 103 events were massive.
- During 2018, 68 projects reached the Credit Committee, stemming from the promotion and support activities for the implementation of projects for assorted institutional products and services by the Regional Promotion and Institutional Relations Deputy General Directorate. Likewise, 37 Productive Chains were implemented in the New and Reactivations mode.

The Deputy General Directorate (DGA, in Spanish) achieved placings for the amount of 23.386 billion pesos, distributed as follows per product management area: Promotion, 19.259 billion pesos; Investment Banking, 3.115 billion pesos, and Financial, 1.012 billion pesos.

Out of 19.259 billion pesos of operation in products managed by the Promotion DGA, 54% corresponds to Productive Chains, 22% to Selective Guarantees, 14% to Sector-based Programs, and the 10% remaining to other products. It is worth noting that in the case of Sector-based Programs the state representatives managed the support of state governments in providing for the counter-guarantee funds.

The Deputy General Directorate achieved placings for the amount of 23.386 billion pesos

2018 report on business agreements by Regional Office:

Region	Other products		Productive chains		Total produced	
	Amount (Billion pesos)	Contribution %	Amount (Billion pesos)	Contribution %	Amount (Billion pesos)	Contribution %
Center	2,507	19%	571	6%	3,078	13%
North East	4,130	32%	2,955	28%	7,085	30%
North West	1,709	13%	2,985	29%	4,694	20%
West	1,806	14%	3,350	32%	5,156	22%
South	2,854	22%	518	5%	3,372	14%
National	13,007	100%	10,379	100%	23,386	100%

Advisory Councils

During fiscal year 2018, the strategic relations of Nacional Financiera with business owners throughout the country were strengthened through the Advisory Councils, which have turned in one of the main communication channels between the Federal Government and the business sector.

Currently, this business network has 658 advisory counselors in total. Likewise, increasing the participation of businesswomen in the Advisory Councils has been a constant gender inclusion task; thus, at the end of 2018, 117 female counselors were participating.

125 Advisory Councils meetings were held in 2018 in the 32 states. The standout contributions made by Nacional Financiera advisory counselors to the five work areas focus on strategic subjects, such as: Product design according to regional vocations, promotion and integration of new clients, support to entrepreneurs and promotion of innovation, training and technical assistance and institutional relations.

The operation and coordination of the Advisory Councils contributed to the generation of 181 agreements, or “business agreements” regarding the promotion of institutional services and generating business, of which 180 applications were processed at the end of 2018, representing a 99% progress.

2018 business agreements report by the Regional Directorates:

Region	Produced agreements on 2018	Concluded agreements on 2018	% of concluded agreements
Center	63	63	100%
North East	28	28	100%
North West	20	20	100%
West	45	44	98%
South	25	25	100%
National	181	180	99%



Advisory Councils helped Nacional Financiera to identify opportunities for the implementation of programs to boost regional and sector-based economic development, as well as to refer new strategic clients from the private sector. Likewise, their contribution encompassed opportunity areas with the public sector, through the participation of the Economic Development Secretaries of each state, who have supported joint and coordinating actions to promote support for SMEs, mainly through the “Impulso” programs, business training and technical assistance.

During fiscal year 2018 the advisory counselors referred several prospects for the placement of the institution’s products and services, such as: Selective Guarantee, Productive Chains, Treasury Contracts, Corporate Financing, Sustainable Projects and Non-Banking Financial Intermediaries.

The advisory counselors were a cornerstone for the successful organization of 34 national promotional events for the Businesswomen Program with more than 3,000 attendants.

The annual meeting of the 32 chairpersons of the Advisory Councils took place in August 2018. The most outstanding results of Nafin were presented at that meeting and the main opportunity areas in regards to the inner workings of the assessment processes and projects authorization of the institution were addressed. Likewise, the National Meeting of

Advisors, with more than 300 business owners from all the country in attendance took place on October. The main subject of the meeting was the new approach of the Federal Government towards the participation of the business sector in the economic decision making process. The response of the guest authorities was favorable for the attendants, since a more active participation of the whole Mexican productive sector will be promoted.

In regards to targeted business training, the advisory counselors actively supported the execution of three collaboration agreements with business chambers and organizations in the southern region of the country, namely in Campeche, Tabasco and Yucatán, with the implementation of course programs for business owners of the main localities. Likewise, the advisory counselors collaborated with the organization of five Jornadas Pyme, technical assistance programs, in the states of Chihuahua, Coahuila, Querétaro, Durango and Tamaulipas. The purpose of the programs is to provide information applicable to practical activities for medium companies to boost and strengthen their economic growth.

Furthermore, Corporate Governance and Collaborative Economies workshops for medium and big companies and non-banking Financial Intermediaries took place at the Nacional Financiera headquarters, with the participation of the advisory counselors. The subject of these meetings

was the more important aspects to achieve the professionalization of companies, with the active involvement of family members at executive positions, and their integration to national and international value chains.

Credit for Young People (Crédito Joven)

The purpose of this initiative, introduced by the President of the Republic on 2015, is to promote financial inclusion and economic growth from financing access at preferential rates in four different modes. Thanks to the Financial Reform, it is possible to support young people without credit history that wish to have access to financing services for amounts

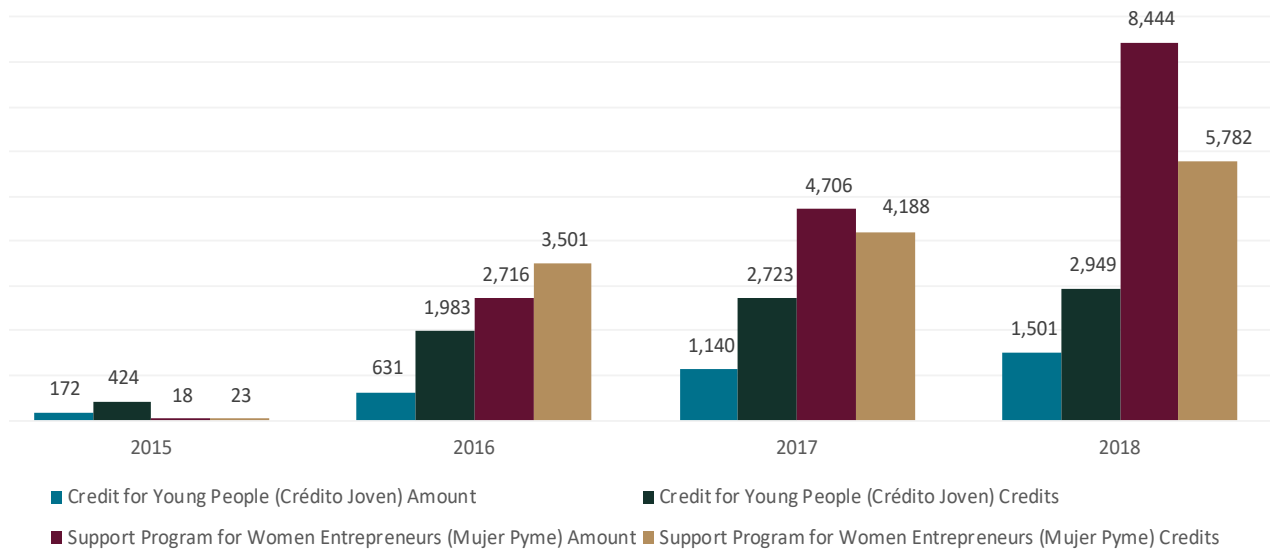
ranging from 50,000 pesos up to 2.5 million pesos. In 2018, 2,949 credits for the amount of 1.501 billion pesos were granted

Women in SMEs (Mujer Pyme)

Financing program aimed at boosting growth and the modernization of women owned companies by eliminating access barriers. This program is aimed at businesswomen enrolled in the Regime of Fiscal Incorporation (RIF, in Spanish), women enrolled as individuals with business activities or corporations with at least 51% of share capital owned by women. At the end of 2018, 5,782 credits for the amount of 8.444 billion pesos were funneled.

CREDIT FOR YOUNG PEOPLE AND WOMEN IN SMES

FIGURES IN MILLIONS OF PESOS AND NUMBER OF CREDITS





INVESTMENT BANKING

STRUCTURED AND CORPORATE CREDITS

Structured credit provides financing through a specific purpose vehicle whereby companies monetize their asset portfolios, allowing to isolate operational risks and obtain higher credit ratings, without negative effects on balances. This program is aimed at medium and large companies that generate portfolios with receivables.

Petrochemical Company in Veracruz

As a follow-up of the work performed in 2017, during the first semester of 2018 the corporate credit guaranteed by P  troleos Mexicanos (Pemex) for the amount of 250 million dollars for a 7.5 years term was restructured with the purpose of allowing the fertilizer plant to continue its rehabilitation and commissioning process. The project is relevant to Mexico since it will replace fertilizer industry imports.

Wind park in Puebla

Financing up to 100 million dollars was authorized for building, commissioning and maintenance of phase II of the wind park in Puebla, which has 84 wind generators with a capacity of 220.5 MW to supply energy to one of the largest beer brewing companies of the country. Hence, the beer brewing group will become the largest corporate buyer of renewable sources under long term supply contracts.

The transaction is supported by the generation capacity of one of the sponsors of the project, which is the largest electrical power private generator in Mexico and one of the largest in the world.

The operation was syndicated by Nafin as the structuring agent bank and included other development bank and a commercial bank to complete the total financing of 177 million dollars.

The negotiations of the documents for the financial closing took place at the end of 2018, and the credit is expected to become available in the first quarter of 2019.

Open Cycle Central in Nuevo Leon

As a follow-up to the work performed in 2017, the final terms and conditions of the operation arising from

the assignment in the 2017 long term auction were reported during the second quarter of 2018.

The negotiations of the documents for the financial closing were performed in the early second semester of 2018 and during the second semester of the same year, the first financing payments took place for the amount of 112.7 million dollars from the senior credit and 607.1 million pesos from the credit for the Value Added Tax (VAT).

Nafin, as the structuring bank, is performing the appropriate procedures to syndicate the operation in 2019 for the amount of 175 million dollars together with the commercial and/or development banks.

Hydrocarbons transport infrastructure

In 2018, as part of the aperture of the hydrocarbon transportation and storage segments since the Energy Reform, financing for up to 500 million pesos was authorized to cover in 100% the VAT generated during the building phase of the storage and delivery terminals, as well as the hydrocarbon transportation polyduct from Tuxpan, Veracruz, to Tula, Hidalgo.

The differentiated logistical costs between regions are obtained from the combination of transportation means that minimize the cost of moving the fuel from the supply point (national or import) to the gasoline station.

At the end of 2018 the following have been granted: (i) 1,918 transport and distribution permits (oil, petroleum products, and petrochemicals); (ii) 136 hydrocarbons, natural gas, petroleum products and petrochemicals commercialization permits; (iii) 149 petroleum products storage permits, and (iv) 11,838 gasoline station permits.

The new regulatory framework allows for private participation in all the links of the hydrocarbon value

chain, which is expected to contribute to: (i) a move to a competitive market, (ii) trigger investment in the petroleum products infrastructure, (iii) foster efficiency conditions in the industry and (iv) guarantee the energy supply and strengthen Mexico's energy security.

Petrochemical Company in Coatzacoalcos, Veracruz

Follow-up of the credits authorized for a petrochemical complex in Coatzacoalcos for high and low density polyethylene production: (i) senior line for the amount of 280 million dollars, (ii) current account line to finance the VAT arising from the investments made during construction totaling 30 million dollars and (iii) simple credit for working capital for the amount of 40 million dollars.

The project, one of the most impactful economic and social projects in the world, was recognized as such by receiving the Best Projects Awards prize granted by the *Engineering News-Record* (ENR) magazine.

Securities market boost

A new scheme to boost the securities market through asset based structured (ABS) financing was implemented in accordance to Nacional Financiera's mandate as set forth in its Organic Law. During 2018 Nafin continued disposing from the first line of storage for the amount of 3,700 billion pesos in favor of a capitals market vehicle.

This type of product has allowed the development of the securities market through the continuous purchase of financial assets until their maturation, after which they are placed in the debt market.

In the syndication headed by the institution, commercial banking complemented financing for the amount of up to 5,000 billion pesos, which was given follow-up in order to dispose of the rest of the financing in the second semester of 2018.



FINANCIAL ADVISORY SERVICES

Two requests to prepare assessment technical rulings were addressed during 2018: (i) one for a wood industry company for capital issuance up to 3,075 billion pesos and (ii) the other for a cement company for capital issuance up to 150.3 million pesos. The institution thus provided assistance in placing the issued ordinary shares certificates in the stock market.

GOVERNMENT BANKING

From January to December 2018 Nafin continued to manage credits previously granted to two semi-public entities, Pemex and the Comisión Federal de Electricidad (CFE), currently State Productive Companies. Their balance as of December 31, 2018 amounts to 4.505 billion pesos.

INVESTMENT PROGRAMS

Direct Stock Investment

Regarding the permanent portfolio of companies, during 2018 several actions were performed to follow-up the direct stock investment portfolio of the institution: i) on May 430,000 dollars were received in the account of distributions from a private capital fund in which Nafin holds investments, and ii) there has been work in the preparation of dossiers for the cancellation of reserves and termination of some investments deemed unrecoverable.

On the other hand, five capital calls were addressed during the year for an amount of 2.2 million dollars which correspond to a bilateral fund in which Nafin holds stocks and contributes to boosting energy and telecommunication companies.

Indirect Stock Investment

Nacional Financiera fosters and develops the industry of risk capital in Mexico through the Corporación Mexicana de Inversiones de Capital, S.A de C.V. (CMIC

or Fund of Funds). The CMIC corporate structure is divided into nine vehicles with specific investment reasoning in Private Capital, Entrepreneur Capital or Venture Capital, Mezzanine Debt and Energy Sector.

As of December 2018, the CMIC holds commitments for 946.3 million dollars in 86 investment funds and 22 direct joint investments, supporting 224 Mexican companies and more than 60,194 direct jobs and 137,846 indirect jobs. Moreover, CMIC manages more than 20.300 billion pesos from the Administrators of Retirement Funds (Afores, in Spanish) through the issuance of five Development Capital Certificates (CKDs).

On the other hand, Nafin is a partner of Corporación Andina de Fomento (CAF), holding 1.2% of the ordinary stock of the multilateral organization. The Chairman of the Directive Board of Nafin (the Secretary of Finance and Public Credit) participates as member of the CAF Board of Directors, with the aim of promoting financial and technical cooperation schemes for the development of the small and medium size enterprises of our country.

Program of Institutional Market of Corporate Alternative Debt-MIDAS

In keeping with its mandate effectively, Nacional Financiera has designed the institutional program called Programa Mercado Institucional de Deuda Alternativa Societaria (Program of Institutional Market of Corporate Alternative Debt)-MIDAS, which pairs the credit support of the institution so companies may implement their modernization and expansion plans, and the promotion of the securities market by means of boosting companies so, in no later than three years, they become candidates to issue debt in the Mexican Stock Exchange through compliance with an institutionalization program of their corporate governance, aimed at contributing to and solidifying the permanence of the company in the market, and providing transparency and certainty to third parties as a future public company.

Through the institutionalization program of its governance bodies, the first capital issuance of a company promoted through the MIDAS program took place in April 2018, for the amount of 700 million pesos which in turn liquidated 137 million pesos of the financing granted.

SUSTAINABLE PROJECTS

The institution, in line with the Federal Government objectives focused on the promotion of sustainable development in Mexico, promotes financing from diverse sources aimed at electrical power generation projects through renewable sources and clean technologies, to optimize the use of public investment as a complement to private investment, and actively contribute in the achievement of the new scopes, responsibilities, investments requirements and goals of the energy sector, consequence of the Energy Reform and set forth in the Development Plan of the Electrical National System.

In this regard, the following 2018 projects stand out:

Combined-cycle plant in Tlaxcala

Two simple credits were executed in January to finance: (i) the purchase, operation and maintenance of the project with an installed capacity of up to 47.8 MW; and (ii) the VAT generated by the purchase of the project. The credits became available in January in a single payment.

Wind park in Yucatan

Two simple credits were executed in January to finance: (i) the building and operation of the project with an installed capacity of up to 70 MW and (ii) the VAT generated by the investments required for the construction of the project. The project started operating in November 2018.

Wind park in Yucatan

One simple credit was executed in January for the financing of the VAT generated by the investments required for the construction of the project with an installed capacity of up to 75.6 MW. The project started operations in December 2018.

Photovoltaic solar plant in Durango

The financing executed in December 2017 became available in February for (i) the construction and operation of a project with an installed capacity of up to 157.8 MW and (ii) the VAT generated by the

investments required for the project in construction. Income from energy sales in the Wholesale Electrical Market will be the source of payment. The credits are in a drawdown period according to the work completion schedule of the project

Simple-cycle central in Chihuahua

In July became available the financing executed for (i) the construction and operation of a project with an installed capacity of up to 110.9 MW and (ii) the VAT generated by the investments required for the construction of the project. Income from energy sales in the Wholesale Electrical Market will be the source of payment. The credits are in a drawdown period according to the work completion schedule of the project.

Photovoltaic solar plants in Zacatecas

Four simple credits were executed in November for (i) the construction and operation of two projects with an installed capacity of up to 300 MW and (ii) the VAT generated from the investments required for the construction of the projects. The credits are in a drawdown period according to the work completion schedule of the projects.

Results

The following projects were added to the portfolio of sustainable projects in 2018:

- A combined-cycle plant in Tlaxcala.
- Two wind parks in Yucatan.
- One photovoltaic plant in Durango.
- One simple-cycle central in Chihuahua.
- Two photovoltaic solar plants in Zacatecas.

With the above Nafin continues driving the national development through financing aimed at the priority and high impact energy sectors.



INTERNATIONAL

PROJECT MANAGEMENT

At the end of 2018, the disbursement of resources as a direct borrower of International Financial Organizations (OFI, in Spanish) amounted to 17.6 million dollars and 180,000 euros from the German Development Bank (KfW) set aside for energy efficiency programs and environmental improvements. Moreover, 300 million dollars of the CAF were disbursed and set aside for working capital operations. The financing projects of the OFIs in force, executed and in negotiations during the period are as follows:

OFI financing in force

Non-reimbursable technical cooperation granted by the Inter-American Development Bank (IDB), ATN/TC-13019-ME for the amount of 0.409 million dollars for the institutional reinforcement of Nafin

Three disbursements from the cooperation were performed in 2018 for a total amount of 35,005 dollars, reaching an accrued amount of 399,387 dollars that represents 97% of the execution of the resources. The final dates established for the execution and disbursement of the resources were December 17, 2017, and April 17, 2018, respectively. When the loan comes to term, the IDB automatically cancels the remaining balances in their systems. Due to the above, the Bank requested to the Secretariat of Public Service (SFP) the scheduling of the closing audit, which was performed from September 21 to December 10, 2018, by the Crowe Gossler audit firm. The results thereof were satisfactory and without observations. Presently the letter of termination from the firm and addressed to the SFP is still pending. Said letter is required to obtain the acceptance of the reports from the aforementioned Secretariat and the instruction to Nafin to settle with the firm.

IDB and Clean Technology Fund (CTF) loans and technical cooperation to finance the Geothermics Financing and Risk Transfer Program

The objective is promoting private investment through financial and risk transfer mechanisms that reduce the investment costs, mobilize the private capital set aside for projects and guarantee

their long term sustainability/growth. By the end of 2017, the IDB proposed a new operation scheme to capitalize on the existing efforts and materialize the participation of the private sector in geothermal projects. The proposal was based in converting the CTF credit into a donation in order to increase the amount of non-reimbursable financing with contingent recovery, to support the exploration phase by hiring geothermal wells drilling services through the Instituto Nacional de Electricidad y Energías Limpias (National Institute of Electricity and Clean Energy or INEEL, in Spanish).

On January 2018 the CTF accepted the IDB proposal; the final amount of non-reimbursable financing with contingent recovery was set to 51.5 million dollars, and the IDB loan for the different exploration and project development stages remained at 54.3 million dollars. Work meetings between the INEEL, IDB, Nafin and the Secretariat of Energy (Sener) took place on May and June 2018 in an effort to prepare the contents of the tender documents for hiring the services of a geothermal wells driller without objection from the IDB. The INEEL published the Open International Public Tender (LPI, in Spanish) call in the Federal Official Gazette on July 12, 2018.

On the second semester of 2018, in the framework of the 5th Geothermics Congress of Latin America and the Caribbean, the new operational scheme of the Program was introduced. Presently the INEEL is waiting for the authorization by the Sener to issue the LPI ruling number CE-018T0K001-E151-2018 for the selection and hiring of geothermal wells drilling services suppliers.

KfW line for 31.2 million euros for the SME Environmental Improvement Program

- **Financial contribution of KfW for the amount of 1.02 million euros.** . The following actions were performed at the end of 2018: consultancy services for the Small Carriers Program (Man-Truck); modernization of the Operational Program Platform of the Energy Savings Trust (Fide); technical assistance to support the Directorate of International Financial Organizations (DOFI) in international hiring processes; implementation of new functionalities for the Information System of Fide's Operational Program; training plan for Fide

representatives involved in the Entrepreneurial Eco Credit Program; hiring of indexing services of 20,000 dossiers for Fide; a market study of MSMEs for positioning the Program; design and implementation of a promotional plan for the Corporate Energy Efficiency and Savings Program; purchase of specialized equipment for monitoring, verification and reporting of the Program; Training and certification program for the design, installation and operation of photovoltaic systems for personnel of Fide; three consultancy services for updating the Fide's Operational System resulting from the incorporation of assorted requirements of the Program; printing of 500,000 promotional flyers and the production of six testimonial videos of the Program; a diploma in energy efficiency, two workshops for certification in Project Management for Nafin personnel and an internship for high level executives at KfW's headquarters at Frankfurt, Germany. The aforementioned represented a disbursement of 991,151 euros, reaching a total drawdown of 97% of the authorized amount of the financial contribution.

Promotional financing line with KfW for 50 million dollars for renewable energies

The contractual commitment to provide information, such as Consolidated Financial Statements of Nafin by 2017 closing and advance reports from the project supported, were honored during 2018.

- **Financial Cooperation.** As part of the contract agreement of this line, KfW committed to Nafin to finance the development and implementation of a custom built Environmental and Social Risks Management System (ESMS) proportional to its operations and that meets the national legislation and international standards requirements. With the ESMS, Nafin will strengthen its assessment, mitigation, management, documentation and monitoring capacities in regards to impacts and risk associated with financing and investment, and will be positioned as a leading institution in green financing. At the end of 2018 the following actions have been performed:

- » Consultancy will last 18 months, split in six months of research work and development of

the system and 12 months of accompaniment (test pilot).

- » A training workshop was organized for the personnel that participate in the institutional credit process, the assessment works for the institutional processes involved, and the preparation of a proposal for the ESMS manual.

Uncommitted line with CAF for 300 million dollars

300 million dollars were used in 2018, set aside for working capital operations, which will be amortized in February 2019.

Concessional financing line of KfW for 56.6 million dollars to support hydraulic desalinization projects

In the framework of financial cooperation between the governments of Germany and Mexico, Nafin agreed to the contracting of a concessional resources allocation through a KfW line of credit. The allocation is set aside to support the Mexican hydraulic sector. The loan agreement was executed in December 2017 and the credit analysis to support a hydraulic desalinization project was performed throughout 2018. The aforementioned project is expected to be financed by this line during 2019.

OFI financing projects contracted in 2018

KfW financing line for 34 million dollars for the Forest Investment Program (FIP)

At the request of the SHCP, Nafin will support the FIRA in contracting a concessional loan with the KfW, since the FIRA does not have a sovereign guarantee. Such loan will be transferred to FIRA under the favorable conditions granted by KfW, plus the operational and risk cost generated to Nafin due to its brokerage. This borrowing line includes a financial contribution of 6 million euros to implement accompaniment measures of FIRA's responsibility program.

Work meetings with FIRA and KfW took place during the first semester of 2018 to analyze and prepare a contractual proposal that defines the relationship and commitments between the three parties. The negotiation and formalization of the loan took place

in December. After the effectiveness conditions of the loan are met, disbursements thereof are expected from the second quarter of 2019.

Concessional financing line of KfW for 113.4 million dollars to support the Renewable Energies and Energy Efficiency Program

In the framework of the celebration of the Mexico-Germany two-year cooperation and exchange pact, on April 2016 the government of the Federal Republic of Germany assigned concessional resources to Mexico for the amount of 100 million euros for climate change mitigation actions. Two objectives that met the aforementioned goal were set: Financing support for large scale photovoltaic solar projects and energy efficiency and photovoltaic solar generation projects in SMEs.

In this context, Nafin and KfW negotiated a loan agreement for 113.4 million dollars, equivalent to 100 million euros and structured in two tranches. The first tranche has an assignment of 60% for photovoltaic projects financed by Nafin. The second tranche has an assignment of 40% for energy efficiency in SMEs funneled through the Entrepreneurial Eco Credit Program implemented by Fide. The negotiations concluded with the formalization of the loan on December 2018; therefore, once the effectiveness conditions of the loan are met, disbursements thereof are expected from the second quarter of 2019.

Financing in process

Concessional financing lines of KfW for 100 million euros each

In the framework of the celebration of the Mexico-Germany two-year cooperation and exchange pact, the government of the Federal Republic of Germany assigned concessional resources to Mexico set aside for a climate change mitigation program for the Mexican transportation sector. As part of the preparation work, KfW hired a consultancy team tasked to prepare a feasibility study about Nafin's programs in the sector. The study took place on August 2017 with the participation of internal areas of Nafin and relevant players of the transportation sector: federal, municipal and state governments, transportation chambers and organizations, financial intermediaries and vehicle manufacturers.

The final results were submitted on April 2018 and the conclusion was that the most feasible proposal with the highest environmental pact was to direct the resources to the replacement of the freight sector vehicle fleet through an innovative auction mechanism in which the financial intermediaries that wish to participate must offer the greatest reduction of greenhouse gases. The proposal takes into consideration the mandatory scrapping, therefore, KfW and Nafin are exploring the possibility of obtaining resources from the European Union and the Mexican government to set up a scrapping fund, which is an essential component for the contracting of the line.

INTERNATIONAL COOPERATION

Inter-American Development Bank (IDB)

Nacional Financiera, through the Financial General Deputy Directorate and the DOFI participated in the 59th Annual Meeting of the Board of Governors of the IDB that took place from March 22 - 25 in Mendoza, Argentina with the attendance of representatives of international economic and financial institutions. In addition to attending the Annual Meeting sessions, several bilateral meetings took place with the Latin American Association of Financial Institutions for Development (ALIDE), the European Investment Bank, the KfW, Reuters, International Development Finance Club (IDFC), Mizuho, Standard Chartered and Crédit Agricole (CACIB), to review the existing business relationship and define new cooperation areas.

Latin American Association of Development Financing Institutions (ALIDE)

ALIDE had a very busy schedule in 2018 in the framework of their 50th anniversary. The General Director of Nafin, as Chairman of the Directive Board of ALIDE, participated in the Directive Board meeting that took place on January 24, in Lima, Peru, where, in addition to reviewing the internal business of the Association, the General Secretary organized a special conference to celebrate the first 50 years of the Association in its host city.

| NACIONAL FINANCIERA

Likewise, other meeting of the Directive Board of ALIDE took place within the framework of the 59th annual meeting of the Board of Governors of the IDB, with the attendance of the Financial DGA and DOFI. Internal business of the Association was reviewed at the meeting together with the definition of the participation of Nafin during the General Assembly and the events associated with the 50th anniversary of the Association, and other subjects.

The General Director of Nacional Financiera also participated in the “Latin American Meeting on Financing and Fostering International Businesses and Investments” organized by ALIDE and the Banco Nacional de Comercio Exterior (Bancomext) on April 11-12 in Mexico City. At said meeting the General Director of Nafin chaired the panel “SMEs: critical aspects, financing, business development and the role of development banking”.

The 48th Ordinary Meeting of the General Assembly of ALIDE took place from May 30 to June 1 in Lima, Peru. The main subject of the meeting was the “Present and future challenges of development banking”, which was addressed from three areas: artificial intelligence and technological leap; resiliency of cities in the face of extreme events, and financial inclusion and integration of individuals, projects, companies and territories. The General Director of Nafin attended the Directive Board meeting as Chairman thereof and also chaired the panel “Technological disruption in the financial sector. A glance at the speed in which the present is being transformed.” and held meetings with his counterparts from the Banco de Desenvolvimento de Minas Gerais, The French Development Agency (AFD) and the Instituto de Crédito Oficial (ICO) of Spain. The Investment DGA participated in the panel “How to make financing work for climate and sustainable development”, while the Promotion DGA participated as panel member in “Resiliency of cities in the face of extreme events: countercyclical actions of development banking for quick recovery”. Financial DGA and DOFI held meetings with the IDFC, Thomson Reuters and HSBC. During the 48th General Assembly of ALIDE, the General Director of Nafin was elected as Chairman of the Directive Board for the 2018-2020 period, stemming from the strategic bonds between both institutions and his performance as President during the previous term.

Therefore, the General Director of Nafin chaired

the Directive Board meeting of ALIDE that took place in Buenos Aires, Argentina, organized in the framework of the 6th D20 Conference and the 3rd Meeting of Argentinian Development, Investment and Foreign Trade Banks on September 10-11. The General Director of Nafin also participated as panel member.

The Montreal Group

The 7th Annual Meeting of The Montreal Group took place in Montreal, Canada, on May 7-11, hosted by the Business Development Bank of Canada. The DOFI participated in the aforesaid meeting as representative of Nafin before the Directive Board of The Montreal Group, accompanied by the Product Development Directorate to attend the work meetings regarding “Online services and digitalization” and “Medium companies growth” corresponding to the 2017-2018 period. At the meeting it was agreed to resume both work groups for the 2018-2019 period in order to give continuity to the work performed. The Italian Cassa Depositi e Prestiti participated in the aforesaid meeting as a new member of The Montreal Group.

For a second consecutive year and apart from the annual meeting, The Montreal Group organized a mission for SMEs focused on the artificial intelligence subject. 220 SMEs representatives and organizations from nine different countries interested in the development of business, networking and onsite visits to leading companies in the sector attended the meeting. The ProMexico office in Montreal accompanied Nafin during this meeting.

The Pacific Alliance

The Pacific Alliance has sought to deepen the economic and financial integration between its member countries: Mexico, Chile, Colombia and Peru. Within this framework, Nafin, in coordination with Bancomext, BBVA Bancomer, BBVA Continental and Cofide of Peru, organized the first “Development and private banking working together in support of SMEs” seminar, which took place on May 29 in Lima, Peru. The General Director of Nafin participated as chair of the panel “Development banking as leverage for companies” and the Development DGA participated as panel member in “Development and commercial banking in support of SMEs through guarantees and the use of new technologies”.

Likewise, the DOFI participated in the “Business meeting in the framework of The Pacific Alliance” which took place on July 22-23 in Puerto Vallarta, Jalisco, attended by the leaders of the Alliance member countries, and business owners and financial institutions as well.

Green Climate Fund (GCF)

The institution participated in the “Green Climate Fund structured dialog with Latin America” which took place on March 5-8 in Bogota, Colombia. Since Nafin is undergoing the accreditation process as GCF Implementing National Entity its participation was of considerable relevance to make progress in this process, have an rapprochement with the Secretariat of the Fund and gain an understanding of the mechanisms and tools offered by the Fund to support projects that contribute to mitigation and adaptation actions against climate change. The Secretariats of Finance and Public Credit and Environment and Natural Resources, who are part of the Appointed National Authority by the GCF, also attended the event.

Likewise, Nafin submitted their formal application to the GCF and started the first phase of the accreditation process, in which the Secretariat performs a review of the competences and compliance with the requirements established by the Fund.

International Financial Cooperation

The General Director of Nacional Financiera participated in the Annual Meeting of the Asset Management Company of the International Financial Cooperation, which took place on October 22-24 on Old Winsor, United Kingdom. In addition to his attendance to the assorted sessions of the event, he also participated in the review of the Mexico-China Fund portfolio.

Moreover, the General Director of Nafin and the Technical Coordination of the General Management participated in a work trip in London, United Kingdom. The purpose of the work trip was to review the activity report and pending matters of the London branch, and to hold assorted meetings with international institutions with which Nafin has close collaboration relationships, such as the European

Bank for Reconstruction and Development and the London School of Economics and Political Science (LSE), among others.

Cooperation Agreements

Development Finance Corporation (Cofide)

As part of the work carried out within the framework of the Pacific Alliance, and during the event organized in May in Lima, Peru, Nacional Financiera and Cofide signed a Memorandum of Understanding with the aim of strengthening mutual cooperation and complementarity in financial services, particularly in guarantees, productive chains and factoring, among other topics of common interest. Through this instrument, the institution and the Development Finance Corporation formalized a working relationship that will contribute to the financial integration of the region.

Exchange of Best Practices

International Program on Best Practices for Development Banking: Nafinsa Model

The Financial Deputy General Directorate (DGA), jointly with the Technical Coordination of the General Directorate and the Finance and Management DGA organized the “4th International Program on Best Practices for Development Banking: the Nafinsa Model”. The event aims to share the experience and best practices of the institution regarding policies, methodologies, programs and products, as well as presenting Nafin’s funding strategy to foreign development banks. The fourth year of the International Program was attended by 23 representatives from 13 institutions, from 11 different countries.

London School of Economics and Political Science (LSE)

The third year of the research program agreed between Nafin and the LSE took place from September to December 2018. The official designated to participate in the institution’s postgraduate courses and to prepare a useful research paper for the bank, focused on climate finance, particularly on environmental safeguards -which are increasingly important for financial institutions at international level. According to the work schedule

| NACIONAL FINANCIERA

agreed with LSE, the research paper will be published during the first quarter of 2019.

FINANCIAL AGENT

As of December 31, 2018, the portfolio of Financial Agent in execution consisted of 20 loans and six donations, for a total amount of 3.545 billion dollars. Seven of them correspond to the International Bank for Reconstruction and Promotion (BIRF, the original World Bank institution), nine to the IDB, three to the International Fund for Agricultural Development (FIDA, in Spanish) and one to AFD; while out of six donations, five were from BIRF and one from FIDA.



During 2018, nine loans and two donations were formalized:

- Loan for the Construction Program and equipment of the National Animal Health Reference Center for 145 million dollars with the IDB.
- Loan for the Program to Strengthen Treasury Management in Federal Entities and Municipalities for 612.4 million dollars, with the IDB.
- Loan for the Program to Strengthen Treasury Management in Federal Entities and Municipalities for 37.6 million dollars, with the Chinese Fund.
- Loan for the Project to Strengthen Access to Social Housing for 100 million dollars, with the World Bank.
- Loan for the Project for a National Agrifood Storage System for 130 million dollars, with the World Bank.
- Loan for the Project for Higher Education for 120 million dollars, with the World Bank.
- Loan for the Project of Energy Efficiency in Schools and Hospitals for 50 million dollars, with the World Bank.
- Fast disbursement loan for the Strengthening Program for the Reform of Urban Development and Territorial Planning for 600 million dollars, with the IDB.
- Loan for the Project of Entrepreneurial Strengthening in Forest Productive Landscapes for 56 million dollars, with the World Bank.
- Donation for the Project of Business Strengthening in Forest Productive Landscapes for 3.3 million dollars, with the World Bank.



As a result of the aforementioned, attention was provided to 82 supervision missions, from which, 27 of them were field visits. On the other hand, two procurement training workshops were given on external credit to the executing agencies; such training was agreed between OFI and SFP.

During the first semester of 2018, the formal closure of the Forest and Climate Change Project was carried out in the city of Guadalajara, Jalisco by officials of the World Bank and the Mexican Government. In that event, the achievements and the fulfillment of the goals and indicators of the Project were presented, as it was accomplished in an outstanding manner. Nafin, acting as a financial agent, has worked jointly with the National Forestry Commission providing technical assistance and training, so that the procurement processes are carried out in accordance with the applicable regulations regarding procurement with external credit so they were eligible for the disbursement of the resources of the three operations associated with the Project (two loans and one donation).

In the second semester of 2018 a field visit was made to the state of Durango for the formal start of the Business Strengthening Project in Forest Productive Landscapes by officials of the World Bank and the Mexican Government, during which the project's objectives, goals, and indicators were presented. In addition, in order to identify future disbursements, potential beneficiaries were visited.

On the other hand, a visit to the state of Sonora was carried out for the official delivery of the combined cycle solar field, which was financed with the grant TF-57033 from the Agua Prieta II Solar Hybrid Project.

The main sectors funded by the financial organizations are: energy, agriculture, social, education, environment, climate change, and health. As of December 2015, disbursements accounted for 1.595 billion dollars, while the income for commissions charged as financial agent accounted for 10.8 million dollars.



TREASURY AND MARKETS

TREASURY

Collection

In order to ensure that the institution has always sufficient resources and is able to allocate them to different business areas under the best cost and term conditions, the Treasury shall carry out a collection strategy based on diversification of the funding sources and in performing operations derived from coverage.

During 2018, the Treasury issued Certificates of Development Banking through the Syndicated Auction mechanism, which has allowed to:

- Improve liquidity conditions.
- Develop the debt curve of the Development Banking at longer terms by transmitting the benefits of funding the industry.
- Promote the integrated development of the security market and of the national financial system.
- Foster the efficiency of local markets of public debt, seeking, at all moments to make efficient the process of price discovery.
- Have a larger participation of investors.
- Improve the operating dynamics in the secondary market of these instruments.
- As of December 31, 2018, out of outstanding 60 billion pesos in Stock Market Certificates of Nacional Financiera, 50 billion pesos were issued through syndicated auctions; 12.050 billion pesos were at three years and revisable interest rate, and 37.950 billion pesos at a 10-year term and fixed interest rate.

Regarding the collection in foreign currency, the Certificate of Deposit Program of the London Branch continued to be used as the main conduit, which, along with the acquisition of the interbank financing lines, time deposits, and working capital lines, has allowed the Treasury to maintain its cost of funding in foreign currency at attractive levels and in line with institutional goals' compliance.

Cebures-Euroclear

In order to continue with the Syndicated Auctions scheme, the issuance of a new series of Stock Exchange Certificates of the Development Bank (Cebures) at a variable rate and a three-year term, as well as a new reopening of long-term Cebures at a fixed rate was made in April. The latter is characterized for being liquidated through Euroclear and Clearstream. It should be remembered that this scheme provides international public investors access to debt certificates. The amount placed in the Syndicated Auction in April was 7 billion pesos in communicating vessels, out of which 2.5 billion pesos allocated in the fixed tranche, with which the issue settled through Euroclear and Clearstream currently has a total amount issued of 12.950 billion pesos.

These actions took place within the framework of the 2018 Operational and Financial Program, which aims to contribute to the economic development of the country to facilitate access to financing for MSMEs, as well as to contribute to the creation of financial markets.

Balance Management

They kept the strategy of minimizing the exposure of the balance of the institution to movements in interest rates, the coverages necessary to protect the income that the bank receives for financial margin, so complying with the objective of the Treasury of ensuring that balance risks are found within the approved limits, being able to strengthen the bank capital.

Investments

In national currency, there is the held-to-maturity portfolio, which is mainly structured with securities of the Federal Government; the liquidity portfolio, comprised mainly by Governmental securities, and which is used as warranty in the payment systems of Banxico, as well as a corporate securities portfolio that contributes to the private debt market development.

Profit generation through financial margin in US Dollars has come from investment portfolios at a certain due date, and available for sale: strategic assets which have been maintained as some of the coverage instruments of the institutional balance, by hosting long-term collection lines. Both portfolios

| NACIONAL FINANCIERA

are maintained, practically in full, in investments of issuance from the Federal Government (UMS), as well as of national state-owned companies like Pemex and CFE. It should be noted that in 2018 they generated revenues of 96.6 million pesos.

Regarding the liquidity portfolio in foreign currency, it was decided to take advantage of the conditions in international markets; therefore, the main strategy was to optimize the profitability of surpluses in dollars, through the execution of synthetic investments in pesos. However, management of liquid resources through checkbooks, and particularly through demand and term deposits with development and commercial banks, allowed the generation of significant interest margins, so that at the end of 2018 this portfolio generated revenues for around of 36.4 million pesos.

London Branch

During 2018, the balance of the certificates of deposit issued by the London Branch reached its historical maximum, amounting 2.782 billion dollars in July to close in a balance of 2.283 billion dollars.

Regarding the placement and issuance of Certificates of Deposit with maturities over one year, it is worth noting that two issues in dollars were placed in April with two different counterparties for a period of 18 months. This allows maintaining the improvement of the liabilities maturity profile that has been planned with this Program, thus reducing the existing gaps in the institution's balance sheet with the attractive collection costs that distinguish the Certificates of Deposit Program.

MARKETS

Markets Promotion

During the second semester of 2018, market promotion activities were directed to increase the profitability of the portfolios of the Money, Treasury, and Exchange trading desks. The important client portfolio of the institution allowed to increase at the end of the year the repurchase amount and to assure the collection of resources at competitive levels for promotion programs of Nafin. It is worth mentioning the important participation of our clients in dollar purchase and investment transactions.

During 2018 the following was achieved:

- Reactivation of the operation with inactive clients, determining target products in which it is desired to increase the business relationship.
- Entering into agreement with new clients.
- Increase, with the support of the Money Desk, Treasury and brokers, in the generation of trading operations among promotional clients.
- Promotion with the support of state representatives to attract new clients in the states, as well as an active participation in some advisory councils for the advertising of our products and services.
- Debugging of investment contracts.
- Updating and obtaining documentation to comply with regulatory aspects: i) Customer Identification and Knowledge Form (FICC) and ii) Self-Certification Form (FATCA)..
- Execution, in due time and manner, of the functions and activities of the Secretariat of the Financial Products Committee.

Thanks to the promotion carried out with customers, the syndicated auction was supported through the Public Offer in April; thus, contributing to the participation of our clients with 20% of the total amount allocated.

Financial Markets

Throughout 2018 there were increases in implied volatility indexes for all type of assets, indicating a lower willingness of investors to take risky positions in relation to their 2017 preferences. The VIX index, which measures the implied volatility of the options on the S&P500 index of shares listed on the US stock market, presented two relevant episodes: the first, on February 5, when it reached the level of 37.32 (the highest since the 40.74 observed on August 24, 2015) due to an increase in the probability - which subsequently diluted - of the Fed becoming more aggressive in its strategy of normalizing its monetary policy; the second, on December 24, when the VIX index reached 36.07 due to the plummeting of shares of issuers such as Facebook, as well as the increase in the probability

of a global economic deterioration for the following years as a result of the materialization of some risks such as geopolitical and commercial tensions worldwide, within the framework of a secular deceleration after almost ten years of uninterrupted global growth.

The oil price presented steep ups and downs throughout 2018. West Texas Intermediate (WTI) closed at 45.41 dollars per barrel (dpb), 15 dpb less than the end of 2017. That took place after that, at the beginning of October, it reached 76.41 dpb, its highest level since it got to 77.94 dpb on November 11, 2014. However, on average, the price of crude oil in 2018 was higher than in 2017: 64.95 dpb vs 52.33 dpb.

Stock markets, particularly those of the US, which started the year with a good performance in the expectation of a better global economic performance, ended up collapsing in the last quarter of 2018. Thus, throughout the year the Dow Jones index dropped -5.6%, S&P500 -6.2%, and Nasdaq -3.88%. Other indexes did not perform better, the FTSE 100 index of the London Stock Exchange fell -12.5%, affected by Brexit uncertainty; the Dax of the German stock market fell -18.3%; in South Africa the adjustment was -11.1%, and the Shanghai Composite contracted -25.3%. Among the most important markets, only the Bovespa index -of the Sao Paulo stock exchange, had a positive performance as it advanced 15.0%.

In terms of interest rates, the increase of 100 bp in the reference rate by the Fed was transferred to the yield curve; although, in a differentiated manner; the greatest response was observed in the short terms, the 1- and 2-year bonds rose 86 bp and 61 bp, respectively, while 5-year bonds rose 31 bp and those of 10 and 30-year bond recorded increases of 28 bp each.

As for currencies, the dollar strengthened against the main currencies of the world, with the exception of the Japanese yen, which advanced 2.84%, and the Mexican peso, which rose 0.06%. The euro showed depreciation of -4.4%, the pound sterling of -5.6%, the yuan of -5.4%, the rand of -13.9%, and the real of -14.7%.

Money Market and Bonds

Bond rates were under pressure throughout the year, affected by different events and the combination of these: the renegotiation of NAFTA, the Mexican electoral process, the monetary policy decisions of Banco de México, the rate hikes of the US bonds

between January and November, and the cancellation of the works of the New Mexico International Airport (NAIM).

Thus, the rates of the 10-year benchmark bond, M-27, rose 99 bp throughout 2018, ending at 8.63%. However, the highest level was observed on November 23, reaching 9.23%, (the highest since November 25, 2008 when it reached 9.29%). At the end of 2018, the bond curve averaged 101 bp, with the M-42 bond recording the highest increase, 116 bp, when it reached 8.93%.

The short-term rates absorbed practically all the adjustment of the monetary policy, that is, 100 bp. The 28-day Cetes rose 92 bp, while the TIEE for the same term increased by 97.

Finally, the surcharges of the reviewable instruments had differentiated behaviors. Those of the values of the Institute for the Protection of Banking Savings with monthly and quarterly coupons rose 3.5 bp and 2.6 bp, respectively, while those of the securities with semi-annual coupons fell 2.4 bp. As for the surcharges of the Bondes D, for the 1-year term the increase was 1.5 bp; for those of 3 years, 1.4 bp, and for those of 5 years, a decrease of 1 bp was observed.

Exchange Rate Market

Due to certain episodes of high volatility during 2018, at the end of said year, the Mexican peso registered an appreciation of 0.06% with respect to the closing of 2017. From the closing of the previous year and until April 17, when it reached the minimum of 17.9787 pesos, our currency appreciated 9.37%, coinciding with a period of generalized depreciation of the dollar. From there, and within the framework of the campaigns to vote for federal authorities in Mexico, as well as the uncertainty surrounding the renegotiation of NAFTA, which meetings were suspended in May to resume in August, and a rapid global recovery of the dollar against a greater aversion to risk in international markets, our currency depreciated 13.21% reaching its peak of the year (20.7160 pesos) on June 15.

As a result of an adjustment of the markets in a context characterized by an ordered electoral day in the country, a more conciliatory discursive tone from the President Elect, and a more optimistic perspective after the new trade agreement reached with USA and Canada, dollar decreased again to 18.4150 Mexican pesos during the first days of

| NACIONAL FINANCIERA

August and showed lateral fluctuation in a wide range of about 80 cents until mid-October.

From there, before the possibility and then cancellation of the construction of the NAIM, our currency was pressed again, when the exchange rate reached its second highest level of the year (20.5105 pesos) on December 5, to then descend to 19.6512 pesos, which was the closing level.

On the other hand, exchange authorities continued with the renewal of foreign exchange hedges under the Non-Delivery Forwards scheme, that, to date reach an amount of 5.5 billion dollars.

Capital Markets

During 2018 there were several events, both domestic and foreign, that caused great volatility in the Mexican stock market. In the international arena, there were events such as the US trade war with China, the Fed's restrictive monetary policy, the lack of agreement for the exit of the United Kingdom from the European Union, the fear of a global economic slowdown, and the execution of the T-MEC. Domestically there were events that marked the economic trajectory, such as the change of government, the cancellation of the NAIM, the increase in the reference rate by Banxico, and the decision to increase the minimum wage by more than 16%.

The Price and Quotation Index (IPC, in Spanish) started the year at 49,354 points and reached a historical high of 51,065 units, thanks to the good outlook of the financial results that Mexican broadcasters would have achieved in the fourth quarter of 2017. Subsequently, the aforementioned events caused periods of nervousness and volatility that led the IPC to minimum levels, reaching 39,427 units and closing the year at levels of 41,640 units, which represented a decrease of -15.6% during 2018.

Derivatives Market

During the period, the Derivatives trading desk significantly supported the institutional objectives through the development of financial markets; thus, consolidating as a market trader in the MexDer derivatives exchange for future contracts of government bonds and IPC. Support was given to priority companies of the State, by providing FxSwaps to serve as coverage. Additionally, the Treasury's risk

management is supported, since the Derivatives trading desk executed 96 hedging transactions that protect the income that Nafin receives as a financial margin.



INVESTMENT FUNDS

Nafinsa Fund Operator continued working on the fulfillment of the objective of fostering Access to the security market of small and medium investors, through the distribution of stocks of the 13 funds it manages, with 31 agreements executed with 24 commercial brands in the stock market. At the end of December 2018, the average assets managed in investment funds amounted to 19.824 billion pesos.

It should be noted that during this period the Fund Operator has interacted with the Regional Development and Institutional Relations Deputy General Directorate of Nafin, through its regional offices, to promote the purchase and sale of shares of the investment funds that it manages, particularly with entities of the Public Administration, such as the finance secretariats of the states, public universities and/or integral port administrations (APIs, in Spanish). Additionally, the trader participates in the project called "open architecture", which is the product of the Financial Reform and consists of the purchase and sale of shares of investment funds in electronic platforms, so that the shares are easily acquired by public investors; all in accordance with the mission of the trader.

CETESDIRECTO

During 2018, an advertising strategy was implemented for the contracting of Cetesdirecto, through various means of communication, mainly electronic, including social media, television and radio, with the support of a sales force. Likewise, as every year, the use of Apps was promoted for the contracting and operation of Cetesdirecto, which allow the public to access them easily and safely. Similarly, permanent presence in the Interactive Museum of Economics and KidZania entertainment center has been kept, and we participated in various exhibitions in Mexico.

The sum of these actions, together with the behavior of the government securities yield rates, allowed superior performance during 2018, reaching more than 475,000 registered customers, of which more than 284,000 already activated their contract with an investment balance exceeding 11.700 billion pesos, exceeding in an outstanding manner the goals established for the year. Similarly, the total amount of debt placed by the Federal Government in 2018 through Cetesdirecto reached 2.21% which, compared to the previous year's participation of 1.23%, represented an increase of 80%.





**LEGAL AND
FIDUCIARY**

CORPORATE AND BUSINESS

Its objective has been to give certainty to legal processes involved in granting credit, financial and risk capital markets, and international and advisory matters. Also, assistance was given to various departments of the institution in preparing and reviewing contracts for national and foreign operations.

In 2018 the legal area had important results, among which the implementation of updates to the Cetesdirecto distribution channel, including advisory activities and review of the legal instruments that were celebrated both with the authorities and with other entities of the financial sector, clients stand out, and service providers; the formulation of consultations to the financial authorities in compliance with the applicable provisions, and the updating and attention of the Stock Exchange Support Program.

In 2018

the legal area had important results, among which the implementation of updates to the Cetesdirecto stands out

Likewise, legal advice was provided to the Fund Operator Nafinsa, Investment Fund Operating Company, and to the investment funds that it manages, in the celebration of ordinary and extraordinary assemblies, meetings of the Board of Directors and execution of contracts.

Likewise, legal advice and elaboration of the legal opinion for the participation of Nafin as an investor debt instruments issuance, such as Cebures and CKDs, among others, were provided.

The revision, negotiation, validation, and updating of the master agreement for securities purchase transactions was also carried out. Moreover, securities loan agreements, custody and bank deposit of securities in commercial and management commission were executed. In addition, International Swaps Dealers Association Master Agreements were entered into, executed with different local and foreign financial institutions; and legal advice was provided in audits carried out by different authorities.

Legal advisory services were provided, together with support for implementing the Secondary Market Auctions Program (SUBASEC) to promote liquidity in corporate and government debt securities, including hiring activities with intermediary participants and brokerage firms that provide negotiation systems.

Legal advice was given for the implementation of (i) the third reopening of the issuance of fixed-rate stock certificates which took place in May 2018, under the syndicated auctions program, with the characteristic of being liquidated in the international market through Euroclear and Clearstream, and (ii) a new issuance of variable rate stock certificates, under the syndicated auction program, in April 2018.

Legal consultancy services were provided to the corporate banking business and advisory schemes, as well as to the transactions of the Federal Government's Broker and financing of an international nature that the institution authorizes to grant or expects to receive regarding lines of credit formalized between Mexican companies and Nafin through the competent authorities, including legal advice in the formalization of guarantees granted by abroad holdings.

In addition to attending the queries generated from the follow-up to financing granted by the institution in past years, as well as to queries from the Corporate Finance and Sustainable Projects departments, legal advice was provided in order to execute the credit documents, documents of the project and other documents related to the participation of Nafin in financing nine energy infrastructure projects, of which legal advice was provided in five of them so as to hold "VAT Credits". Likewise, in order to make the process more efficient, in October 2018, the "VAT Credit Agreement" and "VAT Pledge Agreement" models were developed.



In addition, various requests for waiver of credit documents were analyzed, proposals for modifications to current contracts were reviewed, and legal opinion was integrated in the presentations of different cases rendered before the decision-making bodies.

Legal advisory services have been provided to prepare the documents necessary for Nafin's participation in several corporate financings and energy and petrochemical infrastructure.

As a result of a loan granted under the MIDAS program, the accredited Mexican company managed to comply with the standards of the Mexican Stock Exchange (BMV, in Spanish) for the issuance of debt, and prepay the credit granted by Nafin and commercial banks. Therefore, Nafin, as the agent bank, coordinated and participated in the preparation of the legal instruments necessary to release the guarantee and terminate the loan.

Likewise, as a result of the new businesses initiated by the institution, it has been necessary to create legal instruments for developing corporate business schemes. Such schemes have allowed Nafin to participate in syndicated loans and to grant financing to projects for generating wind power and other alternative energies.

Legal support was also provided to define the strategy for the implementation of the Risk Transfer and Financing Program for Geothermal Energy. This strategy has been launched in collaboration with the IDB, SENER, and INEEL.

Likewise, collaboration agreements have been executed with various institutions in the public and private sectors.

Legal advice has been provided for the execution of credit agreements in which Nafin is accredited by international financing organizations.

Legal advice was provided to the Entrepreneur Capital Trust so as to invest in innovation projects through private investment funds or directly in companies, with contributions made by the National Council of Science and Technology (CONACYT), the CMIC, the Secretariat of Economy and the National Institute of the Entrepreneur (Inadem).



GOVERNMENTAL REGULATIONS

Legal Procurement

Nacional Financiera fully complied with the governmental regulations that apply to it as a National Credit Corporation. This was done by preparing legal instruments to achieve an adequate development of activities in the various areas of the institution. Thus, a total of 458 business cases were reviewed according to:

- The preparation and review of 342 different legal instruments for the acquisition or leasing of goods or provision of services (contracts, agreements, and bonds).

- 116 cases in which legal support was provided in the review of matters and assistance to various institutional committees (reviews of calls for award processes, Procurement, Leasing and Services Committee, and Movable Assets Committee).

Liaison to the Federal Audit Office (ASF)

Regarding the activities where the area performs as liaison to the ASF, it is reported that five audits performed to the institution were attended in a timely manner. Likewise, all information requirements regarding the 2017 Public Account were answered and all audit Opening and Presentation of Final Results and Preliminary Observations meetings were attended.

Federal Law on Transparency and Access to Public Information and the General Law on Transparency and Access to Public Information (LGTAIP)

During 2018, the Transparency Unit (UT) held working meetings with the administrative areas in order to update and/or publish the information they are responsible for, in accordance with the "General Technical Guidelines for Publishing and Standardization of Information of Obligations set in Title Five, Section IV of article 31 of the General Law of Transparency and Access to Public Information" (General Technical Guidelines) in the Transparency Obligation Portals System (Sipot).

In those meetings the improvements and new methods to upload the information were presented. Advice was also provided and questions were answered by means of practical examples in the Platform.

As for the National Platform for Transparency (Infomex), Nafin received 243 requests for information. Of these, eight were personal data queries, and individuals filed 21 motions to review before the National Institute of Transparency, Access to Information and Protection of Personal Data (INAI).

Regarding the National Platform for Transparency of Trusts (Infomex), the institution received and attended a total of 118 requests for information and the individuals filed a review appeal before the INAI.

Likewise, the UT requested the administrative areas to update the Index of Files Classified as Reserved (IECR, in Spanish) to the first semester of 2018. According to this update, Nafin has eight files before the IECR.

LEGAL AND COLLECTING DISPUTES AND CREDIT DEPARTMENT

This year the commitment to promote and direct legal actions that contribute to achieving the objectives of Nacional Financiera as a development banking, in line with the applicable legal regulatory framework was ratified, by providing legal services, recovery of the disputed portfolio, and the design of legal defense strategies for preventing or minimizing economic impacts. Among the main achievements of 2018, the following stand out:

- Regarding the litigation portfolio, 22 labor lawsuits were concluded favorably, in which Nacional Financiera received benefits of 12.7 million pesos, as well as 18 non-labor related lawsuits in which the benefit institution was absolved for 3.3 million pesos.
- The credit recovery of 722.9 million pesos was obtained as a result of the legal actions taken.
- Timely response of 161 requirements of authorities led to 100% service compliance. Therefore, no fines were imposed due to lack of attention.
- Attention to queries related to contentious legal issues for the proper implementation of operations, according to the legal framework, minimizing the risk to the institution derived from its implementation.

On the other hand, in banking formalization services, we have actively worked with the business areas to continue promoting the generation of new business schemes and legal instruments that adjust to market needs to boost the development of SMEs, as well like the support to financial intermediaries. Together with the participation in the development of new schemes, during 2018, 424 requests for the formalization of banking transactions and opinions were received and attended.

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FIDUCIARY OPERATIONS

As of December 31, 2018, the Trusteeship manages 423 businesses, with a trust worth 1.7 trillion pesos, a figure that represents 27% more than at the end of 2017 and which maintains Nafin as the second fiduciary institution in the country in terms of participation in the fiduciary market, concentrating approximately 18% of the total trust assets nationally and more than 70% of the total assets managed by the Development Bank. Of the total managed assets, 677.027 billion pesos, equivalent to 40%, corresponds to liquid resources, 11% higher than in December 2017. Of this amount, 140.278 billion pesos (21%) are invested in the institutional Money Desk and 7.823 billion pesos (1%) in the Nafinsa Fund

Operator. Of the remaining resources, 354.437 billion pesos (52%) are deposited in the Treasury of the Federation and 174.489 billion pesos (26%) with other financial intermediaries.

During 2018, four fiduciary businesses were established, highlighting the formalization of the CFE-TRANSCO Promoted Trust, created as a vehicle that will allow the Federal Electricity Commission to capture investment for the electricity generation and commercialization market, in order to expand the national network power transmission; as well as the constitution of the Trust for the Defense and Legal Assistance of public servants of the institution, in relation to all those acts performed due to their functions.

The income generated by the fiduciary activity amounted to 198.4 million pesos, which represents 3.2% more than in 2017 and 11.4% more than budgeted for the year. This year, the average annual fee per business administered was increased by 7.4%, mainly due to the filtering of the business inventory through the extinction and fiduciary substitution of trusts and mandates that fulfilled their purposes or that are not according to the objectives of the institution.

During the year, various actions have been carried out to streamline business administration, especially the structuring of a catalog of standard clauses applicable to certain trust schemes, in order to have greater security and certainty in executing contracts and agreements.

The income generated by the fiduciary activity amounted to

198.4 MP



SUPPORT OPERATIONS

QUALITY MANAGEMENT AND ORGANIZATIONAL CULTURE

In order to maintain its dynamic growth and qualitative change, Nafin maintains its strategy of continuous improvement in its Quality Management System (SGC, in Spanish), in the development of its human capital, in the strengthening of risk management and in the incorporation into its technological platform of the adequate systems for the efficient operation of its programs.

QUALITY MANAGEMENT SYSTEM (SGC)

Nacional Financiera implemented the Quality Management System in the first quarter of 2001. Since then, this system has supported the institutional commitment to contribute to economic development oriented to national business productivity, under a scheme focused on risk prevention, the use of opportunities, continuous improvement and customer satisfaction. The SGC supports the purpose and strategic direction of Nafin, aligning the institutional objectives as quality objectives, which results in a positive effect in meeting external and internal challenges. Such dynamism is observed in the following table:

Year	Processes	ISO
2012	84	2008
2013	81	2008
2014	81	2008
2015	85	2008
2016	91	2008
2017	93	2015
2018	93	2015

Throughout these 17 years, Nafin has maintained and strengthened the SGC, certifying year after year its processes and achieving successful

migration to ISO 9001: 2015 in November 2017. It is important to emphasize that the new documentation standard facilitated and clarified the transition, incorporating in a natural way the corrections and new elements of the Standard.

QUALITY OPERATING COMMITTEES (COCS)

One of the most important elements of the management of the SGC is the participation of the staff of the institution in the self-management of the quality of their processes through the Quality Operational Committees, which meet at least once a quarter. In 2017, its new information structure was implemented and at the end of December 2018 there were a total of 40 COCs.

Year	COCs	ISO
2012	38	2008
2013	39	2008
2014	38	2008
2015	38	2008
2016	38	2008
2017	40	2015
2018	40	2015

HUMAN CAPITAL DEVELOPMENT

Detection of Talent and Gender Equity

The institution has a human capital management model based on the development of competencies and the permanent evaluation of staff potential, which, during January-December 2018, allowed 69% coverage of vacancies with staff developed within of the institution, reducing recruitment costs and optimizing the investment. Also, vacant positions were covered in accordance with public policies corresponding to government programs and designed to promote gender equity, gaining the promotion 53% women during 2018.

| NACIONAL FINANCIERA

Also, Nacional Financiera has a program to promote the development of talented young people, through professional practical experience and social service. As a result, 11 people for ongoing positions were hired, which represent 20% of those hired during 2018.

On the other hand, with the firm purpose of strengthening the detection of talent, in 2018 the on-line service is continued, allowing internal personnel to identify the competencies required for the performance of their position, and external persons, to identify vacancies that may arise. All this through was carried out through a methodology that aligns the needs of the staff with those of the institution, through a development model by competencies, identification of talent, definition of key positions and their replacements, establishment of an individual development plan, as well as the operation of internal coverage of vacant positions.

Additionally, in 2018, 100% of the actions considered within the Institutional Culture Program on Gender Equality were implemented, as well as the Ethics Committee.

Priority Training Programs

During January-December 2018, 122 internal events were held, including courses, conferences, workshops, and a diploma course, to train the staff of Nacional Financiera. The technical and specialized needs of the employees were attended, and training in soft skills and management development was provided. An update on financial technology was also carried out through conferences and, in addition, an intensive workshop on Digital Banking Innovation was held, benefiting 33 members from different areas of the institution.

As part of the Replacement Chart Program, a Diploma in Management Skills Development was designed and implemented, in which 40 employees from the middle and upper management participated. Moreover, different workshops were taught so as to develop the skills of and empower key operational staff. Likewise, normative training was strengthened in areas such as the LGTAIP, the Procurement, Leasing and Public Sector Services Law, as well as Prevention of Electoral Crimes and Equity.

The Business English Program training was also continued, which had a reach of 115 employees.

In addition, specialized external training was provided for those who required it due to the specificity of their duties or their job, or preparation courses for those who had to be certified before a regulatory body.

Finally, regarding the scholarship programs, 12 scholarships were awarded to employees and 15 to officials to carry out studies of diploma, bachelor's degree and master's degree.

INTERNAL COMPTROLLER

Internal Control

Internal Control System

The holders of the Administrative Units appointed and/or updated the Public Servants responsible for attending in a timely manner the Routine Control Agendas of the processes under their responsibility, which allow the staff to ensure the proper performance of their activities, identified, controlling and mitigating the risks inherent to its functions.

At the end of 2018, the universe of self-control tools stored in the Internal Control and Administration System is integrated as follows:

- 32 Corporate Control Guides.
- 291 Control Routine Agendas.
- 47 Control Routine Agendas of Regulatory Reports.

Compliance with the 2018 Work Program

According with the Work Plan for the Evaluation of the Effectiveness of Internal Control, 21 on-site verifications were carried out to the various control tools, in order to verify the effectiveness of the processes, comparing for that purpose the documentary and electronic evidence that it is generated from the execution of each process. The Internal Comptroller's Office informed the Audit Committee of the results of the visits carried out during the year 2018.

Update and Implementation of Control Tools

As of the date of this report, the processes were permanently monitored by control tools under the supervision of the heads of the Administrative Units, modifying, incorporating, or eliminating questions with the purpose of:

- Verify the fulfillment of the activities that make up the critical processes and the effectiveness of the registered controls.
- Establish or update control mechanism according to the needs of the processes.
- Implement jointly internal controls and inspection points, to avoid the materialization of possible risks.

Updated Record of Relevant Institutional Manuals

In response to Article 156, section I, of the General Provisions Applicable to Credit Institutions (CUB), there is a registry of the status of the substantive manuals in the operation of the institution, which is reported quarterly to the Committee audit. At the end of fiscal year 2018, there are 93 operational manuals, of which 78 are updated and 15 are in the process of being updated.



Performance of Activities Related to Article 164 of the CUB

During the meeting of the Board of Directors held on December 13, 2018, the General Director of Nafin, through the Internal Comptroller’s Office, informed the collegiate body of the Annual Report on the performance of the activities referred to in Article 164 of the CUB, as well as the operation of the Internal Control System as a whole.

The aforementioned Report includes the contribution of the heads of the Administrative Units regarding the relevant results achieved with the implementation of the best practices in Internal Control matters.

Application of Corporate Control Guides (GCC)

During November 2018, with the purpose of carrying out the annual self-assessment exercise of the Internal Control infrastructure, the control tools called Corporate Control Guides (GCC) were reviewed and redesigned, based on the five Internal Control standards and their related principles, supported by the model proposed by the Committee of Sponsoring Organizations of the Treadway Commission, applying to all the Administrative Units that make up the structure of Nafin. The result by principle of Internal Control standard is detailed herein:

Standard	Principle	Self-assessment
Control Environment	1. Integrity, ethics and values	100%
	2. Internal control supervision	100%
	3. Structure, authority and responsibility	93%
	4. Expert personnel commitment	96%
	5. Responsibility compliance	97%
Risk management	6. Specific objectives	97%
	7. Risk identification and management	81%
	8. Corruption risk assessment	94%
	9. Significant changes identification	91%
Control activities	10. Control activities to mitigate risks	91%
	11. TIC controls according to institutional objectives	92%
	12. Policies and procedures	89%
Information and communication	13. Relevant information in IC	91%
	14. Internal communication in IC	96%
	15. External communication	91%
Supervision, monitoring and continuous improvement	16. Assessment on-the-go and IC separately	90%
	17. Report of incidents and follow-up	72%
Average		92%

2018 self-assessment of the Internal Control infrastructure through the control tools is one of the main inputs to generate the Annual Report of the Internal Control System Status in Nafin

The result of the self-assessment of principle 17, “Report of incidents and follow-up”, is due to the number of observations determined in 2017 and 2018 exercises by the different auditing bodies. It should be noted that the 2018 self-assessment of the Internal Control infrastructure through the control tools is one of the main inputs to generate the Annual Report of the Internal Control System Status in Nafin, which will be presented to the Audit Committee and the Board of Directors, in its corresponding meetings, as well as to SFP at the end of January 2019, in compliance with the provisions of the AGREEMENT by which the Provisions and the Administrative Manual of General Application in Internal Control are issued.

Update of the Objectives and Guidelines of the Institutional Model of Internal Control

On September 24, 2018, the Audit Committee of the institution became aware of the updating of the Objectives and Guidelines of the Institutional Model of Internal Control 2018 (LIMICI), and recommended to the administration to submit said update for the approval of the Board of Directors. As a result, during its session on October 30 of the same year, the Board of Directors approved the update of the LIMICI for its implementation. Therefore, the General Director of Nafin exhorted the officials and employees to continue with their compliance, as well as to consult the update. With the proposed update it is intended that the LIMICI become a regulatory instrument of mandatory observance within Nacional Financiera that allows for a safe and efficient operation in the daily work; thereby, strengthening the achievement of the institution’s objectives.

Reconciliation Follow-up Program

During its first session in 2018, the Internal Audit Committee approved the Work Program of the Office of the Internal Comptroller, which includes the follow-up of operational, systems, and accounting reconciliations that are carried out within Nafin, in accordance with the provisions of Article 166 of the CUB.

In the period that is reported, the inventory of reconciliations carried out by the areas was integrated, in order to obtain timely compliance at the institutional level. The degree of progress in the implementation of the Program is 100%.

Supervision of compliance with the Provisions on Investment Services

The report on the supervision of compliance with the General Provisions applicable to financial entities and other persons providing Investment Services, corresponding to the first semester of the year, was prepared and presented to the Board of Directors during the meeting of October 30, 2018.

Similarly, on November 23, 2018, the Internal Comptroller’s Office, responsible for overseeing compliance with the Provisions in question, provided the Compliance Report and certification of the Board’s agreement to the National Banking and Securities Commission, in a timely manner.

Reports Generated by the Office of the Internal Comptroller

One of the functions and responsibilities of the Internal Comptroller’s Office is the preparation of reports under the applicable regulations for presenting it to various authorities. During 2018, 14 regulatory reports on Internal Control, among which the following stand out: Deviations from the objectives, guidelines, policies, procedures, strategies, and regulations in force regarding credit; supervision of compliance with the Provisions regarding Investment Services, as well as the Performance of Activities and the Operation of the Internal Control System.

Management and Control of Unidentified Income in Banks, and Collection and Payment of Interest in National Currency

The Internal Comptroller’s Office implemented control mechanisms that ensure that the involved areas adhere to the procedures established for the management and control of unidentified income in banks, and the collection and payment of interest in national currency, thereby strengthening the processes.

Administration and Control of Unidentified Income in Banks

In the reporting period, 60 operations were validated for 145 million pesos, of which 56 operations correspond to the Trustee Directorate, while the rest were originated in the Alternate Channels, Accounting, and Human Resources, and Quality divisions.

Once the operational areas identify a deposit in the aforementioned circumstances, they must gather the supporting evidence that allows the Internal Comptroller's Office to validate the information, before proceeding to the final allocation of the resources.

Prevention of Operations with Illicitly-Obtained Resources and Combat of Terrorist Financing

Preventive processes of illicit operations

A total of 753 applications were attended to determine the level of risk for the prevention of operations with resources of illegal origin, sent by 12 administrative units.

With regard to the formats that are part of the prevention processes of illicit operations, 585 Customer and User Identification and Knowledge Formats (FICC) were attended; 89 FICC Annexes; 86 Verification Formats for Shareholders, Representatives and Legal Representatives; 90 Low Allocations and Changes or High Allocations, Changes and Derivatives; 162 Client Identification and Knowledge Formats with Fiduciary Operations (FICC-FISO), and 12 Probity Declaration Formats. Thus, a total of 1,025 formats were processed, in which not only the corresponding risk rating was issued, but also documented in order to leave evidence of the name of each client and its shareholders, legal representatives, and persons authorized to execute transactions.

It is worth mentioning that the preventive processes entail the task of reviewing each person, with the possible background registered in the lists of people sanctioned in entities such as the United Nations Organization (UN), the Tax Administration Service (SAT) and the Office of Foreign Assets Control, among others.

Technological Developments in the Monitoring System

Regarding technological developments for the System of Relevant and Unusual Operations according to the agreement derived from the session of the Committee for Planning and Evaluation of Systems, the "Detailed Scope-Implementation of the Illicit Operations Prevention Model Focused on Individuals' Risk" was drafted during the second semester of 2018. This Detailed Scope is one of the three documents used for the implementation of the Nafin Risk-focused Methodology.

With regard to the Model of Prevention of Illicit Operations with a Risk-Based Approach for Companies, once the documentation of the requirements and the use cases in the Detailed Scope has been completed, and once the Compliance Office concluded with the adjustments,⁴ the IT Department had the necessary input to prepare the corresponding Work Plan, which was delivered in December 2018.

Developments for the fulfillment of information exchange between banks and the authorities regarding the Prevention of Illicit Transactions

During the second semester of 2018, Banxico continued to require information and compliance tests in the field of computer security, with respect to the computer equipment assigned exclusively for the statistical information query service in the Transfrontier Transfers Database (BDTT, in Spanish). Presented evidence was ruled valid on October, so as to conclude with the connection requirements.

In November, the agreement for the use of the technological platform called BDTT was executed. Upon execution of the agreement between Banxico and Nafin, the digital certificate was released. Likewise, consultations regarding BDTT statistical information started with successful results in information exchange between credit institutions.

Meetings were held with the relevant areas so as to set the new organization and payment service that involves abroad fund transfers.

FATCA Compliance Process Implementation

The institution complied with the provisions of the Annexes 25 and 25 bis of the Annual Temporary Tax Regulations, referring to the obligation of the banking entity to perform the corresponding actions of the Foreign Account Tax Compliance Act (FATCA) and the Common Reporting Standard (CRS), respectively. To do this, it was necessary to review the Self-Certification Formats, both new customers registered between January 1 and December 31, 2017, as well as of the clients registered in previous years, to know if there were changes in their fiscal status.

The information was issued on September 23, according to the manner and means set by the

⁴ The Traceability Matrix section is being drafted.

SAT, in due time and manner. The institution reported to FATCA two institutional clients of the Trusts Directorate, a file with 247 customer records of Cetesdirecto and 390 trusts with notice in zeros and not reportable ones. Twenty-one files of Cetesdirecto clients were reported to CRS.

Verification of Identification Files and Knowledge of Clients with High Risk Qualification

On December, 25 files of high-risk score client identification a knowledge of clients were verified. The result of the verification of the files was favorable, as it was verified that the areas comply with the applicable regulation, as well as with the Internal Manual for the Prevention of Money Laundering (PLD, in Spanish). The results will be presented to the Communication and Control Committee in the first ordinary meeting of January 2019, in order to comply with the internal policy.

President and Secretary Office of the Communication and Control Committee

According to the Rules of Operation of the Communication and Control Committee, six ordinary meetings and two extraordinary meetings were carried out, and all topics were discussed, as well as the corresponding minutes were elaborated.

Nafin Branch in Grand Cayman, Cayman Islands

The delivery of the documentation required by the Treasury Department was completed, so it could be included in the final compliance report that the Cayman Islands Monetary Authority (CIMA) requested to review. Therefore, said Authorities concluded their audit work and delivered the Final Inspection Report.

Attention to the Requirements of Authorities via the CNBV

From July to December, 25 judicial requests published in the site of the Interinstitutional System of Information Transfer (SITI_AA) of the CNBV were handled, which were attended in a timely manner.

Sending Official Reports to the Authorities

Eighteen official reports were sent to the regulatory and supervisory authorities with information corresponding from July to December. Regarding

Unusual Operations, Alarming Internal Operations, and 24/7 Unusual Operations Reports, no situation was presented that warranted a report.

Observance of Foreign Banks Due Compliance Requirements

In order to maintain the business lines with foreign counterparts, 20 requests regarding Wolfsberg Questionnaire formats, 4 Patriot Act Certifications, and 14 requests for general information from Nafin, Anti-Money Laundering questionnaires, integration of the Board of Directors, identification data of the main executives of the institution and Comprehensive Due Diligence formats, among others, were answered.

Eighteen banks were serviced: Citibank, HSBC (Mexico and New York), Euroclear, UBS, Bank of Tokyo Mitsubishi, Barclays Bank, JP Morgan Chase, Credit Suisse, Inter-American Development Bank (IDB), Société Generale, Morgan Stanley, BNY Mellon, BNP Paribas, Finamex Corporate, Santander, Barclays, and Crédit Agricole.

Training Program in Fighting Money Laundering and Terrorist Financing

From November 21 to December 14 the 2018 Training Program in Fighting Money Laundering and Terrorist Financing was imparted to all active staff, excepting security, cooks, drivers, or new hires that held a money laundering prevention training certificate.

The results of the Training Program will be presented to the Communication and Control Committee during the first ordinary meeting of 2019.

	Trained and Certified	With Repeating Grade	No Certificate
Advanced Course	243	1	4
General Course	632	1	10

INTERNAL AUDITING

The Internal Auditing Department prepared and completed its Annual Work Program, which was aimed to auditing substantive activities of the institution, such as loans, financial markets, trust funds and risk management, among others. The audit's objective was to verify the compliance with the regulations set by the National Banking and Securities Commission (CNBV) and the Bank of Mexico; to verify compliance with the programs and its goals; to verify the management of the risks inherent to processes; and to strengthen the Internal Control System.

According to the aforementioned, the activities of the Internal Auditing Office covered the following aspects:

1. Audits

Twenty audit reviews were carried out, two more than originally scheduled. Of these, 10 were normative, in compliance with the provisions issued by the CNBV and according to the following: i) Credit Process (six), ii) Risk Management (one), and iii) Computer Systems (three). Four audits were carried out under the Banco de México standards', as follows: iv) Operation of Derivative Financial Instruments (one), the SPEI Interbank Payment system (two) and others to the Guidelines for the Exchange of Information between Credit Institutions-BDIT. The remaining six audits were carried out to Treasury strategies (one) and to a trust (one) and four were follow-up audits.

Audited departments were involved during the audit so as to inform all stakeholders of the audit's results and added-value proposals that will allow addressing the findings, as well as the recommendations aimed to strengthen the Internal Control System.



2. Audit Committee (CA)

The Internal Auditing Office supports the Audit Committee by providing the necessary elements that allow it to inform the Board of Directors about the Internal Control System status. It also provides support with the logistics of the meetings, by obtaining relevant information for the audit execution, and for providing adequate follow-up of agreements. In 2018, out of the 12 scheduled meetings, seven were held. From February to June 2018 was held the appointment process for Chair of the Board of Directors.

The audit's objective was to verify the compliance with the regulations

3. Participation as Normative Advisers during the Meetings of the Decision-making Committees.

According to regulatory provisions, we participated in Integral Risk Management Committee and in Communication and Control Committee meetings. Additionally, the Executive Credit Committee of the Board of Directors, the Internal Credit Committee and the Credit Committee were involved.

4. Monthly Review of Variations in the Financial Statements of the institution

With the purpose of evaluating the reasonableness of the figures of the Balance Sheet and of the Income Statement, the items showing the main variations are identified on a monthly basis by making the comparison of balances of the formalized financial information of the previous month against the preliminary figures registered in the Financial Information System by determining increases and decreases of the balances and by analyzing the origin of the variations.

Likewise, the Internal Auditing Department quarterly participated in the working group with the members of the Audit Committee and representatives of the Deputy General Directorate of Administration and Finance so as to analyze the

information in the Financial Statements and any explanations and/or clarifications made.

5. Operational Manual of the Internal Audit Process

In November 2018, the Operational Manual for the Internal Audit Process was published in the intranet of Nafin, once the sub-process synopsis was included in it: Analysis of the Variations of the Financial Statements, Comments to the Request of Credit Committees and Guarantees, Participation in the Allocation of Resources through Auctions to Financial Intermediaries that Collaborate in the Guarantees Program, Review of Credit Default Records, Audit Committee, Preparation of Reports and Activities in Charge of the Audit Committee and Preparation of a Follow-up Report on the Observations in the Process of Attention determined by the different auditing instances.

6. Audit Management System

At the end of 2018, along with the Information Technology Division, the review of the 72 cases of uses (100%) was completed, making the technical clarifications derived from the concept analysis of the functionalities required to systematize the work carried out by the Directorate of Internal Audit.



COMPUTING

Continuous improvement in the Operation

IT Security

Successful containment of the cyber-threats was achieved by applying security measures to the perimeter network, as well as by implementing continuous monitoring. Also, a Web Application Firewall was implemented to protect Internet application. Moreover, the mobile token was implemented in the SIFC system of the Trusteeship, which provides an agile mechanism for the authentication of transactions in case of contingencies.

Technological Update of the Connectivity Infrastructure with Financial Entities

The project consisted of the installation of seven routers so as to provide continuous access to the services provided by Banxico and the BMV from the facilities of Nacional Financiera. Three routers were dedicated to Banxico and four to BMV. This distribution allows a high availability architecture; that is, redundancy (normal and backup), as well as the infrastructure required to provide continuity to services in the event of a contingency (DRP or BCP). The technical characteristics of the equipment complied with the requirements requested by both Banxico and the BMV.

Application Developments

During 2018, 22 business projects were implemented. Of these, 13 were implemented through the contracting and management of external suppliers in accordance with current regulations; and eight, through internal developments that allowed generating significant savings to Nafin -with the additional benefit of not depending on a supplier. It is important to emphasize that this strategy allows knowledge and experience to remain in the institution. Additionally, it reduces the response time so as to meet business needs, thus supporting the professional growth of staff. Moreover, a mixed project was implemented, through internal developments and with an external provider.

Among the internal developments implemented this year, the following stand out:

Version 15.0 Credit Monitoring System (SISEC)

This project was developed with internal resources, which resulted in savings for the institution. The needs of the Portfolio Monitoring and Recovery Directorate were met through the implementation of three new modules (Financial, Views, and Queries and Reports), which mitigates the operational risk in the information re-entering.



FINANCIAL RESULTS

Despite the uncertain context and diminishing economic activity, the institution got a net profit of 2.439 billion pesos, equivalent to a 9.9% nominal return on capital during 2018. This way, the equity capital amounted to a total for the end of the year of 35.554 billion pesos, representing 13.1% nominal growth against the total revenue of the previous year. It is worth mentioning that in this year the Federal Government allocated 1.376 billion pesos to the institution. Without it the net profit would have been 1.832 billion pesos and 6.5% return on capital.

In addition, the bank's financial situation demonstrates solid indicators, including the following:

Indicator	Dec 2017	Dec 2018
Overdue portfolio / private sector portfolio	0.88%	0.31%
Reserves / overdue portfolio	241.6%	534.6%
Financing granted to the SMES / Financing to the Private S.	76.8%	72.4%
Financial penetration (Private Sector Portfolio / GDP) 1/	1.75%	1.83%
Financial penetration (Private Sector Portfolio and Capital Contr. / GDP) 1/	2.07%	2.15%

1 / Mexico's GDP on December 2018 is estimated in base of 2017 GDP, adjusted by the variation of the annual economic activity.

Evolution Risk Overdue Portfolio

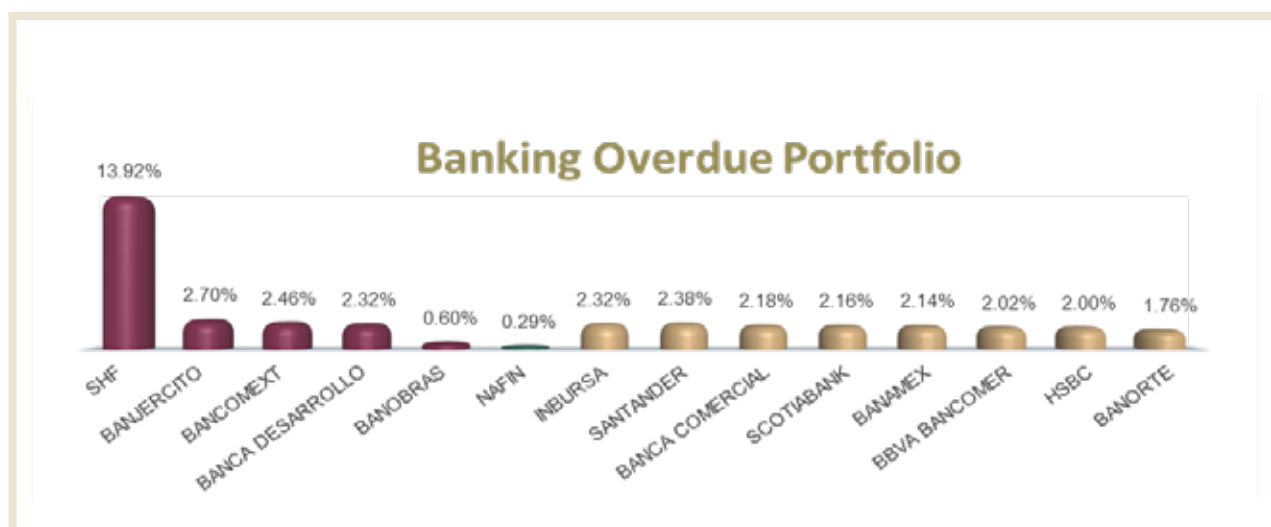
The 2018 Operative and Financial Program considers, within its main indicators, maintaining low levels of, and when possible, reduce the risk overdue loan portfolio.

At the end of December 2018, the credit portfolio registered in the balance sheet was 259.603 billion pesos. At the end of 2018, the risk overdue loan portfolio was at 743 million pesos, primarily concentrated in programs' portfolios (507 million pesos, 68%) Non-banking SOFOM Financial Brokers (228 million pesos, 31%), and former employees (6 million pesos, 1%).

Comparison other Banks

The Overdue Loan Index (ICV) of 0.29% reached in December 2018 places Nafin below the Army, Air Force, and Navy National Bank (Banjército), the National Bank of Foreign Trade (Bancomext) and the National Bank of Public Works and Services (Banobras). The Federal Mortgage Society (SHF, in Spanish) has the highest ICV of the Development Bank, with 13.92%.

On the other hand, the institution compares favorably against 2.18% of commercial banks, as well as with the main commercial banks, such as HSBC,



Santander, Scotiabank, Inbursa, BBVA Bancomer, Banorte, and Banamex

The portfolios of banks and Modality "A", Public Sector and Decentralized Entities Financial Brokers, which make up 48% of the total portfolio at risk, do not have any overdue loan portfolio.

Excepting the first-floor credit reported as of December 2017, the overdue portfolio levels have been contained. The foregoing considering the continuity of the instrumented planning strategies, among which the following are worth mentioning:

- Timely issuance of monitoring reports and monitoring of the first and second floor portfolio, with the result of the visits made and including early alerts that favor decision making.
- Immediate and direct extra judicial collection, paying attention to payment proposals or credit restructuring, where appropriate, for authorization of the authorized bodies.
- Use of preventive reserves and credit penalties, in accordance with the institutional regulations authorized by the Board of Directors.
- Training for the personnel responsible for supervision, follow-up, and recovery, in order to increase their knowledge and skills.
- Improvement of the systems used for supervision, monitoring, and recovery of the assigned portfolio.

In accordance with the above, Nafin has a team of executives specialized in the supervision and monitoring of credit portfolio and guarantees, as well as in extrajudicial collection and institutional tools for portfolio monitoring and control, which allows monitoring the Financial Brokers' and accredited individuals compliance with regulations.

Overall Balance

As of December 2018, the Institution's assets had reached a total of 597.605 billion pesos, financed with 562.051 billion pesos liabilities which, in turn, consist of 218.623 billion pesos from report creditors, 231.099 billion pesos corresponding to internal debt, and 112.329 billion pesos corresponding to external debt and other liabilities.

In addition, Nafin has a Financial Agent balance of 380.375 billion pesos, an amount representing an increase of 8.988 billion pesos during the year (2.4%). The balance for stand-by guarantees reached 79.915 billion pesos, with a 10.1% growth rate when compared to the previous year, due to the dynamism and acceptance of Nafin's Guarantees Program.

An analysis of Nacional Financiera's financial statements for the 2018 period is provided in this report's Annex B, "Report on Consolidated Financial Statements with Subsidiaries, as of December 31, 2018".





INTERNAL CONTROL

- In 2018, the Internal Control Body (OIC, in Spanish) at Nacional Financiera developed its activities in accordance to the powers provided for in Articles 98 and 99 of the Internal Regulations of the SFP, as well as in Article 44 Bis 1 of the Law on Credit Institutions, which after the Financial Reform of 2014, establishes the power to carry out the control, assessment, and monitoring of the administrative provisions applicable to the institutions of development banking on 1) Budget and fiscal responsibility; 2) Agreements resulting from the laws of Acquisitions, Leases and Services of the Public Sector and of Public Works and Related Services; 3) Preservation, use, destination, affectation, alienation, and loss of assets; 4) Administrative responsibilities of public servants, and 5) Transparency and access to public information.
- As a result, the Annual Work Plan of the OIC was prepared and executed based on the General Guidelines issued by SFP, considering three action levels: 1) Objectives: prevent, detect and inhibit; 2) Results: control, improve, verify, investigate, and sanction), and 3) Actions: internal control, processes, audits, complaints resolution, and administrative responsibilities.
- Regarding audits: planning, execution, and reporting of the results of seven audits and one inspection visit were developed, as well as the follow-up of 43 observations -18 of 2017 and 25 incorporated in 2018 - through the strategy that allowed the identification, analysis, and assessment of Nafin processes inherent risks in order to mitigate them, thus ensuring the achievement of institutional goals and objectives in a reasonable manner, in an effective, efficient, and financially-logic manner within the framework of transparency and accountability.
- Regarding management improvement: actions aimed at public procurement, digital government, standardization of processes, regulatory improvement, and alignment of structures towards strategic objectives were carried out. In order to promote a more integrated public service, issues related to transparency, citizen participation, ethics, gender equality, and prevention of conflicts of interest were addressed. As a result of the above, the Internal Control System of the institution was kept; thus, supporting decision-making for compliance with institutional goals and objectives.
- Regarding the investigation of complaints of possible acts or omissions that could constitute administrative offenses committed by public servants for punishable conducts, OIC carried out its activities in accordance with the General Law of Administrative Responsibilities, including those related to individuals and companies due to infringements to the legal provisions on public procurement.
- Regarding prevention, legal advice was provided to the various areas of the institution for due compliance with the regulatory framework applicable to institutional actions.
- Moreover, in order to safeguard the principles that govern the public service and inhibit the breach of obligations by public servants, and in full exercise of powers, administrative liability procedures were initiated and sanctions corresponding to the breaches were imposed under the new General Law of Administrative Responsibilities and in strict compliance with the principles of legality and due process.



ANNEX A
NACIONAL FINANCIERA
IMPORTANT FIGURES

TABLE 1

NACIONAL FINANCIERA, S.N.C., RELEVANT FIGURES
Millions of Pesos at the End of the Year

Concepts	2014	2015	2016	2017	2018
Total Assets 1/	389,750	384,828	503,541	516,230	582,917
Financing Agent Portfolio	1,013	109	94	65	29
Commercial Banks (First-tier) Portfolio	32,926	43,730	66,299	63,004	73,566
Second-tier Banks Portfolio	116,360	127,863	147,920	165,390	186,037
Total Credit Portfolio	150,299	171,702	214,313	228,459	259,632
Equity Investment in Companies	5,740	6,514	8,010	8,952	9,950
Equity Investment in Real Estate Companies	1,496	1,532	1,539	1,637	1,638
Equity Investment in Stocks	23	95	59	269	180
Internal Debt	156,019	184,342	213,222	214,351	231,099
External Debt	31,327	44,054	63,533	71,927	79,944
Previous Reserves for credit risks	3,665	3,999	4,464	4,511	3,971
Total Liabilities	376,342	371,062	488,365	497,638	562,051
Stockholders' Equity	22,942	24,096	26,710	31,444	35,554
Assets in a Trust or Agency	1,325,455	1,403,376	1,544,545	1,725,173	2,099,988
Debtor by Guarantee and Other Contingent Liability	56,359	64,414	53,520	235,458	260,974
Net Profit (Loss)	1,648	1,254	1,321	1,502	2,439
Compounding Level (%)	14.6	13.6	13.3	14.5	14.5

1/ Consolidated with subsidiaries

TABLE 2

DEPOSITS IN MEXICAN PESOS *
(Millions of Pesos)

Instrument	2014	2015	2016	2017	2018
Stock Certificates	28,425	40,000	50,524	56,698	59,491
PG's Nafin	111,837	87,587	108,970	79,575	149,163
New Instruments	140,262	127,587	159,494	136,274	208,654
Time Deposits in National Currency	7,153	41,153	7,153	5,153	5,153
Various Deposits	521	8	1,129	1,505	1,637
TOTAL	147,935	168,747	167,775	142,932	215,444

* It does not include interest.

TABLE 3

TOTAL EXTERNAL DEBT
BALANCE OF DECEMBER 31
(Millions of USD)

Concepts	2014	2015	2016	2017	2018
I. Direct Debt	2,123.9	2,550.2	3,076.3	3,652.3	4,059.6
A. Deposit Certificates (London)	1,258.6	1,139.5	1,387.4	2,066.7	2,274.8
B. Green Bonds	-	500.0	500.0	500.0	500.0
C. Yen Bonds	-	-	-	222.0	227.8
D. Multilateral Organizations	68.2	6.3	4.5	3.3	1.5
E. Private Banking, Eximbank's and Suppliers	797.1	904.4	1,184.4	860.3	1,055.5
Accrued Interest	1.2	3.8	4.9	5.7	8.5
Total	2,125.1	2,554.0	3,081.2	3,658.0	4,068.1

**ANNEX B
REPORT ON CONSOLIDATED
FINANCIAL STATEMENTS
WITH SUBSIDIARIES, AS OF
DECEMBER 31, 2018**

Nacional Financiera, S. N. C.
Institución de Banca de Desarrollo
and Subsidiaries

Consolidated Financial Statements

December 31, 2018 and 2017

(With Independent Auditors' Report Thereon)

(Translation from Spanish Language Original)



INDEPENDENT AUDITOR'S REPORT

The Board of Directors:

Nacional Financiera, S. N. C.

Institución de Banca de Desarrollo

(Millions of Mexican pesos)

Opinion

We have audited the consolidated financial statements of Nacional Financiera, S. N. C., Institución de Banca de Desarrollo and subsidiaries (the Institution), which comprise the consolidated balance sheets at December 31, 2018 and 2017, the consolidated statements of income, changes in stockholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements of the Institution, have been prepared, in all material respects, in accordance with the Accounting Criteria for Credit Institutions in Mexico (the Accounting Criteria), issued by the National Banking and Securities Commission (The Banking Commission).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the "Auditors' responsibilities for the audit of the consolidated financial statements" section of our report. We are independent of the Institution in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Mexico, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

(Continued)



Derivative financial instruments \$7,990 liability, valuation adjustment from hedging on financial assets \$5,870 and valuation adjustment from hedging on financial liabilities \$884

See notes 3(f) and 9 to the consolidated financial statements

Key audit matter	How the key audit matter was addressed in our audit
<p>The fair value determination, at the consolidated balance sheet date, of “over-the-counter” derivative financial instruments and hedging transactions is carried out through the use of valuation techniques that involve significant judgments by Management, mainly when the use of inputs obtained from different sources or data not observable in the market and complex valuation models is required. In addition, the requirements that must be met for the accounting of financial instruments classified as hedges, as well as for the documentation and monitoring to prove their effectiveness, involve a certain degree of specialization by Management.</p>	<p>As part of our audit procedures, we obtained evidence from the Institution, by its risk committee, of the valuation models used by Management for derivative financial instruments and hedging operations used by the Management. Likewise, through selective tests, we assessed the reasonableness of these models and the inputs used, with the participation of our specialists. In addition, through selective testing, we assessed the appropriateness of derivative products fair value determination for hedging operations, the proper compliance with the criteria and documentation to be considered as such, as well as their effectiveness.</p>

Allowance for loan losses \$7,079

See notes 3(i) and 10(d) of the consolidated financial statements

Key audit matter	How the key audit matter was addressed in our audit
<p>The allowance for loan losses of commercial loans involves significant judgments for the evaluation of the borrowers’ credit quality, considering the different factors established in the methodologies established by the Banking Commission for the credit portfolio rating process, as well as to evaluate the reliability of the documentation and updates to the information used as input in the determination of the allowance for loan losses for all loan portfolios.</p>	<p>The audit procedures applied to management's determination of allowance for loan losses and its effect on the year’s net income included the evaluation, through selective tests of both the inputs used and the calculation method for the different loan portfolios based on the current methodologies established by the Banking Commission for each type of loan portfolio.</p>

(Continued)



Calculation of employees' retirement and termination benefits \$7	
See notes 3(s) and 20 to the consolidated financial statements	
Key audit matter	How the key audit matter was addressed in our audit
<p>The Institution has established defined benefit plans for its employees. The determination of the liability related to such plans at the consolidated balance sheet date was made through complex actuarial calculations that require significant judgments in the selection of the assumptions used to determine the net projected liability of the employees' retirement and termination benefits.</p>	<p>We assessed with the participation of our actuaries the reasonableness of the assumptions used by the Institution's Management to determine the net projected liability of the employees' retirement and termination benefits, and the calculation method used.</p> <p>In addition, selective items were tested to corroborate the adequate incorporation of the personnel data that was included as a basis for the actuarial calculation. Likewise, we verified compliance with accounting records and disclosures in accordance with the provisions of the Banking Commission.</p>

Current and deferred income tax (IT) \$(546) and IT and employee statutory profit sharing (ESPS) deferred asset, net \$1,660	
See notes 3(o) and 21 to the consolidated financial statements	
Key audit matter	How the key audit matter was addressed in our audit
<p>The determination of current and deferred income taxes and ESPS is complex, mainly due to the interpretation of the legislation in force on the matter, and requires significant judgments mainly in the valuation of deferred income tax and deferred ESPS assets to evaluate factors relating to the current and future operations of the Institution to estimate the realization of these assets.</p>	<p>The audit procedures applied to the calculations determined by the Institution's Management for the recognition of current and deferred income taxes and ESPS included selective tests of both the inputs used and the nature of the items that were part of the calculations, considering the legislation in force on tax matters.</p> <p>With the participation of our specialists, we assessed the reasonableness of the significant tax assumptions, the reversal period of the temporary differences, as well as the reasonableness of the tax strategies proposed by the Institution's Management.</p> <p>Additionally, we evaluate the reasonableness of the tax profit projections determined by the Institution's management that support the probability of the realization of deferred income tax and deferred ESPS assets.</p>

(Continued)



Responsibilities of management and those charged with governance for the consolidated financial statements

Management is responsible for the preparation of the consolidated financial statements in accordance with the Accounting Criteria established by the Banking Commission, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Institution's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Institution or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Institution's financial reporting process.

Auditors' responsibilities for the audit of the consolidated financial statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Institution's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Institution's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Institution to cease to continue as a going concern.

(Continued)



- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Institution to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Institution audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence and we communicate with them all relationships and other matters that may reasonably be thought to bear our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

KPMG Cárdenas Dosal S. C.

A handwritten signature in black ink, appearing to read 'A. López Ramírez', with a stylized flourish at the end.

Aarón López Ramírez

Mexico City, March 6, 2019.

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and subsidiaries

Av. Insurgentes Sur 1971, Col. Guadalupe Inn, C.P. 01020, Mexico City

Consolidated Balance Sheet

Years ended December 31, 2018 and 2017

(Millions of Mexican pesos)

Assets	2018	2017	Liabilities and Stockholders' Equity	2018	2017
Cash and cash equivalents (note 6)	\$ 57,308	28,551	Deposit funding:		
Margin accounts	16	35	Time deposits (note 15):	\$ 143,812	134,296
Investment securities (note 7):			Money market		
Trading	215,033	194,472	Debt securities issued:		
Available-for-sale	15,836	15,087	In the country (notes 15 and 16):	60,439	57,595
Held-to-maturity	13,579	13,545	Stock certificates	44,774	40,670
	<u>244,448</u>	<u>223,104</u>	Abroad (notes 15 and 17):	14,358	14,246
Debtors on repurchase/resell agreements (note 8)	-	2,718	Bank bonds	<u>263,383</u>	<u>246,807</u>
Derivatives (note 9):			Stock notes		
Trading purposes	-	1,885	Bank and other borrowings (note 18):		
Valuation adjustment from hedging of financial assets (note 9)	5,870	15,294	Due on demand	10,328	8,006
Current loan portfolio (note 10):			Short-term	8,415	4,810
Commercial loans:			Long-term	<u>12,392</u>	<u>12,585</u>
Business or commercial activity	61,672	51,733		<u>31,135</u>	<u>25,401</u>
Financial entities	180,032	158,600	Creditors on repurchase/resell agreements (note 8)	<u>218,623</u>	<u>188,768</u>
Government entities	17,047	16,067	Derivatives (note 9):		
	<u>258,751</u>	<u>226,400</u>	Trading purposes	66	80
Consumer loans	5	8	Hedging purposes	<u>7,924</u>	<u>7,705</u>
Residential mortgages loans	104	119		<u>7,990</u>	<u>7,785</u>
Loans granted as Federal Government Financial Agent	29	65	Valuation adjustments from hedging financial liabilities (note 9)	884	11,203
Total current loan portfolio	<u>258,889</u>	<u>226,592</u>	Other accounts payable (notes 19, 20 and 25):		
Past-due loan portfolio (note 10):			Income tax payable	436	253
Commercial loans:			Employee statutory profit sharing payable	332	275
Business or commercial activity	509	575	Creditors on settlement of transactions	20,358	-
Financial institutions	228	1,284	Creditors on collateral received in cash	1,634	1,109
	<u>737</u>	<u>1,859</u>	Sundry creditors and other accounts payable	<u>940</u>	<u>1,669</u>
Consumer loans	2	2		<u>23,700</u>	<u>3,306</u>
Residential mortgages loans	4	6	Deferred credits and prepayments	85	98
Total past-due loan portfolio	<u>743</u>	<u>1,867</u>	Total liabilities	<u>545,800</u>	<u>483,368</u>
Loan portfolio (note 10)	259,632	228,459	Stockholders' equity (note 22):		
Less:			Paid-in capital:		
Allowance for loan losses (note 10)	(7,079)	(7,016)	Capital stock	9,202	8,805
Total loan portfolio, net	<u>252,553</u>	<u>221,443</u>	Contribution for future capital increases formalized by the Board of Directors	1,376	5,700
Other accounts receivable, net (note 11)	15,456	16,561	Paid stock premium	14,225	8,922
Foreclosed assets, net (note 12)	3	4		<u>24,803</u>	<u>23,427</u>
Property, plant and equipment, net (note 13)	1,452	1,488	Earned capital:		
Permanent investments (note 14)	2,926	2,868	Statutory reserves	1,730	1,730
Deferred income taxes and employee statutory profit sharing, net (note 21)	1,660	1,338	Retained earnings	5,650	4,148
Other assets:			Result from valuation of available for sale securities, net	(202)	108
Deferred income charges, prepaid expenses and intangibles	1,225	943	Remeasurements of defined employee benefits, net (note 20)	32	(213)
			Effects of valuation in associate and affiliate companies	1,102	742
			Net income	<u>2,439</u>	<u>1,502</u>
Total assets	\$ <u>582,917</u>	<u>516,230</u>		<u>10,751</u>	<u>8,017</u>
			Non-controlling interest	1,563	1,418
			Total stockholders' equity	<u>37,117</u>	<u>32,862</u>
			Total liabilities and stockholders' equity	\$ <u>582,917</u>	<u>516,230</u>

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Av. Insurgentes Sur 1971, Col. Guadalupe Inn, C.P. 01020, Mexico City

Consolidated Balance Sheet, continued

Years ended December 31, 2018 and 2017

(Millions of Mexican Pesos)

Memorandum accounts (note 23)

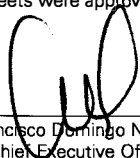
	2018	2017
Contingent assets and liabilities	\$ 70,789	62,510
Loan commitments	190,176	172,948
Assets placed in trust or mandate:		
Trusts	1,705,730	1,339,718
Mandates	13,912	14,133
	<u>1,719,642</u>	<u>1,353,851</u>
Federal Government Financial Agent	380,346	371,322
Assets in custody or administration	542,707	556,669
Collateral received by the entity	17,058	15,413
Collateral received and sold or pledged as a guarantee by the entity	17,055	12,694
Investment banking transactions on behalf of third parties, net	92,007	42,660
Interest earned but not collected arising from past-due loan portfolio	20	168
Other memorandum accounts	750,152	641,690

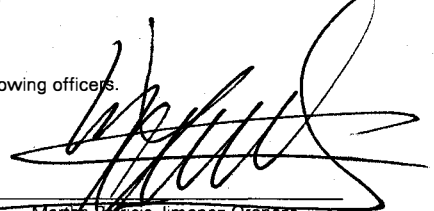
These consolidated balance sheets were prepared in accordance with the Accounting Criteria for credit institutions issued by the National Banking and Securities Commission, based on Articles 99, 101, and 102 of the Law for Credit Institutions which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly they reflect the transactions carried out by the Institution through the dates noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions.


At December 31, 2018 and 2017, the historical capital stock, in accordance with the Regulation of the Organic Law of Nacional Financiera, S. N. C., I. B. D amounts to \$2,390 in both years.

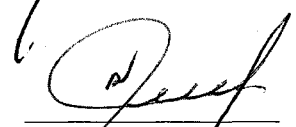
These consolidated balance sheets could be searchable on the following webpage http://www.nafin.com/portalfin/content/nafin-en-cifras/informacion-financiera/estados_financieros_dictaminados.html and <https://portafolioinfo.cnbv.gob.mx/Paginas/contenidos.aspx?ID=37&Titulo=Banca%20de%20Desarrollo>

These consolidated balance sheets were approved by the Board of Directors, under the responsibility of the following officers.


Eugenio Francisco Domingo Najera Solorzano
Chief Executive Officer


Martha Patricia Jimenez Oropeza
Chief Executive Officer of Finance and Administration


Cesar Edmundo Bonada Meneses
Subdirector of Financial Information
Accounting and Fiscal
(In charge of the Office of the Accounting
and Budget Department)


Manuel Anaya Vallejo
Audit Subdirector
(In charge of the Office of the Internal
Audit Department)

See accompanying notes to consolidated financial statements.

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Av. Insurgentes Sur 1971, Col. Guadalupe Inn, C.P. 01020, Mexico City

Consolidated Statement of Income

Years ended December 31, 2018 and 2017

(Millions of Mexican pesos)

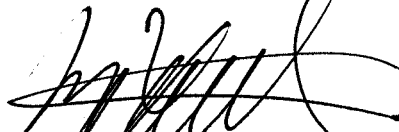
	<u>2018</u>	<u>2017</u>
Interest income (note 24)	\$ 36,611	33,474
Interest expense (note 24)	<u>(32,816)</u>	<u>(28,209)</u>
Financial margin	3,795	5,265
Allowance for loan losses	<u>(2,814)</u>	<u>(2,638)</u>
Financial margin adjusted for the allowance for loan losses	981	2,627
Commission and fees income (note 24)	3,043	2,825
Commission and fees expense (note 24)	(198)	(231)
Financial intermediation income (note 24)	1,315	(1,208)
Other operating income (expenses), net	1,505	1,093
Administrative and promotion expenses	<u>(3,580)</u>	<u>(3,261)</u>
Operating income	3,066	1,845
Equity method in the net income of unconsolidated subsidiaries and affiliates	<u>15</u>	<u>6</u>
Income, before income taxes	3,081	1,851
Current income tax (note 21)	(946)	(777)
Deferred income tax, net (note 21)	<u>400</u>	<u>433</u>
Net income	2,535	1,507
Non-controlling interests	<u>(96)</u>	<u>(5)</u>
Net income on controlling interests	\$ <u>2,439</u>	<u>1,502</u>


These consolidated statements of income were prepared in accordance with the Accounting Criteria for credit institutions issued by the National Banking and Securities Commission, based on Articles 99, 101, and 102 of the Law for Credit Institutions which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly they reflect the transactions carried out by the Institution for the years noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions.


These consolidated balance sheets could be searchable on the following webpage http://www.nafin.com/portalfin/content/nafin-en-cifras/informacion-financiera/estados_financieros_dictaminados.html and <https://portafolioinfo.cnbv.gob.mx/Paginas/contenidos.aspx?ID=37&Titulo=Banca%20de%20Desarrollo>

These consolidated statements of income were approved by the Board of Directors, under the responsibility of the following officers.


Eugenio Francisco Domingo Najera Solorzano
Chief Executive Officer


Martha Patricia Jiménez Oropeza
Chief Executive Officer of Finance and Administration


Cesar Edmundo Bonada Meneses
Subdirector of Financial Information
Accounting and Fiscal
(In charge of the Office of the Accounting
and Budget Department)


Manuel Anaya Vallejo
Audit Subdirector
(In charge of the Office of the Internal
Audit Department)

See accompanying notes to consolidated financial statements.

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Av. Insurgentes Sur 1971, Col. Guadalupe Inn, C.P. 01020, Mexico City

Consolidated Statements of Changes in Stockholders' Equity

Years ended December 31, 2018 and 2017

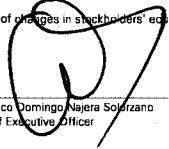
(Millions of Mexican pesos)

	Paid in capital Contributions for future capital stock increases formalized by the Board of Directors					Earned Capital					Total Stockholders' equity
	Capital stock	Paid Stock premium	Statutory reserves	Retained earnings	Result from valuations of available-for-sale securities	Remeasurements of defined employee benefits	Effects of valuation in associate and affiliate companies	Net Income	Non-controlling interest		
Balances as of December 31, 2016	\$ 8,805	2,750	8,922	1,730	2,795	(178)	(574)	640	1,353	1,399	27,642
Changes resulting from stockholders' resolutions											
Appropriation of prior year income	-	-	-	-	1,353	-	-	-	(1,353)	-	2,950
Contributions for future capital stock increases (note 22)	-	2,950	-	-	-	-	-	-	-	-	-
Total	-	2,950	-	-	1,353	-	-	-	(1,353)	-	2,950
Changes related to the recognition of comprehensive income											
Net income	-	-	-	-	-	-	-	1,507	-	-	1,507
Result from valuation in associated and affiliated companies (note 22)	-	-	-	-	-	-	-	102	-	-	102
Result from valuation of available-for-sale securities (note 22)	-	-	-	-	-	286	-	-	-	-	286
Remeasurements of defined employee benefits (note 22)	-	-	-	-	-	-	361	-	-	-	361
Non-controlling interest	-	-	-	-	-	-	-	(5)	19	-	14
Total comprehensive income	-	-	-	-	-	286	361	102	1,502	19	2,270
Balances as of December 31, 2017	8,805	5,700	8,922	1,730	4,148	108	(213)	742	1,502	1,418	32,862
Changes resulting from stockholders' resolutions											
Appropriation of prior year income	-	-	-	-	1,502	-	-	-	(1,502)	-	1,376
Contributions for future capital stock increases (note 22)	-	1,376	-	-	-	-	-	-	-	-	-
Capitalization of Contributions for future capital stock increases (note 22)	397	(5,700)	5,303	-	-	-	-	-	-	-	-
Total	397	(4,324)	5,303	-	1,502	-	-	-	(1,502)	-	1,376
Changes related to the recognition of comprehensive income											
Net income	-	-	-	-	-	-	-	2,535	-	-	2,535
Result from valuation in associated and affiliated companies (note 22)	-	-	-	-	-	-	-	360	-	-	360
Result from valuation of available-for-sale securities (note 22)	-	-	-	-	-	(310)	-	-	-	-	(310)
Remeasurements of defined employee benefits (note 22)	-	-	-	-	-	-	245	-	-	-	245
Non-controlling interest	-	-	-	-	-	-	-	(86)	145	-	49
Total comprehensive income	-	-	-	-	-	(310)	245	360	2,439	145	2,879
Balances as of December 31, 2018	\$ 9,202	1,376	14,225	1,730	5,650	(202)	32	1,102	2,439	1,563	37,117

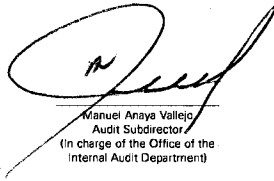
These consolidated statements of changes in stockholders' equity were prepared in accordance with the Accounting Criteria for credit institutions issued by the National Banking and Securities Commission, based on Articles 99, 101, and 102 of the Law for Credit Institutions which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly they reflect the transactions carried out by the Institution for the years noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions.


These consolidated balance sheets could be searchable on the following webpage http://www.nafin.com/portal/inf/content/inf/inf/informacion-financiera/estados-financieros_determinados.html and <https://portal/inf/cnbv.gob.mx/Paginas/contenidos.aspx?ID=37&Titulo=Banca%20de%20Desarrollo>

These consolidated statements of changes in stockholders' equity were approved by the Board of Directors, under the responsibility of the following officers.


Eugenio Francisco Domingo Najera Solórzano
Chief Executive Officer


Marco Patricia Jiménez Oropeza
Chief Executive Officer of Finance and Administration


Manuel Anaya Vallejo
Audit Subdirector
(In charge of the Office of the Internal Audit Department)


Cesar Edmundo Bonada Meneses
Subdirector of Financial Information
Accounting and Fiscal
(In charge of the Office of the Accounting and Budget Department)

See accompanying notes to consolidated financial statements.

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Av. Insurgentes Sur 1971, Col. Guadalupe Inn, C.P. 01020, Mexico City

Consolidated Statement of Cash Flows

Years ended December 31, 2018 and 2017

(Millions of Mexican pesos)

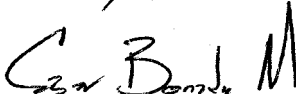
	<u>2018</u>	<u>2017</u>
Net Income	\$ 2,439	1,502
Adjustments for items not requiring cash flow:		
Allowance for uncollectible or doubtful accounts	358	195
Depreciation of property, furniture and equipment	34	35
Provisions	(4,077)	(4,093)
Current and deferred income taxes	546	344
Equity method of unconsolidated subsidiaries and affiliates	(15)	(6)
Others, mainly valuation at fair value	148	(431)
	<u>(3,006)</u>	<u>(3,956)</u>
Operating activities:		
Change in margin accounts	19	(35)
Change in investment securities	(17,050)	28,021
Change in debtors on repurchase/ resell agreements	2,718	(2,698)
Change in derivatives (asset)	4,041	(10,909)
Change in loan portfolio (net)	(30,120)	(11,471)
Change in foreclosed assets	1	-
Change in other operating assests	543	9,318
Change in deposit funding	14,899	11,706
Change in bank and other borrowings	5,697	(4,974)
Change in creditors on repurchase/ resell agreements	29,838	(14,079)
Change in derivatives (liability)	(2,360)	8,103
Change in other operating liabilities	19,899	(367)
Payments of income taxes	(666)	(393)
Net cash flows from operating activities	<u>27,459</u>	<u>12,222</u>
Investing activities:		
Payments for acquisition of property, furniture and equipment	-	(19)
Proceeds from disposal of subsidiaries and associates	461	155
Payments for acquisition of subsidiaries and associates	-	(5)
Collections of cash dividends	28	4
Net cash from investing activities	<u>489</u>	<u>135</u>
Financing activities:		
Contributions for future capital stock increases	1,376	2,950
Net cash flow from financing activities	<u>1,376</u>	<u>2,950</u>
Net increase in cash and cash equivalents	28,757	12,853
Cash and cash equivalents at beginning of year	28,551	15,698
Cash and cash equivalents at end of year	\$ <u>57,308</u>	<u>28,551</u>

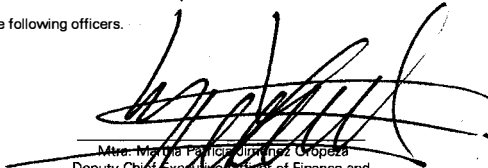
These consolidated statement of cash flows were prepared in accordance with the Accounting Criteria for credit institutions issued by the National Banking and Securities Commission, based on Articles 99, 101, and 102 of the Law for Credit Institutions which are of a general and mandatory nature and have been applied on a consistent basis. Accordingly they reflect the transactions carried out by the Institution for the years noted above. Furthermore, these transactions were carried out and valued in accordance with sound banking practices and the applicable legal and administrative provisions.

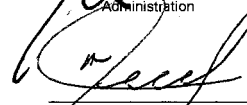
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These consolidated statement of cash flows were approved by the Board of Directors, under the responsibility of the following officers.


Ing. Eugenio Francisco Domingo Najera Solorzano
Chief Executive Officer


Cesar Edmundo Bonada Meneses
Subdirector of Financial Information
Accounting and Fiscal
(In charge of the Office of the Accounting
and Budget Department)


Mtra. María Patricia Quiroz Orta
Deputy Chief Executive Officer of Finance and
Administration


Manuel Anaya Vallejo
Audit Subdirector
(In charge of the Office of the Internal
Audit Department)

See accompanying notes to consolidated financial statements.

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

For the years ended December 31, 2018 and 2017

(Millions of Mexican pesos)

(1) Description of business-

Nacional Financiera, S. N. C. Institución de Banca de Desarrollo (the Institution), was incorporated on June 30, 1934, by Federal Government Decree as an instrument of significant social and economic transformations, with the purpose of promoting the securities market and foster the mobilization of the financial resources in Mexico.

The Institution operates as a development banking institution, in accordance with its internal organic law and regulations, the Credit Institutions Law and the General Provisions Applicable to Credit Institutions (the Provisions) issued by the National Banking and Securities Commission (the Banking Commission).

The Institution's purpose is to contribute to the development of companies, by providing access to financing products, training, technical assistance and information, in order to foster their competitiveness and the productive investment; promote the development of strategic and sustainable projects for the country, in an orderly and targeted manner, under schemes that allow correction of market failures in coordination with other development banks; promote the regional and sectoral development of the country, particularly in the states with less development, through a differentiated product offer and according to the productive vocations of each region: developing the financial markets and the venture capital industry in the country, to serve as sources of financing for entrepreneurs and small and medium enterprises; to be an Institution with an effective management, based on a consolidated structure of corporate governance, that ensures a continuous and transparent operation, as well as the preservation of its capital and to not represent a financial burden to the Federal Government.

In accordance with the provisions of article 2nd. of the Institution's internal regulation, the Institution has the goal of promoting savings and investment, as well as channeling financial and technical supports to industrial development and, in general, to the national and regional economic development of the country.

The Institution operates according to the applicable legal framework and sound banking practices and applications to achieve the general objectives outlined in the 4th article of the Credit Institutions Law, which establishes that the state shall exercise the rectory of the mexican banking system, thus the Institution basically directs its activities to support and promote the development of the country's productive system and the growth of the national economy, based on a sovereign economic policy, by promoting savings in all sectors and regions of Mexico and their appropriate channeling and extensive regional coverage to favour the decentralization of the mexican banking system, with adherence to sound practices and banking applications.

Development banking institutions are oriented to the productive activities determined by the Union Congress as a specialty of each one of these, in the respective internal regulations.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions Mexican of pesos)

The Institution carries out its operations according to financing criteria for development banking, channeling its resources mainly through the first tier banking and non-banking financial intermediaries. The main funding sources for the Institution arise from loans from international development institutions such as the International Bank for Reconstruction and Development and the Inter-American Bank of development (IADB), lines of credit from foreign banks and placement of securities in the national and international financial markets.

At December 31, 2018 and 2017, the Institution and its consolidated subsidiaries are integrated as follows:

- i. *Operadora de Fondos Nafinsa, S. A. de C. V.* - Which aims to contribute to the development of financial markets, promoting access to the securities market to small and medium investors.
- ii. *Corporación Mexicana de Inversiones de Capital, S. A. de C. V.* - Incorporated on February 2, 2006, its main activity, being to buy, sell and invest in companies, institutions and private equity funds, as well as promote productive investment in Mexico in the medium and long term, promoting the institutionalization, development and competitiveness of the small and medium enterprises.
- iii. *Fideicomiso 80595 programa de venta de títulos en directo al público* – Manages the trust funds and carries out the necessary actions to develop and implement the Program for the sale of securities directly to the public, in accordance with the operation rules, which, were appropriate, the Trust's Technical Committee authorizes.
- iv. *Fideicomiso 11480 fondo para la participación de riesgos* - Its purpose is having entities which allow to fulfill compliance with the institutional objectives related to the access of micro, small and medium-sized companies in the country to formal finance. The Institution implemented the guarantee program, in order to share with the financial banking and non-banking institutions (intermediaries) determined by the Trust's Technical Committee, the credit risk of the financing that these grant to national companies and individuals.
- v. *Fideicomiso 11490 fondo para la participación de riesgos en fianzas* – Its purpose is sharing with the country's bonding institutions, established in accordance with the Federal law for bonding institutions determined by the Trust's Technical Committee, the risk of default on administrative bonds and/or procurement concerning section III, article 5 of the law of bonds, granted to micro, small and medium-sized enterprises, as well as to individuals with entrepreneurial activity, which have signed a contract to supply goods, services and public works to the Federal public administration.
- vi. *Plaza Insurgentes Sur, S. A. de C. V.*- Its purpose is to provide the Institution with integral real estate services through the leasing of space and furniture, as well as adaptation of offices with preventive and corrective maintenance programs to real estate infrastructure.
- vii. *Pissa Servicios Corporativos, S. A. de C. V. (in liquidation)*- Provides complementary or auxiliary services in the administration or in the realization of the corporate purpose of any national credit entity that is or becomes its shareholder, as well as auxiliary companies and trusts thereof.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions Mexican of pesos)

At December 31, 2018 and 2017, the operations structure of the Institution abroad, includes two branches located in London, England and another in the Grand Cayman Islands.

(2) Financial statement authorization and presentation -

Authorization

On March 6, 2019, Eugenio Francisco Domingo Najera Solorzano (Chief Executive Officer), Martha Patricia Jimenez Oropeza (CEO of Finance and Administration), Cesar Edmundo Bonada Meneses (Subdirector of Financial Information Accounting and Fiscal (In charge of the Office of the Accountin and Budget Departament) and Manuel Anaya Vallejo (Audit Subdirector, In charge of the Office of the Internal Audit department) authorized the issuance of the consolidated financial statements and related notes.

The Institution's Board of Directors and the Banking Commission are empowered to modify the consolidated financial statements after issuance. The 2018 consolidated financial statements will be approved at the next meeting of the Board of Directors.

Basis of presentation

a) Statement of compliance

The accompanying consolidated financial statements have been prepared, based on the banking legislation, and in conformity with the accounting criteria established by the Banking Commission for credit institutions in Mexico. The Banking Commission is responsible for the inspection and supervision of credit institutions, as well as reviewing their financial information.

The accounting criteria provide that in the absence of a specific accounting criterion by the Banking Commission for credit institutions, and in a wider context in the Mexican Financial Reporting Standards (MFRS), issued by the Mexican Board of Financial Reporting Standards (Consejo Mexicano de Normas de Información Financiera, A. C. or CINIF), the suppletory process as established by MFRS A-8 shall be applicable, and only when the International Financial Reporting Standards (IFRS) referred to by MFRS A-8 do not resolve the accounting treatment, the suppletory application of an accounting standard pertaining to any other regulatory framework may be opted for, provided that all the requirements set out by the MFRS are met by the standard. The suppletory application shall be in the following order: U.S. Generally Accepted Accounting Principles (US GAAP), and then any other accounting standard that is part of a formal and recognized set of standards, provided that they do not contravene the accounting criteria of the Banking Commission.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions Mexican of pesos)

b) Use of estimates and judgments

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period.

Judgments

The information about judgments made in the application of accounting policies that have the most significant effect on amounts reported in the consolidated financial statements are described in the following notes:

— Note 3 (m) Permanent Investments: Whether the institution has significant influence.

Assumptions and uncertainties in the estimates

The information about assumptions and estimation uncertainties that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities in the following year it is included in the following notes:

- Note 3 (s) – Measurement of defined benefit obligations: key actuarial assumptions;
- Note 3 (o)– Recognition of deferred tax assets;
- Note 9 – Derivative financial instruments;
- Note 10 (d)– Allowance for loan losses.

c) Functional and reporting currency

The aforementioned consolidated financial statements are presented in Mexican pesos, which is the same as the recording currency and the functional currency.

For purposes of disclosure in the notes to the consolidated financial statements, “pesos” or “\$” refers to millions of Mexican Pesos, and when reference is made to “dollars” or “USD”, it means millions of dollars of the United States of America.

d) Recognition of assets and liabilities from financial instruments

Assets and liabilities related to the purchase and sale of foreign currencies, investment securities, repurchase/resell agreements and derivatives are recognized in the accompanying consolidated financial statements on the trade date, regardless of the settlement date.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions Mexican of pesos)

(3) Summary of significant accounting policies

The accounting policies shown in this note have been applied consistently in the preparation of the consolidated financial statements.

a) Recognition of the effects of inflation-

The accompanying consolidated financial statements include the recognition of inflation based on Investment Units (Unidades de Inversión or UDI) until December 31, 2007, according to the applicable accounting criteria.

The years ended December 31, 2018 and 2017 are considered non-inflationary economic environment (inflation accumulated over the three preceding years less than 26%), as established in MFRS B-10 "Effects of Inflation", consequently the effects of inflation on the Institution's financial information are not recognized. Should the environment become inflationary again, the cumulative effects of inflation not recognized in prior periods must be retrospectively recognized from the last period that the economic environment was considered as inflationary. The accumulated inflation rate of the last three years is shown as follows:

December 31	UDI	Inflation	
		Annual	Accumulated
2018	6.226631	4.92%	15.71%
2017	5.934551	6.68%	12.60%
2016	5.562883	3.38%	9.97%

(b) Cash and cash equivalents-

Cash and cash equivalents consist of cash in hand, deposits with banks in pesos and dollars, as well as 24, 48 and 72 hours foreign currency purchase and sale transactions. It also includes restricted cash and cash equivalents comprised of bank borrowings with original maturities of up to three days ("Call Money"), and deposits in Banco de México (Central Bank) which include the monetary regulation deposits that the Institution is required to maintain in conformity with the provisions issued by the Central Bank for the purpose of regulating liquidity in the financial market; the deposits have no term and bear interests at the average banking funding rate, recognized in the consolidated income statement as they accrue.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions Mexican of pesos)

The cash and cash equivalents are recognized at nominal value. For dollar currencies, the exchange rate used for the translation is the one published by the Central Bank. The translation effect is recognized in consolidated income statement, as interest income or interest expense, accordingly.

Notes receivable will be recorded as other cash equivalent according to what is mentioned as follows:

- Transactions with Mexican entities: two business days after the transaction took place.
- Transactions with foreign entities: five business days after the transaction took place.

When the aforementioned notes are not collected within the established deadlines, the related amounts will be transferred to the originating item, as applicable, either "Other accounts receivable" or "Loan portfolio", and due consideration should be given to the provisions of criterion A-2, "Application of specific standards", and B-6 "Loan portfolio", respectively.

The transactions transferred to sundry debtors under the caption "Other accounts receivable", and that are not settled within fifteen days following the transfer date will be classified as past-due and an allowance for their total amount will be recorded concurrently.

Notes received subject to collection are recorded in memorandum accounts under the caption "Other memorandum accounts".

Checking account overdrafts, as reported in the statement of account issued by the corresponding credit institution, are shown in the caption "Sundry creditors and other accounts payable".

Likewise, the balance of receivable currencies offset against deliverable currencies, in case this offset results negative.

The foreign exchange currencies acquired and agreed to be settled in 24, 48 and 72 hours purchase/sell transactions are recognized as restricted cash (foreign currency receivable), while the currency sold is recorded as cash outflow (foreign currency deliverable). The rights and obligations from the 24, 48 and 72 hours sales and purchases of foreign exchange are recorded in clearing accounts under the caption "Other accounts receivable" and "Creditors on settlement of transactions", respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(c) Margin accounts-

The margin accounts granted in cash required from the Institution to operate derivatives in recognized markets are recorded at their normal value and presented in the caption "Margin accounts". The value of margin accounts granted in cash is modified by margin calls or withdrawals made by the clearing house and by additional contributions or withdrawals made by the Institution.

Returns and commissions affecting the margin accounts, other than fluctuations in derivatives prices, are recognized in the result of operations for the year as accrued under "Interest income" and "Commission and fees expense", respectively. The partial or total settlement amounts deposited or withdrawn by the clearinghouse owing to derivatives price fluctuations are recognized in "Margin accounts".

(d) Investment securities-

Investment securities consist of equities, government securities, bank promissory notes, and other debt securities listed in recognized markets, which are classified using the categories shown below, based on the intention and ability of Institution's Management on their ownership.

Trading securities-

Trading securities are those acquired with the intention of selling them to get short-term gains arising from differences in prices resulting from their trading in the market. Securities at the time of acquisition are accounted for at fair value (which includes, where applicable, the discount or premium) which presumably corresponds to the price paid; transaction costs for the acquisition of securities are recognized in the income statement on the same date.

Subsequently, securities are valued at fair value provided by an independent price vendor; when the securities are sold, the gain (loss) on purchase/sell is determined by the difference between the purchase and sale prices; this shall cancel the gain (loss) on valuation that has been previously recognized in the income statement.

Interest earned on debt securities are determined according to the effective interest method and are recognized in the year's income under the caption "Interest income".

Dividends from equity securities are recognized in the year's income when the right to receive payment arises, under the caption "Interest income".

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Valuation effects and purchase or sale gain (loss) are recognized in the year's income within the caption "Financial intermediation income".

Available for sale securities-

Available-for-sale securities are those for which there is neither the intention to profit from differences in prices in the short term nor the intention or capacity to hold to maturity. The initial recognition and subsequent valuation is performed in the same manner as trading securities, except that the effect of valuation is recognized in stockholders' equity under the caption "Result from valuation of available-for-sale securities", which is adjusted by the effect of deferred taxes, and then is cancelled by its recognition in the income statement at the time of the sale within the caption of "Financial intermediation income".

Interests earned are determined according to the effective interest method and are recognized in the year's statement of income under the caption "Interest income".

Dividends from equity instruments are recognized in the year's income statement when the right to receive payment arises, in the financial statements caption "Interest income".

Held to maturity securities-

Those are debt securities with fixed or determinable payments and with fixed maturity, for which the entity has the intention and capacity to hold until maturity. These securities are initially recognized at fair value which is presumably the price paid; and later are valued at amortized cost, which implies that the amortization of the premium or discount as well as the transaction costs form part of the interests earned recognized in the income statement under "Interest income". Interest is recognized in the statement of income as earned and when the securities are sold, the gain (loss) from purchase-sell is recognized for the difference between the net realizable value and the book value of the securities within the caption of "Financial intermediation income".

Securities impairment-

Where sufficient objective evidence exists that a security available-for-sale or held-to-maturity has been impaired because of one or more events that occurred after the securities initial recognition, the carrying amount of the security is modified and the impairment is recognized in the current year's profit and loss under the caption "Financial intermediation income". Regarding available-for-sale securities, the amount of loss recognized in equity is canceled.

If, in a subsequent period, the fair value of the security increases, and this effect is related objectively to an event occurring after the impairment was recognized in the income statement, the impairment is reversed in the year's income statement, except if it is an equity instrument.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Value date transactions-

Securities acquired where settlement takes place on a subsequent date, up to a maximum of four business days following the date of the purchase-sale transaction, are recognized as restricted securities, while securities sold are recognized as securities to be delivered, and are deducted from investments securities; the counter entry is a credit or debit to a settlement account, as applicable. Where the amount of securities to be delivered exceeds the balance of same nature proprietary securities (government, bank, equity and other debt securities), this is reflected as a liability under the "Assigned securities pending settlement" caption.

Reclassification between categories-

The accounting criteria allow the reclassifications from held-to-maturity to available-for-sale securities, provided that there is no intention or capacity to hold them until maturity.

Valuation adjustments at the date of the reclassifications are recognized in stockholders' equity. In the case of reclassifications of securities to the held-to-maturity category, or of securities from trading to available for sale, this is only permissible with the express authorization of the Banking Commission.

(e) Repurchase/resell agreements -

At the trade date of the repurchase/resell agreement transaction (repo), the Institution acting as seller recognizes either the cash inflow or a debit clearing account, as well as an account payable, whereas when acting as buyer recognizes either the cash outflow or a credit clearing account, as well as an account receivable. Both the account payable and the account receivable are initially stated at the agreed-upon price, representing the obligation to repay or the right to recover the cash, respectively.

Over the term of the repo, the account receivable and the account payable are valued at amortized cost, recognizing the interest on repos in the result of operations for the year as earned, in accordance with the effective interest method. The interest is recognized under the financial statement caption "Interest income" or "Interest expense", as appropriate. The account receivable and the account payable, as well as the interest earned are reported in the financial statement caption "Debtors on repurchase/resell agreements" and "Creditors on repurchase/resell agreements", respectively.

The Institution acting as buyer recognizes the received collateral in memorandum accounts within the caption of "Collateral received by the entity", in accordance with accounting criterion B-9 "Assets in custody and under management". Financial assets granted as collateral, when the Institution is acting as seller, are reclassified in the consolidated balance sheet within the caption of "Investment securities", reporting it as a restricted asset.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Should the Institution, acting as buyer sell or pledge the collateral, the proceeds from the transaction are recognized and an account payable is recorded for the obligation to return the collateral to the seller, which is valued, in the case of a sale at fair value, or if pledged in another sale and repurchase agreement, at amortized cost. The account payable is offset with the account receivable, which is recognized when the Institution acting as buyer becomes the seller and the debit or credit balance is presented in the consolidated financial statement caption "Debtors on repurchase/resell agreements" or in "Collaterals sold or pledged", as applicable.

Additionally, the collateral received, delivered or sold is recognized in memorandum accounts within the caption of "Collateral received and sold or pledged by the entity", in accordance with accounting criterion B-9 "Assets in custody and under management".

(f) Derivatives-

Transactions with derivative financial instruments comprise those carried out for trading and hedging purposes. Irrespective of their purpose, the derivatives are recognized at fair value.

The valuation effect of the derivatives for trading purposes is shown in the consolidated balance sheet and consolidated statement of income under "Derivatives", in the assets or liabilities, accordingly, and "Financial intermediation income", respectively.

The effective portion of the valuation gain (loss) of hedges designated for cash flow purposes is recognized in stockholders' equity, under the caption "Gain (loss) from valuation of cash flow hedge instruments", while the ineffective portion of the change in fair value is recognized immediately in the consolidated income statement under "Financial intermediation income", and the counter-account with such effect is presented in the consolidated balance sheet under "Derivatives". The gain or loss associated with the coverage of the forecasted transaction that has been recognized in stockholders' equity, is reclassified to the consolidated statement of income within the same caption that presents gain (loss) from valuation of the hedged party attributable to the hedged risk, in the same period during which the hedged forecasted cash flows affect the year's results of operations.

If the cash flow hedge derivative reaches maturity, is exercised, terminated or the hedge does not meet the requirements to be deemed effective, the hedge designation is canceled, while the valuation of the cash flow hedge derivative within stockholders' equity remains in this caption and is recognized in the year's results when the forecasted transaction occurs, in the same caption which presents the gain or loss from the valuation attributable to the hedged risk.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The gain or loss arising from valuing the fair value hedge derivative is recognized in the consolidated balance sheet under "Derivatives" and in the consolidated statement of income in "Interest income" and "Financial intermediation income", since they correspond to hedges of interest rate on loan portfolio and investments securities classified as available-for-sale, respectively. The result of valuation of the item attributable to the hedged risk is recognized in the consolidated balance sheet under "Valuation adjustments from hedging of financial assets" and recognized in the year's statement of income in "Interest income" in the case of the loan portfolio, while for investments securities classified as available-for-sale, in "Financial intermediation income".

Collaterals pledged and received in derivate transactions carried out over-the-counter-

The collateral is a guarantee obtained to ensure payment of the price agreed in contracts with derivative financial instruments in over-the-counter transactions.

The granting of collateral pledged in cash in derivative over-the-counter transactions are recorded as account receivable under the caption "Other accounts receivable", while collateral received in cash are recorded as "Other accounts payable".

The collaterals pledged in securities are recorded as restricted securities in guarantees, and the collaterals received in securities from derivatives transactions are recorded in memorandum accounts.

(g) Offsetting clearing accounts-

Amounts receivable or payable on investment securities, securities repurchase/resell agreements, and/or derivatives, which have expired but have not been settled at the consolidated balance sheet date, including the amounts receivable or payable for purchase or sale of foreign currencies, which are not for immediate settlement or those with a same day value date, are recorded in clearing accounts.

The balances of clearing accounts, credit and debit are offset as long as there is a contractual right to offset amounts recognized, and the intention to settle on a net basis or to realize the asset and settle the liability simultaneously.

The clearing accounts are shown under the financial statement caption "Other accounts receivable, net" or "Creditors on settlement of transactions", as appropriate.

(h) Loan portfolio-

Represents the balance of the total or partial dispositions of credit lines granted to the borrowers plus uncollected accrued interest, less the interest collected in advance. The allowance for credit risks is presented by deducting the balances from the credit portfolio.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Undrawn credit facilities are recorded in memorandum accounts, under "Loan commitments". The withdrawn amount is recorded into the loan portfolio according to the corresponding portfolio category.

At the time of contracting, transactions with letters of credit are recorded in memorandum accounts under "Loan commitments" which, upon being used by the client or its counterparty are transferred to the loan portfolio.

Past-due loans and interest-

Outstanding loans and interest balances are classified as past due according to the following criteria:

1. Knowledge that the borrower has filed for bankruptcy, under the Bankruptcy Law.

An exemption exist from the aforementioned rule, for those loans that continue receiving payment in terms of the Bankruptcy Law under section VIII of article 43, as well as those loans granted under article 75, in relation to sections II and III of article 224 of the mentioned Law, however, if incurred in one of the cases provided in the following numeral 2, they will be recorded as past-due loan portfolio.

2. Their installments have not been fully settled on the terms originally agreed, considering the following:
 - a) If the debt consists in loans with a single payment of principal and interest at maturity, and are 30 or more calendar days past-due;
 - b) If the debt refers to loans with a single payment of principal at maturity and periodic payments of interest, and the related interest payment is 90 or more calendar days past-due, or principal is 30 or more calendar days past-due;
 - c) If the debt consists of loans with principal and interest periodic partial payments, including mortgage loans, are 90 or more calendar days past-due;
 - d) If the debt consists of revolving loans, which are unpaid for two monthly normal billing periods or, where the billing period is other than monthly, when they are 60 or more calendar days past-due; and
 - e) Overdrafts from checking accounts, and notes receivable, upon occurrence of such event.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

When a loan is transferred to the past-due portfolio, accrual of interest is discontinued and record thereof is kept in memorandum accounts. Also suspending the amortization of accrued financial income in the year's income statement.

Once collected, such interest is recognized directly in the consolidated income statement under "Interest income". Recognition in the consolidated income statement of interest income resumes when the portfolio ceases to be considered as past due.

An allowance is constituted for an amount equal to the total of uncollected accrued interest corresponding to loans deemed past-due at the time the loan is transferred to the past-due portfolio. For past-due loans, which restructuring agrees to the capitalization of earned, uncollected interest previously recorded in memorandum accounts, an allowance is created for the total of such interest amount. The allowance is released when there is evidence of sustained payment.

Past-due loans are reclassified as current when the unpaid balances have been fully paid by the debtor (principal and interest, etc.), except for restructured loans or renewed, which are transferred to current portfolio when sustained payment has been made.

Sustained payment-

It is considered that there is sustained payment when the borrower shows compliance of the payment without delay for the total amount of principal and interest, for at least three consecutive amortizations of the loan payment scheme, or in the case of loans with amortizations that cover periods greater than 60 calendar days, the payment of an exhibition.

In loans with periodic payments of principal and interest whose amortizations are less than or equal to 60 days in which the periodicity of payment to fewer periods is modified due to the application of a restructuring, a sustained payment of the loan is considered, when the borrower shows payment of amortizations equivalent to three consecutive amortizations of the original loan scheme.

In the case of consolidated loans, if two or more loans originate the reclassification to the caption "Past-due loan portfolio", in order to determine the three consecutive amortizations required for the existence of a sustained payment, the repayment scheme should be considered, for the original loan whose repayments equal the longer term.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Regarding loans with a single payment of principal at maturity, regardless of whether the payment of interest is periodic or at maturity, it is considered that there is a sustained payment of the loan when any of the following assumptions occur:

- a) the borrower has covered at least 20% of the original amount of the loan at the moment of the restructuring or renewal or,
- b) the amount of interest accrued under the restructuring or renewal payment scheme corresponding to a period of 90 days would have been covered.

Prepayment of an amortization of restructured or renewed loan (amortization of restructured or renewed loan that have been paid without the occurrence of natural days equivalent to three consecutive amortizations of the loan amortization schedule or in the case of loans with amortization covering longer periods than 60 calendar days, the payment of an exhibition), other than those with a single payment of principal at maturity, regardless of whether the interest is paid periodically or at maturity, is not considered as a sustained payment.

Restructuring and renewals

Unless there is evidence of sustained payments, past-due loans restructured or renewed shall remain within the past-due loan portfolio.

Loans with single payment of principal at maturity and periodic interest payments, as well as loans with a single payment of principal and interest at maturity being restructured during the term of the loan or renewed at any time will be considered as nonperforming loans as long as there is no evidence of sustained payment.

Current loans that are restructured or renewed, without at least 80% of the original loan term having elapsed, shall be deemed current only when the borrower has:

- i) Paid the total accrued interest, and
- ii) Paid the original principal loan amount which at the renewal or restructuring date should have been covered.

Current loans that are restructured or renewed during the course of the final 20% of the original term of the loan will be considered as current only when the borrower has:

- i) Fully paid the total interest accrued;
- ii) Covered the total original amount of the loan which at the date of renewal or restructuring should had been paid, and
- iii) Paid 60% of the original loan amount.

Renewed or restructured loans where the borrower fails to meet the above conditions will be deemed past-due from the renewal or restructuring date until there is evidence that sustained payments are being made.

Those loans considered revolving, which have been restructured or renewed, will be considered as current when the borrower has paid off the totality of accrued interest, there are no invoicing periods past due and there is evidence to prove the debtor's repayment capability.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Loans with payable principal and interest amounts which, at the restructuring date, have been repaid in full and for which one or several of the following loan conditions have been changed, shall not be deemed restructured or renewed.

- i) Guarantees: only when involving the extension or replacement with better quality guarantees.
- ii) Interest rate: when the agreed-upon interest rate is improved.
- iii) Currency: provided that the rate corresponding to the new currency is applied.
- iv) Payment date: only if the change does not represent exceeding or modifying the frequency of payments. In no case shall the change in the payment date enable omitting the payment in any given period.

The loan portfolio restructurings or renewals are made in compliance with the General Provisions applicable to credit institutions and their viability is analyzed specifically.

The Institution periodically evaluates if a past-due loan should remain in the consolidated balance sheet or be written-off, provided a provision has been created for 100% of the loan amounts. Such write-off is made by cancelling the unpaid loan balance against the allowance for loan losses previously created for each loan when the Institution has exhausted all legal instances to recover the loan. Any recovery derived from loans that were previously written-off is recognized in the year's income statement.

Write-downs, cancellations, refunds or discounts are recorded against the provision for loan losses. In case the amount of these items exceeds the provision for loan losses balance related to the loan, a charge to provision is recorded up to the amount of the difference

Costs and expenses related to loan origination

The costs and expenses related to loan origination are recorded as a deferred charge, which is amortized to the income statement under the caption "Interest expense" during the average term of the loans, except for origination of revolving loans, which are amortized over a period of 12 months against the expense caption that corresponds according to its nature.

(i) Allowance for loan losses-

An allowance for loan losses is recorded, which, based on the Institution's management best estimate is sufficient to cover probable losses inherent to the loan portfolio as well as guarantees issued and irrevocable loan commitments

Commercial loans - The allowances for the commercial loans are based on the individual assessment of the credit risk of borrowers and their classification, in accordance with the general provisions applicable to the rating methodology of the credit Institution's loan portfolio, established by the Banking Commission. Commercial loans shall be subject to credit rating without including those loans with guarantee from Entities of the Federal Public Administration under direct budgetary control, productive State enterprises or those indicated in Section VI of Article 112 of the Provisions, in which the allowance percentage shall be equal to 0.5%.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The Provisions use a methodology which classifies the loan portfolio into different groups: in states and municipalities, investment projects with own source of payment, trustees acting under trusts, financial institutions and corporations and individuals with business activity not included in the aforementioned groups; the last group must be divided into two subgroups: corporations and individuals with business activity with annual net sales or revenues greater than 14 million UDIS and less than 14 million UDIS. For purposes of rating projects with own source of payment, the Provisions establish that the rating is calculated using a risk analysis of the investment projects according to their stage of construction or operation, and through the extra cost of labor and cash flows of the project. For other groups, an expected loss methodology is established for credit risk, considering the probability of default, loss given default and exposure to default.

Loan portfolio granted to corporations and individuals with business activity, with annual net revenues or sales lesser than 14 million UDIS, is credit rated through the application of methodology set forth on Appendix 21 of the Provisions. For the financial institutions loans, the methodology set forth on Appendix 20 of the Provisions is used, which establishes the concept of probability of default, loss severity and exposure to default.

The estimates carried out at December 31, 2018 and 2017, were determined based on the risk levels and allowance percentage according to the following table:

Grade of risk	Range of allowance percentage	
A1	0.000	0.90%
A2	0.901	1.5%
B1	1.501	2.0%
B2	2.001	2.50%
B3	2.501	5.0%
C1	5.001	10.0%
C2	10.001	15.5%
D	15.501	45.0%
E	Higher than	45.0%

Mortgage loans-

Allowance for mortgage loans losses is determined using the corresponding balances the last day of each month. Furthermore, factors such as the following are taken into consideration: (i) amount payable; (ii) payment made; (iii) house value; (iv) outstanding loan balance; (v) days of delinquency; (vi) loan denomination; and (vii) file documentation. The total amount to reserve for each assessed loan is the result of multiplying the probability of default by the loss severity and exposure to default.

The risk grades and percentages of allowance for loan losses at December 31, 2018 and 2017, are as shown in next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Grade of risk	Range of allowance percentage	
A1	0.000	0.50%
A2	0.501	0.75%
B1	0.751	1.00%
B2	1.001	1.50%
B3	1.501	2.00%
C1	2.001	5.00%
C2	5.001	10.00%
D	10.001	40.00%
E	40.001	100.00%

Non revolving consumer loans portfolio-

The methodology followed to determine the provision for the non revolving consumer loans portfolio is described in articles 91 and 92 of the Provisions. The total allowance amount for each loan is the result of multiplying the probability of default by the loss severity and exposure to default.

The risk grades and percentages of provision for loan losses at December 31, 2018 and 2017, are shown as follows:

Grade of risk	Range of allowance percentage	
A1	0.000	2.0%
A2	2.01	3.0%
B1	3.01	4.0%
B2	4.01	5.0%
B3	5.01	6.0%
C1	6.01	8.0%
C2	8.01	15.0%
D	15.01	35.0%
E	35.01	100.0%

Impaired loan portfolio – For consolidated financial statement disclosure purposes, the Institution considers as impaired loans, those commercial loans for which it determines that there is a considerable probability that they could not be recovered in full, without excluding improvements in risk levels resulting from the secured portion of the loan, or loans that, although current, result from negotiations in which a forgiveness, reduction or settlement was authorized at the end of the agreed-upon term.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Additional identified reserves— Are established for those loans, which in management's opinion, may give cause for concern in the future given the particular situation of the customer, the industry or the economy. Furthermore, it includes estimates for items such as normal interest earned but not collected and other items whose realization is considered to result in a loss to the Institution, as well as reserves maintained for guarantees granted.

(j) Other accounts receivable-

Loans to officers and employees, collection rights and the accounts receivable related to debts whose maturity is agreed from origin to a more than-90-calendar-day term are assessed by the Institution's management to determine the estimated recoverable amount and, as required, to create the corresponding allowance. The balances of other debit items are recorded into the income statement 90 days after their initial recording, if they correspond to identified items and 60 days if the balances are unidentified, regardless of their chance of recovery, except for tax-related (VAT included) balances.

With regards to clearing accounts, in the case where the amount receivable is not settled within 90 calendar days from the record in clearing accounts, it is recorded as past due and an allowance for unrecoverability or doubtful account is recorded for the total amount.

(k) Foreclosed assets or assets received in lieu of payment-

Foreclosed assets are recorded on the date the admission order of the judicial sale by which the foreclosure was decreed, became final and conclusive and is immediately available for execution.

Assets received in lieu of payment are recorded on the date the deed of payment, or that on which the transfer of title to the asset is formally executed.

The accounting recognition of a foreclosed asset considers the value of the tangible asset (at the lower of cost or fair value less strictly necessary costs and expenses incurred for foreclosure), as well as the net value of the asset arising from the foreclosure. When the net value of the asset arising from the foreclosure exceeds the value of the foreclosed asset, the loss is recognized in the consolidated income statement caption "Other operating income". Otherwise, the value of the foreclosed asset is adjusted to the net value of the asset.

The value of the asset originating the foreclosure and the relevant loan loss allowance set up as of that date are derecognized from the consolidated balance sheet.

Foreclosed assets and promised for sale are restricted to their carrying value; collections received on account of the asset are recorded as a liability. On the date of sale, the resulting gain or loss is recognized in the consolidated income statement caption "Other operating income (loss)".

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Foreclosed assets are valued according to the type of assets they represent, recording said valuation (reductions in the value) in the consolidated income statement caption "Other operating income/loss". The Institution creates additional provisions that acknowledge signs of impairment from potential value losses over time in foreclosed assets in the year's results of operations under "Other operating income/loss", which are determined by multiplying the reserve percentage applicable by the value of the foreclosed assets, based on the provisions of foreclosed assets or assets received in payment methodology of the Banking Commission, as follows:

Months elapsed from the date of foreclosure or received in lieu of payment	Reserve percentage	
	Real estate	Receivables, furniture, and equipment and investment securities
Over 6	0%	0%
More than 6 to 12	0%	10%
More than 12 to 18	10%	20%
More than 18 to 24	10%	45%
More than 24 to 30	15%	60%
More than 30 to 36	25%	100%
More than 36 to 42	30%	100%
More than 42 to 48	35%	100%
More than 48 to 54	40%	100%
More than 54 to 60	50%	100%
More than 60	100%	100%

(I) Property, plant and equipment-

Property, plant and equipment are recorded at acquisition cost. Those assets acquired before December 31, 2007 were adjusted using factors based on the UDI value from the date of acquisition through that date, which recognition of the effects of inflation on the financial information was suspended according to the MFRS.

Depreciation is calculated using the straight-line method, based on the estimated useful lives by the Institution's management of the corresponding assets.

Depreciation amount of property, plant and equipment is determined by subtracting the residual value and, as applicable, the cumulative impairment losses from the acquisition cost. The Institution periodically evaluates property, plant and equipment residual values to determine amounts to be depreciated.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The Institution evaluates periodically the net book values of property, plant and equipment, to determine whether there is an indication that these values exceed their recoverable amount. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net revenues expected to be generated by the asset. If the net book value of an asset exceeds its recoverable amount, an impairment charge is recognized in the amount by which the carrying amount of the asset exceeds the fair value of the asset.

(m) Permanent investments-

The permanent investments where there is no control, joint control or significant influence are classified as other investments, which are initially recognized and maintained valued at acquisition cost. Dividends, if any, received from these investments are recognized in consolidated statement of income caption "Other operating income", except if are from prior periods to the acquisition, in which case are decreased from the permanent investment

(n) Other assets-

This caption includes mainly prepaid expenses and commissions as well as guarantee deposits, which are recognized as an asset on the trade date considering economic future benefits for the Institution.

In case of any indication of impairment, the potential impairment loss is determined, and if the net carrying value exceeds the recoverable amount, the asset value is written down and the impairment loss is recognized in the results of operations for the year.

(o) Income taxes and employee statutory profit sharing (ESPS)-

The income taxes and ESPS payable for the year are determined in conformity with the applicable tax provisions.

Income taxes payable are presented as liability in the consolidated balance sheet; when the tax prepayments exceed the income tax payable, the difference corresponds to an account receivable.

Deferred income taxes and deferred ESPS are accounted for under the asset and liability method. Deferred taxes and ESPS assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and in the case of IT for operating loss carryforwards. Deferred tax and ESPS assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred ESPS and taxes assets and liabilities of a change in tax rates is recognized in results of operations for the period enacted.

The deferred income tax asset is periodically estimated creating, where appropriate, valuation allowance for those temporary differences which might exist an uncertain recovery.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Current and deferred income taxes and ESPS are presented and classified in the results of the period, except those that originate from a transaction that is recognized in the OCI or directly in a caption of stockholders' equity.

Current and deferred ESPS is presented in the caption "Administrative and promotion expenses", in the consolidated statement of income.

(p) Deposit funding-

This caption comprises time deposits of the money market funding, the placement of debt certificates and bank bonds. Interest is charged to expense on an accruals basis under "Interest expense". For instruments sold at a value different from their face value, the difference is recognized as a deferred charge or credit and amortized on a straight-line basis over the term of the respective instrument.

(q) Provisions-

Based on management's estimates, the Institution recognizes accruals for present obligations where the transfer of assets or the rendering of services is probable and arises because of past events.

(r) Bank and other borrowings-

Bank and other borrowings comprise short and long-term loans from domestic and foreign banks, which are recorded based on the contractual value of the obligation. Interest is recognized on accruals basis under the caption "Interest expense".

(s) Employees' benefits-

Short-term direct benefits

Short-term direct employee benefits are recognized in income of the period in which the services rendered are accrued. A liability is recognized for the amount expected to be paid if the Institution has a legal or assumed obligation to pay this amount as a result of past services provided and the obligation can be reasonably estimated.

Long-term direct benefits

The Institution's net obligation in relation to direct long-term benefits (except for deferred ESPS - see note income taxes and employee statutory profit sharing), and which the Institution is expected to pay at least twelve months after the date of the most recent consolidated balance sheet presented, is the amount of future benefits that employees have obtained in exchange for their service in the current and previous periods. This benefit is discounted to its present value.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Termination benefits

A liability is recognized for termination benefits along with a cost or expense when the Institution has no realistic alternative other than to make the corresponding payments or when the offer of these benefits cannot be withdrawn or when the conditions that require the recognition of restructuring costs are met, whichever occurs first. If benefits are not expected to be settled wholly within twelve months after the date of the most recent balance sheet presented, then they are discounted.

Defined benefit plans

In addition, the Institution has a defined benefit plan in place that covers the pensions for retirement, the seniority premiums and legal compensation to which employees are entitled in accordance with the Federal Labor Law, as well as obligations related to corresponding to plans medical benefits, food coupons and life insurance for retirees.

Irrevocable trusts have been established for all plans to manage the respective plan funds and assets.

The calculation of liabilities for defined benefit plans, held annually by actuaries using the projected unit credit method. When the calculation results in a possible asset to the Institution, recognized asset is limited to the present value of the economic benefits available in the form of future refunds from the plan or reductions in future contributions to it. To calculate the present value of the economic benefits, any minimum funding requirements should be considered.

The labor cost of current service, which represents the periodic cost of employee benefits for having completed one more year of working life based on the benefit plans, is recognized in administrative and promotional expenses. The Institution determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of estimates of contributions and benefit payments.

Modifications to the plans that affect past service cost are recognized in income immediately in the year the modification occurs, with no possibility of deferral in subsequent years. Furthermore, the effects of events of liquidation or reduction of obligations in the period that significantly reduce future service cost and/or significantly reduce the population eligible for benefits, are recognized in income of the period.

Remeasurements generated as from January 1, 2016 (before actuarial gains and losses) resulting from differences between the projected and actual actuarial assumptions at the end of the period, are recognized when incurred as part of OCI within stockholder's equity and is subsequently recycled to the results of the period, based on the average remaining working life of the employees.

According to the resolution published on December 31, 2015 by the Banking Commission, modifications to the plans and remeasurements accumulated until December 31, 2015, are gradually recognized from 2021 to the next four years, recognizing 20% from its initial application and 20% in each of the subsequent years.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(t) Revenue recognition-

Interest on loans granted including the interbank loans fixed to a term less than or equal to three business days, is recorded in income as earned. Interest on past-due loans is recognized in income upon collection.

The interest collected in advance and loan origination fees are recorded within "Deferred credits and prepayments", and applied to the year's results of operations in "Interest income" and "Commission and fee income", respectively, as accrued, in the term of the loan or during a year, as applicable.

The commissions from assets in custody or under management are recognized in income when the services rendered in "Commission and fees income".

Fees on trust transactions are recognized in income as accrued in "Commission and fees income". Such revenues are not accrued when fees are 90 or more calendar days past due, and are recorded in memorandum accounts. When accrued revenues are collected, they are recorded directly in income for the year.

Fees for restructured or renewed loans are recorded as deferred credits and amortized against the results of operations for the year in "Interest income" using the straight-line method during the new term of the loan.

Commissions from intermediation by the Institution between the lender and the borrower for the contracting of loans on the markets, are recorded in the consolidated statements of income as the service is provided under the caption "Commission and fees income".

(u) Foreign currency transactions-

Foreign currency transactions are recognized at the exchange rate prevailing on the date of execution, for consolidated financial statement presentation purposes. In the cases of currencies other than dollars are translated into dollars at the exchange rates as established in the Provisions, and the dollar equivalent, together with dollar balances, are then translated into Mexican pesos using the exchange rate determined by the Central Bank.

Foreign exchange gains and losses are reflected in results of operations for the year. At the year-end close date of the consolidated financial statements, foreign currency monetary assets and liabilities are translated into pesos at the FIX exchange rate published by Central Bank, while foreign exchange gains or losses arising from foreign currency translation are recorded in the results of operations for the originating period.

(v) Memorandum accounts-

Memorandum accounts corresponds mainly to assets in custody or management and trust transactions.

Client's securities held in custody, guarantee or under management, are recorded in the corresponding memorandum accounts in accordance with the accounting criteria established by the Banking Commission, and represent the maximum expected amount at which the Institution is obliged to respond to its clients.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The amounts of the assets in custody or under management are presented in the caption "Assets in custody or under management", while the trust transactions are presented in the caption "Assets in trust or under mandate".

(w) Contingencies-

Significant liabilities or losses related to contingencies are recorded when it is probable that their effect will realize and the amount thereof can be reasonably estimated. When a reasonable estimation cannot be made, disclosure is provided in the notes to the consolidated financial statements.

Contingent revenues, earnings or assets are not recognized until their realization is assured.

(4) Accounting changes and reclassifications-

(a) Changes in the Commission's Provisions-

On December 27, 2017, several amendments to the Accounting Criteria were published in the Official Gazette of the Federation. According to said publication, said modifications become effective on January 1, 2019, allowing its early application as of January 1, 2018, for the following criteria:

Accounting Criteria B-6, "Loan portfolio" and D-2 "Income statement".

The accounting criteria applicable to the credit institutions are adjusted so that they can cancel, in the period in which they occur, the excedent in the balance of the allowance for loan losses, as well as to recognize the recovery of credits previously written off against the caption "Allowance for loan losses" in the income statement.

Derived from the foregoing, and in compliance with the provisions of the aforementioned publication, the Institution will apply the criteria described above as of January 1, 2019.

The accounting changes recognized by the Institution in 2018 are shown as follows:

MFRS C-3 "Accounts receivable"- effective for years beginning on or after January 1, 2018, with retrospective effects, except for the valuation effects that may be prospectively recognized, if it is impractical to determine the effect on each one of the prior periods presented. Some of the primary changes presented are the following:

- It provides that accounts receivable based on a contract are deemed financial instruments, while some other accounts receivable, resulting of legal or tax provisions, may have certain characteristics of a financial instrument, such as bearing interest, but are not in themselves financial instruments.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- It provides that the allowance for doubtful trade receivables shall be recognized as revenue is earned, based on the expected credit losses, and the allowance shall be recorded as an expense, separately when significant, in the statement of comprehensive income.
- It provides that, upon initial recognition, the time value of money shall be considered. Therefore, should the effect of the present value of the account receivable be significant in light of the term, an adjustment must be made taking into consideration such present value.
- It requires a reconciliation between the beginning and ending balances of the allowance for doubtful accounts for each period presented.

The adoption of this new MFRS did not generate important effects, since there are specific Criteria (B-6 "Loan portfolio" and A-2 "Application of particular rules") established by the Banking Commission

MFRS C-9 "Provisions, Contingencies and Commitments" - effective for years beginning on or after January 1, 2018. It supersedes Bulletin C-9 "Liabilities, Provisions, Contingent Assets and Liabilities and Commitments". The first-time adoption of this MFRS does not result in accounting changes in the financial statements. Some of the primary aspects covered by this MFRS include the following:

- The scope is narrowed by relocating the topic concerning accounting for financial liabilities to MFRS C-19 "Financial instruments payable".
- The definition of "liability" is modified by eliminating the qualifier "virtually unavoidable" and including the term "probable".
- The terminology used throughout the standard is updated to standardize the presentation with the rest of the MFRS.

2018 MFRS Improvements-

In December 2017, CINIF issued the document referred to as "2018 MFRS Improvements", which contains precise modifications to some current MFRS. MFRS Improvements mentioned below that entered into force for the years beginning after January 1, 2018 did not generate important effects in the Institution's consolidated financial statements or they do not apply because of the express provision of the Banking Commission.

- MFRS B-2 "Statement of cash flow"
- MFRS B-10 "Effects of inflation"
- MFRS C-6 "Property, plant and equipment" and FRS C-8 "Intangible assets"
- MFRS C-14 "Transfer and recognition of financial assets"

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Reclassifications-

The statement of cash flows for the year ended December 31, 2017 includes certain presentation reclassifications to conform it with the presentation used in 2018.

(5) Foreign currency position -

Central Bank regulations require that banks maintain balanced positions in foreign currencies within certain limits. The short or long position permitted by the Central Bank is equal to a maximum of 15% of the basic capital computed as of the third immediately preceding quarter. Therefore, as of December 31, 2018 and 2017, the Institution's position is within the authorized limits. The foreign currency position is analyzed as follows:

	Dollars			Equivalent in pesos	
	2018	2017		2018	2017
Assets	5,477	8,006	\$	107,621	157,428
Liabilities	(5,476)	(8,144)		(107,599)	(160,146)
Long (short) position	1	(138)	\$	22	(2,718)

At December 31, 2018 and 2017, the assets and liabilities in millions of foreign currency of domestic currency and valued balances are shown below:

Domestic currency:

	2018			2017		
	Assets	Liabilities	Net position	Assets	Liabilities	Net position
USD dollars	5,213	(5,216)	(3)	7,747	(7,895)	(148)
Japanese Yen	25,038	(25,038)	-	25,038	(25,036)	2
Euros	25	(21)	4	23	(22)	1
Sterling pounds	6	(6)	-	6	-	6
Special draft fees	-	-	-	1	-	1
			1			(138)

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos, except where stated different)

At December 31, 2018 and 2017, the assets and liabilities in foreign currencies translated to pesos are shown below:

	2018			2017		
	Assets	Liabilities	Net position	Assets	Liabilities	Net position
USD dollars	\$ 102,437	(102,500)	(63)	152,326	(155,240)	(2,914)
Japanese Yen	4,483	(4,483)	-	4,372	(4,372)	-
Euros	560	(482)	78	548	(512)	36
Sterling pounds	141	(134)	7	168	(8)	160
Special draft fees	-	-	-	14	(14)	-
	\$ 107,621	(107,599)	22	152,428	(160,146)	(2,718)

The exchange rate relative to the US dollar at December 31, 2018 and 2017, was \$19.6512 pesos per dollar and \$19.6629 pesos per dollar, respectively, and on the issuance date of the consolidated financial statements, it was \$19.3708 pesos per dollar.

(6) Cash and cash equivalents-

At December 31, 2018 and 2017, the caption is integrated as follows:

	2018	2017
Domestic and foreign banks	\$ 15,192	14,573
Call money	8,722	3,020
24 and 48 hours foreign currency sales	(18,469)	(2,353)
Other cash and cash equivalents (notes receivable)	1	1
Restricted funds:		
Deposits with the central bank	13,087	13,082
24, 48 and 72 hours foreign currency purchase	38,775	228
	\$ 57,308	28,551

At December 31, 2018 and 2017, deposits at the Central Bank correspond to monetary regulation deposits of \$13,087 and \$13,082, respectively, which have no maturity. The interest generated by deposits in the Central Bank at December 31, 2018 and 2017, were \$1,015 and \$889, respectively. The Provisions in force issued by the Central Bank for monetary regulation deposits set that may be comprised of cash, securities, or both.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos, except exchange rate)

At December 31, 2018 and 2017, the Institution had the following call money:

	2018			2017		
	Amount	Annual rate	Term	Amount	Annual rate	Term
Central Bank	\$ 7,722	8.25%	2 days	2,770	7.25%	4 days
Credit Suisse	18	8.25%	2 days	-	-	-
Sociedad Hipotecaria Federal, S. N. C.	982	2.5%	2 and 5 days	250	1.42%	4 days
	\$ 8,722			3,020		

At December 31, 2018 and 2017, foreign currency receivable and deliverable equivalent in pesos in connection with the purchases and sales to be settled within 24, 48 and 72 hours were negotiated in USD dollars.

At December 31, 2018 and 2017, cash and cash equivalent in foreign currency are as follows:

	Millions of domestic currency	Exchange rate	Equivalent in pesos
2018			
USD dollars	1,852	\$ 19.65120	\$ 36,393
Euros	1	22.46918	33
Sterling pounds	-	25,04742	7
			\$ 36,433
2017			
USD dollars	640	\$ 19.66290	\$ 12,593
Euros	2	23.60629	57
Sterling pounds	1	26.60489	26
			\$ 12,676

At December 31, 2018 and 2017, the profit (loss) from currencies purchase/sell transactions amounted to \$1,289 and \$(2,914), respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos, except exchange rate)

(7) Investment securities-

At December 31, 2018 and 2017, investment securities at fair value, except held to maturity, are analyzed as follows:

Trading

	2018				2017			
	Acquisition cost	Accrued interest	Valuation	Book value	Acquisition cost	Accrued interest	Valuation	Book value
Shares of Fondo de desarrollo para el mercado de valores (FDMV)	\$ 159	-	15	174	287	-	(19)	268
Bonds	276	9	(13)	272	1,787	8	8	1,803
Certificates	1,594	7	(10)	1,591	4,784	17	5	4,806
CETES	286	4	-	290	79	1	-	80
Ipabonos	160	2	-	162	5,556	62	17	5,635
Bank promissory notes	-	-	-	-	632	-	-	632
Restricted securities :								
Bonds	98,095	-	85	98,180	71,413	44	193	71,650
Certificates	26,185	1	12	26,198	14,244	9	(11)	14,242
CETES	1,936	-	(2)	1,934	-	-	-	-
Ipabonos	85,463	15	78	85,556	92,217	97	86	92,400
Bank promissory notes	673	1	-	674	2,770	1	(21)	2,750
Ipabonos	2	-	-	2	3	-	-	3
Equity investments	-	-	-	-	203	-	-	203
	\$ 214,829	39	165	215,033	193,975	239	258	194,472

Available for sale

	2018				2017			
	Acquisition cost	Accrued interest	Valuation	Book value	Acquisition cost	Accrued interest	Valuation	Book value
Sovereign debt	\$ 2,565	37	(64)	2,538	2,249	29	68	2,346
Bonds issued by credit Institution	435	3	(21)	417	236	2	6	244
Debentures and other securities	4,096	71	(252)	3,915	4,181	72	53	4,306
Securities issued by foreign entities	-	-	-	-	194	1	-	195
Equity investments	7,268	-	1,698	8,966	6,932	-	1,064	7,996
	\$ 14,364	111	1,361	15,836	13,792	104	1,191	15,087

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Held-to-maturity:

	2018			Book value	2017	
	Acquisition cost	Accrued interest	Valuation		Acquisition cost	Accrued interest
Convertible prizes bonds	\$ 5	-	5	5	-	5
Certificates	198	163	361	215	137	352
Segregable certificates	3,333	1,637	4,970	2,286	961	3,247
Sovereign debt	242	6	248	258	6	264
Debenture and other securities	881	13	894	1,192	15	1,207
Udibonos	51	23	74	51	20	71
Restricted securities:						
Segregable certificates	4,705	2,322	7,027	5,905	2,494	8,399
Total	\$ 9,415	4,164	13,579	9,912	3,633	13,545

An analysis by maturity term of the integration of securities for trading purposes, considering the acquisition cost and classification by category is shown below:

Trading

2018	Less than a month	Between one and three months	More than three months	Without term	Total
Shares of Fondo de desarrollo para el mercado de valores (FDMV)	\$ -	-	-	159	159
Bonds	-	-	276	-	276
Certificates	-	-	1,594	-	1,594
CETES	78	133	75	-	286
Ipabonos	-	-	160	-	160
Restricted securities:					
Bonds	-	-	98,095	-	98,095
Certificates	-	2,516	23,669	-	26,185
CETES	-	-	1,936	-	1,936
Ipabonos	921	-	84,542	-	85,463
Bank promissory notes	673	-	-	-	673
Securities placed in guarantee:					
Ipabonos	-	-	2	-	2
	\$ 1,672	2,649	210,349	159	214,829

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2017	Less than a month	Between one and three months	More than three months	Without term	Total
Shares of Fondo de desarrollo para el Mercado de Valores (FDMV)	\$ -	-	-	287	287
Bonds	-	3	1,784	-	1,787
Certificates	64	-	4,720	-	4,784
CETES	28	18	33	-	79
Ipabonos	40	-	5,516	-	5,556
Bank promissory notes	632	-	-	-	632
Restricted securities:					
Bonds	71,413	-	-	-	71,413
Certificates	2,654	55	11,535	-	14,244
Ipabonos	-	470	91,747	-	92,217
Bank promissory notes	105	1,171	1,494	-	2,770
Securities placed in guarantee:					
Ipabonos	-	-	3	-	3
Equity investments	203	-	-	-	203
	\$ 75,139	1,717	116,832	287	193,975

Available for sale

Securities	More than a year	
	2018	2017
Sovereign debt	\$ 2,565	2,249
Bonds issued by credit institutions	435	236
Debentures and other securities	4,096	4,181
Securities issued by foreign entities	-	194
Equity investments	7,268	6,932
	\$ 14,364	13,792

At December 31, 2018, the Institution does not hold debentures and securities with less than one-year term. At December 31, 2017, the Institution holds debentures and securities that amounts to \$406 with less than one-year term.

(Continued)

Nacional Financiera, S. N. C.,
Institución Banca de com
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Held-to-maturity:

2018		Less than one year	More than one year	Total
Convertible Prides bonds	\$	-	5	5
Certificates		-	198	198
Segregable certificates		-	3,333	3,333
Sovereign debt		-	242	242
Debentures and other securities		-	881	881
Udibonos		-	51	51
Restricted securities:				
Segregable securities		-	4,705	4,705
Total	\$	-	9,415	9,415
2017				
Convertible Prides bonds	\$	-	5	5
Certificates		17	198	215
Segregable certificates		-	2,286	2,286
Sovereign debt		-	258	258
Debentures and other securities		304	888	1,192
Udibonos		-	51	51
Restricted securities:				
Segregable securities		-	5,905	5,905
Total	\$	321	9,591	9,912

The valuation result from available for sale securities as of December 31, 2018 and 2017 recognized in Other Comprehensive Income within stockholders' equity amounted to \$(202) and \$108, net of deferred income tax, respectively.

For the years ended December 31, 2018 and 2017, net gains from interest income, trading income and valuation gain (loss) from investments securities are as follows:

		2018	2017
Interest income	\$	1,759	2,946
Valuation gain		311	167
Trading income		92	127

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

For the years ended December 31, 2018 and 2017, the Institution has not made reclassifications from held to maturity to available for sale, or from trading securities to available for sale.

Issuers over 5% of institution's net capital-

At December 31, 2018 and 2017, investments in non-governmental debt securities of the same issuer and exceeding 5% of the Institution's net capital are analyzed below:

2018

Issuer	Serie	Number Of securities	Annual Average rate	Average term	Amount
FEFA	Various	108,386,107	8.33%	2	\$ 10,890

2017

Issuer	Series	Number of securities	Annual average rate	Average Term	Amount
FEFA	Various	165,520,000	7.45%	569	\$ 15,689
SHF	14001	14,993,409	6.08%	781	1,473
PEMEX	Various	138,200	5.05%	1,795	2,948

(8) Repurchase/resell agreements -

At December 31, 2018 and 2017 the "Debtors on repurchase/resell agreements" and "Creditors on repurchase/resell agreements" balances in which the Institution acts as buyer or as seller, are analyzed in the following page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

	Debtors on repurchase/resell agreements		Creditors on repurchase/resell agreements	
	2018	2017	2018	2017
Government securities:				
Udibonos	\$ -	-	-	(1,965)
Segregable certificates	540	-	(6,676)	(8,077)
Bonds	6,898	12,555	(98,095)	(64,536)
Fix rate bonds	1,650	2,001	-	(4,956)
Ipabonos	5,637	850	(85,478)	(92,315)
Cetes	2,341	-	(1,936)	-
Subtotal	17,066	15,406	(192,185)	(171,849)
Banking securities:				
Certificates	-	-	(1,495)	(15,747)
Bank promissory notes	-	-	(252)	(1,172)
Subtotal	-	-	(1,747)	(16,919)
Other debt securities				
Certificates	-	-	(24,691)	-
Collateral sold or pledged as a guarantee (creditors):				
Segregables certificates	(540)	-	-	-
Bonds	(6,898)	(9,837)	-	-
Fix rate bonds	(1,650)	(2,001)	-	-
Bpag28	(950)	-	-	-
Bpag91	(3,000)	-	-	-
Cetes	(2,341)	-	-	-
Ipabonos	(1,687)	(850)	-	-
	(17,066)	(12,688)	-	-
Debtors (creditors) on repurchase/resell agreements	\$ -	2,718	(218,623)	(188,768)

At December 31, 2018 the terms of resell/repurchase agreements, vary between 1 and 57 days (1 and 84 days at December 31, 2017) with annual weighted rates of 8.25% acting as repurchase and 8.28% acting as repurchaser in 2017.

During the years ended December 31, 2018 and 2017, interest income amounted to \$21,796 and \$15,286, respectively; interest expense amounted to \$17,104 and \$14,781, respectively, and are included in the consolidated income statement under the caption of "Interest income" and "Interest expense", respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(9) Derivatives-

At December 31, 2018 and 2017, the fair value of derivative financial instruments for trading and hedging purposes, recognized under the caption "Derivatives", is analyzed as follows:

2018	Assets	Liabilities	Balance	
			Debit	(Credit)
Trading purposes:				
Swaps	\$ 55,632	(55,698)	-	(66)
Hedging purposes:				
Swaps	\$ 38,885	(46,809)	-	(7,924)
2017				
Trading purposes:				
Forward contracts	\$ 84,078	(82,667)	1,411	-
Swaps	(316)	790	474	-
	83,762	(81,877)	1,885	-
Swaps	55,854	(55,934)	-	(80)
Total	139,616	(137,811)	1,885	(80)
Hedging purposes:				
Swaps	\$ 38,870	(46,575)	-	(7,705)

The Institution participates in the Mexican Derivatives Market (MEXDER), through trading shares, CPI, interest rates and currency futures, and interest rate and currency swaps in accordance with the authorization granted by the Central Bank.

In the case of over-the-counter dollar-peso forwards, the master agreement does not establish maintaining guarantees, instead it does apply penalties on the nonperforming counter party. The exchange and interest rates futures and forward contracts carried out by the Institution are oriented to obtain earnings for the Institution.

In the case of dollar-peso forward for trading purposes, the fair value represents the amount that two parties agree to exchange, based on sources of information that affect the prices of these operations.

The Institution through the Risk Management Committee performs various analyses on underlying markets for derivative instruments that are traded in order to identify and assess the inherent risks. Operations with futures and forward contracts, involve recovery risks. To reduce the risks in the operation of these instruments, the institution maintains matched positions.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Futures and forward contracts:

Trading purposes (fair value):

	2017
Sales:	
Contract value	\$ 82,667
Receivable	\$ 81,877
Purchases:	
Contract value	\$ 84,078
Deliverable	\$ 83,762
Valuation	\$ 474

Swaps:

Trading purposes:

		Contract value	Receivable	Deliverable	Net position
2018					
Interest rate	\$	152,952	55,632	55,698	(66)
2017					
Interest rate	\$	172,462	55,854	55,934	(80)

Hedging purposes:

2018	\$	101,368	38,885	46,809	(7,924)
2017	\$	84,844	38,870	46,575	(7,705)

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

At December 31, 2018 and 2017, hedge effectiveness/ineffectiveness derived from the application of the B-5 criterion "Derivatives and hedging transactions" of the Banking Commission, is detailed below:

The net effect of the valuation of the hedged position and the fair value hedge Swaps (with impact in profit and loss):

	2018	2017
Ineffectiveness for:		
Deposit funding hedging	\$ (42)	(18)
Investments hedging	25	9
Total	\$ (17)	(9)

At December 31, 2018 and 2017, the Institution has only contracted fair value hedge swaps.

Trading Swaps (with impact in income statement):

	2018	2017
Interest rate	\$ (66)	(80)

The adjustments to the book value arising from interest rate hedges derivative transactions on financial assets and liabilities, due to the application of the criterion B-5 "Derivatives and hedging transactions" of the Banking Commission, at December 31 2018 and 2017, are detailed below:

	2018		2017	
	Asset	Liability	Asset	Liability
Deposit funding hedging	\$ 6,803	(1,035)	16,082	(11,226)
Investments hedging	(1)	-	-	-
Loan portfolio hedging	(933)	151	(788)	23
Total	\$ 5,869	(884)	15,294	(11,203)

The net gain (loss), for the years ended December 31, 2018 and 2017, recognized in the consolidated income statement derived from the valuation of instruments used for fair value hedging purposes, amounted to \$(883) and \$(277), respectively. The effect of the gain related to the valuation of the effective hedge portion for the year ended December 31, 2018 and 2017 amounted to \$876 and \$311, respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Use of derivative financial instruments policy management (unaudited)-

The Institution's policies allow the use of derivative instruments for hedging and trading purposes. The main objectives of the operation of these instruments is risk hedging and the generation of revenues that support the Institution's profitability. The establishment of objectives and policies related to the operation of these instruments are included in the Risk Management regulatory and operational manuals.

Derivative financial instruments used by the Institution are interest rate and currency swaps, CPI and interest rate futures, as well as exchange rate forwards, which, according to the portfolio, can support hedging and trading strategies.

Derivative financial instruments are traded in over-the-counter markets and recognized stock markets. Eligible counterparties for the OTC derivatives are mainly domestic and foreign banks, whereas for derivatives traded in stock markets, the counterparty is the clearing house.

Processes and levels of authorization-

Control processes, policies and levels of authorization for transactions with derivatives are set forth in the Integral Risk Management Committee (IRMC), whose duties include approval of:

- The specific limits for discretionary risks, when it has been empowered by the Board of Directors therefor, as well as the levels of tolerance in the case of non-discretionary risks.
- The methodology and procedures for identifying, measuring, overseeing, limiting, controlling, reporting and disclosing the different types of risk that the Institution is exposed to, as well as their eventual modifications.
- The models, parameters and scenarios that must be used to value, measure, and control the risks proposed by the Risk Management area, must concur with the Institution's technology.
- The methodologies for identifying, valuing, measuring and controlling the risks of the new operations, products, and services that the Institution plans to offer to the market.
- The corrective actions proposed by the Integral Risk Management area.
- The assessment of aspects of Integral Risk Management referred to in Article 77 of the Provisions for its presentation to the Board of Directors and the Banking Commission.
- The Integral Risk Management manuals, in accordance with the objectives, guidelines, and policies established by the Board of Directors, referred to in the last paragraph of Article 78 of the Provisions.

All the new products or services traded in relation with any line of business are approved by the Committee, in accordance with the powers granted by the Board of Directors.

(Continued)

Nacional Financiera, S. N. C.,
 Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Independent reviews-

The Institution is under the supervision and monitoring of the Banking Commission and the Central Bank, which is performed through processes of monitoring, inspection visits, requirements of information and documentation, and delivery of reports. There are also periodic reviews by the internal and external auditors.

Generic description of valuation techniques-

Derivative financial instruments are valued in accordance with the criterion B-5 "Derivatives and hedging transactions" issued by the Banking Commission.

Valuation methodology-

1. For derivatives with trading and hedging purposes - there is a structure of operating and regulatory manuals that set forth the valuation methodologies used.
2. The reference inputs used in the valuation process are used by convention in the market practices (rates, exchange rates, prices, volatilities, etc.).
3. The frequency of valuation of derivative financial instruments for trading purposes is daily.

The internal and external sources of liquidity used to meet requirements related to derivative financial instruments are national and international treasury (London Branch).

Changes in identified risk exposure, contingencies and known or expected events in derivative financial instruments-

Stress tests and backtesting are performed on a regular basis to estimate the impact on derivatives instruments positions and to validate statistically that the market risk measurement models provide results consistent with the exposure to the market variability, which must be maintained within the parameters approved by the IRMC.

The methodology currently used for preparing stress measurement report, consists of calculating the current portfolio value, having ability to apply changes in risk factors occurring in:

- Tequila Effect (1994)
- Russian Crisis (1998)
- Twin Towers (2001)
- Mexican Stock Exchange Effect (2002)
- Effect on Real Interest Rate (2004)
- Mortgage Crisis Effect (2008)
- USA Elections effect (2016).

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Backtesting tests are based on the daily generation of the following information:

- Valuation of the investment portfolio at day t.
- The VaR of the investment portfolio with a time horizon of 1 day and with a level of confidence of 97.5% (VaR).
- The portfolio valuation with the new risk factors at day t+1.

During 2018, the number of derivative financial instruments traded was the following:

Instrument		Number of transactions		Notional	
		Trading	Hedging	Trading	Hedging
Futures	(1)	47	-	60,815	-
Forwards (Arbitrations)	(2)	741	-	36,105	-
Swaps	(3)	31	96	14,130	29,522

- (1) The number of transactions is equal to purchase transactions minus sales. Notional refers to number of contracts: 30,384 of purchase and 30,431 sales.
- (2) Purchasing transactions. Notional in millions of US dollars.
- (3) Notional amount traded during the year.

During 2017, the number of derivative financial instruments traded was the following:

Instrument		Number of transactions		Notional	
		Trading	Hedging	Trading	Hedging
Futures	(1)	350	-	60,284	-
Forwards (Arbitrations)	(2)	216	-	23,828	-
Swaps	(3)	83	109	67,930	26,797

- (1) The number of transactions is equal to purchase transactions minus sales. Notional refers to number of contracts: 30,317 of purchase and 29,967 sales.
- (2) Purchasing transactions. Notional in millions of US dollars.
- (3) Notional amount traded during the year.

Formal documentation of hedges-

In order to comply with the applicable regulations with respect to derivatives and hedging transactions (Criterion B-5 issued by the Banking Commission), the Institution has a hedge file that includes the information shown in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- I. File cover letter.
- II. Authorization of the hedge.
- III. Diagram of the strategy.
- IV. Evidence of prospective tests of hedge effectiveness.
- V. Evidence of execution of the derivative.
- VI. Details of the primary position being hedged.
- VII. Derivative confirmation.

Sensitivity analysis-

A sensitivity analysis is performed through different measures every day, such as:

- 1. Duration.- There are primarily two types of duration with different meanings:
 - a) Macaulay Duration: It is the weighted average maturity of the current cash flow values where weighting ratios are the time in years up to the payment of the corresponding flow.
 - b) Modified Duration: It is the percentage variation experienced by the price of a bond in light of small variations in the market interest rate.
- 2. Convexity.- It is the variation experienced by the slope of a curve with respect to a dependent variable, i.e., it measures the variation experienced, by the duration when rates change.
- 3. Greeks- Sensitivity measurements for options, except for interest rate options:
 - a) Delta: Price Sensitivity for options at the price of the underlying of the option.
 - b) Theta: Price Sensitivity of options to the time variable.
 - c) Gamma: Third degree price sensitivity of the option to the underlying of the option.
 - d) Vega: Price Sensitivity of the option in response to volatility used for its valuation.
 - e) Rho: Price Sensitivity of the option in response to changes in interest rate.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

4. Beta- It is the measurement of the systematic risk of a share.

This analysis is reported to the instances that define the operating strategy of derivatives on financial markets and operators therein, in order for them to set their criterion in risk taking with these instruments.

(10) Loan portfolio-

(a) Classification of loan portfolio by currency

At December 31, 2018 and 2017, the classification of loans into current and past due by currency (valued in local currency), is analyzed as follows:

	Local currency	2018 Foreign currency	Total	Local currency	2017 Foreign currency	Total
Current portfolio:						
Business or comercial activity loans	21,374	40,298	61,672	16,368	35,365	51,733
Financial institutions loans	165,859	14,173	180,032	149,820	8,780	158,600
Government entities loans	17,035	12	17,047	16,045	22	16,067
Consumer loans	5	-	5	8	-	8
Mortgage loans	104	-	104	119	-	119
Loans granted as agent of the Federal Government	-	29	29	-	65	65
Subtotal	204,377	54,512	258,889	182,360	44,232	226,592
Past due portfolio:						
Business or comercial activity loans	-	509	509	-	575	575
Financial institutions loans	228	-	228	1,284	-	1,284
Consumer loans	2	-	2	2	-	2
Mortgage loans	4	-	4	6	-	6
Subtotal	234	509	743	1,292	575	1,867
Total loan portfolio	204,611	55,021	259,632	183,652	44,807	228,459

Loans granted by the Institution acting as a financial agent, correspond to financing granted to Federal Government entities with resources obtained from international organizations for this particular purpose, which are presented in the loan portfolio.

Loans to financial institutions are granted to banking and non-banking entities through the discount of documents from individuals and entities engaged in business activities.

At December 31 2018 and 2017, the Institution has no loan portfolio subject to support program promoted by the Federal Government.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(b) Classification of loan portfolio by economic sector-

At December 31, 2018 and 2017, credit risk, classified by economic sector and the percentage of concentration are analyzed as follows:

	2018		2017	
	Amount	%	Amount	%
Federal Government	\$ 41	0.02	88	0.03
Decentralized agencies and state-owned enterprises	12,530	4.83	11,540	5.05
State productive enterprises	4,505	1.74	4,504	1.97
Comercial banks	66,050	25.44	53,890	23.59
Other public financial brokers	1,055	0.41	1,224	0.54
Other private financial brokers	113,155	43.58	104,770	45.86
Domestic companies	62,181	23.94	52,308	22.9
Private parties	115	0.04	135	0.06
	\$ 259,632	100	228,459	100

(c) Additional loan portfolio information-

Annual weighted lending rates (unaudited):

During 2018 and 2017, annual weighted rates not audited, were as follows:

	2018	2017
Commercial loans*	9.62%	8.27%
Consumer	4.81%	4.36%
Mortgages	4.96%	3.25%
Excluded	2.70%	2.54%

* Includes commercial, financial and government entities loans.

Restructured loans:

At December 31, 2018 and 2017, restructured and renewed loans are analyzed as follows:

2018	Current portfolio	Past due portfolio	Total
Commercial loans	\$ 4,962	507	5,469
Financial entities	92	-	92
Mortgage	1	-	1
	\$ 5,055	507	5,562

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2017		Current portfolio	Past due portfolio	Total
Commercial loans	\$	46	-	46
Financial entities		191	-	191
	\$	237	-	237

For the years ended December 31, 2018 and 2017, interests arising from restructured loans amounted to \$159 and \$21, respectively.

At December 31, 2018, no renewed loans were recorded.

Risk Concentration (unaudited):

At December 31, 2018, the Institution has thirty-one economic group debtors that exceeded 10% of its basic capital. The amount of funding to these groups is \$186,862, and represent 6.64 times the amount of basic capital as of December 2018. At December 31, 2017, the Institution had twenty-three group debtor that exceeded such limit totaling \$143,130 and represented 6.42 times the amount of the basic capital as of September, 2017. The balance of the loans granted to the three largest borrowers as of December 31, 2018 and 2017, amounts to \$41,162 and \$55,752, respectively.

Past-due portfolio:

An analysis of past-due loans at December 31, 2018 and 2017, from the date the loans were considered past due are summarized in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

	1 to 180 days	181 to 365 days	Over 2 years	Total
2018				
Commercial*	\$ 737	-	-	737
Consumer	1	-	1	2
Mortgage	2	-	2	4
	\$ 740	-	3	743
2017				
Commercial*	-	-	1,859	1,859
Consumer	1	-	1	2
Mortgage	4	1	1	6
	\$ 5	1	1,861	1,867

* Includes commercial, financial and government entities loans.

The movement in the past-due loan portfolio for the years ended December 31, 2018 and 2017, is summarized below:

	2018	2017
Balance at beginning of year	\$ 1,867	2,178
Settlements	(349)	(8)
Write-offs	(1,284)	(275)
Transfer from performing to nonperforming portfolio	443	-
Foreign exchange fluctuation	66	(28)
	\$ 743	1,867

At December 31, 2018 and 2017 the past-due loan portfolio is comprised of 37 and 38 former employees respectively and 2 companies, in both years, which are in a judicial or extra-judicial process.

The interests on the past due loan portfolio not recognized in net income amounted to \$20 for the year ended December 31, 2018 (\$168 in 2017), these are recorded in memorandum accounts.

For the years ended December 31, 2018 and 2017, the Institution recorded write-offs from those past due loans that had been fully reserved, for a total of \$1,284 and \$275, respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The effect derived from the suspension of the accrual of interest on the nonperforming loans, represented a decrease that amounts to \$148 compared to 2017; this is due to adjustments to balances recognized due to borrowers that went into commercial bankruptcy.

For the years ended December 31, 2018 and 2017, the Institution had no recoveries from written off loans.

Impaired loan portfolio:

In accordance with criterion B-6, "Loan portfolio", of the Provisions, commercial loans, are deemed impaired loan when it is determined that, based on current facts and information, as well as the review process of such loans, there is a significant likelihood of them not being entirely recovered (whether their principal component or interest) in accordance with the terms and conditions originally agreed. Both the current and non-performing portfolio may be identified as an impaired portfolio.

At December 31, 2018 and 2017, the impaired portfolio is summarized below:

	Risk grade			Allowance recorded
	D	E	Total	
2018				
Current	\$ 180	-	180	81
Past-due	-	737	737	616
Total	\$ 180	737	917	697
2017				
Current	\$ 235	-	235	106
Past-due	-	1,859	1,859	1,521
Total	\$ 235	1,859	2,094	1,627

Interest and commissions from the loans portfolio at December 31, 2018 and 2017, are integrated as shown in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2018	Interest	Commissions from loans granted	Total
Business or commercial activity loans	\$ 3,782	77	3,859
Financial institutions loans	12,749	55	12,804
Government entities loans	1,330	-	1,330
Mortgage loans	4	-	4
Loans granted as Federal Government Financial agent	1	-	1
	\$ 17,866	132	17,998
<hr/>			
2017			
Business or commercial activity loans	\$ 2,577	37	2,614
Financial institutions loans	10,189	42	10,231
Government entities loans	1,085	-	1,085
Mortgage loans	4	-	4
Consumer loans	1	-	1
Loans granted as Federal Government Financial agent	2	-	2
	\$ 13,858	79	13,937

The average weighted term for the amortization of commissions collected on the granting of loans is one month.

Adjustment from valuation of financial asset hedging:

The fair value hedges of interest rate risk of a portion of a portfolio comprised of financial assets, could generate an adjustment to the carrying amount of the hedged item, from the gain or loss recorded in the consolidated income statement and presented under the valuation adjustments from hedging of financial assets caption.

At December 31, 2018 and 2017, the adjustment to the carrying value of the loan portfolio from the gain or loss recognized in results of operations for the year is presented under the caption "Valuation adjustment from hedging of financial assets" in the consolidated balance sheet for \$5,870 and \$15,294, respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(d) Allowance for loan losses-

At December 31, 2018 and 2017, as a result of the application of the rating methodology, the probability of default and loss given default by type of loan portfolio, obtained as weighted average (unaudited) of the exposure to default, are as follows:

Portfolio type	Probability of default	Loss given default	Exposure to default
2018			
Commercial	2.18%	44.89%	\$ 340,859
Mortgage	7.86%	20.76%	108
Consumer	37.85%	83.91%	7
Exempt	-	-	\$ 29
2017			
Commercial	2.42%	45.02%	\$ 302,205
Mortgage	7.99%	17.62%	125
Consumer	27.30%	83.28%	10
Exempt	-	-	\$ 65

The parameters are weighted on the loans of each of the portfolios. Exposure to default shown for credit includes credit commitments.

In accordance with the provisions for the loan portfolio rating, for development banking institutions, the loan portfolio under the responsibility of the Federal Government and the discounting of development banking entities, is not subject to the creation of allowance for loan losses, since these entities assume the credit risk. The balances of the loan portfolio and contingent operations subject to rating are controlled in memorandum accounts and are rated based on the methodologies established by the Banking Commission.

At December 31, 2018, the credit rated loan portfolio and allowance for loan losses, are analyzed in the following page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Credit rated portfolio

Grade of risk	Business or commercial	Financial institutions	Government entities	Consumer	Mortgage	Total
A-1	\$ 132,302	70,297	17,047	1	72	219,719
A-2	6,135	39,277	-	1	10	45,423
B-1	1,429	44,045	-	1	3	45,478
B-2	1,826	4,290	-	-	7	6,123
B3	1,062	22,075	-	1	5	23,143
C-1	43	44	-	-	4	91
C-2	19	5	-	-	3	27
D	223	-	-	1	3	227
E	513	227	-	2	1	743
Total	143,552	180,260	17,047	7	108	340,974
Exempted portfolio:						
Federal Government						29
Total portfolio					\$	341,003

Allowance for loan losses

Grade of risk	Business or commercial	Financial institutions	Government entities	Consumer	Mortgage	Total
A-1	\$ 654	479	85	-	-	1,218
A-2	65	514	-	-	-	579
B-1	25	745	-	-	-	770
B-2	45	101	-	-	-	146
B3	32	606	-	-	-	638
C-1	3	2	-	-	-	5
C-2	2	1	-	-	-	3
D	95	-	-	-	-	95
E	509	107	-	2	2	620
Total	1,430	2,555	85	2	2	4,074
Exempted portfolio:						
Additional reserves recognized by the Banking Commission						332
Allowance for assignment of lines of guarantees						2,673
Total					\$	7,079

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

At December 31, 2017, the credit rated loan portfolio and the allowance for loan losses, are analyzed as follows:

Credit rated portfolio

Grade of risk	Business or commercial	Financial institutions	Government entities	Consumer	Mortgage	Total
A-1	\$ 105,762	63,939	16,067	1	95	185,864
A-2	9,882	66,137	-	2	10	76,031
B-1	2,414	6,878	-	1	3	9,296
B-2	1,542	23,218	-	1	-	24,761
B3	1,042	2,841	-	1	5	3,889
C-1	27	300	-	1	4	332
C-2	13	22	-	-	4	39
D	231	27	-	1	2	261
E	579	1,284	-	2	2	1,867
Total	121,492	164,646	16,067	10	125	302,340
Exempted portfolio:						
Federal Government						65
Total portfolio						\$ 302,405

Allowance for loan losses

Grade of risk	Business or commercial	Financial institutions	Government entities	Consumer	Mortgage	Total
A-1	\$ 515	363	80	-	-	958
A-2	109	807	-	-	-	916
B-1	39	114	-	-	-	153
B-2	38	499	-	-	-	537
B3	30	103	-	-	-	133
C-1	2	21	-	-	-	23
C-2	2	2	-	-	1	5
D	100	12	-	-	-	112
E	577	946	-	2	1	1,526
Total	1,412	2,867	80	2	2	4,363
Exempted portfolio:						
Additional reserves recognized by the Banking Commission						536
Allowance for assignment of lines of guarantees						2,117
Total						7,016

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The movement in the allowance for loan losses for the years ended December 31, 2018 and 2017 is summarized as follows:

	2018	2017
Balance at beginning of year	\$ 7,016	5,639
Provision charged to results of year	2,814	2,638
Provisions, write-offs and others	(1,289)	(287)
Allowance cancellation	(1,469)	(930)
Exchange rate fluctuations	7	(44)
Balance at end of year	\$ 7,079	7,016

(11) Other accounts receivable, net-

At December 31, 2018 and 2017, other accounts receivable, are shown below:

	2018	2017
Loans to Institution's personnel	\$ 2,912	2,659
Clearing accounts	-	2,272
Other receivables	1,045	800
Receivables for fees on current trading activities	96	93
Payments receivable on swap trades	12,360	11,402
	16,413	17,226
Allowance for write-offs of other receivables	(957)	(665)
Total	\$ 15,456	16,561

(12) Foreclosed assets-

At December 31, 2018 and 2017, foreclosed assets are analyzed as follows:

	2018	2017
Property	\$ 30	30
Furniture, securities and foreclosed rights	20	30
	50	60
Allowances for impairment	(47)	(56)
Balance at end of year	\$ 3	4

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The movement of the allowance for impairment for the years ended December 31, 2018 and 2017 is analyzed as follows:

	2018	2017
Balance at beginning of year	\$ (56)	(54)
Additional provisions due to aging recorded in profit and loss of the year	-	(2)
Provisions on sale of foreclosed assets and write-offs	9	-
Balance at end of year	\$ (47)	(56)

In conformity with the Provisions, additional reserves have been recorded for foreclosed assets in judicial or extra-judicial process or received in lieu of payment.

(13) Property, plant and equipment -

Property, plant and equipment at December 31, 2018 and 2017 are analyzed as follows:

Concept		2018			2017		
		Cost	Restated	Total	Cost	Restated	Total
Property	\$	339	1,892	2,231	310	1,941	2,251
Furniture and equipment		143	97	240	143	97	240
Computer equipment		32	4	36	24	4	28
Land		8	-	8	9	-	9
Subtotal		522	1,993	2,515	486	2,042	2,528
Accumulated depreciation		(244)	(819)	(1,063)	(241)	(801)	(1,042)
Total	\$	278	1,174	1,452	245	1,241	1,486

The useful lives during which the main assets are depreciated are shown below:

	Useful life
Property	53 to 70 years
Furniture and equipment	10 years
Computer equipment	3 to 4 years

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Depreciation charged to results of operations for the years ended December 31, 2018 and 2017 amounted to \$34 and \$35, respectively.

For the years ended December 31, 2018 and 2017, there was no effect from impairment of property, leasehold improvements and adaptations.

According to the assessment carried out by the Institution's management, the residual value (except land) at December 31, 2018 and 2017 is remote.

(14) Permanent investments-

At December 31, 2018 and 2017, the shares in permanent investments, are integrated as follows:

	2018	2017
Corporación Andina de Fomento	\$ 2,576	2,578
Shares of other entities	295	229
	2,871	2,807
Investment of subsidiary companies:	29	29
Total	\$ 2,900	2,836

At December 31, 2018 and 2017, the other permanent investments are integrated as follows:

	2018	2017
Fideicomiso Asistencia Técnica en Programas de Financiamiento PYME	\$ 10	14
Fideicomiso Patronato del Centro de Diseño de México	12	14
Fideicomiso Capital Emprendedor	4	4
Total	\$ 26	32

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The movement in the permanent investments and other permanent investments at December 31, 2018 is summarized as follows:

	2018	2017
Balance at beginning of year	\$ 2,868	2,890
Equity method in the results of unconsolidated subsidiaries and affiliates	15	6
Exchange translation	-	(111)
Investments acquisition	43	123
Investments disposals	-	(40)
Balance at end of year	\$ 2,926	2,868

(15) Deposit funding-

At December 31, 2018 and 2017, the deposit-funding caption is analyzed as follows:

	2018			2017		
	Currency			Currency		
	Domestic	Foreign	Total	Domestic	Foreign	Total
Time deposits:						
Money market	\$ 140,093	3,719	143,812	72,147	62,149	134,296
Debt securities issued:						
Certificates	60,439	-	60,439	57,595	-	57,595
Bank bonds	-	44,774	44,774	-	40,670	40,670
Securities notes	-	14,358	14,358	-	14,246	14,246
	60,439	59,132	119,571	57,595	54,916	112,511
Total deposit funding	\$ 200,532	62,851	263,383	129,742	117,065	246,807

At December 31, 2018 and 2017, time deposits from the money market according to their maturity are integrated as follows:

	2018	2017
Less than one year	\$ 137,992	128,756
Between one and five years	5,153	5,153
	143,145	133,909
Accrued unpaid interest	667	387
	\$ 143,812	134,296

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

At December 31, 2018 and 2017, the unaudited average weighted interest rates and average terms in days on time deposits from money market are as follows:

(a) Time deposits from money market -

2018			
Instrument	Annual average rate	Average term in days	Amount
Stock certificates	7.99	2,780	\$ 5,153
Bank promissory notes	8.27	57	134,275
Deposit certificates in foreign currency (valued)	1.62	9	3,717
			143,145
Accrued interest			667
			\$ 143,812
2017			
Instrument	Annual average rate	Average term in days	Amount
Stock certificates	7.99	2,780	\$ 5,153
Bank promissory notes	7.11	7	66,618
Deposit certificates in foreign currency (valued)	0.24	15	62,138
			133,909
Accrued interest			387
			\$ 134,296

(16) Debt securities issued in the country-

December 31, 2018 and 2017, the Institution has issued stock certificates with par value of one hundred pesos each, under the Institution's financial program authorized by the Ministry of finance, as shown in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Issuance date	Maturity	Securities (millions)	Par value (pesos)	Interest rate	2018	2017
CEBURES settled in INDEVAL:						
03/08/2012	22/07/2022	20	100	5.69	\$ 2,000	2,000
10/12/2012	22/07/2022	20	100	5.69	2,000	2,000
22/11/2013	08/03/2024	30	100	6.55	3,000	3,000
14/03/2014	08/03/2024	47.5	100	6.55	4,750	4,750
06/06/2014	08/03/2024	40	100	6.55	4,000	4,000
26/09/2014	08/03/2024	32.5	100	6.55	3,250	3,250
17/04/2015	07/03/2025	60	100	6.15	6,000	6,000
17/04/2015	13/04/2018	10	100	3.23	-	1,000
24/08/2015	13/04/2018	30	100	3.48	-	3,000
24/08/2015	07/03/2025	40	100	6.15	4,000	4,000
10/04/2017	03/04/2020	47.5	100	8.35	4,750	4,750
12/04/2017	25/09/2026	12.5	100	6.20	1,250	1,250
27/04/2018	23/04/2021	45	100	8.26	4,500	-
02/05/2018	25/09/2026	25	100	6.20	2,500	-
Premium or discount on placement					(361)	(127)
Accrued interest payable					678	615
					42,317	39,488
CEBURES settled in Euroclear and Clearstream						
25/04/2016	17/04/2019	10	100	8.53	1,000	1,000
27/04/2016	25/09/2026	50	100	6.20	5,000	5,000
21/10/2016	17/04/2019	18	100	8.53	1,800	1,800
25/10/2016	25/09/2026	42	100	6.20	4,200	4,200
Premium or discount on placement					(79)	(88)
Accrued interest payable					140	138
					12,061	12,050
Subtotal carried forward to the next page					\$ 54,378	51,538

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Issuance date	Maturity	Securities (millions)	Par value (pesos)	Interest rate	2018	2017
Subtotal						
brought forward						
from previous						
page						
					\$ 54,378	51,538
Green bond denominated in domestic currency						
02/09/2016	01/09/2023	20	100	6.05	2,000	2,000
Accrued interest						
payable						
					39	38
					2,039	2,038
Social bond						
21/07/2017	15/07/2022	40	100	8.32	4,000	4,000
Accrued interest						
payable						
					22	19
					4,022	4,019
Total					\$ 60,439	\$ 57,595

In April 2016, were issued two stock certificates (fixed-rate and reviewable rate) under the communicative units format and under the program of syndicated auctions that the Institution has been carrying out since the end of 2013. However, there was a new feature for the fixed-rate tranche, since the necessary formalities were carried out for that instrument to be settled through Euroclear or Clearstream, allowing the participation of foreign investors and seeks to increase the investors base.

Additionally, in September 2016, the Institution issued its second green bond, through a transaction in the local market, denominated in pesos and with a seven years term. The placement had diversification of investors, which positioned the Institution again as a leading in this type of initiatives to promote the transition toward a competitive, sustainable economy and low carbon emissions. The demand was close to \$6,000 (2.92. times) and the final placement amounted to \$2,000 which was initially used to finance three projects, two mini-hydroelectric plants and an eolian park located in Nayarit and Puebla, respectively. The issuance was also highlighted by the support of the second opinion from Sustainalytic. This marks the beginning of Green bonds in Mexico since it is the first issue in pesos of this type.

In July 2017, the Institution placed the first social bond listed in the Mexican Stock Exchange. The demand of this transaction amounted to \$13,373 (3.34 times) and the final placement amounted to \$4,000 and 6.68 times the target amount that was \$2,000. The placement rate had a difference compared with TIIE rate of 28 days less 2 points basis with a term of 5 years. The rating for this placement was AAA (or its equivalent) at local level by 5 rating agencies S & P, Moody's, Fitch, DBRS and HR.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The Institution's social bond is aligned with the social bonds principles 2017 of the International Capital Market Association ("ICMA"), due to the nature of the eligibility criteria for the programs and populations target. Additionally, contributes to the objectives of development sustainable (ODS) of the United Nations, in order to reduce the poverty, inclusive education, gender equality, worthy employment and sustainable and inclusive economic growth. The social bond had a second opinion from Sustainalytics B.V., firm provider of research and analysis of environmental and social governance which assessed the instrument to ensure that it is aligned with social bonds principles.

Valuation adjustments from financial liabilities hedging

The fair value hedges of interest rate risk of a portion of a portfolio comprised of financial liabilities could generate an adjustment to the carrying amount of the hedged item, from the gain or loss recorded in the consolidated income statement and presented under valuation adjustments for financial liabilities hedging.

At December 31, 2018 and 2017, the loss (gain) recognized in results of operations for the year is presented under the caption "Valuation adjustment from hedging of financial liabilities" in the consolidated balance sheet for \$884 and \$11,203, respectively.

(17) Credit securities issued abroad-

Bank bonds:

At December 31, 2018 and 2017, the bank bonds balance amounts to \$44,774 and \$40,670, respectively. The current balances of securities placed by the Institution abroad, as shown below:

2018

Currency	Securities	Balance in foreign currency in millions	Interest	% Average rate	Balance in local currency	Term
US dollars	73	2,145	141	2.2630	\$ 42,312	Less than one year
	5	125	7	2.9445	2,462	Over one year
					\$ 44,774	

2017

US dollars	120	1,889	4	1.37323	\$ 37,222	Less than one year
	6	174	1	1.58250	3,448	Over one year
					\$ 40,670	

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of pesos, except where stated different)

Stock notes:

At December 31, 2018 and 2017, the current balance of this caption for \$14,358, and \$14,246, respectively, is integrated as follows:

2018

Currency	Balance in foreign currency (millions)	% Average Rate	Balance in local currency	Term
2018				
US dollars	500	3.375	\$ 9,826	5 years
Japanese yen	10,000	0.78	1,791	5 years
Japanese yen	15,000	0.66	2,686	5 years
Premium or discount on placement			(6)	
Accrued interest			61	
			\$ 14,358	

2017

US dollars	500	3.375	\$ 9,831	5 years
Japanese yen	10,000	0.78	1,746	5 years
Japanese yen	15,000	0.66	2,620	5 years
Premium or discount on placement			(8)	
Accrued interest			57	
			\$ 14,246	

(18) Bank and other borrowings -

At December 31, 2018 and 2017, bank and other borrowings are comprised as shown in the next page.

	2018	2017
Multinational and governmental agencies:		
World Bank	\$ 983	983
Inter-American Development Bank	6,907	7,080
Others	5,954	4,025
	13,844	12,088
Banking institutions	6,927	5,285
Other borrowings	10,328	8,003
Accrued interest	36	25
	\$ 31,135	25,401

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

At December 31, 2018 and 2017, maturity term less than one year amount to \$18,743 and \$12,816, respectively.

At December 31, 2018, bank and other borrowings based on their maturity dates are integrated as follows:

Financial Agency	Average rate	Average term to maturity (residual)	Millions in Foreign currency	Local currency
Due on demand				
Local currency	8.15	2 days	10,328	\$ 10,328
Short term				
Us dollars:				
Commercial banking	2.3970	327 days	111	2,178
NF BID Cclip 2226 oc Me desarrollo	3.4200	365 days	5	98
NF BID Cclip 2843/ oc Me prog linea Cred Condicional	3.4200	365 days	5	98
Instituto de Crédito Oficial	1.5000	365 days	1	20
Corporación Andina de Fomento	2.7455	39 days	300	5,896
Euros:				
Commercial banking	1.2433	365 days	3	70
Financial agent				
Euros:				
Inter-American Development Bank Washington D.C.	3.0000	365 days	-	19
Interest			1	36
Total				\$ 8,415

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and subsidiaries

Notes to the Consolidated Financial Statements

(Millions of pesos, except where stated different)

Financial Agency	Average rate	Average term to maturity (residual)	Millions in Foreign currency	Local currency
Long term				
Us dollars:				
Commercial banking	2.4296	7 years/ 10 months	225	\$ 4,417
Instituto Comercial de Crédito	1.3333	2 years/ 3 months	2	38
NF BID Cclip oc Me Desarrollo	3.4200	15 years/ 5 months	78	1,523
NF ctf BIRF 98062 Programa de Sustitución de Electrodomésticos	0.7500	10 years/ 8 months	50	983
2631 tc Me Programa de Financiamiento de Energías Renovables	0.7500	12 years/ 6 months	70	1,376
NF BID Cclip/oc-Me Programa Línea de Créditos	3.4200	18 years/ 4 months	93	1,818
NF BID 3237/oc-Me Programa Financiamiento Impulso Cogeneración	3.4200	20 years/ 5 months	100	1,965
Euros:				
Commercial banking	1.3190	3 years/ 10 months	12	262
Financial agent				
Euros:				
Inter-American Development Bank Washington D.C.	3.0000	1 year/ 3 months	-	10
Total				\$ 12,392

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of pesos, except where stated different)

At December 31, 2017 bank and other borrowings maturity dates are integrated as follows:

Financial Agency	Average rate	Average term to maturity (residual)	Millions in Foreign currency	Local currency
Due on demand				
Local currency	7.15	2 days	8,003	\$ 8,003
Interest			3	3
Total				\$ 8,006
Short term				
Us dollars:				
Commercial banking	1.7633	122 days	29	\$ 576
NF BID Cclip 2226 oc Me desarrollo	2.3300	166 days	5	98
Instituto de Crédito Oficial	2.3300	135 days	2	49
Corporación Andina de Fomento	1.3333	120 days	1	20
	1.5681	19 days	200	3,933
Euros:				
Commercial banking	1.4588	341 days	3	78
				4,754
Financial agent				
Euros:				
Inter-American Development Bank	3.0000	102 days	1	20
Special draft fees:				
International Agricultural Development Fund	2.0800	213 days	-	14
Interest				22
Total				\$ 4,810

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of pesos, except where stated different)

Financial agency	Average rate	Average term to maturity (residual)	Millions in Foreign currency	Local currency
Long term				
US dollars:				
Commercial banking	2.1671	9 years/10 months	218	\$ 4,285
Instituto Comercial de Crédito	1.3333	3 years/3 months	3	59
NF BID Cclip oc Me Desarrollo Pymes Pemex	2.3300	17 years/5 months	83	1,622
NF ctf BIRF 98062 Programa de Sustitución de electrodomésticos	0.7500	12 years/8 months	50	983
2631 tc Me Programa de Financiamiento de Energías Renovables	0.7500	14 years/6 months	70	1,376
NF BID Cclip/oc-Me Programa Línea de Créditos Condicional Me-x1010	2.3300	20 years/4 months	98	1,917
NF BID 3237/oc-Me Programa Financiamiento Impulso Cogeneración	2.3300	22 years/5 months	100	1,966
Euros:				
Commercial banking	1.4220	4 years/9 months	15	346
Financial agent				
Euro:				
Inter-American Development Bank Washington DC	3.0000	2 years/3 months	1	31
Total			\$ 12,585	

The accounts of credits obtained not drawn down (note 23e) represents the lines of credit granted to the Institution not exercised at year-end, and is analyzed in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

	2018	2017
Central Bank	\$ 209	210
Kreditanstalt Fur Wiederaufbau Frankfurt	724	760
Banco Interamericano de Desarrollo	1,686	1,687
Total	\$ 2,619	2,657

(19) Other accounts payable-

At December 31, 2018 and 2017, caption is analyzed as follows:

	2018	2017
Payables for cash collateral received	\$ 1,634	1,109
Sundry creditors	775	1,235
Employee benefits payable	7	306
Income taxes payable	436	253
Employee statutory profit sharing payable	332	275
Clearing accounts	20,358	-
Other accounts payable	155	125
Deposits in guarantees	3	3
Total	\$ 23,700	3,306

(20) Employees' benefits -

a) Defined contribution retirement plan

Beginning in 2006, the Institution amended the General Labour Conditions (GLC) based on trends and best practices in the management and operation of retirement and pension schemes, to incorporate new employees, as well as those who decided to migrate from defined benefits to defined contribution scheme. This scheme allows for having a greater control over costs and liabilities of the plan, maintain an adequate cost-benefit ratio for the Institution and for employees and establishes clear rules of contribution or retirement.

This plan consists of the contributions carried out by the Institution to open individual accounts for each employee, which are divided in two sub accounts, denominated "A" and "B", respectively. It further consists of contributions carried out by the employee to the sub-account "B" and the returns generated by both subaccounts, which are jointly identified as the employee's individual account.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The amount of the contributions for the year ended December 31, 2018, amounted to \$41. During the year 2017, the Institution did not make contributions.

At December 31, 2018 and 2017, the defined contribution plan assets amounts to \$298 and \$281, respectively, and are invested in an irrevocable trust incorporated in the Institution.

b) Defined benefits retirement plan

Moreover, GLCs set forth that employees who reach 65 years of age and complete 30 years of service will be entitled to a retirement annuity. Moreover, upon reaching 65 years of age with 5 years of seniority, employees will be entitled to receive a monthly annuity, whose amount will be equal to the result of multiplying the average of the net monthly salary accrued by the employee during the last year of service by the number of years of service rendered by the 0.0385 factor. The Institution reserves the right to pay a pension for retirement to the employee who has reached 60 years of age or completed 26 years of service.

On the other hand, the articles of the GLC dated August 12, 1994 set forth that employee who joined the Institution prior to the above mentioned date and reach 55 years of age and have completed 30 years of service, 60 years of age and have completed 26 years of service or 60 years of age and completed 5 years of seniority will be entitled for a pension in the terms of the GEC referred to above.

In the event of an unjustified dismissal or termination of the employment relationship, the employee may choose to receive the compensation upon termination or a retirement annuity calculated based on the main characteristics of the retirement plan if the employee is 50 years old and has 16 or more years of seniority.

Article 5 paragraph a) of the GEC, reviewed in 2006, establishes that individuals who have obtained pension for disablement, disability or retirement prior to this GEC review and those employees who joined the Institution prior to such date and to whom the defined retirement benefit plan applies, will continue to enjoy the right to receive from the Institution at the time when they retire the following additional benefits:

- Short-term loans, medium-term loans and special loan for savings, which will be paid with a charge to caption "Administrative and promotional expenses", with an 18% net guaranteed return of the maximum capacity to invest that will be calculated on 41.66% of the net monthly pension multiplied by 72 months, as well as the available capacity that will be over 50% of the net pension, less monthly deductions from the short and medium-term loans with principal and interest multiplied by 72 months, with a 41.66% cap of monthly net pension. The special loan for Savings will bear 1% annual interest on the principal, which will be withheld by the Institution.

The net periodic cost for the years ended December 31, 2018 and 2017, amounts to \$989 and \$960, respectively, including the effect of other post-retirement benefits. The estimated net periodic cost for the year 2018 amounts to \$814.

At December 31, 2018 and 2017, the plan assets of the fund for labor obligations amounted to \$6,773 and \$6,790 respectively, and is invested in an irrevocable trust incorporated in the Institution. The net periodic cost recognized in the unconsolidated statement of income of the Institution amounted to \$144 and \$331, respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

At December 31, 2018 and 2017 plan assets related to "other post-retirement benefits" amounts to \$11,327 and \$10,589 respectively. The net periodic cost recognized in the Institution's consolidated statement of income amounted to \$845 and \$629, respectively.

At December 31, 2018 and 2017, the assets of the plan of the Fund for labor obligations, is invested in the following securities:

Classification of securities in the Fund and its concentration.

		2018	2017
Government securities	\$	39.82%	29.85%
Banking securities		2.02%	11.14%
Other debt securities		58.16%	59.01%
Total	\$	100.00%	100.00%

At December 31, 2018, from the total assets of the plan 2.11% are invested in Certificates of the Treasury of the Federation; 27.12% in Federal Government Development Bonds (23.44% in December 2017); 10.59% in Bonds of the Institute for the Protection of Bank Savings (6.41% in December 2017); 2.02% in term investments with performance payable at maturity and investment companies of securities issued by credit institutions (11.14% in December 2017); 58.16% in Certificates and investment companies, securities issued by credit institutions and private sector companies with high credit rating (59.01% in December 2017).

The summary of the actuarial calculations at December 31 2018, is as follows:

Concept	Pension	Seniority premium	Other retirement benefits	Special loan for savings (SLS) and financial credit cost
Accounting policy for the recognition of losses and gains			Deferred amortization	
General benefits description			According to general employment conditions	
Obligation for acquired benefits	\$ 6,899	7	7,932	3,244

Reconciliation between the value of the Defined Benefits Obligation (DBO) and the fair value of plan assets (PA) with the net liability for defined benefits or net asset for defined benefits

Defined benefits obligations	\$ (7,262)	(27)	(9,608)	(3,672)
Plan assets at fair value	6,628	28	7,917	3,257
Financial situation of the obligation	(634)	1	(1,691)	(415)
Remeasurements pending of recognition	744	3	1,529	516
Net (liability) asset for defined benefits	\$ 110	4	(162)	101

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2018				
Concept	Pension	Seniority premium	Other retirement benefits	Special loan for savings (SLS) and financial credit cost
Net (liability) assets for defined benefits at the beginning of year	\$ (360)	(2)	604	64
Net periodic cost	142	2	662	183
Contributions	(142)	(2)	(662)	(183)
Remeasurements of liabilities or (assets) recognized in OCI	250	(2)	(442)	(165)
Net (liability)/ asset for defined benefits	\$ (110)	(4)	162	(101)
Net periodic cost				
Labor cost	\$ 26	2	150	34
Financial cost	492	2	674	262
Return on assets	(460)	(2)	(529)	(221)
Recycling of remeasurements	84	-	367	108
Net period cost	\$ 142	2	662	183
Net liability (asset) remeasurements for defined benefits				
Defined benefits obligations	\$ 7,262	27	9,608	3,672
Estimated defined benefits obligation	7,286	29	9,786	3,928
Actuarial (gains) / losses on obligations	\$ (24)	(2)	(178)	(256)
Fair value of the plan assets	\$ 6,628	29	7,917	3,257
Estimated value of plan assets	6,845	29	7,745	3,359
(Gains) / losses on return on plan assets	217	-	295	102
Remeasurements generated in the year to recognize in OCI	\$ 193	(2)	(350)	(154)
Average remaining working life	6.29	7.29	6.37	6.29

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The summary of the actuarial calculations at December 31, 2017, is as follows:

2017				
Concept	Pension	Seniority premium	Other retirement benefits	Special loan for savings (SLS) and financial credit cost
Accounting policy for the recognition of losses and gains			Deferred amortization	
General benefits description			According to general employment conditions	
Obligation for acquired benefits	\$ 6,826	7	7,987	3,300
Reconciliation between the value of the Defined Benefits Obligation (DBO) and the fair value of plan assets (PA) with the net liability for defined benefits or net asset for defined benefits				
Defined benefits obligations	\$ (7,299)	(28)	(9,839)	(3,857)
Plan assets at fair value	6,774	27	7,431	3,180
Financial situation of the obligation	(525)	(1)	(2,408)	(677)
Remeasurements pending of recognition	885	3	1,804	613
Net (liability) asset for defined benefits	\$ 360	2	(604)	(64)
Net (liability) assets for defined benefits at the beginning of year	\$ 296	(4)	640	(179)
Net periodic cost	329	2	470	159
Contributions	(329)	(2)	(470)	(159)
Adjustment for recognition of differences in the reserve	56	1	(12)	22
Remeasurements of liabilities or (assets) recognized in OCI	(712)	1	(24)	221
Net (liability)/ asset for defined benefits	\$ (360)	(2)	604	64

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2017				
Concept	Pension	Seniority premium	Other retirement benefits	Special loan for savings (SLS) and financial credit cost
Net periodic cost				
Labor cost	\$ 29	2	152	37
Financial cost	497	2	609	231
Return on assets	(420)	(2)	(457)	(200)
Recycling of remeasurements	223	-	166	91
Net period cost	\$ 329	2	470	159
Net liability (asset) remeasurements for defined benefits				
Defined benefits obligations	\$ 7,299	28	9,839	3,857
Estimated defined benefits obligation	7,954	26	9,928	3,698
Actuarial (gains) / losses on obligations	\$ (655)	2	(89)	159
Fair value of the plan assets	\$ 6,774	27	7,431	3,180
Estimated value of plan assets	6,828	27	7,525	3,239
(Gains) / losses on return on plan assets	54	-	94	59
Remeasurements generated in the year to recognize in OCI	\$ (601)	2	5	218
Average remaining working life	6.26	11.20	15.50	6.26

Main hypothesis used:

	2018	2017
Discount rate	8.48%	7.00%
Increase in wage rate	4.15%	4.00%
Increase of minimum wage rate	4.15%	4.00%
Medical inflation rate	10.50%	9.50%
Long term inflation rate	3.65%	3.50%

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Financial Position

At December 31, 2018 and 2017, the financial position is as follows:

	Other retirement benefits			
	Retirement pension	Seniority plan	Medical service, savings fund insurance, premium sport club	SLS and financial credit cost
2018				
Defined benefits obligation	\$ (7,262)	(27)	(9,608)	(3,672)
Fair value of the plan assets	6,628	28	7,917	3,257
Obligation's financial position	(634)	1	(1,691)	(415)
Remeasurements pending for recognition	744	3	1529	516
Net (liability) / asset for defined benefits	\$ 110	4	(162)	101
2017				
Defined benefits obligation	\$ (7,299)	(28)	(9,839)	(3,857)
Fair value of the plan assets	6,774	27	7,431	3,180
Obligation's financial position	(525)	(1)	(2,408)	(677)
Remeasurements pending for recognition	885	3	1,804	615
Net (liability) / asset for defined benefits	\$ (360)	(2)	(604)	(64)

OCI Reserve reconciliation

At December 31, 2018 and 2017, the reserve and OCI reconciliation are as follows:

	Retirement pension	Seniority plan	Medical service, savings fund insurance, premium sport club	SLS and financial credit cost
2018				
Reserve balance at beginning of year	\$ (360)	(2)	604	64
Net periodic cost	142	2	662	183
Contributions	(142)	(2)	(662)	(183)
Remeasurements liabilities or (assets) recognized in OCI	250	(2)	(442)	(165)
Balance at end of year	(110)	(4)	162	(101)

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2018	Retirement pension	Seniority plan	Medical service, savings fund insurance, premium sport club	SLS and financial credit cost
Accumulated OCI statement				
Balance at beginning of year pending of recognition in OCI	\$ 885	3	1,804	614
Recycling of remeasurements	(141)	-	(275)	(98)
Balance at end of year pending of recognition in OCI	\$ 744	3	1,529	516
Beginning balance recognized in OCI	(360)	(2)	604	64
Recycling of remeasurements	57	-	(92)	(10)
Actuarial (gain) / losses in obligations	(24)	(2)	(178)	(256)
(Gains) / losses in return on plan assets	217	-	(172)	101
Balance at end of year recorded in OCI	\$ (110)	(4)	162	(101)
Net liabilities (assets) due to defined benefits at end of year	\$ (110)	(4)	162	(101)

2017	Retirement pension	Seniority plan	Medical service, savings fund insurance, premium sport club	SLS and financial credit cost
Reserve balance at beginning of year	\$ 296	(5)	640	(179)
Net periodic cost	329	2	470	159
Contributions	(329)	(2)	(470)	(159)
Adjustment for recognition of differences in the reserve	56	2	(11)	22
Remeasurements liabilities or (assets) recognized in OCI	(712)	1	(25)	221
Balance at end of year	\$ (360)	(2)	604	64

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2017	Retirement Pension	Seniority plan	Medical service, savings fund insurance, premium sport club	SLS and financial credit cost
	Retirement	Retirement and termination	Retirement	Retirement
Accumulated OCI statement				
Balance at beginning of year pending of recognition in OCI	\$ 1,052	3	1,930	730
Recycling of remeasurements	(167)	-	(126)	(116)
Balance at end of year pending of recognition in OCI	\$ 885	3	1,804	614
Beginning balance recognized in OCI	\$ 352	(4)	628	(157)
Recycling of remeasurements	(56)	-	(41)	25
Actuarial (gain) / losses in obligations	(654)	3	(89)	159
(Gains) / losses in return on plan assets	54	-	94	58
Adjustment remeasurements for recognition of differences in the reserve	(56)	(1)	12	(22)
Balance at end of year recorded in OCI	\$ (360)	(2)	604	64
Net liabilities (assets) due to defined benefits at end of year	\$ (360)	(2)	604	64

In accordance with the amendments to the provisions published in the Official Federal Gazette on December 31, 2015, and with the effectiveness of the new MFRS D-3 issued by the CINIF, the Institution adopted the progressive application referred to in the third transitory article of the aforementioned Provisions.

Based on the aforementioned, the recognition of the balances indicated in subparagraphs a) and b) of the paragraph 81.2 of MFRS D-3, the balance of modifications to the plan not yet recognized and the unrecognized accumulated balance for gains or losses the plan, respectively, will be recognized in fiscal year 2021 at the latest, recognizing 20% from its initial application and an additional 20% in each of the subsequent years, up to 100% within a maximum period of 5 years. The decision of the Institution to adopt the progressive application of the recognition of these balances, was communicated to the Banking Commission in a timely manner.

The accumulated balance of Plan losses not recognized, amounts to \$(2,791). The initial effects of the application of MFRS D-3 involve the recognition of 20% of the accumulated balance plan losses of \$(558), amount which will be recognized, in the caption of "Remeasurements for employee's defined benefits" in earned capital. The remaining amount of \$(2,233) will be applied in the subsequent years, within a maximum period of 5 years.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(21) Income taxes and employee statutory profit sharing (ESPS)-

IT Law effective as of January 1, 2014 establishes an IT rate of 30% for 2014 and later years. The current ESPS rate is 10%, for the years 2018 and 2017.

At December 31, 2018 and 2017 current IT and ESPS expense is as follows:

	2018		2017	
	IT	ESPS	IT	ESPS
Current IT:				
Institution	\$ (319)	(332)	(106)	(274)
Consolidated trusts	(602)	-	(644)	-
Management funds	(2)	-	(8)	-
Plaza Insurgentes	(23)	-	(19)	-
Current IT and ESPS	(946)	(332)	(777)	(274)
Deferred	400	96	433	119
	\$ (546)	(236)	(344)	(155)

The Institution does not consolidate the tax result with its subsidiaries, thus the information presented below is for informational purposes only.

The Institution has not recognized a deferred tax liability, on the undistributed profits of subsidiaries and associated companies; the Institution currently does not expect these undistributed profits to be reinvested and taxable in the near future.

Deferred IT and ESPS:

The analysis of the effective rate of the Institution without its subsidiaries at December 31 2018 and 2017, is analyzed in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The following is an analysis of the effective tax rate of the Institution without subsidiaries for the fiscal year ended December 31, 2018:

	IT			
	Tax base	Tax at 30%	Effective rate	ESPS at 10%
<u>December 31, 2018</u>				
Income before taxes	\$ 841	(252)	(30%)	(84)
Allocation to current tax:				
Adjustment for inflation effects	(297)	89	11%	30
Mark to market of investment securities	45	(14)	(2%)	(5)
Non-deductible expenses	478	(143)	(17%)	(46)
Allowance for loan losses	410	(123)	(15%)	(41)
Deferred ESPS	(96)	29	4%	10
Deduction of paid ESPS	(274)	82	10%	-
Others, net	(225)	67	8%	22
Current tax	882	(265)	(31%)	(114)
Tax effect of consolidated Trusts ⁽¹⁾		(54)		(218)
Income tax and ESPS in consolidated results		\$ (319)		\$ (332)

	IT			
	Tax base	Tax at 30%	Effective rate	ESPS at 10%
<u>Allocation to deferred tax: (IT 30% and ESPS%):</u>				
Mark to market of investment securities	\$ (149)	45	5%	15
Provisions and others	(82)	25	3%	2
Allowance for loan losses to be deducted	(444)	133	16%	44
Interest on derivative financial instruments (swaps)	211	(63)	(7%)	(21)
Others	342	(103)	(12%)	(34)
Deferred tax	(122)	37	5%	6
Deferred tax effect of Consolidated Trusts		268		90
Current tax		\$ 305		\$ 96

⁽¹⁾ See note in the next page

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The following is an analysis of the effective tax rate of the Institution without subsidiaries for the fiscal year ended December 31, 2017:

	IT			
	Tax base	Tax at 30%	Effective rate	ESPS at 10%
<u>December 31, 2017</u>				
Income before taxes	\$ 861	(258)	(30%)	(86)
Allocation to current tax:				
Adjustment for inflation effects	(531)	159	19%	53
Mark to market of investment securities	(484)	145	17%	48
Non-deductible expenses	378	(113)	(13%)	(37)
Allowance for loan losses	377	(113)	(13%)	(38)
Deferred ESPS	(119)	36	4%	12
Deduction of paid ESPS	(269)	81	9%	-
Others, net	546	(165)	(19%)	(54)
Current tax	759	(228)	(26%)	(102)
Tax effect of consolidated Trusts ⁽¹⁾		(122)		(172)
Income tax and ESPS in consolidated results		\$ (106)		\$ (274)

	IT			
	Tax base	Tax at 30%	Effective rate	ESPS at 10%
<u>Allocation to deferred tax: (IT 30% and ESPS%):</u>				
Mark to market of investment securities	\$ 497	(149)	(17%)	(50)
Provisions and others	8	(2)		(1)
Allowance for loan losses to be deducted	(870)	261	30%	87
Interest on derivative financial instruments (swaps)	737	(221)	(26%)	(74)
Others	(237)	71	8%	24
Deferred tax	135	(40)	5%	(14)
Deferred tax effect of Consolidated Trusts		397		133
Current tax		\$ 357		\$ 119

- (1) In accordance with article 13 of the tax law, when business activities are carried out through a trust, the Institution acting as trustee will determine under the terms of title II of tax law, the result or the fiscal loss for such activities in each fiscal year and fulfill the obligations, including the obligation to make fiscal payments on behalf of trustees.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos, except otherwise noted)

The effects on temporary differences of deferred assets at december 31, 2018, are integrated as follows:

	2018		2017	
	IT	ESPS	IT	ESPS
<i>Deferred asset (liability):</i>				
Mark to market of investment securities	\$ (364)	(121)	(558)	(186)
Provisions and others	118	6	93	4
Allowance for loan losses to be deducted	2,276	759	1,875	625
Interest on derivative financial instruments (swaps)	(294)	(98)	(231)	(77)
Others	2	1	260	56
Deferred tax	1,738	547	1,439	422

Other considerations:

In accordance with Mexican tax law, the tax authorities may examine transactions carried out during the five years prior to the most recent income tax return filed.

According to the IT Law, corporations carrying out transactions with related parties, whether domestic or foreign, are subject to a limits and tax obligations, to certain requirements as to the determination of the transaction prices, since these prices must be similar to those that would be used in arm's-length transactions.

(22) Stockholders' equity -

(a) At December 31, 2018, the Institution's capital stock is comprised as follows:

	Series "A"		Nominal value pesos	Amount		Total
	Capital contribution certificates			Series "A"	Series "B"	
	Series "A"	Series "B"				
Subscribed capital	31,548,000	16,252,000	\$ 50	\$ 1,577	813	\$ 2,390
Unissued Capital	(2,625,815)	(1,352,691)	50	(131)	(68)	(199)
Subscribed and paid in capital	28,922,185	14,899,309	\$ 50	\$ 1,446	745	2,191
		Increase from restatement				7,011
		Total stockholder's equity				\$ 9,202

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

At December 31, 2017, the Institution's capital stock is comprised as follows:

	Series "A"		Nominal value pesos	Amount		Total
	Capital contribution certificates			Series "A"	Series "B"	
	Series "A"	Series "B"				
Subscribed capital	31,548,000	16,252,000	\$ 50	\$ 1,577	813	\$ 2,390
Unissued Capital	(7,868,728)	(4,053,586)	50	(393)	(203)	(596)
Subscribed and paid in capital	23,679,272	12,198,414	\$ 50	\$ 1,184	610	1,794
						7,011
						Total stockholder's equity
						\$ 8,805

The Institution's capital stock will be represented in 66% by "A" series and 34% by "B" series. The "A" series may only be subscribed by the Federal Government and "B" series by Mexican individuals or companies. At December 31, 2018 and 2017, the Federal Government owns 66% of the "A" series in both years, and 33.94% and 33.9% of "B" series, respectively.

(b) Contributions for future capital stock increases-

At December 31, 2018 and 2017, they amount to \$1,376 and \$5,700, respectively.

During its ordinary meeting held on October 30, 2018, the Board of Directors authorized the Management of the Institution, to carry out the necessary arrangements to request to the Federal Executive, through the Ministry of Finance and Public Credit (SHCP for its acronym in spanish), an increase of capital stock amounting to \$1,376, required to be able to support the volume of operations and investment banking, which includes the investments of venture capital, as well as maintain a level of prudential capitalization for the year ended 2018, such increase was received in the month of December 2018.

During its extraordinary meeting held on February 27, 2018, the Board of Directors authorized the Management of the Institution, to formalize within the capital stock, the amount of the contributions for future capital increases made by the Federal Government for \$ 5,700; derived from the previous point, the capital stock increased by \$ 397, through the subscription and payment of equity contribution certificates (ECCs) for 7,943,808 with a nominal value of fifty pesos and increase in the paid stock premium at \$ 5,303.

During its extraordinary meeting held on December 13, 2017, the Board of Directors authorized the Management of the Institution, to carry out the necessary arrangements to request to the Federal Executive, through the Ministry of Finance and Public Credit (SHCP for its acronym in spanish), an increase of capital stock amounting to \$2,950, required to be able to support the volume of operations and investment banking, which includes the investments of venture capital, as well as maintain a level of prudential capitalization for the year ended 2017, such increase was received in the month of December 2017.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(c) Paid stock premium-

This premium applies to payments made by holders of series "B" certificates. The balance of the premiums paid at December 31, 2018 and 2017 amounts to \$14,255 and \$8,992, respectively.

(d) Statutory reserves-

The nominal value of these reserves at December 31, 2018 and 2017, amounts to \$314 in both years and its restated value amounts to \$1,730 in both years.

(e) Dividends declared -

The dividends paid to individuals and residents abroad shall be subject to an additional tax of 10%, which is considered final and must be withheld by entities that distribute such dividends. The rule applies only to dividends payment from earnings generated beginning January 1, 2014.

For the years ended December 31, 2018 and 2017 there were no dividends declared.

(f) Comprehensive income-

The comprehensive income reported in the consolidated statement of changes in stockholders' equity, represents the result of total activity during the year and includes the net income, the effect of the valuation of investments securities available for sale for \$(202) and \$108 at December 31, 2018 and 2017, respectively, as well as the effect on valuation in associated and affiliated companies and the remeasurements of defined employees' benefits for \$1,102 and \$32 at December 31, 2018, respectively, \$742 and \$(213) at December 31, 2017, respectively.

(g) Restrictions on stockholders' equity-

The Credit Institutions Law requires an appropriation of 10% of net income for the year to statutory reserves until such reserves reach an amount equal to paid in capital stock.

In case of contributions or retained earnings distributions to stockholders, income tax is due on the portion of the contributions or distributions exceeding the taxable basis. At December 31, 2018, the Capital contribution account of the Institution (Cuenta de Capital de Aportación or CUCA, unaudited) and the net taxable income account (Cuenta de Utilidad Fiscal Neta or CUFIN, unaudited), amounted to \$54,324 and \$15,439, respectively.

The retained earnings of subsidiaries may not be distributed to the Institution's stockholders until dividends are collected.

(h) Capitalization (unaudited)-

At December 31, 2018 and 2017, the Institution maintained a capitalization ratio in excess of 10.5% (14.52% and 14.46%, at December 31, 2018 and 2017, respectively), it is classified as category I in both years in accordance with article 220 of the Provisions, the capitalization index is calculated by applying certain percentages in accordance with the risk assigned pursuant to the rules established by the Central Bank. The next sheet presents the Institution's capitalization information (capitalization index reported to the Central Bank and subject to its approval).

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(i) Basic and complementary capital-

The Institution's net capital consists of \$29,478 of basic capital and risk adjusted assets of \$203,022. Pursuant to the application of the portfolio rating methodology, complementary capital is zero, which implies that net capital is equal to the basic capital, which in turn equals the fundamental capital.

(j) Assets adjusted for market risks-

Assets adjusted for market risks amount to \$55,557 and are equivalent to a capital requirement of \$4,445, which are integrated as follows:

	Risk weighted assets	Capital requirement
Exposed positions to market risk by risk factor:		
Transactions in Mexican pesos at nominal rates	\$ 12,144	972
Transactions with debt securities in pesos with premium and adjustable rates	7,295	548
Transactions in Mexican pesos at real rates or denominated in UDI's	13,276	1,062
Positions in UDI's or with returns indexed to the NCIP	93	7
Foreign currency transactions at nominal rates	8,356	669
Foreign currency positions or with exchange rate indexed returns	177	14
Equity positions or with returns indexed to the price of a single share or group of shares	14,219	1,137
Total market risk	\$ 55,557	4,445

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(k) Assets adjusted for credit risks-

Assets adjusted for credit risk amount to \$137,019 and are equivalent to a capital requirement of \$10,962. Assets adjusted for risk related to borrowers and deposits amount to \$100,202, which are equivalent to a capital requirement of \$8,016, and are comprised as follows:

	Risk weighted assets	Capital requirement
Weighted assets subject to credit risk by risk group:		
Group III (weighted at 20%)	\$ 17,350	1,388
Group III (weighted at 50%)	4,726	378
Group III (weighted at 100%)	887	71
Group IV (weighted at 20%)	3,690	295
Group VI (weighted at 100%)	774	62
Group VII (weighted at 20%)	8,850	708
Group VII (weighted at 50%)	3,876	310
Group VII (weighted at 100%)	19,094	1,528
Group VII-B (weighted at 50%)	768	61
Group VII-B (weighted at 100%)	39,627	3,170
Group VIII (weighted at Group VI%)	3	-
Group IX (weighted at 100%)	557	45
Total credit risk	\$ 100,202	8,016

l) Assets adjusted for operational risks

Assets adjusted for operational risks amounted to \$10,445 and are equivalent to a capital requirement of \$836.

Weighted assets subject to operational risk		
Used method	Assets weighttd by risk	Capital requirements
Basic benchmark	\$ 10,445	836

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

	Average market and credit risk requirement of the last 36 months	Annual average of positive net income for the past 36 months
	\$ 13,342	5,571

The annex 1-O of the Provisions establishes the requirements for the disclosure of information relating to capitalization, which shall contain, in addition to those listed in the preceding subparagraphs, the following sections:

1. Net capital is presented in accordance with the international format of revelation contained in the document "Format of capital integration without considering transitory application of regulatory adjustments".

Ref.	Tier 1 Common Stock (CET 1): Instruments and reserves	Amount
1	Common shares that qualify for Tier 1 common stock plus its applicable premium	\$ 24,803
2	Prior year income	5,650
3	Other elements of comprehensive income (and other reserves)	4,000
6	Tier 1 common stock before regulatory adjustments	\$ 34,453

Tier 1 common stock: regulatory adjustments

15	Defined benefits pension plan	\$ 14,798
21	Deferred income taxes in favor from temporary differences (amount that exceeds the 10% threshold, net of taxes deferred charges)	546
26	Domestic regulatory adjustments	4,428
A	Other elements of comprehensive income (and other reserves)	-
D	Investments in multi-lateral agencies	644
F	Investments in capital risk	3,587
G	Investments in mutual funds	197
28	Total regulatory adjustments to tier 1 common stock	\$ 4,974

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Ref.	Tier 1 Common Stock (CET 1): Instruments and reserves	Amount
29	Tier 1 Common Stock (CET 1)	\$ 29,478
Additional tier 1 capital: regulatory adjustments		
44	Additional tier 1 capital (AT1)	-
45	Tier 1 Stock (T1 = CET1 + AT1)	29,478
Tier 2 capital: instruments and reserves		
51	Tier 2 capital before regulatory adjustments	-
Tier 2 Capital: regulatory adjustments		
59	Total Capital (TC = T1 + T2)	29,478
60	Assets weighted by total risk	\$ 203,022
61	Common tier 1 capital (as a percentage of the weighted assets by total risk)	14.52%
62	Tier 1 capital (as a percentage of the weighted assets by total risk)	14.52%
63	Total capital (as a percentage of the weighted assets by total risk)	14.52%
64	Institutional specific supplement (it should at least consist of the common tier 1 capital requirement, plus the capital conservation buffer, plus the countercyclical buffer, plus the G-SIB buffer stated as a percentage of the total weighted risk assets)	7.00%
65	of which: Conservation capital supplement	2.50%
68	Tier 1 common capital available to cover supplements (as a percentage of the total weighted risks assets)	7.52%

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2. Ratio of net capital with the balance sheet.

Balance sheet Items Reference	Balance sheet amounts Balance sheet Items (unconsolidated)	2018
BS1	Cash and cash equivalents	57,265
BS2	Margin accounts	16
BS3	Investment securities	235,058
BS4	Debtors on repurchase/resell agreements	2,718
BS5	Securities lending	-
BS6	Derivatives	-
BS7	Valuation adjustment from hedging of financial assets	5,870
BS8	Total loan portfolio (net)	255,661
BS9	Receivable benefits on securities trading	-
BS10	Other receivables (net)	15,268
BS11	Foreclosed assets (net)	3
BS12	Property, plant and equipment (net)	7
BS13	Permanent investments (a)	24,984
BS14	Long-lived assets available for sale	-
BS15	Deferred income taxes and employee statutory profit sharing, net	2,284
BS16	Other assets	1,189
Total assets		\$ 597,605

(a) Includes other investments

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Balance sheet Items Reference	Balance sheet amounts Balance sheet Items unconsolidated	2018
<u>Liabilities:</u>		
BS17	Deposit funding	\$ 278,271
BS18	Bank and other borrowings	31,135
BS19	Creditors on repurchase/resell agreement	218,623
BS20	Securities lending	-
BS21	Collateral sold or furnished as a guarantee	-
BS22	Derivatives	7,990
BS23	Valuation adjustments of hedging financial liabilities	884
BS24	Debentures in securities trading	-
BS25	Other accounts payable	25,063
BS26	Outstanding unsecured obligations	-
BS27	Deferred income taxes and employee statutory profit sharing, net (net)	-
BS28	Deferred credits and prepayments	85
Total liabilities		\$ 562,051
<u>Stockholders' equity:</u>		
BS29	Capital stock	\$ 24,803
BS30	Earned capital	10,751
Total stockholders' equity		35,554
Total liabilities and stockholders' equity		\$ 597,605

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Balance sheet amounts		
Balance sheet Items Reference	Balance sheet Items unconsolidated	2018
<u>Memorandum Accounts:</u>		
BS31	Guarantees granted	-
BS32	Contingent assets and liabilities	83,635
BS33	Loan commitments	66,098
BS34	Assets placed in trust or mandate	1,719,642
BS35	Federal Government Financial Agent	380,346
BS36	Assets in custody or administration	527,308
BS37	Collateral received by the entity	17,058
BS38	Collateral received and sold or pledged as a guarantee by the entity	17,055
BS39	Investment banking transactions on behalf of third party	61,161
BS40	Interest earned but not collected arising from past due – loan portfolio	20
BS41	Other memorandum accounts	737,841

Regulatory items considered for the calculation of the net capital components.

Identifier	Regulatory items considered for the calculation of net Capital	Reference to the disclosure form of the capital integration of section 1 to this exhibit	Amount of combination with notes to regulatory concepts considered for the calculation of net capital components	Reference(s) of the balance sheet item and the related amount to the regulatory concepts consider for the calculation of net capital from the aforementioned reference
Assets:				
5	Deferred income taxes (in favor) from losses and tax credits.	10	546	
15	Investments in multi-lateral agencies	26 – D	644	
17	Investment in risk capital	26 - F	3,587	
18	Investments in mutual funds	26 - G	197	
22	Investments of the defined benefits pension plan	26 - N	14,798	Informative uncomputed data
Stockholders' equity:				
34	Paid in capital in accordance with exhibit 1-Q	1	24,803	

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Identifier	Regulatory items considered for the calculation of net Capital	Reference to the disclosure form of the capital integration of section 1 to this exhibit	Amount of combination with notes to regulatory concepts considered for the calculation of net capital components	Reference(s) of the balance sheet item and the related amount to the regulatory concepts consider for the calculation of net capital from the aforementioned reference
35	Prior year income	2	5,650	
37	Other capital earned elements other than the foregoing	3	4,000	
41	Accumulated effect on translation	3,26 - A	N/A	
42	Net income from non-monetary assets holding	3, 26 - A	N/A	
Regulatory concepts not considered in the balance sheet:				
45	Profit or increase in the value of the assets by acquisition of securitization positions (Originating Institutions)	26 - C	N/A	
46	Transactions that contravene the Provisions	26 - I	N/A	
47	Relevant related parties transactions	26 - M	N/A	
48	Adjustment for capital recognition	26 - O, 41, 56	N/A	

Main characteristics of securities composing stockholders' equity (Series A)

Reference	Characteristic	Option
1	Issuer	Nacional Financiera, Sociedad Nacional de Crédito
2	Identifier ISIN, CUSIP o Bloomberg	
3	Legal framework	In conformity with Article 30 of Credit Institutions Law, Nacional Financiera, Sociedad Nacional de Crédito, Institución de Banca de Desarrollo, is governed by its internal regulations, holders of Series "A", capital contribution certificates, if applicable will have the rights set forth in article 35 of the Credit Institutions Law and article 12 of internal regulations of Nacional Financiera.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Regulatory treatment:

Reference	Characteristic	Option
4	Capital level with transitory status	
5	Capital level without transitory status	Basic 1
6	Level of instrument	Lending institution without consolidating subsidiaries
7	Type of instrument	"A" Series certificates of capital contribution
8	Recognized amount in regulatory capital	66% in accordance with (3)
9	Nominal value of the instrument	50.00
9A	Instrument currency	Mexican pesos
10	Accounting classification	Capital
11	Issuance date	
12	Instrument term	Perpetuity
13	Maturity date	Without maturity
14	Prepaid expense clause	No
15	First prepaid expense date	
15A	Regulatory or tax events	
15B	Liquidation prices of prepaid expense clause	
16	Subsequent prepaid expense dates	
17	Type of yield / dividend	Variable
18	Interest rate / dividend	Variable
19	Dividend Cancellation clause	No
20	Discretionary nature in the payment	Completely discretionary
21	Interest increase clause	No
22	Yield / dividend	Noncumulative
23	Instrument convertibility	Nonconvertible
24	Convertibility conditions	
25	Degree of convertibility	
26	Conversion rate	
27	Type of instrument convertibility	
28	Type of financial instrument of convertibility	
29	Issuer of instrument	
30	Write - down clause	
31	Write - down conditions	
32	Degree of write - down	
33	Temporary status of write - down	
34	Temporary value write - down mechanism	
35	Subordinated position in case of liquidation	
36	Nonperformance characteristics	
37	Description of nonperformance characteristics	

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

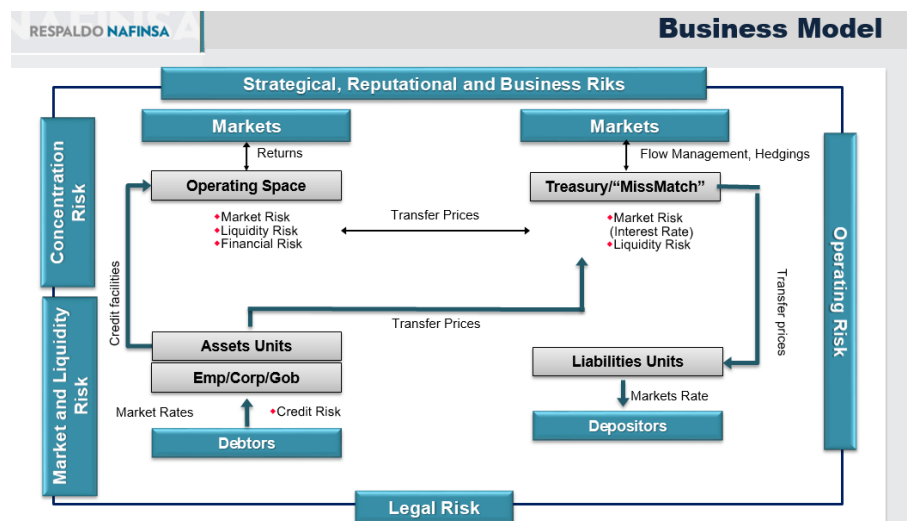
4. Capital management.

The framework for risk management must facilitate and support the measurement and monitoring of quantifiable risks, ensuring solid risk measurements to establish the Institution's risk appetite and generate value.

To ensure that risk management is a decision-making support tool, models and methodologies are established, that allow for measuring, monitoring and controlling the different types of risk to which the Institution is exposed. These risk measures should also contribute to the definition of business strategies and support decision-making of operation.

A fundamental point of departure for establishing limits is the definition of a business model that describes the exposure to different types of risk that generate the different operating units in the Institution.

- Treasury: it operates as the central unit that manages the resources of the Institution. It is responsible for establishing transfer prices, controlling liquidity levels and control the risks of balance sheet. This unit incurs market, credit and liquidity risks, and in the case of the Institution is also responsible for the deposit-funding unit.
- Operation desks: their main function is to generate revenues through the operation in different financial markets, (money, foreign exchange, capital and foreign currency bonds).
- Asset units: are those that encompass the promotion activities of the Institution and are derived from credit activities. These activities are the main generators of credit risk.



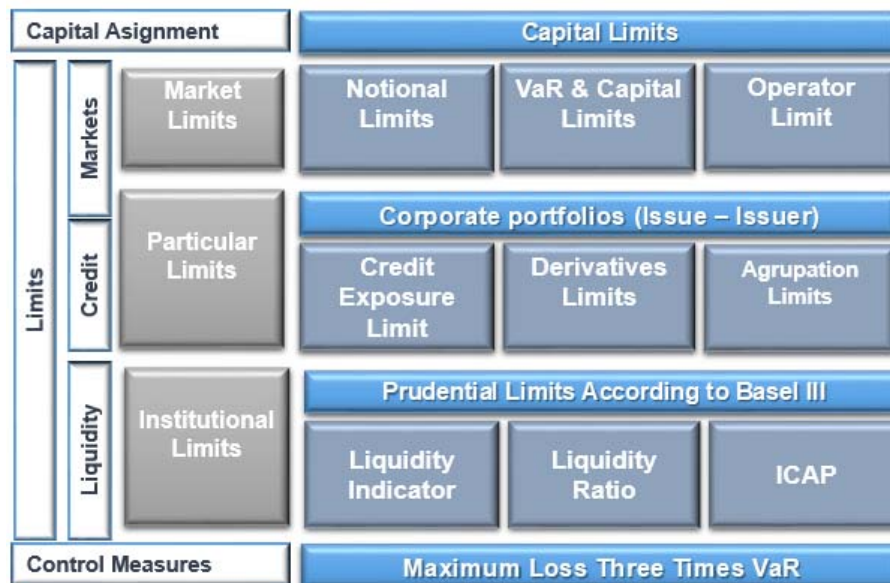
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Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Based on the aforementioned, the Institution has a solid structure of global and specific limits for exposure to different types of risk considering the consolidated risk, breaking down by unit of business, factor risk and cause, as presented in the following diagram:



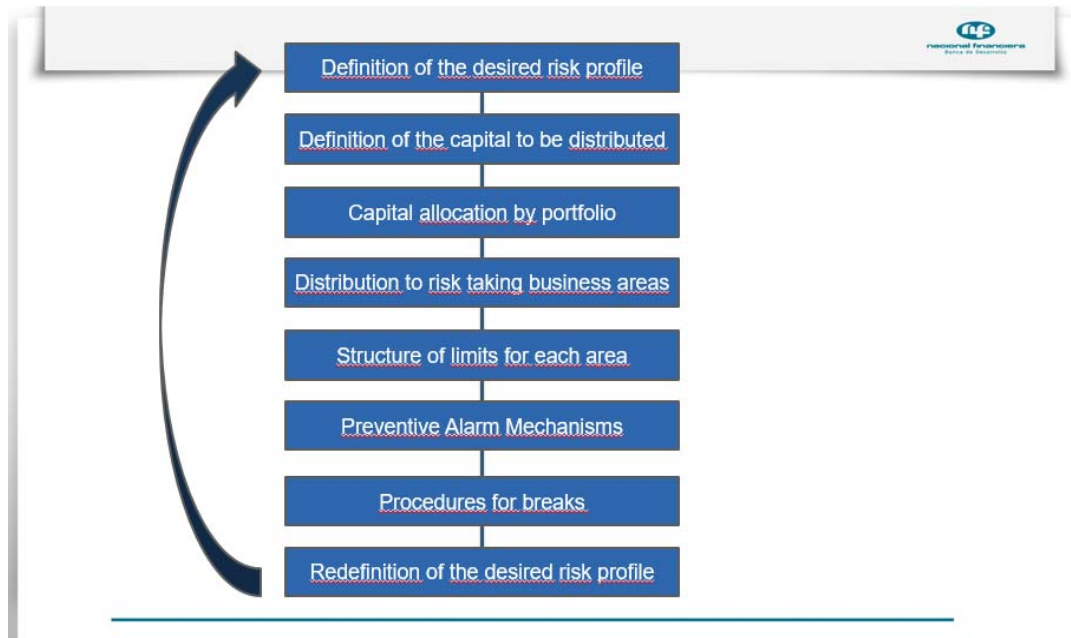
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Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The diagram presented in the prior page, has a strong relevance to the capital limits, for which the following process is followed to determine limits:



The capital allocation process is derived from the regulatory capital, which is regulated based on capitalization rules described in annex 9 called ICAP process forms, included in the risk manual. Based on these concepts, the capital distributable is determined, which is the capital that the Institution has to deal with the risks that its operations consume.

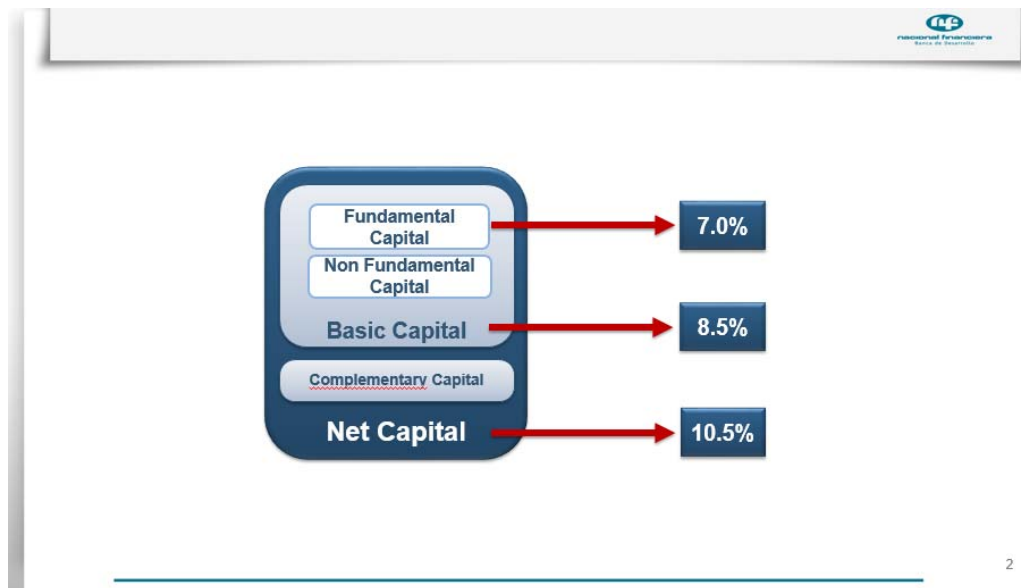
Basilea III establishes that the Institution has three indicators of solvency, where ICAP is the most restrictive, given the fact the requirement changed from 8.0% to 10.5%. It is precisely this restriction that establishes the appetite for risk through the limits of capital, in order to ensure if, 100% of the limits are consumed, and in stress situations, the level of capitalization is in no case less than 10.5%.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)



This increase of 250 basis point in the ICAP is a strong regulator that will replace the capital volatility for risk profile and operational risk previously held.

Capital limits structure

The Institution's capital management considers a limits structure with two levels of allocation:

- a) A strategic level, authorized by the Board of Directors
- b) A tactical level that is regulated by the IRMC, through reallocations or excess of limits, as well as the business areas management. Additionally, Deputy General Managers involved in the business areas can also propose reallocations of the limits, with the approval of the Risk Director, who subsequently informs the CAIR.

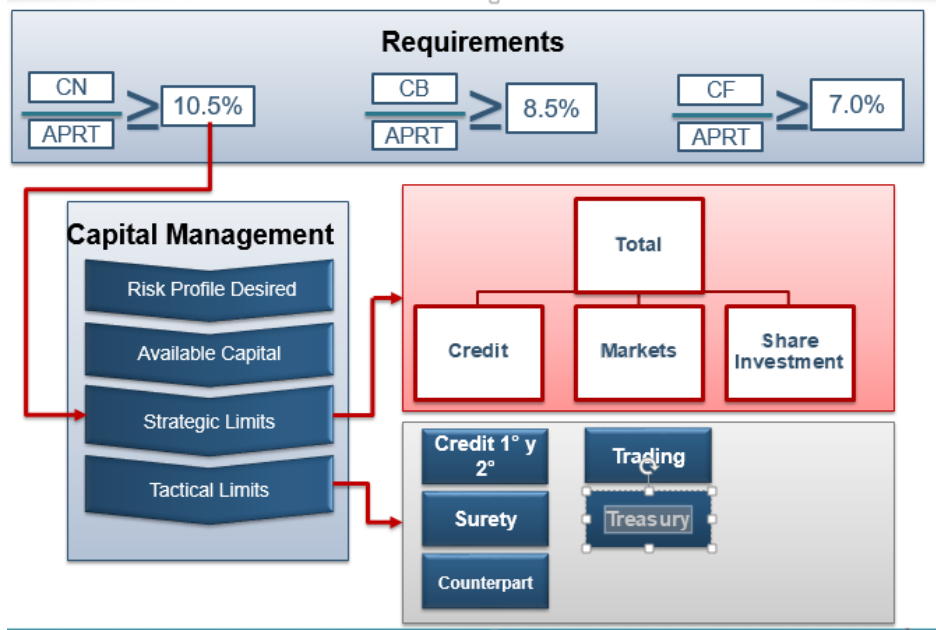
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Nacional Financiera, S. N. C.,
 Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

In summary the Institution has:



It is important to mention that, within the strategic structure of these limits, operational risk is not included, since this does not originate from the discretionary risk taking, i.e., that it is implicit in the operation of the Institution itself. Due to the above, there is a regulator for operational risk that does not compute for the capital limits, but that is considered in the computation of the capitalization level. Nonetheless, in terms of operational risk, the identification, measurement, monitoring, control and mitigation of the risks to which the Institution is exposed are performed.

Considering the above, at the end of December 2018, the capitalization ratio was 14.52% and the capital limit recorded a global consumption of 88%.



(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

There are three basic scenarios:

1. If capital limits are utilized at 100%, the level of funding would remain above the 10.5% required.
2. If, under the current structure, there is an adverse event of default or volatility in the markets affecting capital, there is sufficient capacity to maintain the ICAP above 10.5%
3. The combination of the above events, i.e., capital limits utilized at 100% and an adverse event with an impact on capital, would also allow the ICAP to be maintained above the minimum level required.

Finally, in order to have the capacity to obtain resources and continue operating under a stress scenario, in which the Institution's capital sufficiency is compromised without default of the minimums established by the authorities, the Treasury Department will obtain in the markets, the necessary resources in the best terms of cost and term, based on the guidelines established by the Institution's Management.

In order to manage liquidity risks, the treasury will regulate the operational execution in accordance with strategies that will be aligned with the Institution's Management objectives and will be responsible for detonating the contingent procedures for the management of liquidity, and in some cases, the procedures established in the "Business Continuity Plan" will apply.

The treasury department will inform the Risk Management Officer of any liquidity contingency situation.

(23) Memorandum accounts -

(a) Contingent asset and liabilities

As of December 31, 2018 and 2017, this caption amounts to \$70,798 and \$62,510, respectively, integrated as show in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

		2018	2017
Contingent liabilities:			
Guarantees granted	(1)	\$ 79,916	72,558
Unreimbursed guarantees paid covered by counter guarantee	(2)	13,885	12,696
Receivables on claims		133	132
Acquired commitments		1,883	1,888
		95,817	87,274
Contingent assets:			
Counter-guarantee received from the counter-guarantee trust for enterprise financing	(3)	10,154	11,340
Recoverable guarantees paid covered by counter-guarantors	(4)	13,885	12,696
Guarantees paid pending of recovery without counter-guarantee	(5)	980	728
		25,019	24,764
Total		\$ 70,798	62,510

- (1) In this caption, the Institution has mainly guarantees granted through *Fondo para la Participación de Riesgos* and *Fondo para la Participación de Riesgos en Fianzas*, which at December 31, 2018 and 2017, both present an amount of guarantees granted for \$75,875 and \$67,798, respectively. The spread at December 31, 2018 and 2017, for \$4,041 and \$4,760, respectively, correspond to selective guarantees granted directly by the Institution. These guarantees represent the amount of the responsibilities assumed by the Institution to guarantee financial intermediaries the recovery of their loan portfolio.
- (2) The Institution's contingent obligation to reimburse, mainly to the counter-guarantee Trust for Corporate Financing, the amount of the guarantees paid, has been recorded in this caption which counted with the counter-guarantee and which are in the process of recovery by bank and non-bank financial intermediaries.
- (3) *Fondo para la Participación de Riesgos* reduces the Institution's contingency through the counter-guarantee received from *Fideicomiso de Contragarantía para el Financiamiento Empresarial*, the promoter of granting of credits for specific purposes, which has assigned resources for these purposes for \$10,154 and \$11,340, at December 31, 2018 and 2017 respectively. These funds ensure, the recovery up to these amounts of the guarantees exercised by the financial intermediaries, who assume the commitment of negotiating the recovery of the credits of their final borrowers judicially and out-of-court.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

In addition to this counter-guarantee, the Fund has created a preventive allowance for credit risks, for \$3,108 and \$2,505, as of December 31, 2018 and 2017 respectively, in accordance with the Provisions of the Banking Commission.

With the counter-guarantee received, as well as with the level of preventive allowance created, the Institution considers that the exposure is covered, based on the experience observed in the guarantee program.

- (4) The contingent right of the Institution to recover the amount of the guarantees paid that had a counter-guarantee and were covered by the Fideicomiso de Contragarantía para el Financiamiento Empresarial, and which are in the process of recovery by bank and non-bank financial intermediaries.
- (5) In the caption of paid guarantees pending recovery without counter-guarantee, is recognized the amount of guarantees honored by the Institution that are in the process of recovery by financial intermediaries and that did not have the coverage of Fideicomiso de Contragarantía para el Financiamiento Empresarial.

(b) Credit commitments

At December 31, 2018 and 2017, the balance of authorized credit facilities and lines of guarantees granted to financial intermediaries that have not been withdraw amounted \$190,176 and \$172,948, respectively. At December 31, 2018, \$124,078 correspond to credit and \$ 66,098 to lines of guarantee granted, respectively, where as at December 31, 2017, \$58,606 correspond to lines of credit and \$114,342 to lines of guarantees granted, respectively.

(c) Assets placed in trust or mandates

The Institution's trust activity recorded in memorandum accounts as of December 31, 2018 and 2017, as well as operations as financial agent for the federal Government, are integrated as shown below:

	2018	2017
Investments trusts	\$ 15,169	14,619
Administrative trusts	1,675,280	1,311,276
Guarantee trusts	15,281	1,311,276
	<u>1,705,730</u>	<u>1,399,718</u>
Mandates	13,912	14,133
	<u>1,719,642</u>	<u>1,353,851</u>
Financial Agent of the Federal Government	380,346	371,322
Total	\$ 2,099,988	1,725,173

(Continued)

Nacional Financiera, S. N. C.,
 Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Investment and administrative trusts refer to entities with their own legal incorporation, independent from the Institution. These balances represent the valuation of Trust Assets which, overall, represent assets valued with distinct accounting practices, and which essentially represent neither rights of the entity, nor the contingency to which the Institution is subject in the event of nonperformance in its role as trustee.

Guarantee trusts correspond to entities that maintain loans, securities, real estate, etc., as part of its trust assets, which serve as collateral for the settlement of financing received from other credit institutions by the trustees of the same. The Institution only performs the fiduciary function in such entities.

The Institution's revenue from its trustee activities at December 31, 2018 and 2017, amounted to \$528 and \$330, respectively.

As of December 31, 2018 and 2017, the trust accounts include a balance of \$398 in both years, which corresponds to the assets of *Fideicomiso de Recuperación de Cartera (FIDERCA)*, which manages doubtful accounts that were originally of the Institution and that in the year of 1996 were transferred to the Federal Government. The Institution currently holds the respective trustee rights.

The Institution incorporated the trust for the strengthening of its capital in compliance with the provisions of article 55 Bis of Credit Institution Law and in accordance with the general rules for Domestic Lending Institutions and Development Banking Institutions published on October 24, 2002 in the Official Federal Gazette.

(e) Assets in custody or administration-

As of December 31, 2018 and 2017, this caption includes, trading securities and credit operations, as well as the securities issued by the Institution and managed on behalf of clients, as shown below:

	2018	2017
Custody	\$ 10,579	15,676
Pledge securities	260,293	245,636
Securities in administration	256,436	281,704
Subsidiaries	15,399	13,653
	\$ 542,707	556,669

Fees collected by the Institution for this type of activities for the years ended December 31, 2018 and 2017, amounted to \$5 and \$8, respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(f) Other memorandum accounts -

As of December 31, 2018 and 2017, the balances of other memorandum accounts are comprised as follows:

		2018	2017
Guarantees paid reported by brokers as uncollectible without a counterguaranty	(a) \$	12,312	170
Classification by degree of risk of the credit portfolio		341,003	302,405
Loans obtained pending for disbursements (note18)		2,619	2,657
Other memorandum accounts	(b)	394,218	336,458
Total	\$	750,152	641,690

(a) Correspond to the amounts of unrecovered guarantees on which the collection procedures have been exhausted by the intermediaries and which did not have a counterguarantee.

(b) Other memorandum accounts are included for control of renewed and restructured loans, uncollectible credits, uncollectible loans applied against the provision, mortgage-backed loans, certificates and coupons to be incinerated, VAT recorded by states, portfolio recovery, issue of provisional certificates, foreclosed assets written-off preventively, control of amounts contracted in repurchase/resell agreements and derivative instruments, commitments, allowance for loan losses from financial brokers and various unspecified items.

(24) Additional information on operations and segments-

(a) Segment information (unaudited) -

The factors used to identify the business segments considered the nature of the activities carried out; the existence of specific administrators for those activities, the generation of revenues and expenses thereof as well as the monitoring regularly performed on the results generated that are presented regularly to the Board of Directors of the Institution.

The market and treasury segment includes investments carried out in the money, capital, exchange and treasury markets.

The loan portfolio placed directly with the public and private sector, is considered for the first tier credit segment while the loan portfolio channeled through banking and non-banking financial intermediaries is considered for the second tier credit segment.

Guarantees granted to banks and non-bank financial intermediaries are included in the credit guarantees segment. The balances of this segment are presented in memorandum accounts and as of December 31, 2018 and 2017, amount to \$79,915 and \$66,147, respectively.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The balances of the Financial Agent segment correspond to activities carried out by mandate of the Federal Government, to manage on its behalf, resources obtained from international financial organizations, and as of December 31, 2018 and 2017, amounted to \$380,375 and \$371,387, respectively, of which \$380,346 and \$371,322, respectively, are recorded in memorandum accounts.

The trustee segment includes administrative services for proprietary and external trusts, which amount to \$1,705,730 and \$1,339,718, respectively as of December 31, 2018 and 2017.

Investment banking and balances of Subsidiaries are included in the "other areas segment". Commissions for structuring of credits, stock market guarantees, as well as the participation in venture capital for public and private companies are included in investment banking.

As of December 31, 2018 and 2017, the assets, liabilities and net income of the main operations by business segments of the Institution are presented below:

2018	Assets		Liabilities & Equity		Net income	
	Amount	%	Amount	%	Amount	%
Markets and treasury	\$ 307,642	52.8	307,642	52.8	1,169	47.9
First tier credit	73,566	12.6	73,566	12.6	1,011	41.5
Second tier credit	186,037	31.9	186,037	31.9	771	31.6
Loan guarantees	-	-	-	-	1,444	59.2
Financial agent	29	-	-	-	32	1.3
Trustee	-	-	-	-	(66)	(2.7)
Other areas	15,643	2.7	15,643	2.7	495	20.3
Retirement benefit and expense	-	-	-	-	(2,417)	(99.1)
Total	\$ 582,917	100	582,917	100	2,439	100

2017	Assets		Liabilities & Equity		Net income	
	Amount	%	Amount	%	Amount	%
Markets and treasury	\$ 271,584	52.6	271,584	52.6	1,269	84.5
First tier credit	63,004	12.2	63,004	12.2	630	41.9
Second tier credit	165,390	32.0	165,390	32.0	395	26.3
Loan guarantees	-	-	-	-	564	37.5
Financial agent	65	-	65	-	80	5.4
Trustee	-	-	-	-	(27)	(1.8)
Other areas	16,187	3.2	16,187	3.2	111	7.3
Retirement benefit and expense	-	-	-	-	(1,520)	(101.1)
Total	\$ 516,230	100	516,230	100	1,502	100

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

For the years ended December 31, 2018 and 2017, income by segment is analyzed as follows:

2018	Markets and Treasury	First Tier credit	Second Tier credit	Loan Guarantees	Financial agent	Trustee	(a) Other areas	Retirement Benefit And expense	Total
Income:									
Financial income net	\$ (a) 1,787	1,219	2,389	3,093	207	198	682	-	9,575
Expenses:									
Operating expense	(417)	(125)	(646)	(403)	(155)	(230)	(126)	-	(2,102)
Operating income	1,370	1,094	1,743	2,690	52	(32)	556	-	7,473
Allowance for loan losses and write-offs	(4)	75	(820)	(1,009)	(2)	(3)	(2)	-	(1,765)
Retiree expense	-	-	-	-	-	-	-	(1,041)	(1,041)
Other expenses and taxes	(b) (197)	(158)	(152)	(237)	(18)	(31)	(59)	(1,376)	(2,228)
Net income	\$ 1,169	1,011	771	1,444	32	(66)	495	(2,417)	2,439
2017									
Income:									
Financial income net	\$ (a) 1,851	873	1,416	2,632	225	192	266	-	7,455
Expenses:									
Operating expense	(361)	(77)	(656)	(340)	(130)	(201)	(149)	-	(1,914)
Operating income	1,490	796	760	2,292	95	(9)	117	-	5,541
Allowance for loan losses and write-offs	(4)	(58)	(301)	(1,603)	(2)	(3)	(1)	-	(1,972)
Retiree expense	-	-	-	-	-	-	-	(970)	(970)
Other expenses and taxes	(c) (217)	(108)	(64)	(125)	(13)	(15)	(5)	(550)	(1,097)
Net income	\$ 1,269	630	395	564	80	(27)	111	(1,520)	1,502

(a) Includes the following areas: investment banking, subsidiaries and other income (expenses) net.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(b) Includes \$852 of current and deferred taxes and ESPS.

(c) Includes \$547 of current and deferred taxes and ESPS.

During 2018, accumulated earnings for the markets and treasury segment amounted to \$1,787, comprised of \$1,844 generated by the operation of the different markets and treasury, as well as the winning effect of \$ 58 coming from the portfolio at maturity and the decrease of \$ 115 corresponding to market commissions, which was 3.5% lower than the one obtained in 2017.

As of December 31, 2018, the net income for the First tier credit amounted to \$1,219, comprised of \$553 of financial margin; other net income by \$566 associated with structuring commissions.

The accumulated financial income for the year ended December 31, 2018 for the Second tier credit amounted to \$2,389, of which \$1,978 correspond to financial margin and \$411 to commissions and other net income associated with the credit operation which highlights the extraordinary net recoveries derived from the collection rights to the accredited Homex for \$ 320. The amount of net financial income in 2018 was 68.7% higher than 2017, due to the increase of 32 basis points in the weighted margin of the loan portfolio which contrasts with the 11 base points reduction observed in the previous year. Also, the average balance of the portfolio increased by 11.7%, going from \$ 138,514 to \$ 154,745.

At December 31, 2018, the credit guarantees segment presents net financial income of \$3,093, including \$1,928 of fees charged for the guarantees granted, as well as \$1,165 of interest on investments and net recoveries.

The net financial income of the credit guarantees segment increased by 17.5% from 2017 to 2018, mainly due to the growth in the balance of proprietary guarantees granted during the last twelve months, increasing from \$72,558 to \$ 79,915.

As of December 31, 2018, the net financial income of the Financial Agent segment amounted to \$207, which represents a decrease of \$ 17 with respect to the commissions obtained in the same period of last year that is partially explained by adjustments in the balances of the managed businesses as well as by the reduction of the commission factor of 0.25% on unpaid balances during the term of the original execution of the project and 0.01% from the following year and until its expiration.

During 2018, in the Trustee segment, net financial income was collected for \$198, 3.2% higher than obtained in the prior year, as a result of the update of the services received based on inflation.

(b) Financial margin

For the years ended December 31, 2018 and 2017, the financial margin in the consolidated statement of income is comprised as shown in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

		2018	
	Total	Local Currency	Foreign Currency
<i>Interest income:</i>			
Interests of performing and nonperforming loan portfolio:			
Commercial loans	\$ 3,782	1,787	1,995
Mortgage loans	4	4	-
Loans to government entities	1,330	1,330	-
Credits granted as agent of The Federal Government	1	-	1
Loans to financial entities	12,749	12,378	371
	17,866	15,499	2,367
Interests and returns earned on investments in securities:			
Trading securities	486	486	-
Securities available for sale	301	-	301
Securities held to maturity	972	927	45
	1,759	1,413	346
Interests and returns earned on repurchase / resell agreements:			
	21,796	21,796	-
Cash and cash equivalents interest:			
Banks	269	-	269
Restricted cash and cash equivalents	1,237	1,187	50
	1,506	1,187	319
Subtotal carried forward to the next page	\$ 42,927	39,895	3,032

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

		2018	
	Total	Local Currency	Foreign Currency
Subtotal brought forward from the previous page	\$ 42,927	39,895	3,032
Commissions from credit operations: (return adjustment)			
Commercial loans	131	131	-
Interest and returns from margin accounts	3	3	-
Gain (loss) from hedging transactions	(6,494)	(5,750)	(744)
Premium on debt placement	13	13	-
Equity dividends	28	28	-
Gain from valuation	3	3	-
	(6,316)	(5,572)	(744)
Total interest income	\$ 36,611	34,323	2,288
<i>Interest expenses:</i>			
Interest from time deposits	11,339	10,405	934
Interest on securities issued	5,441	4,043	1,398
Interest paid on interbank loans and other agencies	818	448	370
Interests and returns paid on repurchase / resell agreements	17,104	17,104	-
Expenses from hedge trading	(6,609)	(5,631)	(978)
Discounts for debt issued	60	60	-
Issuance expenses due to debt placement	23	8	15
Loss from valuation	4,640	-	4,640
Total interest expenses	32,816	26,437	6,379
Financial margin	\$ 3,795	7,886	(4,091)

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

		2017	
	Total	Local Currency	Foreign Currency
<i>Interest income:</i>			
Interests of performing loan portfolio:			
Commercial loans	\$ 2,577	1,038	1,539
Mortgage loans	4	4	-
Consumer loans	1	1	-
Loans to government entities	1,085	1,085	-
Credits granted as agent of The Federal Government	2	-	2
Loans to financial entities	10,189	9,913	276
	13,858	12,041	1,817
Interests and returns earned on investments in securities:			
Trading securities	1,481	1,481	-
Securities available for sale	297	-	297
Securities held to maturity	1,168	1,124	44
	2,946	2,605	341
Interests and returns earned on repurchase / resell agreements:			
	15,286	15,286	-
Cash and cash equivalents interest:			
Banks	214	-	214
Restricted cash and cash equivalents	1,031	979	52
	1,245	979	266
Subtotal carried forward to the next page	\$ 33,335	30,911	2,424

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

		2017	
	Total	Local Currency	Foreign Currency
Subtotal brought forward from the previous page	\$ 33,335	30,911	2,424
Commissions from credit operations:			
Commercial loans	79	79	-
Interest and returns from margin accounts	6	6	-
Gain (loss) from hedging transactions	(7)	134	(141)
Premium on debt placement	12	12	-
Equity dividends	49	49	-
	139	280	(141)
Total interest income	33,474	31,191	2,283
<i>Interest expenses:</i>			
Interest from time deposits	8,136	7,738	398
Interest on securities issued	4,435	3,590	845
Interest paid on interbank loans and other agencies	491	246	245
Interests and returns paid on repurchase / resell agreements	14,781	14,781	-
Expenses from hedge trading	(701)	(3,413)	2,712
Discounts for debt issued	34	34	-
Issuance expenses due to debt placement	18	7	11
Loss from valuation	1,015	-	1,015
Total interest expenses	28,209	22,983	5,226
Financial margin	\$ 5,265	8,208	(2,943)

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(c) Commission and fee income -

For the years ended December 31, 2018 and 2017, the commissions and fee income are analyzed as follows:

2018	Total	Local Currency	Foreign Currency
<i>Commissions and fees earned:</i>			
Credit operations	\$ 404	404	-
Assets in custody or administration	8	8	-
Trustee activities	528	528	-
Others	2,103	2,015	88
	\$ 3,043	2,955	88
<i>Commissions and fees paid:</i>			
Loans received	\$ 10	-	10
Debt placement	1	-	1
Others (services)	187	184	3
	\$ 198	184	14
2017			
<i>Commissions and fees earned:</i>			
Guarantees	\$ 1,848	1,848	-
Credit operations	347	347	-
Guarantees granted	1	1	-
Assets in custody or administration	8	8	-
Trustee activities	330	330	-
Others	291	209	82
	\$ 2,825	2,743	82
<i>Commissions and fees paid:</i>			
Loans received	11	-	11
Debt placement	3	2	1
Distribution	1076	107	-
Others (services)	110	106	4
	\$ 231	215	16

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(d) Financial intermediation income-

For the years ended December 31, 2018 and 2017, financial intermediation income is analyzed as follows:

2018	Total	Local Currency	Foreign Currency
<i>Financial intermediation income</i>			
Gain (loss) from valuation at fair value and decrease from securities valued at cost:			
Trading securities	\$ 311	311	-
Derivative financial instruments for trading purposes	(468)	6	(474)
Derivative financial instruments for hedging purposes	(7)	298	(305)
	(164)	615	(779)
Gain (loss) from securities purchase/sale and derivative financial instruments:			
Trading securities	(46)	(46)	-
Securities available for sale	138	244	(106)
Derivate financial instruments for trading purposes	98	98	-
Result from currency trading	1,289	-	1,289
Financial intermediation income	\$ 1,315	911	404

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2017	Total	Local Currency	Foreign Currency
<i>Financial intermediation income</i>			
Gain (loss) from valuation at fair value and decrease from securities valued at cost:			
Trading securities	\$ 167	167	-
Derivative financial instruments for trading purposes	206	(40)	246
Derivative financial instruments for hedging purposes	34	(36)	70
Collaterals sold	(1)	(1)	-
	406	90	316
Gain (loss) from securities purchase/sale and derivative financial instruments:			
Trading securities	146	146	-
Securities available for sale	(19)	-	(19)
Derivate financial instruments for trading purposes	1,173	1,319	(19)
	1,300	1,319	(19)
Result from currency trading	(2,914)	-	(2,617)
Financial intermediation income	\$ (1,208)	1,409	(2,617)

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(e) Other operating income (expenses)-

For the years ended December 31, 2018 and 2017, other operating income (expenses) is analyzed as follows:

2018	Total	Local Currency	Foreign Currency
<i>Other operating income (expenses):</i>			
Loan portfolio recoveries	\$ 361	361	-
Cancellation of excedent of allowance for loan losses	1,469	1,165	304
Other recoveries	75	75	-
Estimation due to irrecoverability or difficult collection	(357)	(357)	-
Income from sale of property, plant and equipment	18	18	-
Others foreclosed	(7)	(7)	-
Income from sale of foreclosed assets	8	8	-
Income from loans to employees	44	44	-
Other items of operating income (expenses)	(a) (161)	(161)	-
Lease income	55	55	-
	\$ 1,505	1,201	304

- (a)** On November 15, 2018, the Institution paid \$1,376, in accordance with the official letter number 368-067/2018 dated November 13, 2018, issued by the Ministry of Finance and Public Credit, whereby the Federal Government instructs the Institution to pay based on the legal nature of use for furnishing sovereign guarantee of the Federal Government.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

2017	Total	Local Currency	Foreign Currency
<i>Other operating income (expenses):</i>			
Reversal of excesses from allowance for loan losses	930	776	155
Other recoveries	46	46	-
Estimation due to irrecoverability or difficult collection	(190)	(190)	-
Allowance for irrecoverability foreclosed assets	(5)	(5)	-
Other losses	(16)	(16)	-
Income from sale of foreclosed assets	2	2	-
Income from loans to employees	41	41	-
Other items of operating income (expenses)	(a) 228	226	1
Lease income	57	57	-
	\$ 1,093	937	158

(a) On December 13, 2017, the Institution paid \$550, in accordance with the official letter number 102-B-057 dated December 11, 2017, issued by the Ministry of Finance and Public Credit, whereby the Federal Government instructs the Institution to pay based on the legal nature of use for furnishing sovereign guarantee of the Federal Government.

(f) Financial ratios (unaudited) -

The main quarterly financial ratios of the Institution, as of and for the years ended December 31, 2018 and 2017 are presented on the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

	2018			
	1st Q	2nd Q	3rd Q	4th Q
Delinquency index	0.84%	0.80%	0.35%	0.29%
Coverage of past due loan portfolio index.	398.12%	412.85%	807.34%	952.91%
Operating efficiency (administrative and promotional expenses / average total assets)	0.67%	0.62%	0.64%	0.73%
ROE (annualized net income for the quarter/ average stockholder's equity)	9.61%	5.57%	11.76%	1.56%
ROA (annualized net income for the quarter / average total assets)	0.62%	0.35%	0.75%	0.10%
Net capital/ Assets subject to credit risk	22.97%	21.87%	24.18%	21.51%
Net capital/ Assets subject to credit, market and operational risk.	14.18%	14.58%	15.41%	14.52%
Liquidity (liquid assets / liquid liabilities)	3,889.98 %	1,210.03%	1,024.63%	371.17%
Financial margin after allowance for loan losses/ average earning assets	0.05%	0.71%	(0.88%)	0.86%
<u>2017</u>				
Delinquency index	1.06%	0.92%	0.88%	0.82%
Coverage of past due loan portfolio index.	273.82%	319.81%	333.85%	375.81%
Operating efficiency (administrative and promotional expenses / average total assets)	0.72%	0.68%	0.68%	0.59%
ROE (annualized net income for the quarter/ average stockholder's equity)	1.64%	3.73%	5.65%	4.57%
ROA (annualized net income for the quarter / average total assets)	0.10%	0.24%	0.33%	0.29%
Net capital/ Assets subject to credit risk	21.74%	22.08%	21.11%	21.78%
Net capital/ Assets subject to credit, market and operational risk.	13.32%	13.84%	13.41%	14.46%
Liquidity (liquid assets / liquid liabilities)	497.83%	853.86%	4,459.17%	406.49%
Financial margin after allowance for loan losses/ average earning assets	0.67%	0.62%	0.34%	0.61%

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

(25) Commitments and contingencies-

(a) Leases-

Leases provide periodic rental adjustments expense, based on changes in various economic factors. The total rental expense for office property, software and others for the years ended December 31, 2018 and 2017, amounted to \$70 and \$73, respectively.

(b) Claims and trials -

In the normal course of operations, the Institution is involved in some claims and trial, which are not expected to have a material adverse effect on the financial situation and results of its operations. In such cases that represent a probable loss or make a cash outflow, the Institution has made necessary provisions.

(c) Labor liabilities-

There is a contingent liability derived from employee's benefits, which is mentioned in note 3s.

(26) Risk management (unaudited information)-

The national and international regulations on risk management have seen an unprecedented evolution in recent years, incorporating a preventive approach in the financial processes carried out by credit institutions, as well as the obligation to issue internal guidelines to establish controls in order to foresee any economic loss due to the materialization of risks, whether discretionary, non-discretionary or even non-quantifiable.

The Institution, to keep up with the implementation of the requirements from the various provisions of prudential nature in matters of risk management, credit and internal control, applicable to credit institutions, as well as what is indicated by regulatory bodies in Mexico for the prevention of money laundering, has tried to implement international standards from a systematic and integral perspective within its controls and processes.

Discretionary quantifiable risks

Market risk-

The Institution uses the VaR methodology to calculate the market risk of its trading and available for sale portfolios. In general, the methodology that is being applied is the historical simulation. The following general principles, stand out:

- The confidence interval that is being applied in the VaR calculation is 97.5% (considering the extreme left of the profit and loss distribution).
- The base time horizon considered is 1 day.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

In the generation of scenarios, a year of historical information is considered in the risk factors and the risk factors related to domestic and foreign interest rates, spreads, exchange rates, indices and share prices are considered. In addition to the VaR information, sensitivity measures are calculated and stress tests are carried out ("stress-test").

As of July 2005, backtesting tests are carried out on a monthly basis to statistically validate that the market risk measurement model provides reliable results within the parameters chosen by the Institution. As of December 31, 2018 and 2017, the limits to which they are monitored on a daily basis are:

- I. Value at risk: based on the capital allocated to market risks.
- II. Regulatory capital: based on the rules for the capitalization requirements of the Commercial Banks National Credit entities and Development Banking Institutions.
- III. Notionals: referring to the maximum nominal values that can be held in position.
- IV. Maximum loss measure: a limit of maximum losses is established in the face of unfavorable market trends.

The amount of the average VaR for the year 2018 is \$ 63.26, which represents 0.21% of the net capital at the end of December 2018.

Markets	
Amount VaR \$63.264 MDP	
Trading	Treasury
VaR \$33.260 MDP	VaR \$30.004 MDP

Management of assets and liabilities-

The management of assets and liabilities refers to the management of risks that affect the Institution's balance sheet. It includes the management techniques and tools necessary to identify, measure, monitor, control and manage the financial risks (liquidity and interest rates) to which the balance sheet is exposed, and also aims to maximize its adjusted performance due to market risks and, consequently, optimize the use of the Institution's capital.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Liquidity risk-

The liquidity risk that affects a banking institution is classified broadly into three categories:

- I. Market liquidity risk: is the possibility of economic loss due to the difficulty of alienating or cover assets without a significant reduction in its price. This kind of risk as a result of drastic interest rate movements, is incurred when large positions are taken in any instruments or when investments are made in markets or instruments for which there is not a wide supply and demand in the market.
- II. Funding liquidity risk: represents the difficulty of an institution to obtain the necessary results and settle its liabilities, through the revenue, from its assets or through the acquisition of new liabilities. This kind of crisis is usually caused by a sudden and drastic deterioration in the quality of assets that originates an extremely difficulty to turn them into liquid resources.
- III. Liquidity risk by mismatch in cash flows: the inability to meet the present and future needs of cash flows affecting daily operations or financial conditions of the institution, as well as the potential loss from the change in the structure of the balance sheet of the institution because of the time difference between assets and liabilities.

The institution, in compliance with the provisions of comprehensive risk management, developed a contingency financing Plan and stress liquidity scenarios, laying down various measures to monitor, quantify and follow up with the risks listed above, as well as a plan of action at the institutional level, in case of possible liquidity problems.

Maturity profile in local currency-

Active and passive operations in national currency increased 7.3% during the year 2018 compared to the previous year, standing at the end of December at \$ 507,336. Based on regulatory criteria, the maturity gap considers both balance sheet items and memorandum accounts, that is, repo and derivatives. It should be noted that the national currency to be delivered for the sale of dollar forwards has been reclassified as a liability, as the valuation of cross-currency swaps has been reclassified to assets.

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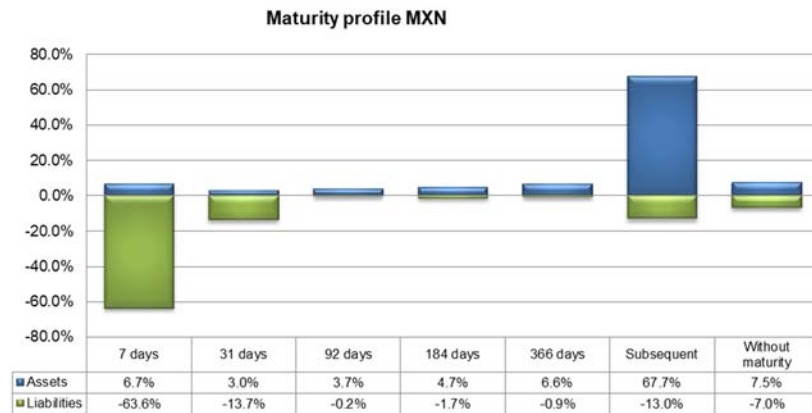
Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Maturity ranges	2018			2017		
	Assets	Liabilities	Gap	Assets	Liabilities	Gap
Up to 7 days	\$ 34,008	322,841	(288,833)	40,189	287,435	(247,246)
Up to 31 days	15,351	69,313	(53,962)	10,885	33,711	(22,826)
Up to 92 days	18,907	1,010	17,897	23,208	50,775	(27,567)
Up to 184 days	23,794	8,489	15,305	23,377	6,272	17,105
Up to 366 days	33,567	4,375	29,192	37,241	985	36,256
Subsequent	343,613	65,753	277,860	313,454	62,171	251,283
With no defined maturity	38,096	35,555	2,541	24,449	31,454	(7,005)
Total	\$ 507,336	507,336	-	472,803	472,803	-

The gap of negative liquidity on the horizon of a month amounts to \$342,795, which is \$(72,723) more than the level recorded in 2017 which amounted to \$270,072.



Maturity profile in foreign currency

Active and passive operations in foreign currency as of December 31, 2018 increased by 34.9% during the year, in relation to the year 2017, resulting from a greater amount in assets and liabilities of less than three months. Based on regulatory criteria, the maturity gap considers both balance sheet items and memorandum accounts, that is, repurchase agreements and derivatives.

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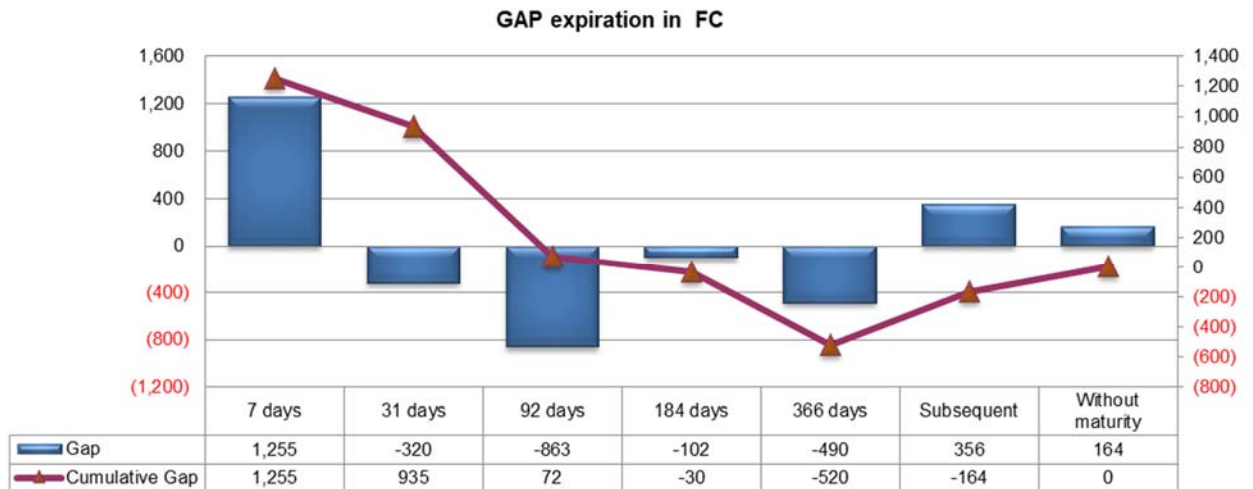
Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Maturity ranges	2018			2017		
	Assets	Liabilities	Gap	Assets	Liabilities	Gap
Up to 7 days	\$ 1,456	201	1,255	853	3,414	(2,561)
Up to 31 days	382	702	(320)	1,772	913	859
Up to 92 days	369	1,232	(863)	2,855	653	2,202
Up to 184 days	30	132	(102)	316	226	90
Up to 366 days	36	526	(490)	54	312	(258)
Subsequent	2,786	2,430	356	2,010	2,508	(498)
With no defined maturity	164	-	164	166	-	166
Total	\$ 5,223	5,223	-	8,026	8,026	-

In accordance with the contractual maturity of assets and liabilities in foreign currency and based on figures of the balance sheet at the end of December 2018, it can be seen that there was a \$1,255 million dollar liquidity in the first 7 days of January of 2019.



(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Estimate of gain or loss on advance sale.

To comply with the provisions of article 81 of the section I, subparagraph (b) of the Provisions, below, is the estimation of results from advance sales of assets under normal and extreme scenarios.

At the end of December 2018 and 2017, considering the scenarios of crisis in the portfolios of corporate trading and investment to maturity, if there was a similar situation to November 9, 2016, it would lead to a loss of \$313.65, equivalent to 2.40% of the value of the position.

Portafolio MN	Position	Advance Sale	Crisis scenarios					
			25/08/1998	11/09/2001	19/09/2002	28/04/2004	16/10/2008	09/11/2016
Corporate trading	1,368.63	(0.07)	(0.30)	1.55	0.34	(0.07)	0.05	0.14
Investment to maturity	11,665.05	(144.02)	(127.62)	(2.87)	(25.94)	(139.57)	(144.02)	(313.79)

Considering the crisis scenarios on the portfolios available for sale and held to maturity of the London branch, if there was a situation similar to the 2016 crisis, this could result in a loss of \$246.5 equivalent to 3.11% of the value of the position.

Portafolio MN	Position	Advance Sale	Crisis scenarios					
			12/10/1998	12/09/2001	19/09/2002	10/05/2004	16/10/2008	09/11/2016
Available for sale	6,823.57	(265.92)	(265.92)	(305.46)	(123.60)	(100.85)	(82.63)	(223.68)
Held to maturity.	1,109.04	(29.27)	(29.27)	(30.12)	(11.74)	(9.98)	(5.24)	22.82

Credit risk-

Credit risk is defined as the possibility that a counterparty or accredited breach in time and form with their credit obligations, it also refers to the loss of value of investment determined by the change in the credit quality of some counterpart or borrowers, without default necessarily occurring.

Expected loss-

The expected loss of the loan portfolio is obtained using the portfolio rating methodology established in the Chapter V of the Provisions, regarding the rating of the loan portfolio. Considering this methodology, the following assumptions are also established:

- The portfolio of former employees is excluded, in order to directly measure the effect of the expected losses of the portfolio with risk from the private sector.
- The contingent portfolio of the credit to the Trust for the Participation to Risks is not considered since this trust is in charge of managing its credit risk.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- Additional reserves are not included.
- The financial agent portfolio is not considered as it is a portfolio without risk
- The nonperforming portfolio is considered, since according to the portfolio qualification methodology based on expected loss, when an event of default occurs, it does not imply that the expected loss is reserved at 100%.

Under the aforementioned assumptions, at the end of December 2018, the total portfolio stood at \$259,204, while the expected loss from the loan portfolio amounted to \$3,205.3 equivalent to 1.24% of the rated portfolio and 1.23% of the total portfolio.

Portfolio	Expected losses allowance		
	Portfolio balance	Expected loss	% Expected loss
Exempt	\$ 115.0	-	-
Risk A	187,398.2	1,404.9	0.75%
Risk B	71,125.0	1,473.1	2.07%
Risk C	48.6	3.0	6.17%
Risk D	180.2	203.2	112.76%
Risk E	737.0	121.1	16.43%
Rated	259,489.0	3,205.3	1.24%
Total	\$ 259,604.0	3,205.3	1.23%

Unexpected loss

Unexpected loss represents the impact that the capital of the Institution could have derived from unusual losses in the loan portfolio, the level of coverage of this loss for the capital and reserves of an institution is an indicator of solvency adjusted for risk of the same.

Since December 2005, the Institution makes the estimation of the unexpected loss of the credit portfolio operations, using Monte Carlo simulation and analytical methodologies, as of that date the stability of these measures has been observed and its behavior in the face of various changes in the environment, to determine which of them should be used as a measure of the risk of the Institution's loan portfolio.

In November 2007, the IRMC concluded that, of the methodologies proposed for the estimation of the unexpected loss of the loan portfolio, the methodology with an economic approach is the one that best aligns with the basic method based on internal Basel II qualifications, according to:

- The similarity of concepts existing between the proposed economic methodology and the capital requirement for credit risk estimated from the Basel II basic approach. This approach allows institutions to estimate with internal methods the capital requirement necessary to support their risk.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- High levels of correlation and similarity in the average capital requirement observed during a year of internal implementation of the proposed credit portfolio unexpected loss methodologies.

In addition, it was considered that the unexpected loss of the loan portfolio should continue to be estimated monthly through the valuation and Monte Carlo methodologies in order to have information regarding future changes in the banking standard in which the portfolio market valuation is requested. These methodologies are applied in a horizon of one year and with a confidence level of 95%

At the end of December 2018, the estimate of unexpected loss under the economic approach amounts to \$19,454 and the credit VaR amounts to \$21,201 and represents 8.16% of the portfolio with risk.

Policies and procedures for granting, controlling and recovering loans

- a) Loans, granted or guaranteed by the Institution, are aimed to finance projects for economic and financial viable companies.
- b) The maximum funding limit is determined based on the needs of the investment project and the assessment of the company or project capacity of payment.
- c) Loans grace periods and terms are established depending on the companies' capacity of payment.
- d) Real guarantees are obtained, preferably mortgage securities in an appropriate and sufficient proportion, according to the loan characteristics and, where appropriate, in accordance with the financial broker that grants it.
- e) Regarding loan guarantees granted by the Institution, these are complementary to those which have to offered by the borrowers and do not substitute those guarantees. Accordingly, brokers should negotiate with the borrowers the guarantees for the loan granted.
- f) The borrower must have a proven integrity and creditworthiness.
- g) Credit granting operations, either for Banking Financial Broker (BFB) and Non-Banking Financial Broker (NBFB), is carried out at the head office. The Institution carries out on monthly basis and quarterly basis a reconciliation of balances with the NBFB and BFB, respectively.
- h) Portfolio turnover is carried out through the Institutional Portfolio Recovery and Administration System (SIRAC), managed by the Credit Administration Office.

(Continued)

Nacional Financiera, S. N. C.,
 Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- i) No new credit operations are carried out with the creditor company, as long as there are past-due loans with that company.
- j) Out-of-court collection procedures are realized in the portfolio with 30 to 90 days of default.
- k) Once 90 days of default of a debt have elapsed, the loan balance is considered nonperforming and collection is made through legal means, either directly in the case of first tier loans or through financial brokers in the case of discounted loans.

The Institution's main policies and procedures for the evaluation and follow-up on loans risks in accordance with the type of operation are as follows:

Second Tier operations

- a) Financial Brokers modality "A", defined as banks or factoring companies and leasing entities that are part of a financial group. These brokers, given the mechanism of payment, which is a charge to its account at the Central Bank, are considered at lower risk scale.

A "Credit Risk Limit Assignment Methodology to Operate with Banks in Mexico" has been established for these brokers, which sets forth the maximum credit risk levels that it is willing to accept with each one of these brokers, in both credit and discount operation, as well as financial market operations. The established limits are followed up on every day, and the limits are updated every month. Considering their high creditworthiness, supervision of the broker is carried out by monitoring the broker through the evolution of its risk rating, and annual visits are realized.

- b) Modality "B" Financial brokers applies to all the NFBF that do not form part of a financial group. They are considered as a regular source of credit risk. Consequently, specific rules and regulations have been established that these brokers must comply with to enter brokerage and trading with the Institution's resources.

Supervision mechanisms have been established for these brokers, with follow up on their financial evolution on a monthly basis, as well as compliance with the regulations that have been imposed thereon. In addition, credits granted to brokers are rated according to the drawdowns, and biannual or annual supervision visits are realized based on their risk rating.

First Tier Operations

This operation is marginal for the Institution. A follow-up mechanism for credit risk is established based on the loan portfolio risk rating, in accordance with the established guidelines.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Guarantee program operations

A monthly follow-up has been established for the operations portfolio of the guarantee program, which includes the analysis of yields, analysis of the results of the follow-up on the processes agreed upon with banks at a sample level, and the analysis of the financial evolution of the deeds of trust established in the Institution. Banks that participate in this program independently submit the loans covered under the guarantee program, to their own credit risk follow-up policies and procedures, as well as the risk rating in accordance with the established guidelines.

Risk of counterparty and diversification-

In the Institution, an integral control of counterparty risk is exercised, applying the established credit exposure limits. These limits consider the operations throughout the entire balance sheet, that is, both the financial markets and the credit portfolio. The methodology used is consistent with the General Rules for the Diversification of Risks in the Realization of Active and Passive Operations Applicable to Credit Institutions. At the end of December 2018 and 2017, no economic group concentrates credit risk above the maximum financing limits.

As of December 31, 2018 and 2017, the number of financing exceeding 10% of the basic capital individually is shown below:

Number of financing	Total amount	Capital percentage
30	\$ 237,542	875.2 %

As of December 31, 2018, the amount of financing that is held with the three largest debtors, or, where applicable, groups of people representing common risk, amounts to \$ 13,407.

Operational risk and non-quantifiable

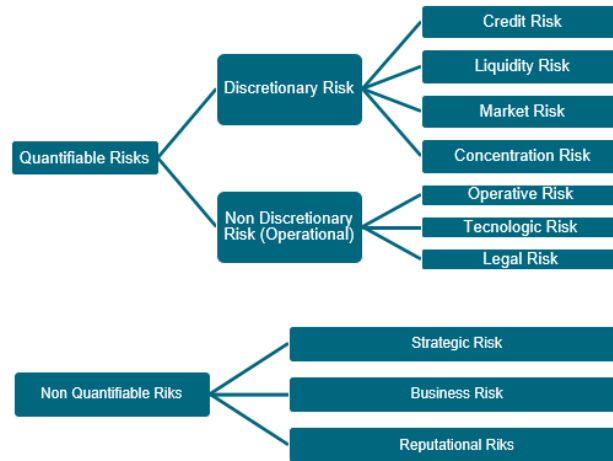
The risks to which a financial institution is exposed are classified into two broad categories; quantifiable and not quantifiable. The quantifiable and non-quantifiable risks, in turn, are divided as shown on the following page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)



The non-discretionary risks, that is, the operational risk, are those resulting from the operation of the business, but they are not the result of taking a risk position. These risks are defined below.

- Operational Risk: potential losses derived from failures or deficiencies of internal controls, due to errors in the processing and storage of operations.
- Technological risk: potential losses derived from damages, interruption, alteration or failures derived from the use or dependence on hardware, software, systems, applications, networks and any other channel of information distribution in the provision of banking services with customers of the Institution that derive in errors in the processing and storage of operations or in the transmission of information.
- Legal Risk: potential losses derived from the applicable legal and administrative provisions, the issuance of unfavorable administrative and judicial resolutions and the application of sanctions, in relation to the operations carried out by the institutions.

Non-quantifiable risks are unforeseen events to which a statistical base cannot be formed to measure potential losses, among which are the following:

- Strategic risk: potential losses by deficiencies in the decision-making process, in the implementation of procedures and actions to carry out the business model and strategies of the institution, as well as the lack of knowledge about the risks to which it is exposed by the development of its business activity and that affect expected results to achieve the objectives agreed upon by the institution in its strategic plan.
- Business risk: potential losses attributable to the inherent characteristics of the business and changes in the economic cycle or environment in which the institution operates.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- Reputation risk: potential losses in the development of the activity of the institution proceeding from the impairment in perception that have the different parties concerned, both internal and external, on its solvency and viability.

The objective of managing operational risk and non-quantifiable risks is to formally establish the rules and policies necessary to systematically and efficiently carry out the identification, measurement, monitoring, limitation, control, information and disclosure of non-discretionary risks and non-quantifiable, which all areas of the Institution that are involved in activities that imply a non-discretionary or non-quantifiable risk must apply, as well as the purpose of ensuring the timely identification of the capital requirements and the resources derived from these risks.

The policies for the management of operational risk and non-quantifiable risks are the following:

- It is the responsibility of the Operational Risk Sub-Direction to define the procedures for the management of inherent and residual operational risks, economic loss events, tolerance levels, risk limits, amounts of probable potential losses derived from judicial resolutions or administrative unfavorable litigation in which the Institution is the plaintiff.
- None of the procedures defined for these risks may be modified or altered, only with the authorization of the Integral Risk Management Committee and annually by the Board of Directors.
- The necessary evidence will be available to manage non-discretionary and non-quantifiable risks.
- The tools that have been developed or acquired by the Institution will be used to manage operational risk and non-quantifiable risks.

The strategy for operational risk and non-quantifiable risks is to identify, manage, quantify (if applicable), document the way to mitigate them through controls and processes considering the institutional expertise of risks, which could impact or violate the solvency of the Institution above the minimum requirements and with this help in the fulfillment of the institutional goals and objectives. Also to disclose in a timely manner the information of these risks to the Governing Bodies for timely decision-making. Likewise, promote the culture of the administration of these types of risks in the Institution.

The process of operational risks is fundamental and is documented and certified according to the quality management system under the ISO 9001-2015 Standard that contributes to the achievement of the objective of managing the operational risk to which the Institution is exposed.

The structure of the staff that manages non-discretionary and non-quantifiable risks has three elements, counting the Deputy Director of Operational Risk.

In relation to the scope and nature of information systems and measurement of operational risks and their reports, the Institution uses the institutional system called Operational Risk Tool to which the information of the results obtained from operational risk monitoring is incorporated, and where everything related to internal reports and regulatory reports (classifications and quantification) is managed.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The reports related to the management of operational risk (including technological and legal) are made in the IRMC through the "Risk management and monitoring report" that has at least a quarterly periodicity.

Methodologies, limits and tolerance levels.

Method to determine the capital requirement for operational risk-

The institution uses the basic indicator method to calculate the capital requirement for their exposure to operational risk, following the methodology described in the provisions.

Non-discretionary risks:

Operational risk-

The methodology used for the management of operational risk (quantitative and qualitative analysis) is through an internal institutional model of operational risk, which is based on a scorecard that considers five risk factors. This methodology is applied to the results of the self-assessments of the processes that describe the Institution's task and allows the comparison of the processes analyzed with two indicators; nature and efficiency, which have defined tolerance levels by risk factor and by indicator.

In addition, the inherent and potential risks of each process are identified, classified and qualified based on the methodology defined by the Banking Commission and the result is sent in an annual report called "Estimation of operational risk levels". The methodology of the Banking Commission provides product catalogs, process, line of business, type of risk and a guide for the calculation of frequency and impact of the inherent risk (without applying controls).

Considering the results obtained, it has been defined that for the inherent risks located in the quadrant nine red zone (high frequency and high impact), together with those responsible for the process to which it belongs, additional actions or controls for its administration will be defined.

The quantitative analysis is carried out through the events of loss due to operational risk aroused in the institution and whose information is provided by the owners of the processes involved. These events are classified according to the methodology defined by the Commission to carry out the regulatory reports "Events of loss due to operational risk" and "Update of loss events due to operational risk". The methodology of the Banking Commission provides the catalogs of the product, process, line of business and type of risk. For the monitoring of loss events, an operational risk limit was defined considering the positive net income of three years, considering methodologies and comments from the Banking Commission.

Technological risk-

The technological risk methodology to identify, quantify and manage this risk is performed by IT and is based on five indicators which are network security, virus detection and blocking, availability of critical services and non-critical ones. As a control of risk monitoring, IRMC is informed at least quarterly.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Its monitoring is monthly and is carried out by comparing the levels obtained in each indicator that considers the events reported by the users areas against the tolerance levels agreed between the area of computer science and these areas. This risk information is captured by the IT area directly in the operational risk tool.

Legal risk-

There is an internal methodology for estimating the registry of potential losses in terms of legal risk, based on the expectations of specialists to obtain a favorable resolution, classifying them into five bands:

- Without sufficient evidence.
- High.
- Moderate.
- Considerable.
- Low.

The application of the methodology is carried out by the Litigation and Credit Legal Department, the staff identifies, quantifies and manages the legal risk. As a control of risk monitoring, IRMC is informed at least quarterly.

The results of the potential losses are grouped, analyzed and reported, with at least a quarterly periodicity to the IRMC, by type of suits, which are the following:

- Labour nature
- Contentious portfolio
- Trust
- Commercial
- Treasury and stock trading

Risks on the assets of the institution

They are those derived from casualties or unforeseen external events that cannot be associated with a probability of occurrence and for which the economic losses caused can be transferred to external entities that bear risks.

<u>Type of risk</u>	<u>Definition</u>	<u>Example</u>
Damage	Risk of loss due to catastrophic natural events that can interrupt the operation or affect assets of the institution.	Fire, earthquake, volcanic eruption, hurricane, among others.
External	Risk of loss caused by entities outside the institution.	Vandalism, seedlings, etc.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

For this type of risk, monitoring is carried out considering the following criteria:

<u>Inventory</u>	<u>Control Measures</u>	<u>Economic impact</u>
Institution Assets	Institutional Program for Assets Insurance	Payment of premiums
Foreclosed Assets	Premium payments Institutional Program for Assurance Assets Deductibles in case of materialization.	Deductibles in case of materialization.

During the years 2018 and 2017, were covered, via policy, the damages that occur within the national territory and abroad of tangible and intangible assets (all kinds of software or packages of programs, licenses, permits, technology information and database) including in general material damages, civil liability, accidental breakage of glass including neon signs, theft and/or assault with violence or without violence, theft of money and securities, banking, electrical equipment, Electromechanical, electronic, electromagnetic and fixed and mobile telephony, boilers and equipment subject to pressure, breakage of machinery, equipment contractor, goods in transit (transport), works of art, and difficult or impossible to reposition objects, money and values, outfitting and safety equipment, personal accident, infidelity of employees and terrorism. A policy covering the vehicle fleet also exists.

Non-quantifiable risks

The implemented methodologies are in accordance with the Provisions. A brief description of these is provided as follows:

- Strategic risk. -The institution has a methodology based on defining, documenting, and following-up on the Institution's Management strategies, which, each year are defined and approved, as well as presented to the Board of director, at least on a quarterly basis, for the decision making and mitigation of detected risks.
- Business risk. - Four indicators that help to identify the possible materialization of the risks that could affect the Institution derived from movements in the financial environment and the economic cycle were defined as a methodology to manage this risk. These indicators are given monthly monitoring through risk reports.
- Reputation risk. - For the administration of this risk, a Communication Plan was defined applied and monitored by the Social Communication Management, said Plan considers the attention to the minimum requirements issued by the Banking Commission in the Provisions regarding the reputation risk. The Social Communication Management monitors the events that affect the negative perception that is held internally or externally of the Institution. As a control of this risk, the IRMC is informed at least quarterly.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Operational risk results:

Results of self-assessments-

The result of the most relevant processes of the Institution in terms of its nature at the end of December 2018, is as follows:

<u>Process</u>	<u>Nature Indicator */</u>	<u>Tolerance Level</u>
Prevention and identification of Operations with Resources of Illegal Origin - BDTT (Database)	138.56	Medium high risk
SPEI operation **	130.97	High risk
Cash flow management and control*	117.56	Medium high risk
Treasury management*	114.10	Medium high risk
Exchange Market *	113.67	Medium high risk
Money market*	110.70	Medium High risk
General cash Fund*	108.73	Medium high risk
Derivatives market *	107.57	Medium high risk
Selective Guarantees management*	105.50	Medium high risk
Securities loan*	99.30	Medium risk
Capital market*	97.02	Medium risk
Trust*	96.65	Medium risk
Credit control desk operation*	95.88	Medium risk
Provision of contentious legal services and banking formalization*	94.11	Medium risk
Custody and Administration of Securities and Cash *	92.97	Medium risk
Administration of Automatic Guarantees *	92.71	Medium risk
Permanent Portfolio in shares and trusts *	89.60	Medium risk
Save values and central file *	88.92	Medium risk

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Process	Nature Indicator */	Tolerance Level
Recovery of First Floor Portfolios, Emerging Programs and Exemployee *	85.68	Medium risk
Electronic Products management	84.55	Medium risk
Financial agent Back office	84.09	Medium high risk
Recovery of Second tier Portfolio *	83.02	Medium risk
Spending operation*	78.40	Medium risk
Rating of Portfolio, Reserves and Regulatory Reports *	62.78	Medium risk

The result obtained at the end of December 2018 of the most relevant processes that describe the Institution's work, in terms of efficiency, is shown below:

Name of process	Efficiency indicator */	Tolerance level
Exchange market*	72.15	Medium risk
Prevention and identification of Operations with Resources of Illegal Origin - BDTT (Database) *	62.80	Low risk
Spending operation *	57.39	Medium risk
Safe value and central file*	56.58	Low risk
Trust*	56.01	Low risk
Money market*	55.14	Low risk
Provision of contentious legal services and banking formalization *	54.60	Low risk
SPEI operation**	54.30	Low risk
Treasury management*	53.49	Low risk

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Name of process	Efficiency indicator */	Tolerance level
Derivatives market*	52.35	Low risk
Selective Guarantees management*	52.34	Low risk
Automatic Guarantees management*	52.06	Medium risk
Capital market*	50.90	Low risk
Securities and cash custody and management *	50.52	Low risk
Electronic Products management *	50.11	Low risk
Recovery of Second tier Portfolio *	48.71	Low risk
Cash flow management and control*	48.65	Low risk
Credit Control Table Operation *	47.88	Low risk
Securities lending*	46.92	Low risk
General cash fund*	46.40	Low risk
Permanent Portfolio in shares and trusts *	46.08	Low risk

* / The higher score, the more critical in terms of efficiency of the process

* Assessed under the new methodology

** Does not belong to the Quality Management system but is considered critical

During 2018, no inherent potential operational risk was identified or recorded in the red zone, i.e. zone nine (high frequency and high impact), so the established risk limit was met.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Results of the events of economic losses.

During the year 2018, forty-five loss events were accounted for due to operational risk with a likely impact of \$7.24. The monthly average was four events with an amount of \$0.60.

Quarter	Number of events	Likely economic impact	% of LEI (IEP) each month
January	3	0.00	0.00%
February	1	0.00	0.00%
March	5	0.00	0.04%
April	8	0.00	0.00%
May	2	0.00	0.00%
June	6	0.25	3.48%
July	5	0.05	0.69%
August	7	4.64	64.08%
September	2	0.00	0.00%
October	4	2.30	31.71%
November	-	0.00	0.00%
December	-	0.00	0.00%
Total	43	7.24	100%

The consumption of the limit of the events of economic loss at the end of each month of year 2018 was within the established parameters, with the exception of September, where it held an exposure of \$4.64.

Result of technological risk indicators

During the twelve months of 2018, the indicator level of security to the network had zero intrusions, the indicator of recovery of critical services under disaster drills had 100% of behavior, likewise, the indicator of detection and blocking of virus to the network had zero impacts. The quarterly and monthly average of these three risk indicators were located in the defined goal.

The behavior of the indicator of availability of critical services in the twelve months of year 2018 is as follows:



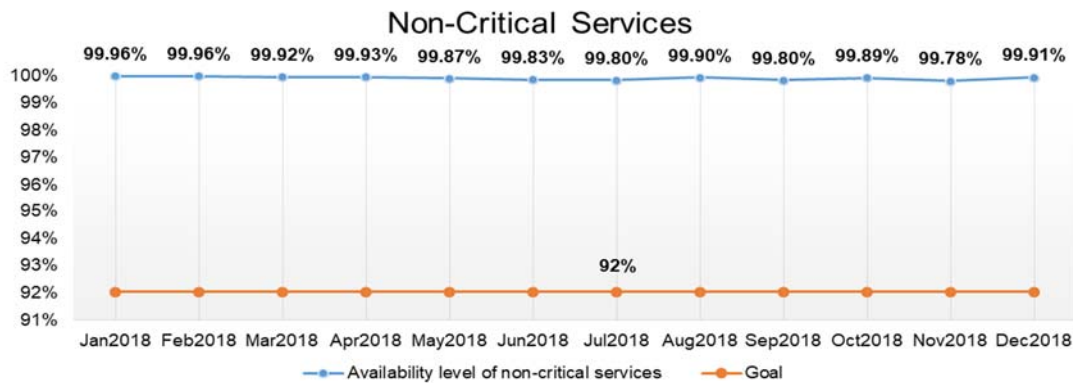
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Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

The behavior of the availability of non-critical services indicator in the twelve months of the year 2018, is as follows:



The five technological risk indicators were found within the goals established for the management of this risk.

During the year 2018, annual average and quarterly average behavior of the indicators; Availability of critical services and the availability of non-critical services were as follows:

T.R. indicator description	Jan2018	Feb2018	Mar2018	Apr2018	May2018	Jun2018	Jul2018	Aug2018	Sep2018	Oct2018	Nov2018	Dec2018	Prom Monthly 2018
Availability level of critical services	99.73 %	99.64%	99.66%	99.44%	99.73%	99.30%	99.39%	99.70%	99.95%	99.82%	99.96%	99.70%	99.65%
Availability level of non-critical services	99.89%	99.89%	99.92%	99.91%	99.87%	99.83%	99.80%	99.90%	99.80%	99.89%	99.78%	99.91%	99.88%

The quarterly and annual average of the availability level of critical and non-critical services were within the established goals.

Result of the legal risk-

At the end of December 2018, the statement that keeps the record of potential losses in terms of legal risk is shown in the next page.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Type of lawsuit	Contingency	Provision	Provision/ Contingency	Income Loss	Income or loss Provision
Total (1+2+3+4)	\$ 133.37	50.46	37.84%	\$ 12.20	24.18%
1) Labor nature	34.54	19.94	57.74%	11.37	57.02%
2) Litigation portfolio	12.51	11.24	89.84%	0.02	0.22%
3) Trusts	86.33	19.29	22.34%	0.81	4.19%
4) Treasury and securities trading	0.00	0.00	0.00%	0	0.00%

1. The contingency of the Labor Portfolio reports an amount of \$ 34.54, which had an increase of 12.95% with respect to the closing of the previous quarter that is equivalent to an amount of \$ 3.96. The provision reports an amount of \$ 19.94, which had an increase of 39.18% with respect to the closing of the previous quarter, which is equivalent to an amount of \$ 5.61. The movement in the Contingency and Provision is derived mainly from the update in the expectation of the demand and the amounts demanded according to the law. In the fourth quarter of 2018, the favorable termination to the interests of the Institution was obtained in three non-labor litigations and six indirect labor litigation, all of them of an undetermined amount, in which the Institution was acquitted of all the claimed benefits.

Likewise, during the reporting period, a direct labor case concluded in which the Institution was acquitted of benefits equal to \$1.67 and, on the other hand, concluded a direct labor trial in which the Institution was ordered to pay equivalent benefits of \$1.15.

The aforementioned resulted in the fact that, in the fiscal year 2018, 18 non-labor lawsuits filed against our Institution, 17 corresponding to non-quantifiable benefits and a trial in which benefits were claimed for \$3.27 were finally concluded, obtaining favorable resolutions in 100% of them and absolving Nacional Financiera, S.N.C. of the totality of the claim, which resulted in the release of contingencies for \$0.81.

While, regarding the labor lawsuits filed against our Institution, during fiscal year 2018, 17 indirect labor lawsuits and 5 direct labor lawsuits were concluded, with favorable resolutions in all of them and absolving Nacional Financiera, S.N.C. of claimed benefits for \$12.75; As regards resolutions against the Institution, these derived from 4 direct labor lawsuits with condemnatory awards of \$5.13.

2. The contingency of Contentious Portfolio reports an amount of \$12.51, which had an increase of 0.19%, which is equivalent to \$0.02.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

3. The contingency for Trusts reports an amount of \$86.33, with an increase of 1.57% compared to the close of the previous quarter, which is equivalent to an amount of \$1.33. The provision of Trusts recorded an increase compared to the previous quarter's closing of 1.19%, which is equivalent to an amount of \$0.22. The movement in the Contingency was derived mainly from the volatility of the MXP / USD exchange rate.

At the end of December 2018 there is a contingency of approximately \$133.37, a provision that amounts to \$50.46 and an effect on results of \$12.20.

Non-quantifiable risks

Results in the affectations to the patrimonial assets of the Institution: During the year 2018, five claims were reported that affected the patrimonial assets of the Institution in the branch related to electronic and diverse equipment, with an estimated amount of \$ 28 thousand of Mexican pesos.

Strategic risk: During the year 2018, at least quarterly monitoring of the compliance behavior of senior management goals has been carried out to identify, in an expert manner, the main risks in order to mitigate them and make decisions that do not cause failure to comply with the Institution's goals.

Business risk: During the year 2018, the indicators defined by management for this risk were monitored, through market risk, reports, stressing that there are no variances out of the established limit.



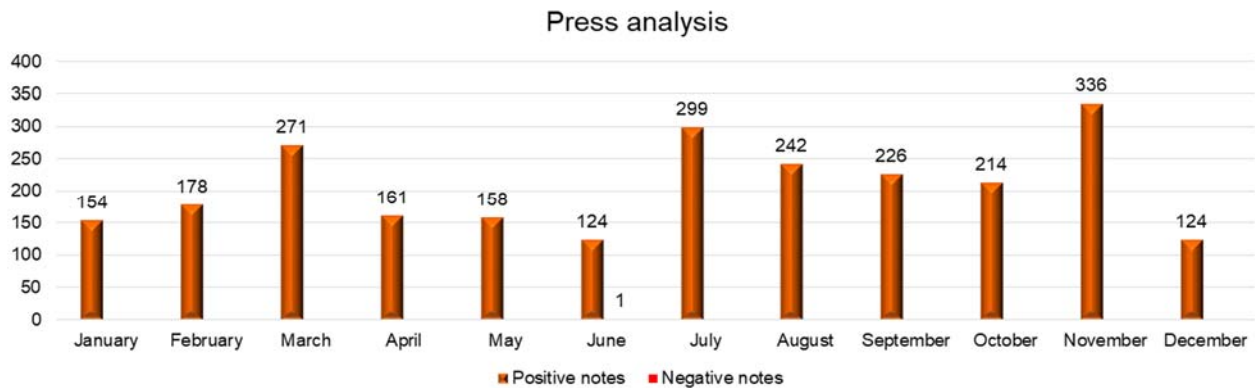
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Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Reputation risk: During the year 2018, the Social Communication Management met the minimum requirements in terms of reputation risk issued by the Banking Commission in the Provisions, additionally they monitored events that affect the negative perception that is held both internally and externally on a monthly basis, analyzing the positive and negative notes via printed, electronic communication channels, internet portals and state information.



Leverage ratio

The information related to leverage is disclosed with figures as of December 2018, in compliance with the Resolution that modifies the general provisions applicable to credit institutions, published by *Diario Oficial de la Federación* (Official Gazette) on June 22, 2016, article 2 Bis 120, articles 180, 181 and annex 1 - O Bis:

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

TABLE I.1
STANDARDIZED DISCLOSURE FORMAT FOR THE LEVERAGE RATIO

REFERENCE	CATEGORY	AMOUNT
Exposures in the balance		
1	Items on the balance sheet (excluding derivative financial instruments and repurchase and securities lending operations -SFT by its acronym in English- but including the collateral received as guarantee and recorded in the balance sheet)	574,669
2	(Amounts of assets deducted to determine the level 1 of Basel III capital)	-
3	Exposures within the balance sheet (net) (excluded derivative financial instruments and SFT, sum of lines 1 and 2)	574,669
Exposure to derivative financial instruments		
4	Current replacement cost associated with all operations with derivative financial instruments (net of the margin of variation in admissible cash)	-
5	Amounts of additional factors due to future potential exposure, associated with all operations with derivative financial instruments	2,042
6	Increase in collateral contributed in operations with derivative financial instruments when said collaterals are derecognized from the balance sheet in accordance with the operating accounting framework	N.A.
7	(Deductions to accounts receivable for variation margin in cash contributed in operations with derivative financial instruments)	-
8	(Exposure due to transactions in derivative financial instruments on behalf of clients, in which the settlement partner does not grant its guarantee in case of breach of the obligations of the Central Counterparty)	N.A.
9	Adjusted notional cash amount of the credit derivative financial instruments subscribed	N.A.
10	(Offsetting made to the adjusted notional cash of the credit derivative financial instruments subscribed and deductions of the additional factors by the credit derivative financial instruments subscribed)	N.A.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

11	Total exposure to derivative financial instruments (sum of lines 4 and 10)	2,042
Exposures for financing transactions with securities		
12	Gross SFT assets (without recognition offsetting), after adjustments for accounting transactions for sales	17,066
13	(Accounts payable and receivable from SFT compensated)	(17,066)
14	Counterparty Risk Exposure by SFT	194
15	Exposures by SFT acting on behalf of third parties	-
16	Total exposures from securities financing transactions (sum of lines 12 to 15)	194
Other off-balance sheet exposures		
17	Off balance sheet exposures (gross notional amount)	149,733
18	(Adjustments for conversion to credit equivalents)	(134,760)
19	Items out of balance (sum of lines 17 and 18)	14,973
Capital and total exposures		
20	Tier 1 capital	29,478
21	Total exposures (sum of lines 3, 11, 16 and 19)	591,878
Leverage ratio		
22	Basel III leverage ratio	5.0%

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

TABLE II.1
ADJUSTED ASSETS AND TOTAL ASSETS COMPARATIVE

REFERENCE	DESCRIPTION	AMOUNT
1	Total assets	597,605
2	Adjustment for investments in the capital of banking, financial, insurance or commercial entities that are consolidated for accounting purposes, but are outside the scope of regulatory consolidation	-
3	Adjustment related to trust assets recognized in the balance sheet in accordance with the accounting framework, but excluded from the exposure measure of the leverage ratio	N.A.
4	Derivative financial instruments adjustment	(3,828)
5	Repurchase/resell agreements and securities lending transactions adjustment	(16,872)
6	Adjustment for items recognized in the balance sheet	14,973
7	Other adjustments	-
8	Exposure of the leverage ratio	591,878

TABLE III.1
RECONCILIATION OF TOTAL ASSETS AND EXPOSURE WITHIN THE BALANCE

REFERENCE	CONCEPT	AMOUNT
1	Total assets	597,605
2	Derivative financial instruments transactions	(5,870)
3	Repurchase/resell and securities lending transactions	(17,066)
4	Trust assets recognized in the balance sheet in accordance with the accounting framework, but excluded from the exposure measure of the leverage ratio	N.A.
5	Exposures in the Balance	574,669

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

TABLE IV.1

**MAIN CAUSES OF THE MAJOR VARIATIONS OF THE ELEMENTS
(NUMERATOR AND DENOMINATOR) OF LEVERAGE RATIO**

CONCEPT/QUARTER	Nov 18	Dec 18	VARIATION (%)
Basic capital	27,355	29,478	17.8%
Adjusted assets	575,503	591,878	2.8%
Leverage ratio	4.75%	4.98%	4.8%

(27) Recently issued financial reporting standards

Changes in the provisions of the Banking Commission

On December 27, 2017, the Banking Commission published in the Official Gazette various modifications to the Accounting Criteria. These changes will be effective on January 1, 2019, Management is in the process of evaluating the effects that these modifications will have on the financial information. Most relevant changes are shown below:

Criterion A-2 "Application of particular rules"

Certain MFRS issued by the CINIF are incorporated, with the purpose of being applicable to the credit institutions, so as the term for its application, in order for credit institutions to comply with them. Mentioned MFRS are the following: B-17 "Fair value determination", C-16 "Impairment of financial instruments receivable", C-19 "Financial instruments payable", C-20 "SPPI Financial instruments", D-1 "Revenue from contracts with customers" and D-2 "Costs from contracts with customers".

Criterion B-6 "Loan portfolio" and D-2 "Income statement"

Accounting Criteria for credit institutions are adjusted so these institutions be able to cancel, in the period of occurrence, excess of allowance for loan losses, as well as to recognize recovery of loans previously impaired in the "allowance for loan losses" caption in the consolidated income statement.

Management is assessing the possible impacts of the change in the Provisions on the financial statements.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

Standards recently issued by the CINIF

The CINIF has issued the MFRS and improvements listed below:

MFRS B-17 “Determination of fair value”- effective for years beginning on or after January 1, 2018 (January 1, 2019 for credit institutions). Changes in valuation or disclosure have to be recognized prospectively. It establishes the valuation and disclosure standards in the determination of fair value, in initial and subsequent recognition, if the fair value is required or allowed by other specific MFRS

MFRS C-16 “Impairment of financial instruments receivable”- effective for years beginning on January 1, 2018 (January 1, 2019 for credit institutions) with retrospective effects. It establishes standards for the accounting recognition of impairment losses of all financial instruments receivable; it indicates when and how an expected impairment loss should be recognized and establishes the methodology for determination.

The primary changes arising from this MFRS consist of determining when and how expected impairment losses on financial instruments receivable should be recognized, including:

- It establishes that impairment losses on financial instruments receivable should be recognized if the credit risk increases and thus it is concluded that a portion of future cash flows of the financial instruments receivable will not be recovered.
- It proposes recognizing the expected loss based on the entity's historical experience of credit losses, current conditions and reasonable and supportable forecasts of the various quantifiable future events that could affect the amount of future cash flows of the financial instruments receivable.
- With regard to interest-bearing financial instruments receivable, it establishes estimating how much of the financial instruments receivable amount is deemed recoverable and when, since the recoverable amount must be recorded at present value.

MFRS C-19 “Financial instruments payable” - effective for years beginning on or after January 1, 2018 (January 1, 2019 for credit institutions) with retrospective effects. Some of the main points covered by this MFRS include the following

- It provides for the possibility of measuring, subsequent to their initial recognition, certain financial liabilities at fair value when certain conditions are fulfilled.
- Long-term liabilities are initially recognized at present value.
- In restructuring a liability, without the future cash flows for its settlement being substantially modified, the costs and commissions expensed in this process shall affect the amount of the liability and be amortized on a modified effective interest rate basis instead of directly affecting net income or loss.

(Continued)

Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- It includes the provisions of IFRIC 19 “Extinguishing Financial Liabilities with Equity Instruments”, which was not provided for by the existing standard.
- The effect of extinguishing a financial liability should be presented as financial income (loss) in the comprehensive statement of income.
- It introduces the concepts of amortized cost in valuing financial liabilities and of the effective interest method based on the effective interest rate.

MFRS C-20 “SPPI Financing instruments receivable” - effective for years beginning January 1, 2018 (January 1, 2019 for credit institutions), and is applicable retrospectively. Some of the main aspects resulting from the adoption of this MFRS are as follows:

- Classification of financial instruments within assets. To determine such classification, the concept of intention to acquire and hold financial instruments has been removed. Instead, the concept of business management model is adopted, either for obtaining a contractual yield, generating a contractual yield and selling in order to achieve certain strategic objectives, or generating earnings from the purchase and sale thereof, in order to classify them in accordance with the respective model.
- The valuation effect of investments in financial instruments is also focused on the business model.
- The reclassification of financial instruments is not permitted among receivables, strategic investments, and negotiable instruments, unless the entity changes its business model.
- An embedded derivative that modifies the cash flows of principal and interest is not separated from its host receivable financial instrument. The entire receivable financial instrument shall be measured at fair value, as if it were a negotiable financial instrument.

MFRS D-1 “Revenue from contracts with customers”- establishes standards for the accounting recognition of revenues arising from contracts with customers and is effective for periods beginning on or after January 1, 2018 (January 1, 2019 for credit institutions), and is applicable retrospectively. It eliminates the supplementary application of International Accounting Standard (IAS) 18 “Revenues”, SIC 31 “Revenues – Barter transactions of advertising services”, IFRIC 13 “Customer Loyalty Programs”, and IFRIC 18 “Transfers of assets from customers”. Additionally, this MFRS, along with MFRS D-2, repeals Bulletin D-7 “Construction and manufacturing contracts of certain capital goods” and IFRS 14 “Construction, sales and service contracts related to real estate”. Some of the primary changes are the following:

- The transfer of control as basis for the opportunity of revenue recognition is established.
- The identification of the obligations to be fulfilled in a contract is required.

(Continued)

140
Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

(Millions of Mexican pesos)

- It indicates that the transaction amount between obligations to fulfill must be assigned based on independent sales prices.
- The concept “conditional account receivable” is introduced.
- The recognition of collection rights is required.
- Requirements and guidance on how to value the variable consideration and other aspects, upon valuing the income are established.

MFRS D-2 “Costs from contracts with customers” - establishes rules for the accounting recognition of costs of sales of goods or provision of services. This is effective for periods starting on or after January 1, 2018 (January 1, 2019 for credit institutions), and is applicable retrospectively. Along with MFRS D-1 “*Revenues from contracts with customers*”, it repeals Bulletin D-7 “*Construction and manufacturing contracts of certain capital goods*” and IFRS 14 “*Construction, sales and service contracts related to real estate*”, except regarding the recognition of assets and liabilities in this type of contracts within the scope of other MFRS.

The primary change is the separation of the standard related to the recognition of revenues from contracts with customers, from the standard corresponding to the recognition of costs for contracts with customers. Additionally, it extends the scope of Bulletin D-7, referring exclusively to costs related to construction and manufacturing contracts for certain capital goods, to include costs related to all types of contracts with customers.

MFRS mentioned will come into force as of January 1, 2020 according to the resolution that modifies the general provisions applicable to credit institutions published in the Official Gazette of the Federation on November 15, 2018.

Management is evaluating the possible impacts of the MFRS in the financial statements, considering if they are applicable or if there is specific criterion of the Banking Commission in this regard.

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Nacional Financiera, S. N. C.,
Institución de Banca de Desarrollo
and Subsidiaries

Notes to the Consolidated Financial Statements

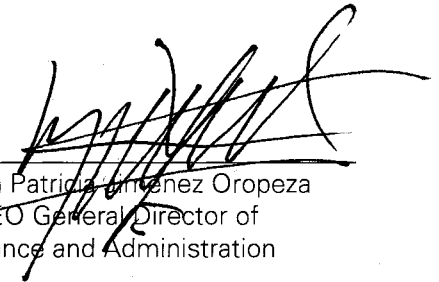
(Millions of Mexican pesos)

(28) Approval of the financial statements-

On March 6, 2019, the officers who signed the consolidated financial statements, authorized the issuance of the accompanying consolidated financial statements and related notes. These accompanying notes are part of the consolidated financial statements at December 31, 2018 and 2017.



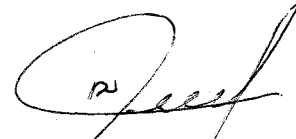
Eugenio Francisco Domingo Najera Solorzano
Chief Executive Officer



Martha Patricia Martínez Oropeza
CEO General Director of
Finance and Administration



Cesar Edmundo Bonada Meneses
Subdirector of Financial Information
Accounting and Fiscal
(In charge of the Office of the Accounting
and Budget Department)



Manuel Anaya Vallejo
Audit Subdirector
(In charge of the Office of the
Internal Audit Department)

ANNEX C

DIRECTORY OF REGIONAL AND OVERSEAS OFFICES

REGIONAL OFFICES

NORTHWEST REGIONAL OFFICE

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WESTERN REGIONAL OFFICE

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