SCOTIABANK INVERLAT, S. A.
Institución de Banca Múltiple
Grupo Financiero Scotiabank Inverlat
AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2004 and 2003

(With Independent Auditors' Report thereon)

(Free Translation from Spanish Language Original)

KPMG®

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Independent Auditors' Report

(Free Translation from Spanish Language Original)

The Board of Directors and Stockholders
Scotiabank Inverlat, S. A.,
Institución de Banca Múltiple,
Grupo Financiero Scotiabank Inverlat:

We have examined the accompanying consolidated balance sheets of Scotiabank Inverlat, S. A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat and Subsidiaries ("the Bank") as of December 31, 2004 and 2003 and the related consolidated statements of income, stockholders' equity and changes in financial position for the years then ended. These consolidated financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Mexico. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement and are prepared in accordance with the accounting criteria for credit institutions in Mexico. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting criteria used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 2 to the consolidated financial statements, the Bank is required to prepare and present its consolidated financial statements in accordance with the accounting criteria established by the National Banking and Securities Commission ("the Banking Commission") for credit institutions in Mexico, which in general conform to accounting principles generally accepted in Mexico, issued by the Mexican Institute of Public Accountants. These accounting criteria include particular rules, which in certain respects depart from such principles.

As discussed in note 3 to the consolidated financial statements, the new *"General Provisions Applicable to Loan Portfolio Rating Methodology"*, including foreclosed assets, ("the Provisions") issued by the Banking Commission for credit institutions came into effect on December 1, 2004. The adoption of these Provisions did not impact 2004 income because the resulting increase in specific reserves of $311 million pesos was transferred from global reserves. With respect to foreclosed assets, the additional allowance of $91 million pesos resulting from the adoption of the Provisions was recorded by a charge to unappropriated retained earnings as permitted under the prescribed optional accounting treatment.

(Continued)

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Scotiabank Inverlat, S. A., Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat and Subsidiaries as of December 31, 2004 and 2003, and the results of their operations, the changes in their stockholders' equity and the changes in their financial position for the years then ended in conformity with the accounting criteria established by the Banking Commission for credit institutions in Mexico, as described in note 2 to the consolidated financial statements.

KPMG CARDENAS DOSAL, S. C.

Alejandro De Alba Mora

February 11, 2005.

SCOTIABANK INVERLAT, S. A.
Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat
AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2004 and 2003

(Millions of constant Mexican pesos as of December 31, 2004)

Assets	2004	2003
Cash and equivalents (note 5)	$ 19,127	17,954
Investment securities (note 6):		
Trading	9,510	8,031
Available-for-sale	149	107
Held-to-maturity	3,502	10,037
	13,161	18,175
Securities and derivative transactions:		
Debit balances of repurchase/resell agreements (note 7)	5	19
Derivative financial instruments (note 8)	11	1
Unassigned securities pending settlement (note 9)	–	2
	16	22
Current loan portfolio (note 10):		
Commercial loans	19,835	19,558
Financial institutions	7,692	1,634
Consumer loans	11,928	11,017
Residential mortgages	12,935	9,650
Government entities	16,660	15,342
IPAB	–	2,973
Total current loan portfolio	69,050	60,174
Past due loan portfolio (note 10):		
Commercial loans	724	1,022
Consumer loans	182	112
Residential mortgages	820	1,852
Other past due debt	19	22
Total past due loan portfolio	1,745	3,008
Total loan portfolio	70,795	63,182
Less:		
Allowance for loan losses (note 10h)	3,298	3,777
Loan portfolio, net	67,497	59,405
Other accounts receivable, net	1,736	1,927
Foreclosed assets (note 11)	277	523
Premises, furniture and equipment, net (note 12)	1,908	1,928
Permanent investments in shares (note 13)	400	437
Deferred taxes (note 18)	73	–
Other assets:		
Other assets, deferred charges and intangibles	305	268
Total assets	$ 104,500	100,639

Liabilities and Stockholders' Equity	2004	2003
Deposit funding (note 14):		
Demand deposits	$ 35,103	40,899
Time deposits:		
General public	41,000	37,556
Money market	3,503	3,421
	79,606	81,876
Bank and other loans (note 15):		
Due on demand	4,677	79
Short-term	935	704
Long-term	4,615	5,184
	10,227	5,967
Assigned securities pending settlement (note 6)	312	–
Securities and derivatives transactions:		
Credit balances of repurchase/resell agreements (note 7)	4	20
Derivative financial instruments (note 8)	2	2
Unassigned securities pending settlement (note 9)	–	2
	6	24
Other accounts payable:		
Income tax and employee statutory profit sharing	45	342
Sundry creditors and other accounts payable	3,415	3,283
	3,460	3,625
Deferred taxes (note 18)	–	218
Deferred credits	335	504
Total liabilities	93,946	92,214
Stockholders' equity (note 19):		
Paid-in capital:		
Capital stock	3,596	3,596
Additional paid-in capital	425	425
	4,021	4,021
Earned capital:		
Statutory reserves	441	257
Unappropriated retained earnings	3,371	1,808
Unrealized gain from valuation of available-for-sale securities	9	2
Gain from holding non-monetary assets:		
From valuation of premises, furniture and equipment	2	1
From valuation of permanent investments in shares	482	498
Net income	2,228	1,838
	6,533	4,404
Total stockholders' equity	10,554	8,425
Commitments and contingent liabilities (note 23)		
Total liabilities and stockholders' equity	$ 104,500	100,639

(Continued)

SCOTIABANK INVERLAT, S. A.
Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat
AND SUBSIDIARIES

Consolidated Balance Sheets, Continued

December 31, 2004 and 2003

(Millions of constant Mexican pesos as of December 31, 2004, unless otherwise indicated)

Memorandum accounts (notes 7 and 21)

		2004	2003
Guarantees issued	$	300	92
Other contingent liabilities		1,000	1,055
Irrevocable lines of credit		1,124	614
Assets in trust or under mandate		59,815	57,821
	$	62,239	59,582
Investments on behalf of customers, net	$	71,015	49,571
Assets in custody or under management		83,314	71,170
Securities receivable under repurchase agreements	$	31,639	28,083
Less – Creditors under securities repurchase agreements		31,634	28,075
		5	8
Debtors under securities resell agreements		9,436	20,256
Less – Securities deliverable under resell agreements		9,440	20,265
		(4)	(9)
Securities repurchase/resell agreements, net	$	1	(1)

"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.

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

The historical capital stock amounts to $2,851,865,508 pesos".

Anatol von Hahn	Jean-Luc Rich	Ken Pflugfelder	Jesús Eduardo Velázquez Reyes
General Director	Deputy General Director Group Finance	Deputy Divisional Director Group Audit	Director of Group Accounting

See accompanying notes to consolidated financial statements.

SCOTIABANK INVERLAT, S. A.,
Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat
AND SUBSIDIARIES

Consolidated Statements of Income

Years ended December 31, 2004 and 2003

(Millions of constant Mexican pesos as of December 31, 2004)

	2004	2003
Interest income (note 22)	$ 11,448	10,856
Interest expense (note 22)	(6,162)	(6,251)
Monetary position loss, net (note 22)	(350)	(158)
Financial margin	4,936	4,447
Provision for loan losses (note 10h)	(550)	(108)
Financial margin after provision for loan losses	4,386	4,339
Commission and fee income	1,460	1,469
Commission and fee expense	(356)	(360)
Financial intermediation income, net (note 22)	647	799
Total operating income	6,137	6,247
Administrative and promotional expenses	(5,383)	(4,908)
Net operating income	754	1,339
Other income (note 22)	1,358	959
Other expense (note 22)	(73)	(205)
Income before taxes and employee statutory profit sharing (ESPS) and equity in the results of operations of associated companies	2,039	2,093
Current asset tax and ESPS (note 18)	(47)	(312)
Deferred income tax and ESPS (note 18)	291	50
Income before equity in the results of operations of associated companies	2,283	1,831
Equity in the results of operations of associated companies, net	(55)	7
Net income	$ 2,228	1,838

"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 revenues and disbursements relating to 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 statements of income were approved by the Board of Directors under the responsibility of the following officers".

Anatol von Hahn
General Director

Jean-Luc Rich
Deputy General Director Group Finance

Ken Pflugfelder
Deputy Divisional Director Group Audit

Jesús Eduardo Velázquez Reyes
Director of Group Accounting

See accompanying notes to consolidated financial statements.

SCOTIABANK INVERLAT, S. A.,
Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat
AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity

Years ended December 31, 2004 and 2003

(Millions of constant Mexican pesos as of December 31, 2004)

	Paid-in capital		Earned capital						
						Gain from holding non-monetary assets			
	Capital stock	Additional paid-in capital	Statutory reserves	Unappropriated retained earnings	Unrealized gain from valuation of available-for-sale securities	From valuation of premises, furniture and equipment	From valuation of permanent investments in shares	Net income	Total stockholders' equity
Balances at December 31, 2002	$ 3,242	–	136	719	–	1	502	1,210	5,810
Changes resulting from stockholder resolutions:									
Resolution passed at the Extraordinary General Stockholders' Meeting of March 31, 2003 – Subscription of shares (note 19a)	354	425	–	–	–	–	–	–	779
Resolution passed at the Ordinary and Special General Stockholders' Meetings of April 29, 2003 – appropriation of prior year's income	–	–	121	1,089	–	–	–	(1,210)	–
Total entries related to stockholder resolutions	354	425	121	1,089	–	–	–	(1,210)	779
Changes related to the recognition of comprehensive income (note 19b):									
Net income for the year	–	–	–	–	–	–	–	1,838	1,838
Result from holding permanent investments in shares	–	–	–	–	–	–	(4)	–	(4)
Valuation of available-for-sale securities	–	–	–	–	2	–	–	–	2
Total comprehensive income	–	–	–	–	2	–	(4)	1,838	1,836
Balances at December 31, 2003	3,596	425	257	1,808	2	1	498	1,838	8,425
Changes resulting from stockholder resolutions:									
Resolution passed at the Ordinary and Special General Stockholders' Meeting of April 30, 2004 – appropriation of prior year's income	–	–	184	1,654	–	–	–	(1,838)	–
Changes related to the recognition of comprehensive income (note 19b):									
Net income for the year	–	–	–	–	–	–	–	2,228	2,228
Effect from change in accounting policy - initial recognition of the application of new provisions on reserves for foreclosed assets and assets received in lieu of payment (notes 3 and 11)	–	–	–	(91)	–	–	–	–	(91)
Result from holding permanent investments in shares	–	–	–	–	–	–	(16)	–	(16)
Valuation of premises, furniture and equipment	–	–	–	–	–	1	–	–	1
Valuation of available-for-sales securities	–	–	–	–	7	–	–	–	7
Total comprehensive income	–	–	–	(91)	7	1	(16)	2,228	2,129
Balances at December 31, 2004	$ 3,596	425	441	3,371	9	2	482	2,228	10,554

"These consolidated statements of changes in stockholders' equity were prepared in accordance with 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 all the stockholders' equity account entries relating to 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 statements of changes in stockholders' equity were approved by the Board of Directors under the responsibility of the following officers".

Anatol von Hahn General Director	Jean-Luc Rich Deputy General Director Group Finance	Ken Pflugfelder Deputy Divisional Director Group Audit	Jesús Eduardo Velázquez Reyes Director of Group Accounting

See accompanying notes to consolidated financial statements.

SCOTIABANK INVERLAT, S. A.,
Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat
AND SUBSIDIARIES

Consolidated Statements of Changes in Financial Position

Years ended December 31, 2004 and 2003

(Millions of constant Mexican pesos as of December 31, 2004)

		2004	2003
Operating activities:			
Net income	$	2,228	1,838
Income statement items not requiring (providing) funds:			
Provision for loan losses		550	108
Equity in the results of operations of associated companies, net of dividends received		55	-
Allowance for foreclosed asset impairment		45	-
Valuation of securities under repurchase/resell agreements, derivative transactions and financial instruments		(9)	10
Available-for-sale securities impairment		–	32
Deferred income tax and employee statutory profit sharing		(291)	(50)
Depreciation and amortization		125	182
		2,703	2,120
Changes in items related to operations:			
(Decrease) increase in operating liabilities:			
Deposit funding		(2,270)	11,467
Bank and other loans		4,260	(4,502)
Other accounts receivable and payable, net		26	901
(Increase) decrease in operating assets:			
Loan portfolio		(8,642)	(4,471)
Investment securities and assigned securities pending settlement		5,330	(2,877)
Securities and derivative transactions		–	3
Funds provided by operating activities		1,407	2,641
Financing activities:			
Amortization of subordinated debentures		–	(792)
Increase in capital stock		–	354
Additional paid-in capital		–	425
Funds used in financing activities		–	(13)
Investing activities:			
Acquisition of premises, furniture and equipment, net		(104)	(42)
Decrease (increase) in foreclosed assets		110	(94)
Increase in permanent investments in shares		(34)	(25)
Increase in other assets and deferred credits, net		(206)	(14)
Funds used in investing activities		(234)	(175)
Increase in cash and equivalents		1,173	2,453
Cash and equivalents:			
At beginning of year		17,954	15,501
At end of year	$	19,127	17,954

"These consolidated statements of changes in financial position 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 all the sources and applications of funds relating to 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 statements in changes in financial position were approved by the Board of Directors under the responsibility of the following officers".

Anatol von Hahn
General Director

Jean-Luc Rich
Deputy General Director Group Finance

Ken Pflugfelder
Deputy Divisional Director Group Audit

Jesús Eduardo Velázquez Reyes
Director of Group Accounting

See accompanying notes to consolidated financial statements.

These consolidated financial statements have been translated from the Spanish language original solely for the convenience of foreign/English-speaking readers.

(1) Description of business and significant transactions-

Description of business-

Scotiabank Inverlat, S. A. ("the Bank") is a subsidiary of Grupo Financiero Scotiabank Inverlat, S. A. de C. V. ("the Group") which owns 99.99% of its capital stock. The Group, in turn, is a subsidiary of The Bank of Nova Scotia ("BNS"), which owns 97.3% of its capital stock. In accordance with the Credit Institutions Law, the Bank is authorized to carry out multiple-service banking transactions such as accepting deposits from the general public, granting and receiving loans, engaging in securities transactions and providing trust services, among others. Scotiabank Inverlat, S. A. and its subsidiaries include Scotiabank Inverlat, S. A., Inmobiliaria Scotiabank Inverlat, S. A. de C. V., Servicios Complementarios y Resguardo, S. A. de C. V. and Scotia Servicios de Apoyo, S. A. de C. V. The subsidiaries are primarily engaged in real estate leasing and banking-related supplementary services.

Significant transactions-

On April 30, 2003, BNS acquired from the Institute for the Protection of Bank Savings (IPAB) 36% of the shares representing the capital stock of the Group and, indirectly, of the Bank. On March 23, 2004, BNS acquired 6.3% of the Group's capital stock. Consequently, BNS currently holds 97.3% of the Group's capital stock; the remaining 2.7% is still held by other minority stockholders.

On September 1, 2003, the Bank acquired consumer car loans (approximately 50,000) at an agreed-upon price of $3,978 (nominal), which contract value was $3,879 (nominal) (see note 10c).

On December 1, 2003, the Bank sold its credit card acquiring business ("the acquiring business") to First Data Merchant Services Mexico, S. de R. L. de C. V. (FDMS) at an agreed-upon price of USD 8,200,000 (see note 22c). Settlement of this transaction is to be made by a payment of USD 200,000 in December 2003 and two payments of USD 4,000,000 each in March 2004 and 2005. On January 22, 2004, Scotia Servicios de Apoyo, S. A. de C. V. was incorporated as a subsidiary of the Bank, which holds 99.99% of its capital stock, with the its principal activity being to act as an intermediary between Promoción y Operación, S. A. de C. V. (PROSA, processor) and FDMS.

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(2) Summary of significant accounting policies-

(a) Financial statement presentation and disclosure-

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

The accompanying consolidated financial statements include the financial statements of the Bank and its wholly-owned subsidiaries, Inmobiliaria Scotia Inverlat, S. A. de C. V. ("the Real Estate Company") engaged in real estate leasing; Servicios Complementarios y Resguardo, S. A. de C. V. (SECORESA), which provides maintenance and security services to the Bank, and Scotia Servicios de Apoyo, S. A. de C. V. ("Scotia Servicios"), which acts as an intermediary between FDMS and PROSA.

The consolidated financial statements also include the financial statements of the Bank's restructured loan portfolio (UDI Trusts), created for the purpose of managing restructured loans through Mexican government support programs (see note 10f), where the Bank acts as settlor and trustee and the Mexican government is the trust beneficiary. The trusts have been valued and presented in conformity with the accounting rules prescribed by the Banking Commission.

In general, the accounting criteria established by the Banking Commission conform to accounting principles generally accepted in Mexico ("Mexican GAAP"), issued by the Mexican Institute of Public Accountants (IMCP) and include particular rules relating to accounting, valuation, presentation and disclosure, which depart from such principles —see paragraphs (c), (d) and (f) of this note.

For cases not contemplated therein, the accounting criteria include a process that provides for the supplementary use of other accounting principles and standards, in the following order: Mexican GAAP; International Accounting Standards issued by the International Accounting Standards Committee; accounting principles generally accepted in the United States of America ("US GAAP"); or in cases not covered by these principles and standards, any other formal and recognized accounting standard that does not contravene the general criteria of the Banking Commission.

SCOTIABANK INVERLAT, S. A.
Institución de Banca Múltiple, Grupo Financiero Scotiabank Inverlat
AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Millions of constant Mexican pesos as of December 31, 2004)

The accompanying consolidated financial statements are expressed in millions of Mexican pesos of constant purchasing power, using for such purpose the Investment Unit (UDI) value. The UDI is a unit of measure whose value is determined by the Banco de México (Central Bank) based on inflation. UDI values were as follows:

December 31,	UDI	Annual inflation
2004	$ 3.5347	5.45%
2003	3.3520	3.91%
2002	3.2258	5.58%

For purposes of disclosure, the term "pesos" or the symbol "$" means Mexican pesos, and "dollars" or "USD", it means U.S. dollars of the United States of America.

Assets and liabilities related to the purchase and sale of foreign currencies, investment in securities, securities repurchase/resell agreements and derivative financial instruments are recognized in the consolidated financial statements on the day the transactions are entered into, regardless of the settlement date.

The 2003 consolidated financial statements include reclassifications to conform to the classifications used in 2004.

(b) Cash and equivalents-

Cash and equivalents consist of cash on hand, precious metals (coins), deposits with banks, 24 and 48-hour foreign currency purchase and sale transactions, bank loans with original maturities of up to three days ("Call Money") and deposits with Banco de México, which include statutory monetary deposits that, in conformity with the law, the Bank is required to maintain in the Central Bank in order to regulate liquidity in the financial system. Such deposits have no maturity and bear interest at the average bank funding rate.

The receivables associated with 24 and 48-hour foreign currency sales are recorded in "Other accounts receivable", while the obligations arising from such foreign currency purchases are recorded in "Sundry creditors and other accounts payable".

(c) Investment securities-

Investment securities consist of equities, government securities and bank promissory notes, listed and unlisted, classified into the categories that are shown on the following page, according to management's investment intentions.

Trading securities-

Trading securities are bought and held principally to be sold in the near term. Debt securities are initially recorded at cost and subsequently marked to market using information provided by an independent price vendor. When a fair and representative market value cannot be determined, the most recent fair value is used or otherwise the security is carried at cost plus accrued interest.

Equity securities are valued at the lower of: information provided by an independent price vendor, by applying the equity method, or as an exception, at cost adjusted for inflation using UDI factors, or estimated net realizable value. Valuation adjustments are reflected in results of operations.

On value date transactions, where the amount of trading securities is insufficient to cover the amount of securities deliverable in the securities purchase and sale transaction, the credit balance is shown as a liability under "Assigned securities pending settlement".

Available-for-sale securities-

Securities not classified as trading, but which are not intended to be held to maturity. Available-for-sale securities are initially recorded at cost and valued in the same manner as trading securities, except that the mark-to-market adjustments are reported in stockholders' equity under "Unrealized gain from valuation of available-for-sale securities", which upon a sale, is cancelled in order to recognize the difference between the proceeds and the acquisition cost in results of operations. If there is pervasive evidence that a security represents a high credit risk and/or the estimated value has decreased, the book value is written down through a charge to operations. According to Mexican GAAP, the unrealized gain or loss from valuation of available-for-sale securities is recognized in the current year's results of operations.

Held-to-maturity securities-

Held-to-maturity securities are debt securities that the Bank has the intent to hold until maturity, and which have defined payments and maturities of more than 90 days. Held-to-maturity securities are recorded at acquisition cost and interest is recognized in income as earned.

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Transfers between categories-

Transfers between categories, except transfers to the trading securities category, and held-to-maturity securities to available-for-sale category, require express authorization from the Banking Commission. Any unrealized gain or loss from valuation of available-for-sale securities is cancelled and recognized in income upon transferring available-for-sale securities to the trading category. For transfers of available-for-sale securities to the held-to-maturity category, any unrealized gain or loss from valuation of available-for-sale securities is amortized to income over the remaining term of the instrument.

(d) Securities under repurchase/resell agreements-

Securities under repurchase/resell agreements are stated at fair value using information provided by an independent price vendor, and the obligations or rights from the commitment to repurchase or to resell are stated at their net present value at maturity. The net assets and liabilities are reported in the consolidated balance sheet after individually offsetting the restated values of the securities receivable or deliverable and the repurchase/resell agreement commitment of each transaction. Repurchase/resell agreements where the Bank is the repurchasing and reselling party with the same entity cannot be offset. Repurchase/resell agreement presentation differs from Mexican GAAP, which requires reporting balances separately and offsetting only similar transactions with the same counterparty. Interest and premiums are reported in the results of operations under "Interest income" and "Interest expense", respectively, while both realized and unrealized gains or losses from these transactions are reported under "Financial intermediation income, net".

Effective September 3, 2004, in accordance with the Central Bank's Circular 1/2003, the parties to repurchase/resell agreements maturing in more than three days, must contractually secure such transactions in the event that the fluctuations in value result in an increase in the net exposure that exceeds the maximum amount contracted by the parties. Guarantees granted (without transfer of title) are recorded in the securities portfolio as restricted or pledged trading securities, or in other restricted cash equivalents if granted in cash deposits. Guarantees received that do not represent a transfer of title are recorded in memorandum accounts as assets in custody or under management. Such guarantees are valued in accordance with current rules for investment securities, cash equivalents and assets in custody or under management, respectively.

Securities under repurchase/resell agreements that cannot be renegotiated are reported as secured borrowing or lending transactions. Premiums are recognized in income as earned using the straight-line method over the term of the transaction.

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(e) Transactions with derivative financial instruments-

Transactions with derivative financial instruments comprise those carried out for trading or hedging purposes, the accounting treatment of which is described below:

Futures and forward contracts – The net market value of the future price of the contracts (forwards) is presented in the consolidated balance sheet with a corresponding charge or credit to results of operations, except in the case of transactions designated as hedges where the difference between the current value and future value at the beginning of each contract is deferred and amortized over the term of the underlying instrument, and are reported together with the primary position.

Swaps – Rights or obligations arising from the exchange of cash flows or asset yields (swaps) are recorded as assets or liabilities. The assets and liabilities derived from the swaps for trading purposes are marked to market, reporting the net value of the swap on the consolidated balance sheet, while the related gains or losses are recognized in income, except in the case of interest rate swaps designated as hedges where gains or losses are recorded as deferred credits or debits, and amortized using the straight-line method over the term of the underlying instruments, and are reported together with the primary position.

Options – Put and call option obligations (premiums collected) and rights (premiums paid) are recorded at the contract value and marked to market, recording gains or losses in results of operations. Premiums collected or paid are recognized in "Financial intermediation income, net" when the option expires.

(f) Unassigned securities pending settlement-

Unassigned securities pending settlement are transactions for which there is an obligation to execute the purchase or sale of securities within 24 to 96 hours, or under repurchase/resell agreements until September 2, 2004 by reason of implementation of the Central Bank's Circular 1/2003, where the specific characteristics of the securities are not known at the time such transactions are entered into. The Bank records an asset for the securities receivable or the contracted amount receivable, and a liability for the contracted amount payable or the securities deliverable. The securities receivable or deliverable are marked to market, with a corresponding charge or credit to results of operations under "Financial intermediation income, net". The amount receivable or payable is recorded at the contracted amount and debit and credit balances of each transaction are offset individually. Under Mexican GAAP, balances would be reported separately and the offsetting of similar transactions with the same counterparty is required. Once the specific characteristics of the securities are known, transactions are transferred to "Securities pending settlement".

(Continued)

The net debit or credit balances resulting from offsetting are reported in the consolidated balance sheet as an asset or liability under "Unassigned securities pending settlement".

(g) Clearing accounts-

Amounts receivable or payable for investment securities, securities repurchase/resell agreements, securities loans and/or derivative financial instruments which have expired but have not been settled at the balance sheet date, as well as 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 debit or credit balances of clearing accounts resulting from the purchase or sale of foreign currencies may be offset providing a contractual right to offset exists, and it is the intention to settle on a net basis, or realize the asset and settle the liability simultaneously. Assets and liabilities of similar transactions or arising from the same contract may also be offset, provided that they have the same maturity and are settled simultaneously.

(h) Past due loans and interest-

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

Commercial loans with one principal amortization and interest payment – 30 or more days after due date.

Commercial installment loans – 90 or more days after the first unpaid installment of principal and interest.

Commercial loans with one principal amortization and periodic interest payments – 30 or more days after due date in the case of the principal payment and 90 or more days after due date in the case of interest payments.

Revolving credits, credit cards and others – When unpaid for two normal billing cycles or when 60 or more days past due.

Residential mortgage loans – 90 or more days after the due date of the first unpaid installment (60 days in 2003).

(Continued)

Overdrafts from checking accounts without lines of credit – When the overdraft occurs.

In addition, a loan is classified as past due when the debtor files for bankruptcy protection.

Past due loans are reclassified as current when the past due principal and interest has been fully paid by the debtor, except for restructured loans or renewals, which are transferred once a satisfactory payment pattern has been established. Up until 2003, loans were reclassified from past due to current once a satisfactory payment pattern has been established.

(i) Allowance for loan losses-

An allowance for loan losses is maintained which, in management's opinion, is sufficient to cover credit risks associated with the loan portfolio, guarantees issued and irrevocable loan commitments. The allowance is established as follows:

Graded commercial portfolio – studies are conducted to classify the loan portfolio using the Bank's internal grading model applicable to its commercial portfolio. The Banking Commission's official document number 601-II-07676 dated November 30, 2004 authorized the continued use of the Bank's internal grading model for a two-year period beginning December 1, 2004. The internal grading model complies with the methodology prescribed by the Ministry of Finance and Public Credit (SHCP) and follows the provisions set forth by the Banking Commission for loan grading.

In compliance with the *General Provisions applicable to the Loan Portfolio Rating Methodology for Credit Institutions* ("the Provisions"), published in the Federal Official Gazette on August 20, 2004, the Bank correlates the results of its internal grading process to those contained in the Provisions in order to validate the adequacy of the allowance. Loans granted to Federal and Municipal Entities, self-paying Investment Projects, trustees acting for established Trusts, and "structured" loans which permit the assessment of the related risk, are individually graded in accordance with the methodologies prescribed in the abovementioned Provisions (see note 24).

Consumer and residential mortgage portfolios – These loans are parametrically assessed. Effective December 1, 2004, the Provisions establish new rules for creating allowances that recognize potential loan losses resulting from the passage of time.

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Until November 30, 2004, the abovementioned portfolio was graded following the provisions set forth by the Banking Commission's Circulars 1449, 1493, 1494 for consumer loans and 1460 for residential mortgage loans, along with applicable amendments.

The allowance percentages are determined based on the risk levels, according to the following table:

Risk level	**Range of allowance percentages**
A - Minimum	0.5 – 0.9
B - Low	1 – 19.9
C - Medium	20 – 59.9
D - High	60 – 89.9
E - Loss	90 – 100.0

General reserves – According to the Provisions, general reserves are those allowances that result from risk level "A" ("A", "B" and "C-1" in 2003).

Specific reserves – Those allowances that result from risk levels "B", "C", "D" and "E" ("C-2", "D" and "E" in 2003).

Impaired loans – For financial statement disclosure purposes, impaired loans are those commercial loans that are classified by the Bank as having the risk levels "C", "D" and "E", without considering any improvements in risk levels that result from the secured portion of the loan.

Exempt portfolio – consists mainly of loans to government entities, including the IPAB, which are not graded.

Additional reserves – are established for those loans, which in management's opinion, may give rise to concern in the future given the particular situation of the customer, the industry or the economy. In addition, allowances are made for past due interest and other items that in management's opinion could result in a loss.

Global reserves – are established to cover inherent losses in the loan portfolio, but which cannot be identified with any individual loan.

Loans considered unrecoverable are written off against the allowance when their collection is determined to be impractical. Recoveries on loans previously written off are credited to the allowance.

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(j) Other accounts receivable-

Based on an evaluation of the levels of risk, reserves are established through a charge to operations for accounts receivable arising from non-credit transactions that are not recovered within 30 days.

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

Foreclosed assets are stated at the lower of foreclosure or net realizable value. Assets received in lieu of payment are stated at the lower of the appraisal value or the price agreed upon by the parties. Any shortfall between the appraisal value and the balance due is written off against the allowance for loan losses. Assets under an enforceable promise to sell are recorded at the agreed-upon selling price, reporting any gains or losses compared to the last foreclosed asset value under deferred credits or results of operations for the year, respectively. Income received from foreclosed assets is reported as a reduction of the carrying value.

Foreclosed assets are written down to reflect any subsequent impairment in their value through a charge to results of operations. In conformity with the Provisions mentioned in (i) above, on December 1, 2004 the Bank began establishing additional reserves on a quarterly basis to recognize the potential impairment in asset value arising from the passage of time. Reserves are set up in accordance with the following:

	Reserve percentage	
Months elapsed from the date of foreclosure or received in lieu of payment	**Premises**	**Chattels, receivables and investment securities**
Over: 6	0%	10%
12	10%	20%
18		45%
24	15%	60%
30	25%	100%
36	30%	
42	35%	
48	40%	
54	50%	
60	100%	

(Continued)

(l) Premises, furniture and equipment-

Premises, furniture and equipment are initially recorded at their acquisition cost, and adjusted for inflation by applying UDI factors.

Depreciation and amortization are calculated on the asset values adjusted for inflation, using the straight-line method over the estimated useful lives of the assets.

The Bank evaluates periodically the values of premises and leasehold improvements, to determine whether there is an indication of potential impairment. 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 carrying amount exceeds the estimated net revenues, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are reported in the financial statements at the lower of the adjusted value or realizable value.

(m) Permanent investments in shares-

Investments in the common stock of affiliated companies are accounted for by the equity method. The Bank's equity in results of operations of affiliated companies is recognized in operations for the year whereas equity in the increase or decrease in other stockholders' equity accounts is recognized in the Bank's stockholders' equity under "Gain from holding non-monetary assets from valuation of permanent investments in shares".

Also, this caption includes long-term investments in shares of issuing companies where the Bank exercises no significant influence, which are valued at cost and adjusted for inflation by applying the National Consumer Price Index (INPC) issued by Banco de México. Valuation adjustments are recognized in the Bank's stockholders' equity under "Gain from holding non-monetary assets from valuation of permanent investments in shares". When the valuation of the investment is consistently below the adjusted cost, the investment is written down to its realizable value through a charge to results of operations.

(n) Income tax (IT) and employee statutory profit sharing (ESPS)-

Deferred IT and ESPS (ESPS beginning 2004) is accounted for using the asset and liability method. Deferred tax 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. The Bank does not recognize a deferred tax asset for tax loss carryforwards, since in order to be utilized such tax losses must comply with all of the conditions agreed upon with the IPAB (see note 18). Accordingly, the benefit of tax loss carryforwards is recognized when realized.

(Continued)

Deferred tax 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 tax assets and liabilities of a change in tax rates is recognized in results of operations for the period enacted.

Until 2003, deferred ESPS was recognized for timing differences arising from the reconciliation of book income to income for ESPS purposes, on which it may reasonably be estimated that a future liability or benefit will arise and there is no indication that the liabilities or benefits will not materialize.

(o) Deposit funding-

Deposit funding comprises demand and time deposits from the general public, as well as money market funding. Interest is charged to expense on the accrual basis. For instruments sold at a price other than face value, the difference is recognized as a deferred charge or credit and amortized on the straight-line basis over the term of the respective instrument.

(p) Bank and other loans-

Bank and other loans comprise short and long-term loans from domestic and foreign banks, loans obtained through credit auctions with the Central Bank and development fund financing. In addition, this caption includes loans rediscounted with agencies specializing in financing economic, productive or development activities. Interest is recognized on the accrual basis.

(q) Pensions, seniority premium and post-retirement benefits-

As provided for by a collective bargaining agreement, all employees who are 60 years old with 5 years of service or 55 years old with 35 years of service are eligible under the established non-contributory pension plan. The plan also covers seniority premium benefits to which employees are entitled in accordance with the Mexican Labor Law.

The net periodic cost and accrued liabilities for pensions and seniority premiums are determined by independent actuaries using the projected unit credit method and real interest rates in accordance with Bulletin D-3 of Mexican GAAP issued by the IMCP.

(Continued)

Similarly, the cost, accrued liabilities and funding of the post-retirement benefits arising from the medical expenses plan, food vouchers and life insurance for retirees are recorded based on independent actuarial calculations.

Other compensation to which employees may be entitled in case of separation or disability, are expensed when payable.

(r) Restatement adjustment of capital stock, statutory reserves and unappropriated retained earnings-

This adjustment is determined by multiplying stockholder contributions and retained earnings by factors derived from the UDI, which measure accumulated inflation from the dates of origin through the most recent year end. The resulting amounts represent the constant value of stockholders' equity.

(s) Gain or loss from holding non-monetary assets-

The gain or loss from holding non-monetary assets represents the difference between the specific valuation of these assets and their cost restated based on the value of the UDI.

(t) Monetary position gain or loss-

The Bank recognizes in results of operations the effect (gain or loss) in the purchasing power of its monetary position, which it determines by multiplying the difference between monetary assets and liabilities at the beginning of each month by inflation through year end. The aggregate of these results represents the monetary gain or loss for the year arising from inflation, which is reported in results of operations for the year.

The gain or loss arising from interest-bearing monetary assets and liabilities is included in the consolidated statement of income as part of the "Financial margin", while the gain or loss from all other monetary items is presented in "Other income".

(u) Revenue recognition-

Interest on loans granted is recorded in income as earned. Interest on past due loans is not recognized in income until collected.

(Continued)

Fees and interest collected in advance are recorded as "Deferred credits" and recognized in results of operations as earned.

Fees related to the issuance of credit cards and services rendered are recorded in income upon collection, while those corresponding to commercial, personal and mortgage loans are deferred and recognized in income using the straight-line method over the shorter of the term of the loan or three years.

Fees earned on trust activities are recognized in income as earned. Fees not collected within 90 days (180 days in 2003) are fully reserved.

Premiums earned on securities resell agreements are calculated based on the present value of the price at maturity.

(v) Foreign currency transactions-

The accounting records are maintained in both Mexican pesos and foreign currencies. For financial statement presentation purposes, currencies other than dollars are translated to dollars at the exchange rates, as established by the Banking Commission, and the dollar equivalent, together with dollar balances, is then translated into Mexican pesos using the exchange rate determined by the Central Bank. Foreign exchange gains and losses are charged to results of operations for the year. Until 2003, the unrealized gain or loss from the structural hedge (see note 4) was deferred and presented in the consolidated balance sheet under "Deferred credits".

(w) UDI Trusts-

Asset and liability accounts of the loan portfolios restructured in UDI Trusts are expressed in Mexican pesos by applying the UDI value determined by Banco de México at the end of each month. Income and expense accounts are expressed in Mexican pesos by applying the average UDI value.

(x) Contributions to the Institute for Protection of Bank Savings (IPAB)-

Among other provisions, the Bank Savings Protection Law created the IPAB, which purpose is to establish a system to protect the savings of the public and regulate the financial support granted to banking institutions in order to comply with this objective.

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According to the Law, IPAB will guarantee depositors' accounts as follows:

Year	**Guaranteed amount**
2003	10 million UDIS
2004	5 million UDIS
2005	400 thousand UDIS

(y) Contingencies-

Liabilities for loss contingencies are recorded when it is probable that a liability has been incurred and the amount of the assessment and/or remediation can be reasonably estimated. When a reasonable estimation cannot be made, qualitative disclosure is provided in the notes to the consolidated financial statements and certain items are recorded in memorandum accounts. Contingent revenues, earnings and assets are not recognized until their realization is assured.

(z) Use of estimates-

The preparation of 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, as well as the reported amounts of income and expenses during the reporting period. Actual results may differ from those estimates and assumptions.

(3) Accounting change-

General Provisions Applicable to Loan Portfolio Rating Methodology ("the Provisions")-

The Provisions superseded Banking Commission Circulars 1449, 1460, 1480, 1493, 1494, 1496 and 1514 and relevant amendments, and establish a new portfolio rating methodology and rules to establish allowances to recognize potential impairment of foreclosed assets or assets received in lieu of payment resulting from the passage of time (see note 2k).

(Continued)

The adoption of the Provisions resulted in additional allowances of $266 and $45 with respect to the commercial and retail loan portfolios, respectively. This did not impact 2004 income because the resulting increase was transferred from global to specific reserves. With respect to foreclosed assets, the additional allowance of $91 million pesos resulting from the adoption of the Provisions was recorded by a charge to unappropriated retained earnings as permitted under the prescribed optional accounting treatment.

(4) Foreign currency position-

Central Bank regulations require that banks maintain balanced positions in foreign currencies within certain limits. The short or long foreign position permitted by the Central Bank is equal to a maximum of 15% of the basic capital. At December 31, 2004 and 2003 the Bank had a long foreign currency position in excess of this limit since it has been authorized by Central Bank to exceed the limit by US$50 million. Accordingly, as of December 31, 2004 and 2003 the Bank's long position is within the authorized limits.

The consolidated foreign currency position in millions of dollars is analyzed as follows:

	2004	2003
Assets	961	1,179
Liabilities	(905)	(1,111)
Long position	56	68

At December 31, 2004, 97% of the long foreign currency position is in dollars, 2% in euros and 1% in other foreign currencies.

At December 31, 2004 and 2003, the exchange rate of the peso to the dollar was $11.15 and $11.24, respectively.

(5) Cash and equivalents-

Cash and equivalents at December 31, 2004 and 2003 are analyzed as shown on the next page.

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	2004	2003
Cash on hand	$ 1,435	1,446
Deposits with domestic and foreign banks	4,876	3,287
Deposits with Banco de México	12,032	9,677
Clearing house margin account	105	121
Three-day interbank call money	885	3,841
24 and 48-hour foreign currency sales	(888)	(1,290)
Other funds available	87	131
Restricted funds:		
24 and 48-hour foreign currency purchases	595	741
	$ 19,127	17,954

According to Central Bank regulations, the Bank is required to maintain statutory monetary deposits with the Central Bank to regulate the liquidity in the financial system. Such deposits have no maturity and bear interest at the average bank funding rate. At December 31, 2004 and 2003, the statutory monetary deposits with the Banco de México amount to $10,064 and $8,254, respectively.

At December 31, 2004 and 2003, the Bank had the following three-day bank ("Call money") loans:

	2004			2003		
Institution	Amount	Rate	Term	Amount	Rate	Term
Banco Mercantil del Norte, S. A.	$ 195	8.70%	3 days	37	6.10%	2 days
BBVA Bancomer, S. A.	650	8.70%	3 days	2,098	6.10%	2 days
HSBC México, S. A.	40	8.70%	3 days	–	–	–
Banco Inbursa, S. A.	–	–	–	1,582	6.15%	2 days
Banco Nacional de Obras y Servicios Públicos, S.N.C.	–	–	–	34	6.10%	2 days
Banco JP Morgan, S. A.	–	–	–	77	6.12%	2 days
Ixe Banco, S. A.	–	–	–	13	6.10%	2 days
	$ 885			3,841		

(Continued)

Foreign currency receivable and deliverable in connection with the purchases and sales to be settled within 24 and 48 hours (expressed in millions of Mexican pesos) are analyzed as follows:

	Receivable		Deliverable	
	2004	2003	2004	2003
Dollar	$ 518	737	811	1,276
Other currencies	77	4	77	14
	$ 595	741	888	1,290

(6) Investment securities-

(a) Composition-

At December 31, 2004 and 2003, the Bank's investment securities are as follows:

	2004	2003
Trading (short term):		
Debt securities:		
Government securities (see note 7)	$ 8,932	5,974
Bank promissory notes	575	2,056
Mexican treasury bills (CETES)	3	1
	9,510	8,031
Available-for-sale (long term):		
Equities	149	107
Trading and available-for-sale securities, carried forward	$ 9,659	8,138

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		2004	2003
Trading and available-for-sale securities, brought forward	$	9,659	8,138
Held-to-maturity (long term):			
Special CETES of the UDI Trusts:			
Domestic productive plant		793	817
States and municipalities (1)		(20)	127
Residential mortgages		1,358	1,434
		2,131	2,378
M bonds*		1,084	–
M3 bonds*		–	2,072
M5 bonds		–	4,938
MYRAS		250	543
Hedging swaps (see note 8)		–	12
Hedging futures (see note 8)		–	(3)
Other		37	97
		3,502	10,037
Total investment securities	$	13,161	18,175

* At December 31, 2004 and 2003, held-to-maturity securities in the amounts of $735 and $231 have been pledged to comply with the provisions of the Central Bank's telefax Circular 21/2003, which sets forth the procedures for guaranteeing compliance with additional settlement obligations of institutions participating in the Extended Use Electronic Payments System (SPEUA). The amounts of guarantees issued at December 31, 2004 and 2003 represent 90% and 30% of the largest risk exposure limits established with respect to other participating institutions. Such percentage will increase 5% monthly until reaching 125%, as required by the aforementioned Circular.

(1) The negative balance of Special CETES of States and municipalities is a result of the swap liability exceeding the assets.

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(b) ***Issuers in excess of 5% of the Bank's net capital-***

At December 31, 2004, investments in other than Mexican government debt securities of the same issuer do not exceed 5% of the Bank's net capital.

At December 31, 2003, investments in other than Mexican government debt securities of the same issuer in excess of 5% of the Bank's net capital, classified as "trading securities", are as follows:

Issue	Thousands of certificates	Rate	Term (days)	Amount
IINBURSA04094	303,270	6.17%	2	$ 316
IINBURSA04143	162,869	6.17%	2	169
IINBURSA04154	285,448	6.17%	2	295
IINBURSA04204	59,548	6.17%	2	61
	811,135			841
INAFIN04035	189,183	6.17%	2	198
INAFIN04041	276,222	6.17%	2	290
INAFIN03525	22,549	6.10%	2	24
	487,954			512
	1,299,089			$ 1,353

(c) ***Analysis of significant held-to-maturity investments-***

At December 31, 2004, investments in Mexican government M bonds are analyzed as follows:

Issue	Coupon rate	Amount	Unexpired term (days)
M 081224	8.00%	$ 405	1,454
M 101223	8.00%	378	2,183
M 131219	8.00%	301	3,275
		$ 1,084	

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At December 31, 2003, investments in Mexican government M3 and M5 bonds classified as "Held-to-maturity" are analyzed as follows:

Issue	Coupon rate	Amount	Unexpired term (days)
M3 051229	9.00%	$ 2,072	729
M5 050512	14.50%	$ 1,549	498
M5 060302	13.50%	2,908	792
M5 060824	10.50%	481	967
		$ 4,938	

(d) Assigned securities pending settlement-

At December 31, 2004, assigned securities pending settlement are analyzed as follows:

Issuer	Series	Number of certificates	Average rate	Term (days)	Amount
Sales:					
BI Cetes	050623	15,000,000	8.42%	171	$ 144
BI Cetes	050331	10,000,000	8.76%	87	98
BI Cetes	051124	5,000,000	8.50%	325	47
M Bonds	231207	150,000	9.99%	6,911	12
M0 Bonds	110714	100,000	8.91%	2,383	11
					$ 312

(7) Securities under repurchase/resell agreements-

At December 31, 2004 and 2003, the Bank's repurchase/resell agreements are analyzed as shown on the next page.

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	2004			
	Receivables under resell agreements	**Securities deliverable**	**Asset**	**Liability**
Purchases:				
Net asset positions	$ 3,504	(3,504)	–	–
Net liability positions	5,932	(5,936)	–	(4)
	$ 9,436	(9,440)	–	(4)
	Securities receivable	**Payables under repurchase agreements**		
Sales:				
Net asset positions	$ 16,595	(16,590)	5	–
Net liability positions	15,044	(15,044)	–	–
	$ 31,639	(31,634)	5	–
			$ 5	(4)
				$ 1

	2003			
	Receivables under resell agreements	**Securities deliverable**	**Asset**	**Liability**
Purchases:				
Net asset positions	$ 5,749	(5,744)	5	–
Net liability positions	14,507	(14,521)	–	(14)
	$ 20,256	(20,265)	5	(14)
	Securities receivable	**Payables under repurchase agreements**		
Sales:				
Net asset positions	$ 20,062	(20,048)	14	–
Net liability positions	8,021	(8,027)	–	(6)
	$ 28,083	(28,075)	14	(6)
			$ 19	(20)
				$ (1)

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At December 31, 2004 and 2003, the net positions by type of security are as follows:

Securities	Debit balances: Weighted average term (days)	Debit balances: Net position	Credit balances: Weighted average term (days)	Credit balances: Net position
December 31, 2004				
Government:				
CETES	140	$ 1	88	$ 1
Itbonos	3	–	3	1
Ipabonos	22	2	14	1
Bonds	3	2	3	1
		$ 5		4
December 31, 2003				
Government:				
CETES	15	$ 1	26	$ 1
Itbonos	19	1	15	–
Ipabonos	15	10	13	11
LS Bondes	102	4	16	2
LT Bondes	4	1	4	1
Bonds	4	2	4	4
		19		19
Bank:				
Promissory notes	9	–	2	1
		$ 19		$ 20

At December 31, 2004, 246,943 government BI CETES bills issue 050203 for $2,449 (thousand) classified as trading securities, have been pledged by the Bank on repurchase/resell agreements of over three days. Also, the Bank has received as guarantee 22,339 government BI CETES bills, issue 050804 for $212 (thousand) recorded in memorandum accounts as "Assets in custody or under management".

(Continued)

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(8) Derivative instruments-

Trading:

At December 31, 2004 and 2003, derivative financial instruments for trading purposes are analyzed as follows:

	2004		2003	
	Assets	Liabilities	Assets	Liabilities
Interest rate and foreign exchange futures and forwards	$ 11	–	–	(1)
Foreign currency options	–	(1)	1	(1)
Interest rate swaps	–	(1)	–	–
	$ 11	(2)	1	(2)

At December 31, 2004, the Bank has recorded an obligation with respect to a dollar exchange rate "call" for a two million dollar notional amount (short option, obligation to sell if the option is exercised), with a $1 premium as valued on the same date, with no hedge (call option). At December 31, 2003, the options are balanced since for each buy option there is a sell option; accordingly, the Bank's operation is limited to negotiating the contract premiums, which are included in the consolidated statement of income under "Financial intermediation income, net".

Hedge transactions:

Derivative transactions for hedging purposes are presented in the consolidated balance sheet together with the primary position they cover. At December 31, 2004 and 2003, derivative financial instruments for hedging purposes are analyzed as follows:

Derivative	Primary position	Fair value 2004	Fair value 2003
Interest rate swaps (sold)	Loan portfolio	$ (5)	–
Interest rate swaps (bought)	Held-to-maturity securities (note 6)	–	12
Interest rate futures	Held-to-maturity securities (note 6)	–	(3)

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Notional amounts:

The following notional amounts of contracts represent the derivative volume outstanding and do not represent the potential gain or loss associated with the market risk or credit risk of such instruments. The notional amounts represent the amount to which a rate or price is applied to determine the amount of cash flows to be exchanged. Notional amounts of the derivative financial instruments at December 31, 2004 and 2003 are as follows:

Type of instrument	2004 Hedging purposes	2004 Trading purposes	2004 Total
Interest rate contracts:			
Bought:			
Futures (traded on MexDer, the Mexican derivatives market)	$ –	18,072	18,072
Swaps		1,350	1,350
	$ –	19,422	19,422
Sold:			
Futures	$ –	100	100
Swaps	728	2,424	3,152
	$ 728	2,524	3,252
Sold:			
Swaps (in millions of dollars)	36	–	36
IPC (Mexican stock exchange index):			
Bought:			
Futures	$ –	5	5
Foreign exchange (in millions of dollars):			
Bought:			
Futures	–	16	16
Forwards	–	580	580
Options	–	1	1
	–	597	597

(Continued)

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	2004		
Type of instrument	**Hedging purposes**	**Trading purposes**	**Total**
Sold:			
Futures	–	15	15
Forwards	–	568	568
Options	–	3	3
	–	586	586

	2003		
Type of instrument	**Hedging purposes**	**Trading purposes**	**Total**
Interest rate contracts:			
Bought:			
Futures (traded on MexDer, the Mexican derivatives market)	$ 35,642	1,371	37,013
Swaps	949	475	1,424
	$ 36,591	1,846	38,437
Sold:			
Swaps	$ –	137	137
Sold:			
Swaps (in millions of dollars)	–	5	5
Foreign exchange (in millions of dollars):			
Bought:			
Futures	–	6	6
Forwards	–	180	180
Options	–	1	1
	–	187	187
Sold:			
Futures	–	7	7
Forwards	–	179	179
Options	–	1	1
	–	187	187

(Continued)

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Since 2001, the Bank's management designed a hedging strategy to reduce financial margin adverse effects resulting from a potential decrease in interest rates. Accordingly, the Bank entered into derivative instruments in which fixed and variable interest rates were to be received and paid, respectively. At the end of 2003, there were signs indicating an upward trend in interest rates; therefore, it was decided to sell most of the derivative hedging instruments during 2004.

The contribution to the derivative instruments margin from the hedging position is estimated at $16 for the year ended December 31, 2004 (unaudited figure).

(9) Unassigned securities pending settlement-

At December 31, 2003, unassigned securities pending settlement are analyzed as follows:

	2003			
	Receivables under resell agreements/ Securities receivable	Securities deliverable/ Payables under repurchase agreements	Asset	Liability
Direct:				
Sales:				
Net asset positions	$ 35	(33)	2	–
Purchases:				
Net asset positions	$ 28	(28)	–	–
Net liability positions	72	(74)	–	(2)
	$ 100	(102)		
			$ 2	(2)

At December 31, 2003, the net positions of unassigned securities pending settlement are as follows:

	2003					
	Debit balances			Credit balances		
Securities	Average term (days)	Average rate	Net position	Average term (days)	Average rate	Net position
Government	5	7.75%	$ 2	4	7.88%	$ 2

(Continued)

(Millions of constant Mexican pesos as of December 31, 2004)

(10) Loan portfolio-

(a) Classification of loan portfolio by currency-

At December 31, 2004 and 2003, the classification of loans into current and past due by currency, which includes the restructured portfolio in UDI Trusts, is analyzed as follows:

	2004		2003	
	Current	**Past due**	**Current**	**Past due**
Pesos:				
Commercial loans	$ 14,329	455	12,310	683
Financial institutions	7,687	–	1,598	–
Consumer loans	11,928	182	11,017	112
Residential mortgages	10,050	325	6,821	750
Government entities	16,445	–	15,113	–
IPAB	–	–	2,973	–
Other past due debt	–	19	–	22
	60,439	981	49,832	1,567
Foreign currency:				
Commercial	5,506	269	6,802	326
Financial entities	5	–	36	–
	5,511	269	6,838	326
Denominated in UDIS:				
Commercial loans	–	–	446	13
Residential mortgages	2,885	495	2,829	1,102
Government entities	215	–	229	–
	3,100	495	3,504	1,115
	$ 69,050	1,745	60,174	3,008
	$ 70,795		63,182	

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(b) Classification of loan portfolio by economic sector-

At December 31, 2004 and 2003, credit risk (loans, guarantees and irrevocable lines of credit) classified by economic sector and the percentage of concentration are analyzed as follows:

	2004		2003	
	Amount	**%**	**Amount**	**%**
Community, social and personal services, mainly government entities	$ 20,496	28	18,625	29
Construction and housing	14,807	20	12,705	20
Financial, insurance and real estate services	6,996	10	4,832	8
Manufacturing	11,326	16	8,126	13
Commerce and tourism	5,008	7	6,223	10
Consumer loans and credit cards	12,112	17	11,130	17
Agriculture, forestry and fishing	584	1	711	1
Transportation, warehousing and communication	697	1	1,340	2
Other	193	-	196	-
	$ 72,219	100	63,888	100

Credit risk is disclosed in the consolidated balance sheet as follows:

	2004	2003
Recorded as assets:		
Current loan portfolio	$ 69,050	60,174
Past due loan portfolio	1,745	3,008
	70,795	63,182
Recorded in memorandum accounts:		
Guarantees	300	92
Irrevocable lines of credit	1,124	614
	1,424	706
	$ 72,219	63,888

(Continued)

(c) ***Acquisition of consumer loans-***

On September 1, 2003, the Bank acquired consumer loans (car loans) at an agreed-upon price of $3,978 (nominal) from a non-bank bank (SOFOL) which contract value was $3,879 (nominal). The purchase price was determined on the basis of discounted cash flows of the loans, which resulted in a difference of $99 (nominal) between the present value of the loan portfolio and the agreed-upon price; this difference was recorded as a deferred charge and credit of $172 and $73 (nominal), respectively, depending if the contractual value of each of the loans was lower or higher than the agreed-upon price. Deferred credits and charges are amortized over a term equal to the remaining life of the loans. At December 31, 2004 the amortized deferred charge and credit amounts are $69 and $35, respectively ($72 and $28, respectively in 2003).

Settlement terms consist of a payment equal to 85.3% of the agreed-upon price on execution of the agreement, with the remainder payable from December 2004 through the loan maturity dates. On September 27, 2004, the Bank made a partial prepayment of $253.

The SOFOL is charged with managing the loan portfolio and sends the necessary information to the Bank on a daily basis for accounting purposes; for this service the Bank pays an annual fee of 1%, computed on the outstanding average balance of the loan portfolio.

At December 31, 2004 and 2003 the outstanding balance of this portfolio aggregates $900 and $3,179, respectively.

(d) Loan to the IPAB-

On July 29, 2000, a $15,000 loan was granted to the IPAB. The loan was documented by four promissory notes of $3,750 each, with final settlement in 2004 but with the right of prepayment. The promissory notes bore interest at the 28-day TIIE plus 0.30%; principal and interest were payable semiannually and monthly, respectively. During 2004 and 2003, the IPAB made payments of capital of $2,812 and $4,219 and interest of $72 and $360, respectively. This loan was fully repaid on July 1, 2004.

(Millions of constant Mexican pesos as of December 31, 2004)

(e) ***Loans to government entities-***

At December 31, 2004 and 2003, loans granted to government entities are analyzed as follows:

		2004	2003
Highway construction loans	$	5,349	5,625
Loans to the Federal District government		7,767	7,133
Autonomous entity loan		1,001	1,055
Receivables under financial support programs		333	381
UDI restructured loans for supporting Mexican states and municipalities		215	229
Other		1,995	919
Total loans to government entities	$	16,660	15,342

Highway construction loans:

These loans, granted for construction of highways, were rescued by the Mexican government in 1997 and restructured in bonds. The bonds, which were issued as of September 1, 1997, mature in 15 years and are redeemable on August 31, 2012. The principal is payable in quarterly installments, with a grace period of 10 years, starting in 2007 and bears interest at the arithmetic average of the 91-day TIIE and 91-day CETES rates.

Loans to the Federal District government:

The balance of loans granted to the Federal District government is composed of loans that bear interest at rates between TIIE + 0.20% and TIIE + 0.40%, which are analyzed as follows:

Starting date	Maturity date		December 31, 2004	December 31, 2003
September 18, 2001	August 31, 2015	$	3,001	3,164
January 1, 2002	August 29, 2015		2,496	2,631
September 30, 2002	September 30, 2016		63	68
September 11, 2002	September 12, 2016		1,207	1,270
December 13, 2004	December 31, 2011		1,000	-
		$	7,767	7,133

(Continued)

(Millions of constant Mexican pesos as of December 31, 2004)

Mexican government support programs:

As a result of the economic crisis in 1995, the Mexican government and the Asociación de Banqueros de México, A. C. (the Mexican Bankers' Association) established loan support programs and agreements, to assist debtors of credit institutions in meeting their obligations. The programs and agreements established were as follows:

- Immediate Support Program for Bank Debtors (ADE).
- Credit Support Program for the Domestic Productive Plant (PACPPN).
- Financial Support and Promotion for Micro, Small and Medium-sized Companies (FOPYME).
- Financial Support to the Agricultural, Cattle-raising and Fishery Sector (FINAPE).
- Additional Benefits to Housing Loan Debtors (BADCV).

Subsequently, other programs were established such as the Benefits for Bank Debtors of the Agricultural, Cattle-raising and Fishery Sector, the Benefits for Corporate Loan Debtors and the Agreement for Benefits to Housing Loan Debtors ("Punto Final").

The financial support programs and agreements consist of discounts granted to debtors, which are generally absorbed proportionately by the Mexican government and the Bank, in accordance with the terms of each program. Certain discounts are conditional subject to the net cash flows contributed by the Bank to the specific economic sector. As of December 31, 2004 and 2003, receivables from the Mexican government in connection with discounts granted are as follows:

	2004	2003
Unconditional receivables:		
Related to BADCV and BADCVF	$ 333	378
Related to FOPYME	–	1
Related to FINAPE	–	2
	$ 333	381

The Bank's cost associated with the various debtor support programs and agreements for the years ended December 31, 2004 and 2003 is shown on the next page.

(Millions of constant Mexican pesos as of December 31, 2004)

	2004	2003
FOVI	$ 38	43
Residential mortgages	21	26
FOPYME	–	1
FINAPE	–	1
	$ 59	71

(f) ***UDI Trusts restructured loans-***

The Bank participated in several loan-restructuring programs established between the Mexican government and the Mexican banks. The Bank underwrote restructuring programs that consisted mainly of changing peso-denominated loans to UDIS through trusts created with funding provided by the Central Bank at preferential interest rates. At December 31, 2004 and 2003, the outstanding balances of restructured loans under UDI Trusts are analyzed as follows:

	2004		
	Loan portfolio		Average annual
	Current	Past due	interest rate
States and municipalities	$ 215	–	6.45%
Residential mortgages	2,779	491	9.04%
Individual loans	106	3	9.57%
	$ 3,100	494	

	2003		
	Loan portfolio		Average annual
	Current	Past due	interest rate
Domestic productive plant	$ 447	13	6.20%
States and municipalities	229	–	7.50%
Residential mortgages	2,711	1,089	8.91%
Individual loans	117	13	9.61%
	$ 3,504	1,115	

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(g) Additional loan portfolio information-

Annual weighted lending rates:

Annual average loan rates during 2004 and 2003 were as follows:

	2004	**2003**
Commercial loans	7.56%	7.34%
Personal loans	14.73%	14.60%
Credit cards	25.15%	23.85%
Residential mortgages	11.16%	11.52%

Loans rediscounted with recourse:

The Mexican Government has established certain funds to promote the development of specific areas of the agriculture, cattle-raising, industrial and tourism sectors, which are managed by the Central Bank, Nacional Financiera (Nafinsa) and Banco Nacional de Comercio Exterior (Bancomext) and Fideicomisos Instituidos en relación con la Agricultura (FIRA) by rediscounting loans with recourse. At December 31, 2004 and 2003, the amount of loans granted under these programs aggregated $3,630 and $5,447, respectively, and the related liability is included in "Bank and other loans" (see note 15).

Restructured loans:

At December 31, 2004 and 2003, restructured loans and renewals are analyzed as follows:

	2004		
	Current loans	**Past due loans**	**Total**
Commercial loans	$ 6,226	43	6,269
Residential mortgages	39	13	52
	$ 6,265	56	6,321

(Continued)

(Millions of constant Mexican pesos as of December 31, 2004)

	2003		
	Current loans	**Past due loans**	**Total**
Commercial loans	$ 6,699	350	7,049
Government entities	230	–	230
Residential mortgages	2,862	1,112	3,974
	$ 9,791	1,462	11,253

During the years 2004 and 2003, no past due interest were capitalized.

During the year ended December 31, 2004, a commercial loan totaling $396 (nominal) was restructured, by modifying the term and interest rate, granting a debt reduction of $56. During the year ended December 31, 2003, there were no material restructures in the commercial loan portfolio, and no cases in residential mortgages and consumer loans.

Risk concentration:

At December 31, 2004, balances due from four debtors individually exceed 10% of the Bank's basic capital (three in 2003). As of December 31, 2004 and 2003, such loans amount to $5,112 and $2,865, and represent 55.94% and 38.90% of the Bank's basic capital, respectively. At December 31, 2004, the balances due from the Bank's three largest debtors amount to $4,150.

Past due loan portfolio:

The table shown on the next page analyzes past due loans at December 31, 2004 and 2003, from the date the loans went past due.

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December 31, 2004

	1 to 180 days	181 to 365 days	1 to 2 years	Over 2 years	Total
Commercial*	$ 133	3	415	173	724
Consumer	160	22	–	–	182
Residential mortgages	120	92	122	486	820
Other past due debt	11	3	2	3	19
	$ 424	120	539	662	1,745

December 31, 2003

	1 to 180 days	181 to 365 days	1 to 2 years	Over 2 years	Total
Commercial*	$ 55	420	158	389	1,022
Consumer	66	7	1	38	112
Residential mortgages	875	110	121	746	1,852
Other past due debt	3	1	1	17	22
	$ 999	538	281	1,190	3,008

* Includes commercial loans, loans to financial institutions and government.

The movement of the past due loan portfolio for the years ended December 31, 2004 and 2003 is summarized on the next page.

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	2004	2003
Balance at beginning of year	$ 3,008	3,340
Settlements	(118)	(501)
Write-offs and debt reductions	(657)	(374)
Transfers (to) from current portfolio	(390)	577
Foreign exchange gains (losses)	(98)	(34)
	$ 1,745	3,008

Nominal interest on the past due loan portfolio not recognized in results of operations amounted to $163 for the year ended December 31, 2004 ($220 in 2003).

Impaired loans:

The balance of impaired commercial loans as of December 31, 2004 and 2003 is $1,361 and $1,978, of which $630 and $956 are current loans and $731 and $1,022 are past due loans, respectively.

(h) ***Allowance for loan losses-***

As explained in notes 2(i) and 24(c), the loan portfolio is classified and an allowance is established to provide for credit risks associated with the collection of the Bank's loan portfolio.

At December 31, 2004 and 2003, the allowance for loan losses classified between general reserves and specific reserves according to the criteria mentioned in note 2(i), is as follows:

	2004		2003	
Loan portfolio	General	Specific	General	Specific
Commercial	$ 170	930	632	634
Consumer	56	289	243	9
Residential mortgages	38	688	207	690
	$ 264	1,907	1,082	1,333
	$ 2,171		2,415	

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At December 31, 2004, the graded loan portfolio is classified as follows:

	Graded loan portfolio			
Degree of risk	**Commercial***	**Consumer**	**Residential mortgages**	**Total**
A-1/A	$ 12,298	11,063	10,957	34,318
A/2	11,639	–	–	11,639
B-1/B	3,587	686	1,902	6,175
B-2	421	–	–	421
B-3	233	–	–	233
C-1/C	401	181	208	790
C-2	319	–	–	319
D	74	149	341	564
E	371	32	358	761
Total portfolio graded	$ 29,343	12,111	13,766	55,220

At December 31, 2004, the allowance for loan losses is summarized as follows:

	Allowance for loan losses			
Degree of risk	**Commercial***	**Consumer**	**Residential mortgages**	**Total**
A-1/A	$ 61	56	38	155
A/2	109	–	–	109
B-1/B	124	69	43	236
B-2	32	–	–	32
B-3	31	–	–	31
C-1/C	137	82	48	267
C-2	191	–	–	191
D	44	107	239	390
E	371	31	358	760
Total portfolio graded	$ 1,100	345	726	2,171
Additional reserves (including among other items, past due interest and reserve for yield on highway bonds of $232)				675
Global reserves (see note 23b)				452
Total allowance for loan losses				$ 3,298

* Includes commercial loans, loans to financial institutions and government entities.

(Continued)

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At December 31, 2003, the graded loan portfolio is classified as follows (nominal):

	Graded loan portfolio			
Degree of risk	**Commercial***	**Consumer**	**Residential mortgages**	**Total**
A - Minimum	$ 21,223	9,429	7,764	38,416
B - Low	825	742	2,154	3,721
C - Medium	1,258	135	284	1,677
D - High	4	69	892	965
E - Loss	519	9	–	528
Total portfolio graded	$ 23,829	10,384	11,094	45,307

At December 31, 2003, the allowance for loan losses is summarized as follows:

	Allowance for loan losses			
Degree of risk	**Commercial***	**Consumer**	**Residential mortgages**	**Total**
A - Minimum	$ 141	47	34	222
B - Low	64	74	107	245
C - Medium	472	61	85	618
D - High	4	49	624	677
E - Loss	519	9	–	528
Total portfolio graded	$ 1,200	240	850	2,290
Additional reserves (including among other items, past due interest and reserve for yield on highway bonds of $232)				693
Global reserves				599
Total allowance for loan losses				3,582
Adjustment for inflation				195
				$ 3,777

* Includes commercial loans, loans to financial institutions and government entities.

(Millions of constant Mexican pesos as of December 31, 2004)

The movement of the allowance for loan losses for the years ended December 31, 2004 and 2003 (nominal) is summarized below:

	2004	2003
Balance at beginning of year	$ 3,582	3,687
Provisions charged to results of operations	550	103
Recoveries	218	246
Write-offs and debt reductions	(1,117)	(542)
Other	65	88
Subtotal	3,298	3,582
Adjustment for inflation	–	195
Balance at end of year	$ 3,298	3,777

(11) Foreclosed assets-

Foreclosed assets at December 31, 2004 and 2003 are analyzed as follows:

	2004	2003
Premises	$ 369	445
Chattels	7	8
Securities	3	6
Assets under enforceable promise to sell	58	74
Income from foreclosed assets	(11)	(10)
	426	523
Allowance for impairment of assets	(149)	–
	$ 277	523

Entries of the allowance for impairment of assets for the year ended December 31, 2004 (nominal) is summarized below:

Balance at beginning of year	$ –
Transfer of provision recorded in liabilities	13
Additional provisions arising from the passage of time:	
Charged to unappropriated retained earnings (see note 3)	91
Charged to results of operations for the year	45
Balance at end of year	$ 149

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(12) Premises, furniture and equipment-

Premises, furniture and equipment at December 31, 2004 and 2003 are analyzed as follows:

	2004	2003	Annual depreciation rate
Office premises	$ 1,777	1,769	Various
Office furniture and equipment	502	467	10%
Computer equipment	639	681	30%
Transportation equipment	22	24	25%
Telecommunications equipment	120	118	10%
Leasehold improvements	322	290	10%
Construction in progress	1	10	
	3,383	3,359	
Accumulated depreciation and amortization	(1,475)	(1,431)	
	$ 1,908	1,928	

Depreciation and amortization charged to income in 2004 and 2003 amounted to $125 and $182, respectively.

(13) Permanent investments in shares-

Permanent investments in shares, classified by activity, are analyzed as follows:

	2004	2003
MexDer operation	$ 248	175
Security and protection	84	200
Banking related services	62	57
Mutual funds	6	5
	$ 400	437

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(14) Deposit funding-

The average weighted interest rates on deposit balances during the years ended December 31, 2004 and 2003 are as follows:

	2004 Rates		2003 Rates	
	Pesos	Dollars	Pesos	Dollars
Demand deposits	1.78%	0.61%	1.97%	0.56%
Savings deposits	0.73%	–	1.28%	–
Time deposits	5.25%	0.74%	4.53%	0.73%
Money market	6.23%	–	6.89%	–

At December 31, 2004, the money market funding consists primarily of Mexican peso promissory notes with interest payable at maturity and terms ranging from 1 to 999 days (1 to 728 days in 2003) and CEDES time deposits with terms ranging from 60 to 999 days (60 to 899 days in 2003).

(15) Bank and other loans-

At December 31, 2004 and 2003, bank and other loans are analyzed as follows:

	2004	2003
Due on demand and short-term:		
Pesos:		
Banco de México [(1)]	$ 4,500	–
Development banks*	410	75
Development agencies*	281	309
Accrued interest	7	11
	5,198	395
Denominated in dollars:		
Foreign banks	99	327
Development agencies*	85	55
Development banks - interbank [(2)]	223	–
Accrued interest	7	6
Total due on demand and short term, carried forward	$ 5,612	783

* [(1)] [(2)] – see next page.

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	2004	2003
Total due on demand and short term, brought forward	$ 5,612	783
Long-term:		
Pesos:		
Development banks*	623	471
Development agencies*	3,758	4,228
	4,381	4,699
Denominated in dollars:		
Development banks*	–	11
Development banks – interbank (2)	223	474
Development agencies*	11	–
Total long-term	4,615	5,184
Total bank and other loans	$ 10,227	5,967

* Secured by the loans granted under the respective programs (see note 10g).

(1) At December 31, 2004, loans from Banco de México had average terms of 9 days.

(2) The balance at December 31, 2004 and 2003 is composed of two loans granted by Bancomext for US$20 million each that mature in July 2005 and August 2007. Both loans bear interest at LIBOR plus 1.3% and 1.5% plus the equivalent to the income tax rate, respectively. Interest is payable semiannually in January and July and in February and August, respectively. During 2004 and 2003, interest was paid of USD 1,097 (thousand) and USD 1,282 (thousand), respectively.

(Continued)

(Millions of constant Mexican pesos as of December 31, 2004)

At December 31, 2004 and 2003, current average annual interest rates are as follows:

	2004 rates		2003 rates	
	Pesos	Foreign currency	Pesos	Foreign currency
Banco de México	8.65%	–	–	–
Development banks	11.12%	3.50%	10.37%	2.77%
Development agencies	8.16%	2.49%	5.75%	1.22%
Foreign banks	–	2.40%	–	1.25%
	====	====	====	====

(16) Pensions, seniority premiums and post-retirement benefits-

The components of the net periodic cost for the years ended December 31, 2004 and 2003 are as follows (nominal):

	2004		2003	
	Pensions and seniority premiums	Medical benefits, food vouchers &life insurance for retirees	Pensions and seniority premiums	Medical benefits, food vouchers &life insurance for retirees
Service cost	$ 53	32	47	23
Interest cost	81	50	77	32
Return on plan assets	(84)	(39)	(75)	(33)
Amortization of variances in assumptions and experience	1	14	1	1
Net periodic cost	$ 51	57	50	23
	==	==	==	==

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At December 31, 2004 and 2003, benefit obligations are analyzed as follows (nominal):

	2004		2003	
	Pensions and seniority premiums	Medical benefits, food vouchers & life insurance for retirees	Pensions and seniority premiums	Medical benefits, food vouchers & life insurance for retirees
Projected benefit obligation (PBO)	$ 1,781	1,101	1,692	707
Plan assets at market value	1,797	863	1,660	744
PBO in excess of (less than) plan assets	(16)	238	32	(37)
Unrecognized items:				
Prior service cost and plan modifications	(14)	–	(13)	–
Variances in assumptions and experience	30	(311)	(19)	(34)
Unamortized transition asset	–	73	–	71
Net projected asset (liability)	$ –	–	–	–

Rates used in the actuarial projections are:

	2004	2003
Yield on plan assets	5.0%	5.0%
Discount rate	5.0%	5.0%
Salary increase rate	1.0%	1.0%
Medical expenses increase rate	3.0%	3.0%
Estimated inflation rate	4.0%	4.4%

For 2004, the amortization period of unrecognized items is 16.9 years for pensions, medical benefits, food vouchers and life insurance for retirees and 8.6 years for seniority premiums.

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(17) Subordinated debentures outstanding-

At the Extraordinary General Stockholders' Meeting held on March 31, 2003, it was resolved to exchange mandatory convertible preferred subordinated debentures of $792 (720 nominal) wholly owned by the Group, for shares representing the Bank's capital stock. This resulted in an increase in capital stock and additional paid-in capital of $354 and $425, respectively - see note 19 (a).

(18) Income (IT) and asset (AT) taxes and employee statutory profit sharing (ESPS)-

Under current Mexican tax law, corporations must pay the greater of IT or AT. For determining taxable income for IT purposes there are specific rules relating to the deductibility of expenses and the recognition of the effects of inflation.

On May 19, 2004, the Bank was awarded a favorable court ruling on a proceeding with respect to articles 16 and 17, last paragraph of the IT Law passed in 2003. Accordingly, the Bank may determine its profit sharing basis using the taxable income as determined under article 10 of the abovementioned Law. Consequently, the basis for calculating employee statutory profit sharing will be the same as that used to determine IT payable.

Current AT and ESPS expense:

The current AT and ESPS expense in the consolidated statement of income is analyzed as follows:

	2004		2003	
	Taxes	ESPS	Taxes	ESPS
Bank (AT)	$ 16	–	14	260
Real Estate Company (IT and AT)	29	–	15	–
Adjustment for inflation and other	2	–	3	20
	$ 47	–	32	280
	$ 47		312	

The AT Law establishes a 1.8% tax rate on restated assets, less certain liabilities. AT payable in excess of IT for the year may be recovered in the ten succeeding years, adjusted for inflation, provided that IT exceeds AT in any of such years. Due to the uncertainty of its recovery, the AT for 2004 and 2003 of $16 and $29 (nominal), respectively, was charged to results of operations of those years. At December 31, 2004, recoverable AT of $146 expires from 2006 through 2014.

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Following is a condensed reconciliation between the Bank's consolidated accounting income and taxable income for IT and ESPS purposes (nominal pesos):

	2004		2003	
	IT	ESPS	IT	ESPS
Income before taxes, ESPS and equity in the results of operations of associated companies	$ 2,039	2,039	1,985	1,985
Less Real Estate Company and Scotia Servicios	–	(75)	–	(32)
	2,039	1,964	1,985	1,953
Accounting effects of inflation	344	331	165	154
Tax effects of inflation	(364)	(353)	69	–
Valuation of financial instruments	(109)	(98)	61	61
Depreciation and amortization	89	65	68	–
Non-deductible expenses	797	798	502	494
Recoveries and other	(609)	(609)	(91)	(59)
Taxable income before tax loss carryforwards	2,187	2,098	2,759	2,603
Utilization of prior years' tax loss carryforwards	(2,098)	(2,098)	(2,747)	–
Taxable income	$ 89	–	12	2,603
IT payable at 33% and 34%	$ 29		4	
ESPS payable at 10%				$ 260

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Deferred IT and ESPS:

The deferred IT and ESPS income for the years ended December 31, 2004 and 2003 comprises the following:

	2004	2003
Valuation of financial instruments	$ 8	5
Expense accruals and others	107	40
Premises, furniture and equipment	19	36
Unearned fees collected	(14)	16
Foreclosed assets	38	-
	158	97
Decrease (increase) in valuation allowance	133	(47)
	$ 291	50

The deferred tax asset (liability) at December 31, 2004 and 2003 comprises the following:

	2004	2003
Valuation of financial instruments	$ 3	(5)
Expense accruals and others	145	38
Premises, furniture and equipment	(148)	(167)
Unearned fees collected	73	87
Foreclosed assets	42	4
	115	(43)
Valuation allowance	(42)	(175)
	$ 73	(218)

(Continued)

Other considerations:

According to the IT Law, tax losses, restated for inflation, may be carried forward to offset the taxable income of the ten succeeding years. At December 31, 2004, there are tax loss carryforwards which originated from 1995 through 2000; however, as a result of the agreement between The Bank of Nova Scotia ("BNS") and IPAB, the Bank shall not benefit from tax losses sustained in fiscal years between June 30, 1996 and December 31, 1999 without the prior written consent of the IPAB. Should the Bank derive any economic benefit from the carryforward of such tax losses, the IPAB will be paid an amount similar to the economic benefit received.

For the years ended December 31, 2004 and 2003, tax losses carryforwards of $2,098 and $2,747 (nominal), respectively, were utilized which resulted in tax benefits of $692 and $934 (nominal) respectively, reported in the statement of income as a reduction of current income tax expense. The Bank does not recognize the potential AT benefit that as of December 31, 2004 and 2003 amounts to $146 and $130, respectively, because its realization depends on first utilizing all of the tax loss carryforwards.

In accordance with tax reforms made to the Income Tax Law, the IT rate for 2005 will change from 32% to 30% and will subsequently be reduced one percentage point per year to reach 28% in 2007.

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.

Corporations carrying out transactions with related parties, whether domestic or foreign, are subject to certain requirements as to the determination of prices, since such prices must be similar to those that would be used in arm's-length transactions.

(19) Stockholders' equity-

(a) Structure of capital stock-

At the Extraordinary General Stockholders' Meeting held on March 31, 2003, the stockholders agreed to exchange mandatory convertible preferred subordinated debentures of $792 ($720 nominal), wholly owned by the Group, for shares representing the Bank's capital stock, applying the conversion formula indicated by the debenture document. This resulted in an increase in capital stock and additional paid-in capital of $354 ($328 nominal) and $425 ($392 nominal), respectively.

(Continued)

Also at this Meeting, of the 720,000,000 Series "F" shares held as treasury stock at December 31, 2002, it was resolved to subscribe 327,918,161 and cancel the remaining 392,081,839 shares.

After the above activity, the authorized and paid capital stock at December 31, 2004 and 2003 is represented by 2,851,865,508 common, registered shares with a par value of one peso each, divided into 2,851,865,467 Series "F" and 41 Series "B" shares.

(b) Comprehensive income-

The comprehensive income reported in the consolidated statement of stockholders' equity represents the results of the total performance of the Bank during the year, and includes the net income, plus the result of the valuation of available-for-sale securities and of non-monetary assets (premises, furniture and equipment and permanent investments in shares), and in 2004 the effect of the change in the accounting policy for foreclosed assets, which was charged to unappropriated retained earnings as described in note 3.

(c) Restrictions on stockholders' equity-

No individual or entity may acquire direct or indirect control of Series "B" shares in excess of 5% of the Bank's paid-in capital, through one or more simultaneous or successive transactions of any kind. If deemed appropriate, the SHCP may authorize the acquisition of a higher percentage, provided that it does not exceed 20% of the capital stock.

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.

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The tax basis of stockholder contributions and retained earnings may be distributed to the stockholders tax free. Distributions in excess of the tax bases are subject to income tax.

The undistributed retained earnings of subsidiaries may not be distributed to the Bank's stockholders until these are received by way of dividends from the subsidiaries. Also, unrealized gains from the valuation of investment securities and derivative financial instruments may not be distributed until realized.

(d) Capitalization-

The SHCP requires credit institutions to maintain a minimum capital as a percentage of assets at risk. The percentage is calculated in accordance with the assigned risk in conformity with the Central Bank's regulations. Information relating to the Bank's capitalization is shown as follows:

Capital as of December 31:

	2004	**2003**
Stockholders' equity	$ 10,554.0	8,423.8
Investments in financial service entities and their holding companies	(255.9)	(179.3)
Investments in other companies	(50.2)	(85.5)
Intangible assets and deferred taxes	(316.7)	(222.1)
Basic capital (Tier 1)	9,931.2	7,936.9
Excess of allowance for loan losses over past due portfolio – Supplementary capital (Tier 2)	238.4	574.0
Net capital (Tier 1 + Tier 2)	$ 10,169.6	8,510.9

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Assets at risk as of December 31, 2004:

	Risk weighted assets	Capital requirement
Market risk:		
Transactions in Mexican pesos at nominal interest rates	$ 15,697.6	1,255.8
Transactions in Mexican pesos at real interest rates or denominated in UDIS	26.3	2.1
Foreign currency transactions at nominal interest rates	162.5	13.0
Positions in UDIS or with returns linked to the INPC	0.7	–
Foreign currency positions or with exchange rate indexed returns	1,225.0	98.0
Equity positions or with returns indexed to the price of a single share or group of shares	277.5	22.2
Total market risk	17,389.6	1,391.1
Credit risk:		
Group II (weighted at 20%)	2,489.5	199.2
Other (weighted at 50%)	16.3	1.3
Other (weighted at 10%)	389.3	31.1
Group III (weighted at 100%)	48,215.8	3,857.3
Other (weighted at 112%)	3,956.6	316.5
Total credit risk	55,067.5	4,405.4
Total market and credit risk	$ 72,457.1	5,796.5

Capitalization indices as of December 31:

	2004	2003
Capital to credit risk assets:		
Basic capital (Tier 1)	18.0%	16.4%
Supplementary capital (Tier 2)	0.4%	1.2%
Net capital (Tier 1 + Tier 2)	18.4%	17.6%

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	2004	2003
Capital to market and credit risk assets:		
Basic capital (Tier 1)	13.7%	13.2%
Supplementary capital (Tier 2)	0.3%	0.9%
Net capital (Tier 1 + Tier 2)	14.0%	14.1%

Capital adequacy is projected and monitored by the Strategic Planning function, which considers the various established operating limits vis-à-vis the net capital, with a view to avoiding any possible capital shortfalls and taking any necessary measures to ensure that the capital is maintained at an adequate and sound level.

At December 31, 2004, the net capital structure improved as a result of the increase in stockholders' equity, which resulted mainly from the year's net income.

(20) Related-party transactions-

During the normal course of business, the Bank carries out transactions with related parties. According to the Bank's policies, the Board of Directors authorizes all credit transactions with related parties, which are granted at market rates with guarantees and terms in accordance with sound banking practices.

The principal transactions carried out with related parties for the years ended December 31, 2004 and 2003 are analyzed as follows:

	2004	2003
Income:		
Premiums and interest collected on securities purchased under agreements to resell	$ 1,096	807
Commissions	3	2
Loan interest	11	3
Other	70	87
	$ 1,180	899

(Continued)

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		2004	2003
Expense:			
Leases and related services	$	3	3
Advisory services		21	28
Interest		217	1
Premiums paid on securities sold under agreements to repurchase		860	757
Interest on mandatory convertible subordinated debentures		–	18
Other		14	13
	$	1,115	820

Balances receivable from and payable to related parties as of December 31, 2004 and 2003 are as follows:

		2004	2003
Receivable:			
Repurchase/resell agreements, net	$	–	6
Loans granted		773	346
Value date transactions		144	–
Other		14	–
Payable:			
Demand deposits	$	12	329
Bank loans		–	32
Other		1	138

(21) Memorandum accounts-

(a) Irrevocable lines of credit and guarantees issued-

At December 31, 2004, the Bank had irrevocable commitments to grant loans for $1,124 and had issued guarantees for $300 ($614 and $92, respectively, in 2003).

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Allowances created at December 31, 2004 and 2003 for letters of credit and guarantees amount to $8 and $5, respectively, and are included in the allowance for loan losses.

(b) ***Assets in trust or under mandate-***

The Bank's trust activity, recorded in memorandum accounts as of December 31, 2004 and 2003, is analyzed as follows:

		2004	2003
Trusts:			
Administrative	$	55,293	52,783
Guarantee		3,963	4,442
Investment		–	3
Other		84	73
		59,340	57,301
Mandates		475	520
	$	59,815	57,821

Trust revenue for the years ended December 31, 2004 and 2003 amounted to $83 and $114, respectively.

(c) ***Investments on behalf of customers-***

As of December 31, 2004 and 2003 customers' funds managed by the Bank for investment in different instruments of the Mexican financial system are recorded in memorandum accounts and are analyzed as follows:

		2004	2003
Equities and others	$	36,752	31,710
Government securities		27,940	10,998
Mutual funds		6,228	6,303
Bank securities not issued by the Bank		95	560
	$	71,015	49,571

(Continued)

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The amount of any funds invested in the Bank's own instruments forms part of the liabilities included in the consolidated balance sheet.

(d) ***Assets in custody-***

In this account, the Bank records property and securities received in custody, in guarantee or under management. At December 31, 2004 and 2003, this account consists of:

	2004	2003
Securities in custody:		
Safe-deposit box	$ 819	906
General safe box	184	85
Investment	136	182
Other	945	934
	2,084	2,107
Securities in guarantee	38,795	30,226
Securities under management:		
Securities	39,619	35,860
Other	2,816	2,977
	42,435	38,837
	$ 83,314	71,170

(22) Additional information on operations and segments-

(a) ***Financial margin-***

For the years ended December 31, 2004 and 2003, the financial margin is composed of the following elements:

Interest income:

Interest income for the years ended December 31, 2004 and 2003 is composed of the following (nominal):

	2004	2003
Cash and equivalents	$ 721	611
Investment securities	1,262	1,459
Interest and premiums collected on securities purchased under agreements to resell	3,156	3,236
Loan portfolio	5,897	4,775
Other, including restatement for inflation	412	775
	$ 11,448	10,856

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An analysis of the loan portfolio interest and commission income by type of loan is shown below, for the years ended December 31, 2004 and 2003 (nominal):

	2004		2003	
	Current	**Past due**	**Current**	**Past due**
Commercial	$ 2,036	5	1,224	5
Financial institutions	197	–	144	–
Consumer	1,796	15	1,185	7
Residential mortgages	1,269	7	877	17
Government entities	510	–	955	–
IPAB	61	–	360	–
Other past due debt	–	1	–	1
	$ 5,869	28	4,745	30
	$ 5,897		4,775	

For the years ended December 31, 2004 and 2003, consumer loan interest income includes fees that represent a yield adjustment of $190 (thousand) and $166 (thousand), respectively.

For the years ended December 31, 2004 and 2003, interest income denominated in foreign currency amounted to the equivalent of 28 and 25 million dollars, respectively.

Interest expense:

Interest expense for the years ended December 31, 2004 and 2003 is composed of the following (nominal):

	2004	**2003**
Demand deposits	$ 555	566
Time deposits	1,731	1,536
Bank and other loans	508	477
Interest and premium paid on securities sold under agreements to repurchase	3,196	3,203
Interest on mandatory convertible subordinated debentures	–	18
Other, including restatement for inflation	172	451
	$ 6,162	6,251

(Continued)

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For the years ended December 31, 2004 and 2003, interest expense denominated in foreign currency amounted to the equivalent of 1 and 3 million dollars, respectively.

Monetary position loss:

For the years ended December 31, 2004 and 2003, the net monetary position loss arising from the accounts related to the financial margin was $350 and $158, respectively ($339 and $152 respectively, related to the Bank).

The average balance of the principal monetary assets and liabilities used to determine the Bank's monetary position loss was as follows (nominal):

	2004	2003
Assets:		
Cash and equivalents	$ 11,835	10,802
Investment securities	17,302	17,385
Loan portfolio	53,593	47,384
Other	63	3,350
Total assets	82,793	78,921
Liabilities:		
Deposit funding	69,175	64,813
Bank and other loans	7,373	7,118
Other	4	3,549
Total liabilities	76,552	75,480
	$ 6,241	3,441

(b) Financial intermediation income-

For the years ended December 31, 2004 and 2003, financial intermediation income is analyzed as follows (nominal):

Valuation result:		
Investment securities	$ (3)	4
Securities repurchase/resell agreements	(1)	(3)
Trading derivatives	12	(3)
Unassigned securities pending settlement	1	(7)
Foreign currencies and precious metals	93	8
Valuation result, carried forward	$ 102	(1)

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	2004	2003
Valuation result, brought forward	$ 102	(1)
Result from purchases and sales:		
Investment securities	235	371
Trading derivatives	6	14
Hedging derivatives	–	30
Foreign currencies and precious metals	287	329
	528	744
Restatement for inflation	17	56
	$ 647	799

(c) ***Other income-***

For the years ended December 31, 2004 and 2003, other income is analyzed as follows (nominal):

	2004	2003
Recoveries:		
Own residential mortgage support programs	$ 3	19
Other	196	74
Income from sales of assets foreclosed or received in lieu of payment	117	94
Monetary position result arising from items not related to the financial margin	(20)	(36)
Sale of the acquiring business (see note 1)	–	85
Income from loan insurance	270	142
FDMS transactions	122	103
Distribution of mutual fund shares	70	73
Loans to employees	35	35
Food vouchers	36	27
Other, including restatement for inflation	529	343
	$ 1,358	959

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The average balance of the principal monetary assets and liabilities used to determine the gain or loss in the purchasing power of the monetary position arising from items not related to the financial margin is as follows (nominal):

	2004	2003
Assets:		
Cash and equivalents	$ 2,372	1,985
Investment securities	83	182
Other accounts receivable	2,872	2,551
Foreclosed assets	474	504
Other	220	367
Total assets	6,021	5,589
Liabilities:		
Other accounts payable	5,258	4,109
Deferred credits	429	381
Other	–	198
Total liabilities	5,687	4,688
	$ 334	901

(d) ***Other expense-***

For the years ended December 31, 2004 and 2003, other expense is composed of the following (nominal):

	2004	2003
Write-offs and miscellaneous losses	$ 68	189
Other, including restatement for inflation	5	16
	$ 73	205

(Continued)

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(e) ***Financial ratios-***

Following are some principal quarterly financial rations as of and for the years ended December 31, 2004 and 2003:

	2004			
	Fourth	**Third**	**Second**	**First**
Past due loan portfolio / Total loan portfolio	2.5%	2.6%	3.3%	3.4%
Allowance for loan losses / Past due loan portfolio	189.0%	204.2%	179.8%	178.1%
Operating efficiency (*administrative and promotional expenses / average total assets*)	5.8%	6.7%	5.3%	5.1%
ROE (*annualized net income for the quarter / average stockholders' equity*)	28.3%	23.3%	25.1%	19.8%
ROA (*annualized net income for the quarter / average total assets*)	2.9%	2.4%	2.4%	1.8%
Net capital / Assets at credit risk	18.5%	19.4%	19.6%	18.7%
Net capital / Assets at credit and market risks	14.0%	16.2%	15.8%	15.0%
Liquidity (*liquid assets / liquid liabilities*)	70.7%	74.3%	65.1%	57.8%
Financial margin after allowance for loan losses / Average earning assets	4.2%	5.1%	5.2%	5.0%

	2003			
	Fourth	**Third**	**Second**	**First**
Past due loan portfolio / Total loan portfolio	4.8%	4.9%	5.7%	5.5%
Allowance for loan losses / Past due loan portfolio	125.6%	124.0%	118.8%	126.1%
Operating efficiency (*administrative and promotional expenses / average total assets*)	5.5%	5.3%	5.5%	5.5%
ROE (*annualized net income for the quarter / average stockholders' equity*)	21.8%	24.4%	33.1%	23.1%
ROA (*annualized net income for the quarter / average total assets*)	1.8%	2.1%	2.7%	1.6%
Net capital / Assets at credit risk	17.6%	17.2%	17.8%	17.2%
Net capital / Assets at credit and market risks	14.2%	12.2%	13.2%	13.3%
Liquidity (*liquid assets / liquid liabilities*)	63.1%	52.0%	48.4%	43.6%
Financial margin after allowance for loan losses / Average earning assets	4.8%	5.2%	5.2%	5.1%

(Continued)

(23) Commitments and contingent liabilities-

(a) Leases-

The Bank is obligated under various leases for certain premises and operating equipment, which provide for periodic rental adjustments based on changes in economic conditions. Total rent expense was $290 in 2004 and $272 in 2003.

(b) Litigation-

The Bank is involved in a number of lawsuits and claims arising in the normal course of business. It is not expected that the final outcome of these matters will have a significant adverse effect on the Bank's financial position and results of operations. Certain cases are covered by an indemnity clause of the agreement with the IPAB.

The Bank is awaiting official notification of the final resolution on the proceeding (*amparo*) that was filed against the adjustments ordered by the Banking Commission on accounting imbalances in certain UDI Trusts. These imbalances arose from changes in the terms requested by the debtors for residential mortgage loan restructuring processes carried out by the Bank in 1997. In such restructuring process, all relevant benefits were granted in conformity with each program and the new terms, including any additional benefits which were granted with the Bank's own funds. The court dismissed the Bank's appeal, because, among other things, it considered that the adjustments resulted from a contractual relationship under which the Bank had failed to advise of the changes in a timely manner. The adjustment and the contractual penalty amount to $121, which has been provided for as of December 31, 2004, with $101 included in global reserves and $20 included in provisions for miscellaneous obligations.

<u>*Litigation on recoverable VAT*</u>

During 2004, the Bank obtained a favorable final resolution as to the method used to determine the recoverable value-added tax (VAT) factor. Such decision confirms the right to fully recover the VAT paid during the period from January 1, 2003 to July 31, 2004, which amounts to $479 ($317 net of IT effect). The recoverable tax is recorded in memorandum accounts and will be recognized in results of operations upon collection.

(c) Personnel benefits-

Those arising from the obligations mentioned in the last paragraph of note 2(q).

(24) Risk management-

The purpose of the comprehensive risk management function is to identify and measure risks, monitor the impact that these risks may have on the operations and control their effects on income and shareholder value by applying the best mitigating strategies available, and the incorporation of a risk culture in daily transactions.

The ultimate purpose of the Bank is to generate shareholder value by maintaining the organization's stability and creditworthiness. Sound financial management increases the profitability of performing assets, helps maintain appropriate liquidity levels and provides control over exposure to losses.

In compliance with the provisions issued by the Banking Commission and the guidelines established by BNS, the Bank continues to implement a series of initiatives designed to strengthen the comprehensive risk management function and thus identify and measure, monitor, transfer and control the credit, liquidity and market risk exposures and other risks arising from day-to-day transactions, including compliance with regulatory requirements and other legal matters.

The Board of Directors is responsible for establishing the Bank's risk management policies as well as the overall risk level to which the Group is exposed and for approving related policies and procedures, at least once a year. The Board of Directors is also responsible for establishing the structure of limits for the various types of risks; such limits may be based on value-at-risk, volumetric or notional amounts and are established in relation to the Bank's stockholders' equity. Furthermore, pursuant to the policies in force, the Board of Directors entrusts the implementation of the procedures designed to measure, manage and control risks to the Risk Management Committee and the Comprehensive Risk Management Unit (UAIR).

In turn, the Risk Management Committee assigns responsibility for monitoring compliance with the policies and procedures on market and liquidity risks to the Asset-Liability and Risks Committee (CAPA). Also, the UAIR has policies to inform and correct any deviations from the specified limits. Such deviations must be reported to the Risk Management Committee and the Board of Directors.

(a) Market risk-

The purpose of the market risk management function is to identify, measure, monitor, and control risks arising from interest and exchange rate and market price fluctuations and other risk factors that are present in the money, foreign exchange, capital and derivative instruments markets, in which the Bank maintains positions for its own account.

(Continued)

The CAPA performs weekly reviews of the various activities that represent market risks for the Bank, focusing on the management of asset and liability positions reported in the consolidated balance sheet, in connection with credit, funding and investing, as well as securities trading activities.

Derivative instruments are valuable risk management tools for the Bank and its customers. The Bank uses derivative instruments to control the market risk originating from its funding and investing activities, as well as to reduce funding-related costs. To control interest rate risks inherent in fixed-rate loans, the Bank enters into interest rate swaps, forward and futures contracts. Forward foreign exchange contracts are also used to control exchange rate risks. The Bank trades derivative instruments on behalf of its customers and also maintains positions for its own account.

Market risk management in securities trading activities - The Bank's securities trading activities are directed primarily to providing service to its customers. Accordingly, to meet its customers' demand, the Bank maintains positions in financial instruments and holds an inventory of financial instruments for trading purposes. Access to market liquidity is available through offers to buy from and sell to other intermediaries. Even though these two activities represent transactions the Bank carries out for its own account, they are essential to allow customers access to markets and financial instruments at competitive prices. In addition, the Bank has treasury positions invested in the money and capital markets as well as in mutual funds so that surplus cash generates the maximum yields in the Bank's income. In general, trading positions are taken in liquid markets, which avoid high costs at the time such positions are liquidated. The trading securities portfolio (fixed and variable income and derivative instruments) is marked to market on a daily basis.

The Bank applies a series of techniques designed to assess and control the market risks to which it is exposed in the normal course of its activities. The Risk Committees both of the Bank in Mexico and of BNS in Toronto and the Board of Directors authorize individual limit structures for each of the financial instruments traded in the markets and by business unit. The limit structure considers mainly volumetric or notional amounts for value at risk, stop loss, diversification, stress, intraday, marketability, precious metals, and other limits.

(Continued)

The value at risk (VaR) is an estimate of the potential loss of value within a specific level of statistical confidence that might arise from maintaining a specific position during a specific period of time (the holding period) under normal market conditions. VaR is calculated daily on all of the Bank's risk-exposed financial instruments and portfolios using the Risk Watch methodology developed by Algorithmics.

VaR is calculated using the historical simulation method (with a 300-working day time span). In order to conform to the measurement methodologies used by BNS, the Bank calculates VaR considering a 99% confidence level and a 10-day holding period.

Since VaR is used to estimate potential losses under normal market conditions, stress testing is performed monthly assuming extreme conditions, with the purpose of determining risk exposure under unusually large market price fluctuations (volatility changes and the correlation among risk factors). The Risk Committee has approved stress limits.

For purposes of marking the Bank's positions to market, a price vendor has been contracted to determine prices using technical and statistical methods as well as valuation models authorized by the Banking Commission. During 2004 the authorized limits and the average and maximum VaR levels (in millions of nominal pesos, except for foreign currency forwards and futures, which are expressed in millions of dollars) are as follows (unaudited data):

Market	Average position	Maximum position	Position limit	Average VaR	VaR limit
Money market	31,922.5	43,479.5	45,320.0	44.1	80.0
Foreign currency forwards*(2)	793.3	1,499.0	1,700.0		
Foreign currency futures (1)	1,647.0	3,111.0	10,000.0		
Currency exchange*(2)	5.8	32.2	35.0	1.1	30.0
Foreign currency options*	5.0	19.0	60.0	0.2	3.0
Interest rate swaps	3,068.7	5,536.6	8,000.0	3.1	11.5
Interest rate futures (1)	68,902.0	182,754.0	225,000.0	5.0	14.0
Shares	66.8	93.5	100.0	7.0	10.0

* Forwards position and currency exchange are expressed in millions of dollars.

(1) The position and the limit are expressed in the number of contracts traded in MexDer.

(2) The Forwards position is a gross position (long + short) and the foreign exchange position is net (long – short).

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The Bank's average global VaR (unaudited data) during 2004 was $52.24 and the global VaR at December 31, 2004 (unaudited data) was $30.71 ($29.93 and $26.16, respectively in 2003, nominal).

Market risk management in lending and borrowing activities- The interest rate risk originating from lending and borrowing activities is assessed weekly through analyses of the interest rate gaps derived from funding and investing activities. This weekly supervision function is supported by a risk assessment process, which includes simulation models and sensitivity analyses.

Simulation models help the Bank assess interest rate risks dynamically. These models are applied mainly to the balance sheet position and consider hypotheses with respect to growth, mix of new activities, interest rate fluctuations, maturities and other related factors.

(b) Liquidity risk-

The Bank's liquidity risks result from the funding, borrowing and securities trading transactions, such as demand deposits, maturities of time deposits, drawing against credit lines, settlement of transactions involving securities, derivative instruments trading and operating expenses. The liquidity risk is reduced to the extent that the Bank is able to obtain funds from alternate financing sources at an acceptable cost.

Among the factors that are implicit in the strategy applied to liquidity risk management are assessing and anticipating commitments payable in cash, controlling asset and liability maturity gaps, diversifying sources of funding, establishing prudential limits and assuring immediate access to liquid assets.

(c) Credit risk-

Transactions with customers originate credit risk exposure. Such exposure is recorded in balance sheet and memorandum accounts. Exposure to credit risk recorded in the balance sheet consists primarily of loans granted, while that recorded in memorandum accounts includes guarantees issued, as well as any other financial instrument whereby credit is extended to a third party.

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The Bank has developed policies and procedures to manage its loan portfolio risk level and composition, with the purpose of quantifying and managing the loan portfolio-related credit risks and reducing the risk of loss resulting from a customer's failure to comply with the agreed terms.

Policies and procedures for granting, controlling and collecting loans, as well as evaluating and monitoring credit risk and the methods used to identify current or past due impaired commercial loans- The Bank's credit risk management is based on the application of well-defined strategies to control this type of risk. Among these are the centralization of credit processes, the diversification of the portfolio, improved credit analysis, strict supervision and a credit risk-scoring model.

The Bank has three different levels of credit authorizations: The Board of Directors, Credit Committees and the Credit Department. Each level is defined depending on the amount of the transaction, the type of borrower and the purpose for which the funds will be used.

The business areas prepare and structure the different proposals, which are analyzed and authorized by the Credit Department, or, if applicable, recommended to the corresponding authorization level, thus ensuring an appropriate separation between loan origination and the authorization of transactions.

The business areas also continually evaluate the financial situation of each customer, conducting an in-depth review and analysis of the inherent risk in each loan at least once a year. Should any impairment in a customer's financial situation be detected, the customer's rate is immediately revised. In this way, the Bank identifies the changes that occur in the risk profile of each customer. Such reviews consider the overall credit risk, including derivative transactions and foreign exchange exposure. In the case of risks above the acceptable level, additional reviews are carried out more frequently, at least once a quarter.

Loan risk concentrations- The Bank has implemented policies and procedures to maintain a sound and diversified portfolio with a prudent and controlled risk. Among such policies are the setting of credit risk exposure limits, considering business unit, currency, term, sector, etc. The limits are submitted annually to the Board of Directors for approval and their behavior is monitored and reported to the Risk Committee on a monthly basis.

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Methodology used to determine allowances for loan losses- The Bank uses a credit risk classification system derived from the BNS methodology in order to identify the level of risk of loans as well as to ensure that the yields from each loan are proportionate to the risk assumed. This also includes systems and strategies to grant loans and monitor the loan portfolio. These systems, processes and strategies are used in more than 50 countries. The Bank also takes advantage of BNS experience in portfolio grading, estimating allowances and losses, adapted as appropriate to the laws and needs of the Mexican market.

This model considers the following risk factors: country risk, financial behavior, financial hedging, debtor management, overall strength (the customer's relation to the economic environment, competitiveness, strengths and weaknesses), account management, industry conditions and payment experience.

Such factors constitute an evaluation of the customer's risk profile and the result is obtained by applying an algorithm that considers such elements. This algorithm is the result of BNS experience, its statistical analysis and adaptation to the Mexican market.

The internal grading system (classified by "IG Codes") uses eight grades considered to be acceptable (IG 98 to IG 77), five grades to reflect a higher than normal risk (IG 75 to IG 60) and four considered to be unacceptable (IG 40 to IG 20). A correlation has been established between the internal grading model and the levels of risk contained in the Banking Commission's *General Provisions applicable to the Loan Portfolio Rating Methodology for Credit Institutions* published in the Federal Official Gazette on August 20, 2004 ("the Provisions").

Through official document number 601-II-360447 dated November 30, 2004; the Banking Commission renewed the Bank's authorization to continue using its internal loan portfolio grading model for a two-year period beginning December 1, 2004. The internal grading model is applicable to the entire loan portfolio, except for loans granted to Federal and Municipal Entities, self-paying Investment Projects, trustees acting for Trusts, and "structured" loan schemes which permit the assessment of the related risk, which are individually graded in accordance with the methodologies prescribed in articles 24, 26 and 27 of the Provisions. From December 2004 loans are graded and provided for in accordance with articles 38 and 43 of the aforementioned Provisions.

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(Millions of constant Mexican pesos as of December 31, 2004)

The following chart shows the correlation between the Bank's internal grading model and the risk levels established in the aforementioned Provisions:

Risk	IG Code	Banking Commission
Excellent risk	98	A-1
Very good risk	95	A-1
Good risk	90	A-1
Satisfactory risk	87	A-1
High adequate risk	85	A-2
Medium adequate risk	83	A-2
Low adequate risk	80	B-1
Medium risk	77	B-1
High moderate risk	75	B-2
Medium moderate risk	73	B-2
Low moderate risk	70	B-3
Watch list	65	C-1
Special supervision	60	C-1
Sub-standard	40	C-2
High impairment	22	C-2
Doubtful recovery	21	D
Non-performing	20	E

Description of each risk level:

Excellent risk: Borrowers with the highest credit rating, outstanding financial structure and solid/consistent profitability. Their capacity for the timely repayment of debt is outstanding, which provides them with unrestricted access to the money and capital markets as well as to alternative financing sources. Management has sufficient experience and optimum performance. These borrowers are not vulnerable to changes in the environment of the country or of their economic sector.

Very good risk: Borrowers with a solid financial structure that generate sufficient funds and liquidity to cover short and long-term debts; however, they depend on the Bank to a greater extent than excellent risk borrowers. The management team is competent, with the capacity to easily overcome moderate setbacks. They operate in a stable or growing economic sector.

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Good risk: Borrowers with a good financial structure, with consistent earnings and reliable cash flow. Their capacity to cover and service the debt is good. The management team has shown itself to be good, with adequate capabilities in critical areas. The characteristics of the economic sector and the country's economy are sound, without indications that may adversely affect them.

Satisfactory risk: Borrowers with an adequate financial structure that can easily repay their loans in an effective manner. Although their earnings are consistent with the industry average, they are more susceptible to adverse economic conditions than borrowers in higher ratings. Management is competent and has the support of stockholders. The industry where they operate may be subject to cyclical trends.

High adequate risk: Borrowers who still have satisfactory ability to repay their loans and an adequate financial structure. However, although consistent, their earnings are slightly below industry average. The management team's capabilities to obtain efficient and profitable results are satisfactory. The industry where they operate may be subject to cyclical trends.

Medium adequate risk: Borrowers whose timely repayment of principal and interest thereon is still guaranteed; however, their earnings are currently below industry average, which suggest that their continued strength may be at risk. Management may be family-owned or professional and performance is satisfactory; accordingly, stockholders support their initiatives. The industry where they operate may be subject to cyclical trends.

Low adequate risk: Borrowers whose financial structure, profitability and current funding are generally adequate. Although earnings are below the industry average, operating cash flows are at the break-even point and show adequate levels to cover the debt. Management evidences certain weaknesses, which are compensated by other strengths. The industry where they operate may be subject to cyclical trends or be slightly affected by applicable regulations.

Medium risk: Borrowers that can easily meet their loan commitments in the short-term but whose payments in the long-term are potentially uncertain; with growing leverage and lower debt capacity. Management meets the minimum risk criteria. The industry where they operate may be subject to cyclical trends or be affected by macroeconomic changes.

(Continued)

High moderate risk: Borrowers face a slight decrease in earnings, although they have good potential for successfully overcoming these difficulties. Operating cash flows are at the break-even point and suffice to timely meet their debt payments, but with a certain descending trend. Management shows mixed operating results and long-term prospects. The industry where they operate shows growth problems.

Medium moderate risk: Borrowers face growth problems or weak capitalization, although they have a regular potential for successfully overcoming their financial weaknesses. They are currently meeting their payment obligations in a timely manner; however, their funds rarely come from alternative sources and therefore, their sustained repayment capacity is contingent. Management evidences certain weaknesses that make stockholders skeptical, to a certain degree, of their performance.

Low moderate risk: Borrowers whose financial structure shows clear signs of weakness that may adversely affect their capacity or willingness to meet their long-term payment obligations. They regularly use alternative funding sources and payments are generally late. Management shows certain noteworthy limitations and share ownership may be concentrated in one single individual. The industry sector in which they operate is highly susceptible to changes in macroeconomic conditions.

Watch list: Borrowers whose financial structure is weak, the debt position is unbalanced and debt is overextended. They require constant funding from non-routine sources; their repayment performance is weak. These borrowers meet the Bank's minimum acceptable requirements. Management performance is poor. Borrowers are vulnerable to any business and/or industry problems.

Special supervision: Borrowers who have cash flow and liquidity problems that may require funding from alternative sources to prevent defaulting on their loans. Urgent changes are required in how the business is managed and its direction in order to combat the deterioration, which probably can be corrected in the medium term. Both the country and industry environments are frail. These customers definitely have unacceptable risks.

Sub-standard: Borrowers whose future feasibility is uncertain unless there are changes in their business activities, market conditions and management. Customers in this category call for substantial reorganization. Repayment history is bad and their loans are currently past due. The industry in which they operate faces temporary problems.

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High impairment: Borrowers with clear financial problems that put at risk compliance with the service of their debt, are susceptible to file bankruptcy proceedings, have defaulted on their payments and are highly dependent on alternative sources for meeting their loan repayment commitments. Management problems threaten the borrower's ability to continue as a going concern and so the impairment is deemed permanent. Viability of the industrial sector relies on structural changes.

Doubtful recovery: Borrowers with permanent financial problems. Businesses in this category are likely to have ceased operating and so their repayment performance is practically non-existent. Payments are up to one year past due and considered as doubtful recovery. Management is deficient and unreliable and the industry where they operate has been permanently affected.

Non-performing: Borrowers who have ceased making loan payments and whose situation does not allow for restructuring. Management is ineffective or has shown clear signs of dishonesty. The industry where they operate faces permanent problems and so it is practically impossible to maintain the loan as a performing asset.

Part of the portfolio is exempt from grading, examples are: Mexican government sovereign debts, highway loans guaranteed by the Mexican government, and IPAB loans not arising from portfolio sales. No allowances are required for this portfolio.

The Bank has implemented the CreditMetrics® methodology and adapted it to the conditions in Mexico. This methodology measures and controls the credit risk of the different segments of the loan portfolio.

- The methodology includes estimating expected and unexpected losses using measurements of the probability of the occurrence of credit events (transition matrices) including likelihood of non-compliance.

- A level of confidence of 99.75% over a one-year period is used to determine unexpected losses *("Credit VaR")*.

- The correlation between different economic sectors is used to measure the effect of the concentration in the commercial loan portfolio. Constant correlation assumptions in accordance with international practices are used for retail portfolio (credit card, personal and residential mortgage loans).

- Furthermore, stress testing is performed regularly as to both expected and unexpected losses.

Credit culture- To create and promote a credit culture, the Bank has permanent training programs for personnel involved in the loan origination and authorization processes. Among such programs is required advanced training in commercial banking practices that provides support tools for the analysis and evaluation of credit risks, as well as decision-making workshops.

Implementation of prudent credit criteria – In accordance with the *Prudent Credit Provisions*, the Bank has established control measures to timely identify, measure and limit the taking of risks derived from the credit activity in its different phases, which are documented in the Credit Policies and Procedures Manual and are constantly reviewed and updated, as well as being submitted for approval by the Board of Directors annually.

(d) Operational Risk-

In accordance with the *Prudent Provisions for Comprehensive Risk Management* applicable to credit institutions and published in the Federal Official Gazette on July 1, 2004, operational risk is a non-discretionary risk, which is defined as the potential loss arising from failures or deficiencies in internal controls, errors in transaction processing or storage or in data transmission as well as loss resulting from adverse judicial and administrative resolutions, frauds or theft. Technological risk and legal risk are part of operational risk on the understanding that:

1. Technological risk is defined as the potential loss resulting from damages, interruptions, changes or failures derived from the use of or reliance on hardware, software, systems, applications, networks and any other data distribution channel for providing banking services to the institution's customers.

2. Legal risk is defined as the potential loss arising from non-compliance with relevant legal and administrative provisions, issue of adverse judicial and administrative resolutions and the application of penalties concerning the transactions carried out by the institutions.

Operational risk is inherent in all of the Bank's lines of business and key supporting activities, and may result in a potential financial loss, a regulatory penalty and/or damage to the Bank's reputation.

Operational risk losses can be categorized within the following types:

- Errors or failures in transaction processing, such as an error in the amount paid to a customer and payments made to incorrect parties, that cannot be recovered.
- Legal liability arising from failure to comply with legal or contractual obligations, such as labor and social security laws.
- Fines and penalties for failure to comply with regulations or legislation.
- Losses resulting from fraud, theft or unauthorized activities; and loss of or damage to assets resulting from natural disasters, acts of terrorism (Barzon) or war, or other accidents.

The Bank has established the following operational risk management policies to comply with the provisions set forth in the *Prudent Provisions for Comprehensive Risk Management*:

- Policies for Operational Risk Management - These policies primarily promote the risk management culture, particularly as to operational risk so that the Bank can identify, measure, monitor, limit, control and disseminate the operational risks inherent in the day-to-day activities.
- Policies to Obtain Operational Risk Information - These policies define the requirements to report information that supports measuring processes, including the scope, functions and responsibilities of the units that provide information as well as its classification and specific characteristics.

The Bank also has a structured methodology to identify and assess those operational risks to which it is exposed. The objectives of such methodology are as follows:

- Prioritize significant operational risks
- Establish explicit criteria to promote awareness of operational risks
- Establish plans to mitigate risk
- Comply with the requirements established in section I of Article 23 of the *Prudent Provisions for Comprehensive Risk Management.*

Also, regular audits are performed by an experienced independent internal audit department, including comprehensive reviews of: the design and operation of internal control systems in all businesses and support groups; new products and systems; and the reliability and integrity of data processing operations.

Recognizing the need for a coordinated approach with respect to the emergence of new methodologies and advances in the area of operational risk, the Bank has created an Operational Risk Sub-Committee with overall responsibility for the administration of operational.

This unit works together with groups of specialists and the business areas and has been instrumental in the preparation and application of new methods to identify, measure, value and manage operational risk. The initiative includes the definition of a framework for identifying risks and the preparation of a centralized database of operating losses to assist in quantifying operational risk.