Mercantile Bank
Holdings Limited
Member of CGD Group

Integrated Annual Report 2013

The Business Bank inspired by entrepreneurs

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Mercantile Bank Holdings Limited
Registration Number: 1989/000164/06
Member of CGD Group

Bank Regulations public disclosure
The December 2013 disclosure, required in terms of Regulation 43 of the Banks Act Regulations, is published on the Group's website.

ABOUT THIS REPORT

This is Mercantile's third Integrated Annual Report, prepared in accordance with the provisions of King III. The aim of this report is to provide effective and transparent communication with all stakeholders, in a useful, accessible and informative format.

OUR BRAND AND VALUE PROPOSITION

MERCANTILE BANK

The Business Bank inspired by Entrepreneurs

OUR MISSION

We financially partner with you on your journey in creating a successful business

OUR VISION

We grow entrepreneurs through successful partnerships

OUR VALUES

WE ARE CURIOUS

We are visionary and innovative, dynamic and unconventional. We know that innovative thinking and action requires boldness, determination, passion and daring, and the courage to do things differently.

WE ARE COMMITTED

We act with absolute integrity, professionalism, honesty and transparency at all times. We value lifelong relationships above all else, and understand that success is ultimately built not on profit but on mutually profitable partnerships.

WE ARE CONNECTED

We always behave in the best interest of the individual and the community we serve, and strive to deliver excellence in everything we do.

HIGHLIGHTS

PROFILE

Mercantile provides a wide range of international and local banking services to the business community with a segment focus on the Portuguese market. The Group aims to satisfy all the banking needs of the business client and seeks to differentiate itself through a single point of contact, high-touch, personalised service model.

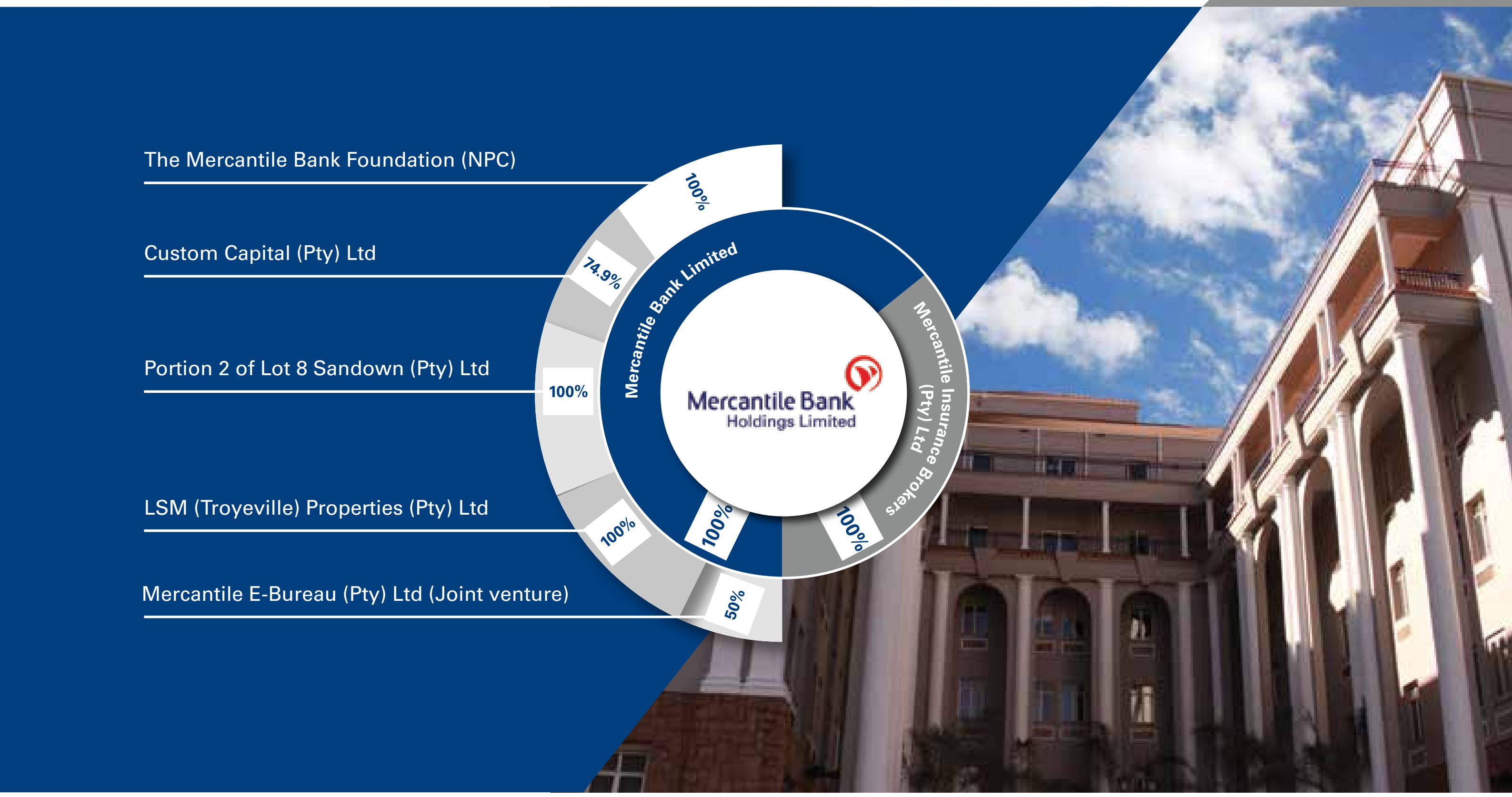
The Bank's core focus is on Business Banking and Commercial Banking. It also has an Alliance Banking division that offers credit card, debit card and payment services to non-banks who seek to, or are already participating in, the financial services industry. In addition, the Bank also has a Treasury division that offers a full suite of vanilla foreign exchange products.

SALIENT FEATURES

PROFIT AFTER TAX	R138 million
ROE	7.9%
GROWTH IN DEPOSITS	6.4%
ROA	1.8%
TOTAL ASSETS	R7.7 billion
COST TO INCOME	63.0%
CREDIT LOSS RATIO	0.4%
INCREASE IN OPERATING EXPENDITURE	3.9%

GROUP STRUCTURE

(EXCLUDING DORMANT/NON-TRADING COMPANIES) AS AT 31 DECEMBER 2013



MERCANTILE BANK HOLDINGS LIMITED is a registered bank-controlling and investment holding company. Its holding company is CGD and its principal operating subsidiaries are:

MERCANTILE BANK LIMITED, which provides a full range of international and domestic banking services. It operates in selected business, commercial and alliance banking niches, in which it offers banking, financial and investment services.

CUSTOM CAPITAL (PTY) LTD, a rental finance business that offers financing of office automation and allied equipment through operating rentals.

MERCANTILE INSURANCE BROKERS (PTY) LTD, an insurance brokerage, whose only source of revenue at present is the collection of legacy commission for insurance written in the past. Effective from 1 July 2012, all life assurance and short-term insurance broking is facilitated through an alliance partnership agreement with Commrisk Insurance Brokers (Pty) Ltd.

PORTION 2 OF LOT 8 SANDOWN (PTY) LTD, a property-owning company. The underlying property, located in Sandton, is used by the Group as its head office.

LSM (TROYEVILLE) PROPERTIES (PTY) LTD, a property-owning company, located in Troyeville, that leases office space to the Bank.

MERCANTILE E-BUREAU (PTY) LTD, a joint venture company that processes and administers electronic financial transactions on behalf of customers.

THE MERCANTILE BANK FOUNDATION (NPC), the primary Corporate Social Responsibility arm of the Group. The Foundation plays a fundamental role in enabling the Group to achieve its objective of making a meaningful contribution to the communities in which it operates.

BOARD OF DIRECTORS AND ADMINISTRATION

at 26 February 2014

J A S de Andrade Campos (76)
Chairman, Non-Executive Director, Portuguese

Joaquim holds a degree in Law from Coimbra University in Portugal. His career spans over 50 years, having started as a Public Prosecutor, he later held senior positions in various banks and other companies in Europe and Africa, including CEO of Banco Totta Standard (Angola), Banco Totta e Açores (London), Navang and Navetur (Shipping) (Angola), Chairman of the Portuguese airline TAP and Regional General Manager of Caixa Geral de Depósitos (France and Luxemburg), and Chairman of Banque Franco Portugaise in Paris (Part of CGD group), from which position he retired in 2002.

K R Kumbier (42)
CEO

Karl holds a B.Compt degree from the University of South Africa and a PGDA from the University of Cape Town. He is a Chartered Accountant (SA) and a Chartered Financial Analyst (CFA Institute). Before joining Mercantile, he worked for the Standard Bank group for nine years in various positions, including Provincial Director, Western Cape, and Chief Operating Officer of Stanbic Bank Ghana Limited. He joined Mercantile in 2010. With effect from 1 April 2013, Karl was appointed CEO of the Group.

J P M Lopes (48)
Executive Director, Portuguese

Julio holds a degree in Law from the Lusiada University of Lisbon, and a Certificate in Corporate Finance from the London School of Business. He has been employed by CGD since 1991 and he spent a number of years in London where he successfully managed Derivative Products and Structured Products. His most recent appointment was that of Managing Director of Banco Interatlântico, which is an affiliated bank of CGD, operating in the Republic of Cape Verde, focusing on Corporate Banking, Trade Financing and Private Banking. He was appointed as Executive Director of Mercantile in 2005.

A T Ikalafeng (47)
Independent Non-Executive Director

Thebe holds BSc (Bus Admin) and MBA degrees from Marquette University in the USA and has completed executive development courses in finance at the University of the Witwatersrand and Harvard Business School. A chartered marketer (CM(SA)), he has held various marketing positions in the USA and Africa. He is the Founder of the Brand Leadership Group and Brand Africa and is a member of the Brand Council of South Africa advisory board. He was named one of the 100 Most Influential Africans by New Africa Magazine.

L Hyne (70)
Independent Non-Executive Director

Louis is a Chartered Accountant (SA). He attended executive programmes at the Witwatersrand Graduate School of Business and Stanford University in the USA. He was appointed as a partner with Deloitte & Touche in 1970 and later became Chief Operating Officer and Deputy Chairman, from which position he retired in May 2003.
He holds directorships with various companies.

G P de Kock (59)
Independent Non-Executive Director

Deon attended executive programmes at the Business Schools of the Universities of Cape Town and Stanford, California (SEP). He retired in 2004 as Managing Director of Woolworths Financial Services (Pty) Limited and as an executive director of Woolworths Holdings Limited. Before that, he was the General Manager of the Credit Card Division of Edgars Stores Limited. He is currently operating as an independent consultant in the retail and financial services industries.

T H Njikizana (38)
Independent Non-Executive Director, Zimbabwean

Tapiwa is a Chartered Accountant (SA) and his professional career includes international experience in Africa, the United Kingdom and the Republic of Ireland. He is currently operating as a director at W Consulting, which offers services across Africa, the United Kingdom and Australia. Tapiwa is a member of the Association for the Advancement of Black Accountants in Southern Africa and sits on various SAICA committees, including the Accounting Practices Committee since 2007. He is a JSE-registered IFRS Advisor. Tapiwa also serves as an Independent non-executive director on the Board of Iliad Africa Limited.

ADMINISTRATION

GROUP SECRETARY F J Schutte

REGISTERED OFFICE

1st Floor
Mercantile Bank
142 West Street
Sandown 2196

Postal address
PO Box 782699
Sandton 2146

FIVE-YEAR GROUP SALIENT FEATURES

years ended 31 December

	2013 R'000	2012 R'000 (restated)	2011 R'000 (restated)	2010 R'000	2009 R'000
Statement of financial position					
Total assets	**7 733 848**	7 240 349	6 215 275	6 254 311	5 818 734
Loans and advances	**5 227 941**	5 291 748	4 489 863	3 720 907	3 629 574
Cash and cash equivalents	**1 490 690**	1 223 016	952 621	1 759 897	1 400 937
Total equity attributable to equity holders of the parent	**1 793 644**	1 674 091	1 678 774	1 539 394	1 437 671
Long-term funding	**583 173**	581 876	–	–	–
Deposits	**5 041 649**	4 736 758	4 251 543	4 563 988	4 246 598
Statement of comprehensive income					
Profit before tax (from continuing operations)	**188 988**	195 910	163 919	144 071	217 069
Profit after tax (from continuing operations)	**136 309**	147 042	119 119	101 026	162 202
Profit after tax attributable to equity holders of the parent (from continuing operations)	**137 506**	146 424	119 924	101 026	162 202
Profit after tax attributable to equity holders of the parent (including from discontinued operations)	**137 506**	151 017	124 150	101 026	162 202
Financial performance ratios (%)					
Return on average equity (ROE)	**7.9**	9.0	7.7	6.8	12.0
Return on average assets (ROA)	**1.8**	2.3	2.1	1.7	2.8
Cost to income	**63.0**	60.3	64.9	65.5	52.7
Share statistics (cents)					
Net asset value per share	**49.6**	46.3	42.9	39.4	36.8
Tangible net asset value per share	**44.2**	40.8	36.1	33.6	32.4

GROUP REVIEW

HOLDING COMPANY

CGD, which is wholly owned by the Portuguese state, is the Group's holding company and sole shareholder.

BUSINESS FOCUS

The Group's business focus is unchanged, namely:

- to grow enterprise banking by offering products and services to small- and mid-sized commercial/entrepreneurial businesses across the South African spectrum, while retaining a key segment focus on Portuguese customers;
- to grow existing, and seek out, new opportunities in the alliance banking arena, primarily in the areas of payment products; and
- to grow market share of rental finance through its subsidiary, Custom Capital.

TRADING CONDITIONS

Although the banking sector in South Africa has remained sound, uncertainty in the global banking environment continued into 2013. Albeit stable, interest rates remained at all time low levels during 2013 in South Africa. The rand weakened significantly against its main trading partners resulting in tougher trading conditions. Business confidence remained negative on the back of labour unrest and political challenges.

FINANCIAL OVERVIEW

The Group's net profit after tax from continuing operations decreased year-on-year by 6.1%. This decrease is mainly as a result of non-recurring income of R26.6 million realised in 2012 on the disposal of investments in the structured loan portfolio.

Eliminating this after tax profit of R21.6 million from the disposal of investments from the 2012 results, the increase year-on-year is 10.2%, which was as a result of the following:

- 7.2% growth in net interest income, as a result of a strong lending book through the first 10 months of the year and a strong focus on margin management. During the last quarter, two significant loans and advances were settled by clients (resulting in a slight decrease in loans and advances year-on-year);
- a decrease in charges for credit losses from a level of R29.2 million in 2012 to R19.5 million in 2013 on the back of a sound lending portfolio; and
- an ongoing strong emphasis on cost management with operating expenditure increasing by only 3.9%.

FUNDING

The Group remains fully compliant with the capital adequacy, liquidity coverage ratio and net stable funding ratio, as required under Basel III. To ensure ongoing compliance with Basel III and to provide support to our growth objectives, initiatives commenced during 2012 to securitise the Bank's residential home loan book and Custom Capital's rental finance book. Due to the strong cash position of the Bank during 2013, the securitisation of the home loan book was postponed; however, the securitisation of the rental finance book became fully operational during February 2014. Funding of R180 million was secured with the first tranche and a further R60 million will be secured towards the latter part of 2014.

NEW INITIATIVES

The Group embarked on several projects in 2013 to enable it to meet its objective of better serving its stakeholders and, while many of these will continue into 2014, we have already had success with the following:

- a refurbishment was started on the Group's Head Office building, at 142 West Street in Sandown. The first two floors were completed late in 2013, with the remaining floors scheduled to be completed by September 2014. The modern, spacious, open-plan layout has inspired staff and customers alike and has set the "look and feel" for the new business centre concept;

GROUP REVIEW (CONTINUED)

- Menlyn Business Centre was the first business centre opened under the new business centre concept. This concept allows for smaller, more modern and more automated business centres to be opened more quickly. This has been assisted by the centralisation of a number of back office processes previously carried out in the business centres and implementation of cash recycling machines;
- a new treasury system, fully integrated with the core banking system, BaNCS, was rolled out during the course of 2013. This system provides more functionality, scope for integration with intermediary processing and other initiatives, and improves compliance through enabling straight-through-processing on exchange control transactions;
- Mercantile Online Invest (MOI), an online deposit-taking platform for third party fund administrators (such as estate agents, attorneys or any entity that operates in a fiduciary capacity) to manage their clients' funds. The initiative is contributing to the growth in the Bank's deposit base; and
- an Integrated Sales Team, staffed by highly-skilled deal makers, and launched in the last quarter of 2013, is contributing to growth in the advances book through new business deals. This team is mandated to cross-sell all of the Bank's products, ensuring a single point of contact for customers and sharp turnaround times, which has improved the Bank's customer acquisition rate.

Of the projects started in 2013, the following should be concluded in the first half of 2014:

- the Group has begun work on implementing a new workflow solution to improve efficiencies and enhance processes. Treasury Back Office will be the first to benefit from the solution (likely by March 2014), but there are plans to roll out workflow to a large number of other business units; and
- to provide improved security to our credit- and debit card customers when transacting, work is underway to make the Group's card products EMV-compliant (i.e. through chip-and-pin cards) for card-present transactions, and 3D-Secure for card-not-present transactions (for example, online shopping).

DIRECTORATE AND COMPANY SECRETARY

D J Brown's tenure as CEO of the Group ended on 31 March 2013 and he remained on the Board as a Non-Executive Director until 19 August 2013. We would like to thank Dave for his dedication, leadership, and enormous contribution to building Mercantile Bank into a successful and profitable financial institution. We wish him all the best for his future endeavours.

K R Kumbier, who had served as Deputy CEO, was appointed as CEO of the Group, effective 1 April 2013.

D Naidoo resigned as a Non-Executive Director on the Board, on 23 August 2013.

F J Schutte (Head of Legal for the Group), who was serving as Acting Company Secretary, was appointed as Company Secretary with effect from 12 April 2013.

CREDIT RATING

Moody's issued the following RSA national scale issuer ratings for the Bank on 10 June 2013:

Short term	P-3.za (previously P-3.za)
Long term	Baa3.za (previously Baa3.za)
Outlook	Negative (previously Negative)

Apart from Moody's assessed concerns on contagion risks from CGD, the Bank's parent company, the rating agency has assessed the Bank's financial fundamentals as remaining sound.

OUTLOOK

2014 is likely to continue to bring challenges for the Group caused by the difficult trading conditions for our business and commercial customers, and volatility in the exchange rate exacerbated by global conditions as well as political and social unrest locally. However, we remain confident that 2014 will be a watershed year for Mercantile as there are a number of initiatives that will be implemented to improve processes, expand our footprint, offer new banking solutions, and raise deposits.

APPRECIATION

Our sincere thanks go to all our stakeholders. It is due to the commitment and dedication of all our staff during the year under review and the strong support of our other stakeholders (our clients, shareholder, alliance and joint venture partners, regulators and suppliers), that we were able to grow our business and deliver a good set of results.

J A S de Andrade Campos
Chairman

K R Kumbier
Chief Executive Officer

26 February 2014

SUSTAINABILITY

The Group subscribes to a sustainable future, and to this end, aims to ensure sustainable practices across the entire scope of its business activities and the activities of all stakeholders, both external and internal. The Sustainability Policy identifies and documents the themes, principles, strategy, objectives, management, performance and reporting of sustainability, with the aim of integrating sustainability into the culture of Mercantile, and aligning our sustainability strategy with our business strategy.

As a member of the Banking Association of South Africa, the Group subscribes to the Association's Code of Conduct for Managing Environmental and Social Risk. The Group's sustainability themes are accordingly based on the Association's Code and recommendations set out in King III, read with the JSE Sustainability Reporting Index criteria, and taking into account the size of our business and the community and industry that the Group operates in. The broad categories are:

- environment – materials, energy, water, emissions, effluent and waste, products and services;
- society – education, employment practices, occupational health and safety, training and development; and
- governance and related sustainability concerns – good corporate practices.

The Board is responsible for ensuring that the Group operates as a responsible corporate citizen, and has set strategic guidelines for meeting sustainability requirements recognised by the Group, with the aim of translating its corporate values into sustainable business practices and interaction with all its stakeholders, with key focus areas covering the short, medium and long term as follows.

ENVIRONMENTAL PRINCIPLES

The Group acknowledges that the sound management of natural resources is a cornerstone of sustainable development. As a financial institution, the Group recognises that its direct environmental impacts are associated primarily with the operation of the Group's office infrastructure. Systems aimed at reducing resource consumption, over time, are in place. The Group continuously explores ways in which to reduce paper, energy and water usage. The Group is also cognisant of the fact that, through its lending practices, it impacts indirectly on the environment. Assessment and management of environmental risks associated with a particular client or credit application is integral to the credit decision-making process. In order to apply those environmental standards, the Group is adhering to its Environmental Risk Management Policy, and has adopted elements of the IFC's Sustainability Framework (which includes the global Equator Principles) into its Environmental Risk Management Policy.

The Group has a policy of withholding financial assistance from any organisation that it considers to be engaged in socially, morally or environmentally reprehensible activities.

The Group is therefore committed to complying with relevant environmental legislation and regulations applicable to all its operations, as well as incorporating best practice where appropriate.

ETHICAL STANDARDS

The Group is committed to high moral, ethical and legal standards, and expects all representatives of the Group to act in accordance with the highest standards of personal and professional integrity and honesty in all aspects of their activities, to be accountable for their actions, and to comply with all applicable laws, regulations and the Group's policies in the performance of its banking activities with all its stakeholders, i.e. shareholders, customers, employees, alliance partners, service providers, joint venture partners, the community, government and society at large.

The Group's Code of Conduct (Ethics) is the cornerstone of its Ethics management framework. The Group's commitment is clearly stated in its Code, which contains a set of standards that the Group believes will contribute to its commercial success, as adherence thereto is a strategic business imperative and a source of competitive advantage. The Code is a constantly evolving document that is intended to be a permanent fixture in the daily activities of the Group and its employees. It is reviewed and benchmarked on an annual basis to ensure compliance with legislative requirements/good governance principles, and best practices. Annually, the Compliance function undertakes an exercise whereby all staff are required to re-affirm their commitment to the standards enshrined in the Code of Conduct, thereby ensuring that there are adequate levels of awareness of and commitment to the Code.

The standards in the Code are designed to preserve the highest standards of professional confidentiality in terms of access to, as well as management and processing of all information and, in general, in the performance of our banking activity as a whole, and ensuring the adoption of best banking and financial practice, and transparent, responsible and prudent business and risk management. It contributes to the promotion of an organisational culture of compliance with legislation and conformity, with the values and principles adopted, in addition to the development of best corporate governance principles and ethical conduct.

The Board's Social, Ethics and Transformation Committee is confident that the Group has adhered to Mercantile's ethical standards during the year under review.

SUSTAINABILITY (CONTINUED)

SAFETY AND HEALTH

The Group is striving to improve its facilities on an ongoing basis to ensure the safety and wellbeing of its employees during the execution of their duties, and of persons who may enter any of its premises. Regular inspections of the workplace are carried out to identify potential hazards, and the Group does not hesitate to take and enforce practical measures to eliminate or mitigate any hazard or potential hazard to the safety of its employees or other persons.

TALENT MANAGEMENT

The bank follows an industry-aligned talent review process and, through this, has identified growth opportunities for talented employees to move into more senior roles. This has culminated in promotion opportunities for 10% of employees, thus driving retention of these key individuals. Furthermore, in support of the Bank's growth ambitions, a highly skilled deal-making team was established (it comprised a mix of internal talent and externally sourced skills).

In terms of leadership development, the Supervisory Development programme (aimed at middle- and junior-management-level employees) remains a focus and 22 managers successfully completed the program in 2013. The candidates who completed the 2013 programme were registered on the ETDP Seta national learner database, with NQF level 5 credits in supervisory skills.

The BANKSETA International Executive Development Programme provides an opportunity for our senior managers to participate in a robust learning process, which aims to fast-track development into Executive positions. Two Senior Managers participated in 2013 and had exposure to the Retail and Investment Banking learning tracks.

During 2013, Mercantile provided training and up-skilling to ten BANKSETA learners (a group of five matriculants and five graduates; three of the graduates have been retained in the business).

EMPLOYEE ENGAGEMENT

The Bank's culture has transformed significantly, with not only a focus on superior service to customers, but also emphasis on Living the Mercantile Way, which has become an integral part of how management and employees conduct themselves on a day-to-day basis. The Mercantile Way entails the following behaviours, which aligns to the values i.e. Committed, Curious and Connected:

- Teamwork
- Trust
- Mutual respect
- Empowerment
- Appropriate risk taking
- Continuous improvement
- Sense of urgency
- Keep it simple
- Have fun
- Make money

This has been a key driver in the improved climate within the Bank, which has resulted in a more engaged workforce as evidenced in the bank's Employee Engagement Survey.

With the sustained focus on a Total Reward approach, the flexible work arrangement policy that was implemented in 2009 continues to provide employees the flexibility to meet family needs, personal obligations, avoid traffic and the stress of commuting during peak hours, thereby increasing personal control over their work schedule, reducing potential burnout, and allowing employees to work when they accomplish the most. For the Group, it increases morale, engagement and commitment and, at the same time, reduces absenteeism and the staff turnover rate.

The attrition rate for 2013 is 16%, which is below the industry average of 18%. We continue to monitor this closely.

In April 2011, the Group introduced a reward and recognition programme, namely the Wings Awards, through which employees have the opportunity to nominate their colleagues who show commitment and exceptional performance. The nominations criteria were reviewed in 2013 and aligned to the desired culture. The programme allows for three winners to be selected per month. In September 2013, the Group held a function, where gold, silver and bronze prizes were awarded to three employees who were selected from the monthly winners.

EMPLOYEE HEALTH AND WELLNESS

We view the health, wellness and productivity of our employees as very important, and hence the Company offers a comprehensive Employee Assistance Programme, provided by an external company, to all employees and their immediate family members residing with them. This programme contributes to a reduction in healthcare costs and absenteeism; thus potentially increasing productivity. A 24-hour telephone counselling service is supplemented by face-to-face counselling (if required). Issues raised by employees are monitored by the service provider, and the Bank receives quarterly reports indicating trends and frequency of usage. Employees receive health and wellness information on a monthly basis by email. A Health and Awareness Day was also implemented and employees had the opportunity to benefit from services such as health screening, eye testing and various health presentations and offerings.

The Group runs an absenteeism management programme to assist management and employees in understanding the impact of absenteeism. It actively monitors trends and engages employees to potentially reduce this impact. The programme also supports a sustainable and value-adding approach to the way the Group manages its absenteeism and employee wellness.
It assists management and employees to understand the impact of unplanned absenteeism, as well as why it is important for them to take a more pro-active stance. It supports the effective utilisation of the Employee Assistance Programme to address potential external drivers causing absenteeism, and timeous identification of incapacity cases, thereby reducing the direct and indirect costs of absenteeism and working towards creating a wellness-culture. Sick leave data is analysed on a monthly basis. The absenteeism rate remained at 1.5% for 2013.

TRANSFORMATION

The Group is fully committed to social and economic transformation and regards it as a key business imperative. Initiatives are driven and directed by the Board and integrated into the Group's strategic business plans. The Social, Ethics and Transformation Committee receives regular and detailed reports on progress from the Group's executive team, and monitors the progress of transformation in the Group. The Committee's charter stipulates how transformation will be implemented, monitored and integrated across the Group. The Group subscribes to, and is bound by, the objectives of the Financial Sector Code.

EMPLOYMENT EQUITY

Transformation in the workplace is an important aspect of employment equity, and the Group strives to provide an environment that values and fosters diversity and equality. This includes developing a culture that supports mutual trust, respect and dignity for all employees.

Adherence to the Employment Equity Act and associated Skills Development, Basic Conditions of Employment and Labour Relations legislation, is regarded as essential. The desired results of the implementation of the employment equity plan are to improve the representation of black people, women, and people with disabilities, towards reflecting the demographic profile of the country and prioritising the development and career advancement of the designated groups.

As employment equity is regarded as a key business imperative, targets were set for 2013 to 2017, and progress is monitored on a quarterly basis. Good progress has been made in the employment of black people in the skilled/technical/junior management/semi-skilled categories, and the employment of people with disabilities.

The overall level of representation of black people in the Bank has increased from 35% in 2004 to 60% in 2013. Although some progress has been made in management levels, the challenge remains to attract, employ and retain suitably experienced and skilled employment equity candidates for middle management, professional, specialist banking positions, and senior management level positions – see tables on page 21.

PROCUREMENT

A targeted procurement strategy to enhance Broad-Based Black Economic Empowerment ("BBBEE") has been adopted. The principles are detailed in the Group's Procurement Charter and Procurement Policy. The objective is to actively promote the effective support of suppliers and contractors from BEE-accredited enterprises as set out in the Financial Sector Code ("FSC") and the Department of Trade and Industry's ("DTI") Broad-Based Black Economic Empowerment Codes of Good Practice. The Group has successfully met the DTI and FSC procurement targets since 2008, and is confident that we will achieve the 2014 targets in respect of procurement spend with BEE enterprises.

LOAN APPROVAL TO BLACK SMEs AND BEE TRANSACTION FINANCING

Black small and medium enterprises play a critical role in job creation, income generation and the economic growth of the country. The Group extends support to SMEs across the country, giving them access to dedicated, skilled bankers supported by a team of finance and business specialists. The Financial Sector Code, although gazetted in November 2012 was officially launched during 2013 by the Industry Associations. The Group projected its portion (0.20%) of the Industry Target Growth for BEE SME Financing to be R96 million and BEE Transaction Financing to be R64 million, to be achieved by the end of 2017.

In 2013, the Group achieved R28 million (2012: R29 million) and R388 million (2012: R286 million), respectively, of the projected targets. The 2012 figures were restated according to the new definition of qualifying BEE SME's.

CORPORATE SOCIAL RESPONSIBILITY

One of the Group's objectives is to make a meaningful contribution to the society in which it operates and the communities that are in essence its key stakeholders. The Group's Corporate Social Responsibility ("CSR") Policy ensures that there is a close link to its market positioning, so that the various initiatives it supports are aligned to all of its stakeholders, both external and internal. The purpose of the CSR Policy is to identify and document the themes, principles, strategy, objectives, management, performance and reporting of the Group's CSR, to ensure that the maximum value is extracted for all stakeholders from the spend made by the Group. To this end, the following CSR objectives have been identified:

SUSTAINABILITY (CONTINUED)

- adoption, implementation and ongoing refinement of a CSR strategy;
- compliance with the Financial Sector Charter and the associated outlined contributions to CSR;
- ensuring we continue to behave, and be viewed, as a good corporate citizen in the eyes of our various stakeholders;
- to make a meaningful contribution to the society in which we operate and to the market which we serve;
- to create a targeted and focused outlet point for staff-led community outreach projects;
- to optimise the value of our Group CSR spend in our core focus areas; and
- to ensure close alignment to the agreed strategy of the Bank.

In 2012, a refined approach was adopted towards CSR to ensure that we continue to optimise the benefits for all stakeholders from these investments. For 2013, the budgeted funding was allocated on an 80:20 split, where 80% was used for formal entrepreneurial development through partnership with the Hope Factory, and 20% for initiatives that involved staff participation. All investments made on behalf of the Group were managed by the Mercantile Bank Foundation. Details of the various 2013 investments are as follows:

THE HOPE FACTORY

The Hope Factory's Johannesburg programme primarily focuses on existing entrepreneurs, giving them guidance and support to grow their businesses. Our contribution has not only been financial – the Bank has also provided support in terms of guidance from a group of internal content experts.

During 2013, 43 entrepreneurs from a range of industries (including manufacturing, construction, education, beauty and sound and entertainment) and with a turnover of R250k – R5 million per annum were enrolled in the programme. A full business analysis programme was developed to measure the entrepreneurs on a quarterly basis and significant growth and improvement has been seen in a number of key performance areas.

The Hope Factory commits to a four-year journey with the entrepreneur and they ensure that the entrepreneur is practically equipped to be able to run their business efficiently and achieve sustainability. The programme is made up of various elements which include business development and mentorship. Several workshops carrying various themes are hosted and have been an important and necessary part of the programme.

Key successes that have been noted are:

- 53% of the entrepreneurs' businesses have increased turnover;
- 65% of the businesses have increased profit since the beginning of the programme;
- 24% of the businesses have registered an improvement in their salary bills for the last quarter; and
- 100% of the entrepreneurs have improved the state of their financial management systems and the vast majority are now generating monthly management accounts.

The above results affirm the importance of entrepreneurial development and the key role such programmes play to assist and increase the success rate of entrepreneurial businesses in South Africa.

EMPLOYEE INITIATIVES

During the year under review, Mercantile participated in a number of CSR projects initiated by employees and/or the Bank. The participation was from a cross-section of staff from different levels and areas of the Bank. The budget allocation for this purpose was R200k, of which R135k was used for the following initiatives:

- Winter Warmer Blanket Drive – The campaign started in 2011 and has since gained traction by creating huge excitement, increased competitive spirit between departments, and anticipation of the final results. In 2013, employees donated 405 blankets (compared with 220 in 2012) and the Foundation matched the contribution to make a total of 810 blankets, which were donated to the Salvation Army;
- Food and Trees for Africa – In partnership with the organisation, a donation of R35k was made and a group of employees went to Kwa Bhekilanga Secondary School in Alexandra to plant a vegetable garden. The produce from the garden is used for the school's feeding scheme;
- Jacaranda Children's Home – a home based in Pretoria that takes care of abandoned and abused children. A group of employees used funding of R20k to donate educational material and refurbish their creative room and outdoor play area;
- Astra School for the Disabled – based in Western Cape. The Cape Town and Tygerberg teams, who have chosen to support this school on an ongoing basis, used funding of R15k for educational material and refurbishments to their library;
- Gordonia – based in south of Johannesburg, is an institution which takes care of adults with mental health problems. Employees raised funds towards the annual Christmas party function, which is also used as a fundraising mechanism. The Foundation matched the funds and the Comaro Crossing team bought groceries and also assisted with the planning of the function;

- Boys and Girls Town – employees participated in the Discovery 702 Walk the Talk annual event and the Foundation matched the contribution to donate to the organisation. Another contribution was made to Forever Friends foundation towards life line kits that are used for abused children that have been removed from their homes after a court instruction;
- Canned food drive – is a new campaign launched in October 2013 to assist beneficiaries that require food donations. Employees donated over 2 000 cans of food, which were donated to Tumelo Home for the Mentally and Physically Disabled in Ivory Park; and
- Azuriah Foundation – An annual donation was made by the Mercantile Bank Foundation to purchase 363 pairs of school shoes for children from underprivileged backgrounds.

OWNERSHIP AND CONTROL

The Group remains committed to empowerment at shareholder level and will continue to explore opportunities in this regard.

CORPORATE GOVERNANCE

The Boards of Directors of the Company and the Bank (collectively referred to as "the Board") hold joint Board meetings. The Board aims to entrench the collective behaviours and practices in the Group that will ensure delivery of our obligation to sound governance. The Board subscribes, and is committed, to ensuring that the Group complies with the corporate governance principles of fairness, accountability, responsibility and transparency, as set out in King III.

In accordance with the principles of King III, the Board, acting in the best interests of the Company and the Bank, has followed the "apply or explain" approach.

The following is a summary of the corporate governance processes of the Group for the year ended 31 December 2013.

BOARD OF DIRECTORS

The Board exercises effective control over the Group and gives strategic direction to the Bank's management.

Key responsibilities of the Board, assisted by its Board Committees are to:

- approve the Group's strategy, vision and objectives, and monitor/review the implementation thereof;
- approve and annually review the Group's limits of authorities;
- annually review corporate governance processes and assess the achievement of these against objectives set;
- annually review its charter and approve changes to the charters of the Board Committees;
- annually review and approve the Executive and Non-Executive Directors' remuneration and submit such for approval and ratification by shareholder at the AGM;
- consider, approve, govern and review long-term incentive remuneration structures for the Group;
- annually approve the Group's financial budget (including capital expenditure);
- be accountable for financial, operational and internal systems of control and overall risk management;
- approve changes to the Group's financial and accounting policies;
- review and approve the audited financial statements and interim results;
- be responsible for ensuring that the Group complies with all relevant laws, regulations, codes of business practice and ethics;
- appoint appropriate Board Committees and determine the composition thereof; and
- annually approve the Board and Board Committees' self-evaluations conducted on their effectiveness.

The Board comprises Non-Executive and Executive Directors with different skills, professional knowledge and experience, with independent Non-Executive Directors comprising the majority on the Board, ensuring that no individual director has unfettered powers of decision-making. For detail on the composition of the Board, the frequency of meetings and attendance thereof, refer to Annexure A to this document. The roles of the Chairman of the Board and CEO, who are appointed by the Board, are separated, thereby ensuring a clear division of responsibilities at the head of the Group. The Chairman of the Board is a Non-Executive Director.

Non-Executive Directors offer independent and objective judgement and, apart from their fees, there are no extraneous factors that could materially affect their judgement. If there is an actual or potential conflict of interest, the Director (Executive or Non-Executive) concerned, after declaring his/her interest in terms of the Companies Act, is excluded from the related decision-making process.

The process of identification of suitable candidates to fill vacancies on the Board and to re-appoint Directors upon termination of their term of office is conducted by the DAC. This Committee's nominations are submitted to the Board for approval, subject to the SARB having no objections to the nominations of new appointments. Any person appointed to fill a casual vacancy or as an addition to the Board, will retain office only until the next AGM, unless the appointment is confirmed at that meeting.

All Non-Executive Directors retire on a three-year rotational basis. The service contract of Mr D J Brown, the former CEO, had been amended to expire on 31 March 2013, where after he had taken up a position on the Board as a Non-Executive Director until 19 August 2013. Mr K R Kumbier was appointed CEO for the Company and the Bank, effective 1 April 2013. The service contract of Mr J P M Lopes, an Executive Director seconded by the major shareholder, was extended in 2011 to terminate on 31 July 2014. Directors are required to retire from the Board at age 70, subject to the Board's discretion to allow a Director to continue in office beyond this age. Such Director is still subject to retirement by the rotation provisions as explained above.

The Board operates in terms of a charter that defines its duties, responsibilities and powers. The charter is reviewed annually. The evaluation of the performance of the Board as a whole is conducted annually by means of a self-evaluation process. An evaluation of the Chairman is conducted by the other Directors. The evaluation of individual Non-Executive Directors' performance is conducted on a bilateral basis between the Chairman and each Director. At 31 December 2013, the Board, which has a unitary board structure, comprised seven Directors, of which two were executives.

In accordance with King III, an annual formal evaluation of the independence of Non-Executive Directors was approved by the Board and implemented during the year. The evaluation consists of a comprehensive questionnaire, which is independently assessed via an online software tool, and includes a personal declaration by each Director. With the exception of the Chairman, all of the Non-Executive Directors are classified as independent. The Board is satisfied that its composition currently reflects an appropriate balance in this respect.

The Board has unrestricted access to all Company information, records, documents, property and management. If required, Directors are entitled to obtain independent professional advice at the Group's expense.

GROUP SECRETARY

The appointment and removal of the Group Secretary is a matter for consideration by the Board as a whole. The Group Secretary ensures that statutory and regulatory procedures are complied with, and acts as custodian of good governance. The Group Secretary attends all Board and Board Committee meetings, and has unrestricted access to the Chairman. The Group Secretary provides a central source of advice and guidance on business ethics, compliance with good corporate governance, and changes in legislation, assisting the Board as a whole and its members individually with guidance as to how their duties, responsibilities and powers should be adequately discharged and exercised in the best interests of the Group.

The Group Secretary also maintains and regularly updates a corporate governance manual, copies of which are distributed to all Directors, and organises and conducts a Board-approved induction programme to familiarise new Directors with the Group's operations, their fiduciary duties and responsibilities, and the Group's corporate governance processes. The Group Secretary assists the Board in developing a training framework annually to assist the Non-Executive Directors with continuous development as Directors, and in particular in a banking environment. The Group Secretary is not a Director of Mercantile.

Mr F J Schutte, who was serving as acting Company Secretary, was appointed as Company Secretary with effect from 12 April 2013.

BOARD COMMITTEES

The Board has appointed a number of Board Committees to assist it in carrying out its duties and responsibilities. This does not relieve the Board of any of its responsibilities, and the Board critically evaluates the recommendations and reports of these committees before approving such recommendations or accepting such reports. These committees all operate in terms of Board-approved charters, which define their roles. All Board Committees' charters are reviewed annually by the Board.

The performance of Board Committees, based on the duties and responsibilities as set out in the respective charters, are evaluated annually by means of a self-evaluation process, and the results are discussed at the Board Committee concerned and then reviewed and approved by the Board.

For detail on the composition of the Board Committees, frequency of meetings and attendance thereof, refer to page 22.

All Directors who are not members of the Board Committees may attend Board Committee meetings, but will not be able to participate in the proceedings without the consent of the relevant chairman, and will not have a vote.

All Directors who are not Board Committee members receive copies of all documentation sent to the Board Committees from time to time.

Further details on the Board Committees are provided below.

GAC

The GAC comprises three independent Non-Executive Directors, one of whom acts as chairman, who is not the Chairman of the Board. The CEO and Executive Director attend GAC meetings as permanent invitees. The Board is satisfied that the collective skills of the members of the GAC are appropriate, relative to the size and circumstances of the Company.

GAC meetings are held at least four times per annum. The meetings of the GAC are attended by the CFO, the heads of Internal Audit and Risk, and the External Auditors. If a special meeting is called, the attendance of non-members is at the discretion of the Chairman of the GAC. The CFO, the heads of Internal Audit and Risk, the CEO, the Executive Director, and the External Auditors have unrestricted access to the Chairman of the GAC.

As defined in its charter, the primary objective of the GAC is to assist the Board in fulfilling its responsibilities relative to:

- financial control and integrated reporting;
- compliance with statutory and regulatory legislation, which includes but is not limited to the Banks Act, Companies Act, common law, IFRS, and tax legislation;
- corporate governance;
- risk management; and
- shareholder reporting.

The GAC reviews, *inter alia*, accounting policies, the audited annual financial statements, interim results, internal and external auditors' reports, regulatory public disclosures required in terms of the Regulations to the Banks Act, the adequacy and effectiveness of internal control systems, the effectiveness of management information systems, the internal audit process, the Bank's continuing viability as a going concern, and its

CORPORATE GOVERNANCE
(CONTINUED)

complaints handling duties in terms of the Companies Act. The Compliance Officer also gives feedback to the GAC on compliance issues and updates on changes to legislation that could have an impact on the Group.

The external auditors' appointment is recommended by the GAC and approved at the AGM. The GAC reviews the external auditors' terms of engagement and fees, and also pre-approves an engagement letter on the principles of what non-audit services the external auditors could provide. The GAC meets with the external auditors, separate from management, at least annually.

The GAC carried out its function during the year by considering all information provided by management for discussion, decision and/or recommendation to the Board for approval at its meetings (refer to page 22). The GAC has fulfilled its statutory duties and responsibilities in terms of its charter during the year under review.

The report of the GAC (included in the annual financial statements section on page 28) provides comprehensive details of its terms of reference, composition, meetings, statutory duties and delegated duties with respect to internal financial controls and internal audit, regulatory compliance, external audit, the financial function and financial statements.

RMC
The RMC comprises five members, three of whom are Non-Executive Directors, the CEO, and the Executive Director. The Chairman of the Board chairs the RMC. The Board has considered the position of the chair of the RMC in view of King III, and is satisfied that the Chairman of the Board is the most appropriate Board member to act as Chairman of the RMC, given his experience and individual skills set. This position will be reviewed on an annual basis.

RMC meetings are held at least four times per annum. The RMC meetings are attended by the heads of Risk, Credit, Treasury, Treasury Middle Office and Asset and Liability Management and Internal Audit, as well as the CFO and the Compliance Officer.

As defined in its charter, the RMC's objectives are to:
- assist the Board to fulfil its risk management and control responsibilities in the discharge of its duties relating to risk and control management, assurance, monitoring and reporting of all risks identified and managed through the Enterprise Wide Risk Management Framework;
- monitor and oversee the risk management process;
- facilitate communication between the Board, the GAC, Internal Auditors, Compliance and other parties engaged in the risk management activities;
- ensure the quality, integrity and reliability of the Group's risk management and control;
- review the Group's process and allocation of capital and capital management;
- provide an independent and objective oversight and review of the information presented by management on risk management, generally and specifically taking into account reports by management and the GAC to the Board on financial, operational and strategic risks; and
- monitor, oversee and provide an independent and objective oversight over the Compliance function and processes.

The RMC has fulfilled its responsibilities in terms of its charter during the year under review.

For more detailed information relating to the Risk Management of the Group refer to pages 75 to 86.

DAC
The DAC comprises all the Non-Executive Directors. The Chairman of the Board chairs the DAC and the CEO attends the meetings by invitation. Meetings are held at least four times per annum.

As defined in its charter, the primary objectives of the DAC are to:
- assist the Board in its determination, evaluation and monitoring of the appropriateness and effectiveness of the corporate governance structures, processes, practices and instruments of the Group;
- establish and maintain a continuity plan for the Board;
- be responsible for the process of Board nominations and appointments for recommendation to the Board, and in doing so, review the skills, experience and other qualities required for the effectiveness of the Board;
- ensure that a management succession plan is in place; and
- assist the Board in determining whether the employment/appointment of any Directors should be terminated (excludes resignations).

The DAC has fulfilled its responsibilities in terms of its charter during the year under review.

REMUNERATION COMMITTEE
This committee comprises all of the Independent Non-Executive Directors. An Independent Non-Executive Director chairs this committee and the CEO attends the meetings by invitation. The Remuneration Committee must meet at least twice per annum.

As defined in its charter, this committee's primary objectives are to:
- assist the Board in determining the broad policy for executive and senior management remuneration, and oversee the Bank's remuneration philosophy;
- ensure alignment of the remuneration strategy/philosophy and policy with Mercantile's business strategy, risk and reward, desired culture, shareholders' interests, and commercial wellbeing;

- assist the Board in the consideration of performance-related incentive schemes, performance criteria and measurements, including allocations in terms of the Conditional Phantom Share Plan ("CPSP") and other long-term awards;
- assist the Board in reviewing CEO performance against set management and performance criteria, and:
  - recommend guaranteed and performance-based individual remuneration, including CPSP and other long-term award allocations of the Executive Directors and Company Secretary;
  - ensure full disclosure of Director and prescribed officers' remuneration in the Integrated Annual Report on an individual basis, giving details of earnings, long-term awards, restraint payments and other benefits. There are no designated prescribed officers other than the Executive Directors;
  - approve guaranteed and performance-based individual remuneration, including CPSP and other long-term award allocations of senior management; and
- assist the Board in reviewing the Non-Executive Directors' fees.

The Remuneration Committee has fulfilled its responsibilities in terms of its charter during the year under review.

SOCIAL, ETHICS AND TRANSFORMATION COMMITTEE ("SETCOM")

This committee comprises two Non-Executive Directors, of which one acts as Chairman, and the CEO. This committee must meet at least four times per annum.

As defined in its charter, the SETCom's primary objectives are to monitor Mercantile's activities with regard to:

- social and economic development, including the goals and purposes of:
  - the United Nations Global Compact principles;
  - the OECD recommendations regarding corruption;
  - the Employment Equity Act; and
  - the Broad-Based Black Economic Empowerment Act.
- good Corporate Citizenship, including:
  - the promotion of equality, prevention of unfair discrimination, and reduction of corruption;
  - contribution to development of the communities in which its products and services are predominantly marketed; and
  - sponsorship, donations and charitable giving.
- the environment, health and public safety, including the impact of Mercantile's products or services;
- consumer relationships, including advertising, public relations and compliance with consumer protection laws; and;
- labour and employment, including:
  - Mercantile's standing in terms of the International Labour Organisation Protocol on decent work and working conditions; and
  - Mercantile's employment relationships and its contribution toward the educational development of its employees.

The SETCom has fulfilled its responsibilities in terms of its charter during the year under review.

TECHNOLOGY COMMITTEE

This committee is mandated to assist the Board in its duties with regard to the governance of Information Technology in accordance with the provisions of King III. The Technology Committee comprises two independent Non-Executive Directors, the CEO and the Executive Director. An independent Non-Executive Director chairs this committee. The heads of Information Technology ("IT") and Internal Audit, and the IT Security and Governance manager are permanent invitees.

As defined in its charter, the Technology Committee's primary objectives are to:

- strategically align IT with the performance and sustainability objectives of the Bank;
- ensure that prudent and reasonable steps have been taken with regard to IT governance, by developing and implementing an IT governance framework;
- concentrate on optimising expenditure and proving the business value of IT;
- ensure appropriate IT risk assessment and management;
- address the safeguarding and security of IT assets, continuity of operations and disaster recovery; and
- adequately protect and manage information.

The Technology Committee has fulfilled its responsibilities in terms of its charter during the year under review.

MANAGEMENT COMMITTEES

A number of Management Committees have been formed to assist executive management and the Board in carrying out its duties and responsibilities. These are:

- Group EXCO;
- ALCO;
- CREDCOM;
- Employment Equity Committee;
- Human Resources Committee;
- IT Steering Committee;
- New Product Committee; and
- Procurement Committee.

All of these committees operate in terms of their charters, which define their duties and responsibilities. Directors may attend any Management Committee meetings.

CORPORATE GOVERNANCE
(CONTINUED)

REMUNERATION PHILOSOPHY AND GOVERNANCE PRINCIPLES

The Remuneration Committee approves and oversees the remuneration philosophy of the Group. The main purpose of the remuneration philosophy adopted by the Group is:

- to promote performance-based and equitable remuneration practices;
- to ensure compliance with relevant legislation and contractual obligations contained in the contracts of employment and conditions of service; and
- to play a vital role in the Group achieving its strategic objectives.

The remuneration philosophy encapsulates five elements, namely compensation, benefits, work-life balance, performance-based recognition, and development of career opportunities to help attract, motivate and retain the talent needed to achieve the Group's objectives, and optimise management of employees, i.e. grow curious, committed, and connected employees who are enthusiastic about work and will further the Group's interests. Bonus pools and long-term incentives are reviewed and monitored on a regular basis, to align with the Company's risk management strategy.

To attract, motivate and retain employees, the Group ensures that remuneration practices are fair, equitable and competitive, and align risk with reward. The three main components of remuneration are described below:

The total guaranteed package concept gives all employees a certain degree of flexibility as they can structure their packages to include a 13th cheque, select the appropriate level of travel allowance (in accordance with SARS regulations), and have the option of two medical aid schemes to choose from. It also includes retirement contribution, i.e. the employer contributes 11% to the retirement fund and the employee contributes 7.5%. External equity is ensured by comparing packages to market levels through salary surveys. This is done every year, prior to annual salary review processes. Market benchmarking information compiled by Remchannel is used to judge the appropriateness and competitiveness of guaranteed packages.

Increases and movements in individual pay levels are based on performance, levels of competence, and current position/pay level within the market. The market median pay level for the comparative position is used as a guideline.

Short-term incentives (bonus pools) form an important component of variable pay. The objective of the short-term incentive scheme is to reward performance, and to motivate employees to perform beyond expectations and drive the Company results. It is also an important element of establishing a performance culture and retaining the services of key contributors who assist in achieving the goals of the Group. Payouts occur in April each year and, for employees with payouts in excess of R300k, payment is split into tranches (April and October – i.e. the higher of R300k or 50% in the first tranche). Measurement criteria are aligned to Company strategic objectives and financial growth and performance targets, as well as customer service satisfaction targets and culture transformation. The rules include a range of payouts as a percentage of the guaranteed package according to job level. Whereas Company performance determines the size of the bonus pool and the range of incentive percentages per broadband (job grade) that may be awarded, individual performance determines the actual incentive percentage within the range that is awarded. Individual performance is measured by way of a Performance Management process, incorporating an aligned Balanced Scorecard framework through which Key Result Areas are agreed and documented in a Personal Performance Contract. Financial performance is measured by reference to the annual budget cycle. No deferral of short-term incentive payments takes place (except as outlined above), unless the Board should be of the view that revenues recognised during the budget year may be reversed in future years. Periodic reviews of the short-term incentive scheme take place at the discretion of the Board Remuneration Committee and/or Executive Directors, to ensure market competitiveness and alignment to regulatory requirements/good governance.

The third element of the remuneration mix is long-term incentives. The purpose of this element is to attract and reward key staff members whose contribution within the next three to five years is viewed as critical, and whose retention is regarded as a priority. A long-term incentive scheme, the Conditional Share Plan ("CSP"), was introduced in 2008 in place of the previous share option scheme, and was amended in 2009. Due to ongoing lack of liquidity of the Company shares in the market and the consequential impact on the share price, the Board decided during November 2011 to discontinue new awards under the CSP scheme for an indefinite period, and to convert existing unvested awards to a new performance-based Conditional Phantom Share Plan ("CPSP") – a deferred bonus scheme settled in cash. Conditional awards are made annually to participants on the basis of their job grade as a percentage of their cost to company packages. Participants are selected from eligible employees (earning above R300k per annum) who can have an impact on the future strategic growth of the Company. Awards will normally vest three years after the grant date, and will be settled in cash. The value of a phantom share is a function of the net asset value of the Company on vesting date, and a percentage (as determined by the Remuneration Committee) of the median price to book ratio of the four major banks in South Africa. The number of phantom shares vesting to determine the cash settlement will be subject to performance criteria set by the Remuneration Committee, and approved by the Board.

Vesting of awards will occur within a range of 25% to 175% of the original conditional awards made, depending on whether performance conditions are achieved. Performance conditions are based on the achievement of specified targets for growth in Group earnings and return on equity. The key drivers of earnings and return on equity, measured over a three-year period, would allow for the longer-term impact of short-term decisions to manifest itself. PWC Remchannel provided expert input to the Remuneration Committee as part of the design of the CSP and the CPSP schemes.

The CSP scheme and/or the share option scheme may be reinstituted by the Board, at their discretion, at a future date. All of the long-term incentive schemes include protection of participants in the event of a change of control or similar corporate action. The CPSP scheme is considered to be particularly suitable to the Group, following its delisting from the JSE in 2012.

The remuneration of Non-Executive Directors takes into account the responsibilities of the role, and the skills and experience of the individual, without losing sight of the requirement for market related, fair and defendable compensation from a regulatory and stakeholder viewpoint. King III requires fair and responsible remuneration policies in relation to Non-Executive Director remuneration, and hence the Remuneration Committee advises the Board on appropriate remuneration for Non-Executive Directors. Incentives such as share options/plans or rewards geared to the Company's share price or performance do not form part of the remuneration of Non-Executive Directors. Shareholders annually approve all Directors' fees.

With reference to Basel III disclosure requirements for remuneration, the aggregate compensation for the year is:

	Number or R'000
Employees receiving variable awards (number of employees)	397
Sign on awards (number of employees)	5
Value of sign-on awards	740
Severance payments (number of employees)	2
Value of severance awards	256
Portion of 2013 compensation not deferred	
Guaranteed compensation	142 916
Variable compensation	22 386
Vested and settled in cash CPSP awards	6 034
Portion of 2013 compensation deferred	–
Estimated value of CPSP awards awarded in 2013, not yet forfeited at 31 December 2013 and assuming 100% vesting	17 080

The Remuneration Committee is responsible for remuneration in respect of Mercantile, but the Board has the ultimate authority to approve the proposals considered and recommended by the Remuneration Committee. In addition, there is cross-representation of non-executive members of the RMC on the Remuneration Committee.

Risk measures are part of determining the bonus pool value and also part of individual Key Result Areas measures. Risk decision-making is separated from sales – there is a clear separation between the management and approval of risk, and the sale of risk products. Credit risk is the main risk that the Group faces (as there is no proprietary trading activity), and it is managed through different levels of governance, ranging from the mandates of Credit Managers and the head of Risk, to the mandates of the Credit Committee and the approval by the RMC of the Board. All of these risk mandates are informed by the risk appetite defined by the Company.

Due to the nature of the Bank's business, material risk-taking is confined to the two Executive Directors and the head of Risk. In the case of the Executive Directors, risk-taking is informed by their discretion in terms of managing the business, individual mandates and executive capacity, particularly as it pertains to execution on strategy. In the case of the head of Risk, the risk-taking revolves primarily around the relevant mandate in the area of credit risk.

Management and staff of the Risk, Compliance, and Internal Audit functions are effectively independent and are compensated appropriately. These functions operate in accordance with the provisions of the Banks Act and Regulations, as well as industry best practices and King III requirements. Performance measurements for these functions are principally based on the achievement of the objectives of their function. The overall size of the bonus pool in which they participate is a function of the overall performance of the Bank; hence, if there is no bonus pool for the Bank, there can be no bonus participation for these functions. There are no guaranteed bonuses.

Business Units are allocated capital on an annual basis as part of the budget process. This capital is charged out to the respective units at the Bank's deemed cost of capital; therefore, the Business Units' performance targets take this cost into consideration. In turn, the overall capital position of the Bank is taken into consideration as part of the structure of targets and performance measures set for the Bank. The cost of capital takes credit and operational risk into account.

CORPORATE GOVERNANCE

(CONTINUED)

INTERNAL AUDIT ACTIVITY

The Internal Audit activity is an integral component of the Group's overall risk management and governance processes. The head of Internal Audit reports functionally to the Chairman of the GAC, and administratively to the CEO, and has direct and unrestricted access to the CEO and the Chairmen of the GAC, the RMC and the Board. The GAC must concur with any decision to appoint or dismiss the head of Internal Audit.

The Internal Audit Charter, which governs Internal Audit activities in the Group, was reviewed and revised by the Board during the year. The charter defines the purpose, authority and responsibility of the Internal Audit activity in line with the requirements of the International Professional Practices Framework of the Institute of Internal Auditors Inc., as well as the requirements of Regulation 48 of the Banks Act.

All operations, business activities and support functions are subject to Internal Audit review. The annual internal audit plan is risk-based and is approved by the GAC. Audits are conducted according to a risk-based approach, and the audit plan is updated quarterly or as needed to reflect any changes in the risk profile of the Group. Updated plans are then presented to the GAC for review and approval.

The Internal Audit activity is responsible for reviewing the adequacy and effectiveness of control and governance processes throughout the Group. Any significant or material control weaknesses are reported to management, the GAC, and/or the RMC for consideration and remedial action, if necessary.

The activity also works closely with the Risk and Compliance Management functions to ensure that audit issues of an ethical, compliance or governance nature are made known and are appropriately resolved. The Risk and Compliance Management processes are also reviewed by the Internal Audit activity in accordance with the annual internal audit plan.

To complement the Internal Audit activity, the Bank has entered into a co-sourcing arrangement with KPMG to provide specialist internal audit skills in the IT environment.

EXTERNAL AUDITORS' SERVICES: NON-AUDIT SERVICES

The Group will not contract its external auditors for non-audit services where such an engagement compromises their independence and, in particular, the following areas are specifically excluded from the services that are procured from the external auditors:

- bookkeeping or other services related to accounting records or annual financial statements;
- financial information systems design and implementation;
- appraisal or valuation services, fairness opinions, or contribution-in-kind reports for financial reporting purposes;
- actuarial services;
- internal audit outsourcing and/or co-sourcing;
- performance of management functions;
- staff-recruitment agents;
- broker-dealer, investment advisor or investment banking services; and
- legal services.

The following is a summary of the policy adopted by the GAC to ensure proper governance and approval of the use of external auditors to provide non-audit services:

The GAC approved a "Blanket" engagement letter for non-audit services ("the Engagement Letter") on the basis that the external auditors confirm in writing, prior to providing a service contained in the Engagement Letter, that such service does not impair their independence, and that they may provide such service. The GAC has approved that non-audit services, which the external auditors may provide in terms of the Engagement Letter, with a value of R250k or less, may be provided subject to the CEO's approval. A report on these services provided is submitted to the GAC meetings for notification. The GAC requires that all non-audit services that the External Auditors may provide in terms of the Engagement Letter, with a value of more than R250k, must be submitted to the GAC for approval prior to the External Auditors providing the service.

THE CODE OF BANKING PRACTICE

As a member of the Banking Association of South Africa, the Group subscribes to the Code that promotes good banking practices by setting standards for disclosure and conduct, thereby providing valuable safeguards for its clients. The Group aims to conduct its business with uncompromising integrity and fairness to promote complete trust and confidence. In meeting this fundamental objective, the Group conducts its relationships with the regulatory authorities, clients, competitors, employees, shareholder, suppliers and the community at large, by striving for high service levels with veracity, and encourages its employees to acquaint themselves with the Code and honour its precepts.

EMPLOYMENT EQUITY

The table below illustrates the number of staff per occupational level as at 31 December 2013:

Occupational levels	Male				Female				Foreign nationals		Total
	A	C	I	W	A	C	I	W	Male	Female	
Top management	0	0	0	1	0	0	0	0	1	0	2
Senior management	0	2	1	11	1	0	1	3	0	0	19
Middle management	4	2	8	39	4	5	4	37	1	0	104
Junior management	19	8	12	10	44	26	14	59	0	0	192
Semi-skilled	11	6	0	3	36	18	5	14	0	0	93
Unskilled	5	0	0	0	2	0	1	0	0	0	8
Total permanent	**39**	**18**	**21**	**64**	**87**	**49**	**25**	**113**	**2**	**0**	**418**
Temporary employees	0	2	0	0	1	0	0	0	0	0	3
Grand total	**39**	**20**	**21**	**64**	**88**	**49**	**25**	**113**	**2**	**0**	**421**

A = African, C = Coloured, I = Indian, W = White

The effective management of key talent and succession planning remain a focus in order to achieve the Bank's strategic objectives. Talent management is also a key lever to ensure achievement of the Bank's transformation objectives in relation to the Financial Sector Code targets and Employment Equity plan.

SKILLS DEVELOPMENT

A significant number of employees benefitted from in-house and external training programmes, as reflected in the skills development statistics schedule below:

Training intervention	Number of EE employees trained	Number of employees trained
Functional/Technical/Regulatory	196	343
Management/Leadership training	22	73
In-house training	233	340

Participation in the BANKSETA Learnership programme commenced in 2004, and has proven to contribute constructively in developing skills for the sector, but equally it continues to be a channel through which the Bank gains access to talented entry-level employees. The 2013 intake of ten learners (5 Letsema and 5 Kuyasa) resulted in the retention of 30% of the learners, compared to 8% retention during the previous financial year.

ANNUAL FINANCIAL STATEMENTS

Accounting policies, and the basis of accounting on which the annual financial statements are prepared, are set out on pages 32 to 39 of this report.

REGULATION

The Bank Supervision Division of the SARB is the lead regulator of the Group. The Financial Services Board, the National Credit Regulator and the Registrar of Companies also regulate the various activities of the Group. The Group strives to establish and maintain open and active dialogue with regulators and supervisors. Processes are in place to respond proactively and pragmatically to emerging issues, and the Group regularly reports to regulators and supervisory bodies. Where appropriate, the Group participates in industry associations and discussion groups to maintain and enhance the regulatory environment in which the Group operates.

COMMUNICATION WITH STAKEHOLDERS

The Board communicates with its shareholder in accordance with the Companies Act. Appropriate communication is also sent to the employees of the Bank from time to time. The Board has delegated authority to the CEO to speak to the press. Communication with the SARB and the Registrar of Companies is done in compliance with the respective laws/guidelines.

CORPORATE GOVERNANCE
(CONTINUED)

ATTENDANCE OF MEETINGS BY DIRECTORS

Name	Date of first appoint-ment	Board (joint meetings)	Board Committees					
			GAC	RMC	DAC	Remu-neration	Social, Ethics and Trans-formation	Technology
Number of meetings held during the year under review		4	5	4	4	3	4	4
Director								
J A S de Andrade Campos	26.07.2002	4 C	▲	4 C	4 C	▲	4	▲
D J Brown*	29.03.2004	3	▲	3	2	▲	1	1
G P de Kock	23.11.2000	4	5	4	4	3 C	▲	4
L Hyne	01.06.2003	4	5 C	4	4	3	▲	▲
A T Ikalafeng	16.11.2004	4	▲	▲	4	3	4 C	▲
K R Kumbier	01.06.2010	4	▲	4	▲	▲	▲	4
J P M Lopes	09.11.2005	4	▲	4	▲	▲	▲	4
T H Njikizana	06.11.2008	4	5	▲	4	3	▲	4 C
D Naidoo**	23.05.2012	3	3	3	2	1	3	▲

▲ Non-member of committee/permanent invitee. The ad hoc attendance by a Director at a meeting that he/she is not a member of, is not disclosed.

C Chairman of meeting.

* Resigned 19 August 2013.

** Resigned 23 August 2013.

COMPLIANCE OFFICER'S REPORT

Compliance risk is the risk to earnings, capital and reputation arising from violations of, or non-compliance with, laws, rules, regulations, supervisory requirements, prescribed practices, or ethical standards. The role of the Compliance function is to identify, assess and monitor the statutory and regulatory risks faced by the Group, and advise and report to senior management and the Board on these risks.

The objective of the Compliance function is to ensure that the Group continuously manages and complies with existing and emerging regulations impacting on our business activities.

To ensure the independence of the Compliance function from the business activities of the Group, in accordance with the requirements stipulated in section 60A of the Banks Act, read with the provisions of regulation 49, the Board has authorised the Compliance function to:

- carry out its responsibilities on its own initiative in all areas of the Group in which regulatory risk may or may not exist;
- ensure it is provided with sufficient resources to enable it to carry out its responsibilities effectively; and
- not have direct business line responsibilities.

The head of Compliance reports to the head of Risk and has unrestricted and unfettered access to the CEO, the Chairmen of the Board, the GAC and the RMC. The head of Compliance is supported by two Compliance Officers, a Money Laundering Control Officer, a Compliance Monitoring Specialist, and a Money Laundering Control/Compliance Analyst. The compliance function at Mercantile follows a centralised structure co-ordinating activities across the Group and business units.

A Compliance Charter has been approved, and is annually reviewed by the Board to assess the extent to which the Group is managing its regulatory risks effectively.

The RMC annually reviews and approves a compliance plan. The RMC monitors the progress against the compliance plan, which sets out training, monitoring and review of compliance with the regulatory requirements in the Group.

A successful compliance function is built on relationships. These relationships are in the form of senior management, Board and staff buy-in, relationships with industry bodies, the regulators, and other governance functions (such as Internal Audit). The Compliance function keeps senior management and the Board informed about significant regulatory issues and any trends exhibited, and identifies where urgent intervention is needed. The Group's Compliance Officers are charged with developing and maintaining constructive working relationships with Regulators, Supervisors and Compliance staff, and work closely with business and operational units to ensure consistent management of compliance risk.

Compliance risk is managed within the Group through the following key activities:

- creating awareness by training employees in respect of the impact and responsibilities related to legislative requirements;
- monitoring and reporting on the level of compliance with regulatory requirements, including reporting specific incidents of non-compliance to senior management and the Board;
- providing assurance that the risks relating to regulatory requirements are identified, understood and effectively managed; and
- consulting with the business units and providing compliance opinions with regard to new business ventures and processes.

The Compliance risk management tools provided to management include a comprehensive and consolidated Compliance Manual, Compliance Risk Management Plans, Compliance Opinions, and Compliance Monitoring Reports.

Reporting to the Board is done in the form of several Compliance Reports via Board Sub-Committees. Certain reports are also submitted to the SARB, once they have been presented to the Sub-Committees.

The key Acts that the Compliance function focused on during the year under review were:

- The Banks Act, No. 94 of 1990;
- The Companies Act, No. 71 of 2008;
- The National Credit Act, No. 34 of 2005 (NCA);
- The Financial Intelligence Centre Act, No. 38 of 2001 (FICA);
- The Financial Advisory and Intermediary Services Act, No. 37 of 2002 (FAIS); and
- The Occupational Health and Safety Act, No. 85 of 1993 (OHS).

The most notable development and focus area in respect of regulatory reforms, during the upcoming year, is the anticipated implementation of the Protection of Personal Information Act, No. 4 of 2013 ("POPI"). The aim of POPI is "To promote the protection of personal information processed by public and private bodies; to introduce certain conditions so as to establish minimum requirements for the processing of personal information; to provide for the establishment of an Information Regulator to exercise certain powers and to perform certain duties and functions in terms of this Act and the Promotion of Access to Information Act, No 2 of 2000; to provide for the issuing of codes of conduct; to provide for the rights of persons regarding unsolicited electronic communications and automated decision making; to regulate the flow of personal information across the borders of the Republic; and to provide for matters connected therewith." POPI becomes enforceable at a date to be set by the President.

COMPLIANCE OFFICER'S REPORT (CONTINUED)

The other focus area will be "Treating Customers Fairly". The South African financial sector regulation includes various measures aimed at protecting consumers of financial products and services. Although these have proven useful in mitigating various specific risks to consumers, a holistic and co-ordinated consumer protection regulatory framework that applies consistently across the financial services sector – and is tailored to address the specific conduct risks peculiar to the sector – has been lacking. The "Treating Customers Fairly" framework was created to address these shortcomings. "Treating Customers Fairly" is an outcome-based regulatory and supervisory approach designed to ensure that specific, clearly articulated fairness outcomes for financial services consumers are delivered by regulated financial firms. Banks are expected to demonstrate that they deliver 6 "Treating Customers Fairly" outcomes to their customers throughout the product life cycle, from product design and promotion, through advice and servicing, to complaints and claims handling – and throughout the product value chain of Mercantile.

Compliance with FICA, as amended, and the Protection of Constitutional Democracy against Terrorist and Related Activities Act, No. 12 of 2004, is ongoing. The requirements provided by these pieces of legislation are set out in the Group's anti-money-laundering and anti-terror financing policy, which also incorporates Mercantile's client acceptance policy. The electronic Anti-Money-Laundering system focuses on transaction monitoring and the detection of potential money laundering activity. This system includes cross-referencing clients against international databases consisting of adverse client information (including persons named on the United Nations' lists). The Anti-Money-Laundering system was enhanced to address suspicious activity reporting, and to determine potentially suspicious activities. Such activities are further investigated to determine whether they need to be reported to the Financial Intelligence Centre as required by legislation. The system is also utilised to discharge Mercantile's cash threshold reporting obligation. In accordance with the amended FICA requirements, all Mercantile units that are 'accountable institutions' have been registered with the Financial Intelligence Centre. All cash threshold reports and suspicious transaction reports are submitted to the Financial Intelligence Centre centrally by the Money Laundering Control Officer. Training of staff on anti-money-laundering and related topics remains a key focus area, and the training material is constantly updated to provide for any changes in legislation, international best practice, and industry trends.

Consumer protection regulation continued to be a key focus in 2013, with ongoing monitoring and reporting of compliance with the requirements of FAIS and the NCA. The NCA has imposed strict requirements on credit and service providers, including affordability assessments, disclosures to consumers, advertising and marketing practices, complaints, pricing, and reporting to the respective regulators. Business processes have been reformulated, and undergo ongoing enhancements to ensure compliance with these pieces of legislation. Compliance carried out extensive training and monitoring reviews throughout the year.

The ongoing implementation of the FAIS Fit and Proper requirements, and especially the requirement for all Key Individuals and Representatives to undertake regulatory examinations continued as the major imperative for Business and the Compliance function during the year. The Group has a declaration of interest process designed to proactively identify potential conflicts of interest. Emphasis is placed on declaring outside business interests and gifts.

Through the Banking Association of South Africa, a Code of Banking Practice has been endorsed by its members to provide safeguards for consumers. A revised Code came into operation on 1 January 2012, which was an area of focus and will remain so in the coming year.

Compliance risk is managed through internal policies and processes, which include legal, regulatory and business-specific requirements. A compliance tool was developed to assist management in reporting compliance breaches electronically, and thereby supporting Compliance in fulfilling its obligations. The compliance officers provide regular training to ensure that all employees are familiar with their regulatory obligations. They also provide advice on regulatory issues. Compliance staff independently monitor the business units to ensure adherence to policies and procedures, and other technical requirements. Compliance staff work closely with business and operational units to ensure consistent management of compliance risk.

No material incidents of non-compliance were reported during the year under review.

H Stoffberg
Head: Compliance

26 February 2014

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In terms of section 29(1)(e)(ii) of the Companies Act, it is confirmed that the preparation of these annual financial statements is the responsibility of Ms M E L Teixeira (CA)SA, the CFO of the Bank.

These annual financial statements have been audited in compliance with the requirements of section 29(1)(e)(i) of the Companies Act.

DIRECTORS' RESPONSIBILITY STATEMENT

In terms of the Companies Act, the Directors are required to maintain adequate accounting records and prepare annual financial statements that fairly present the financial position at year-end, and the results and cash flows for the year of the Company and the Group.

To enable the Board to discharge its responsibilities, management has developed, and continues to maintain, a system of internal controls. The Board has ultimate responsibility for this system of internal controls, and reviews the effectiveness of its operations, primarily through the GAC and other risk-monitoring committees and functions.

The internal controls include risk-based systems of accounting and administrative controls designed to provide reasonable, but not absolute, assurance that assets are safeguarded and that transactions are executed and recorded in accordance with sound business practices, and the Group's written policies and procedures. These controls are implemented by trained and skilled staff, with clearly defined lines of accountability and appropriate segregation of duties. The controls are monitored by management, and include a budgeting and reporting system operating within strict deadlines and an appropriate control framework. As part of the system of internal controls, the Group's internal audit function conducts inspections, and financial and specific audits, and co-ordinates audit coverage with the external auditors.

The external auditors are responsible for reporting on the fair presentation of the Company and Group annual financial statements.

The Company and Group annual financial statements are prepared in accordance with IFRS, issued by the International Accounting Standards Board and incorporate responsible disclosures in line with the accounting policies of the Group. The Company and Group annual financial statements are based on appropriate accounting policies consistently applied, except as otherwise stated, and are supported by reasonable and prudent judgments and estimates. The Board believes that the Group will be a going concern in the year ahead. For this reason, they continue to adopt the going concern basis in preparing the annual financial statements.

These annual financial statements, set out on pages 28 to 86, have been approved by the Board of Mercantile Bank Holdings Limited, and are signed on their behalf by:

J A S de Andrade Campos
Chairman

K R Kumbier
Chief Executive Officer

26 February 2014

CERTIFICATE FROM THE COMPANY SECRETARY

In terms of the provisions of the Companies Act, I certify that, to the best of my knowledge and belief, the Company has lodged with the Registrar of Companies for the financial year ended 31 December 2013, all such returns as are required of a public company in terms of the Companies Act, and that all such returns are true, correct and up-to-date.

F J Schutte
Company Secretary

26 February 2014

INDEPENDENT AUDITOR'S REPORT

to the shareholder of Mercantile Bank Holdings Limited

REPORT ON THE FINANCIAL STATEMENTS

We have audited the Group annual financial statements and annual financial statements of the Company, which comprise the statements of financial position at 31 December 2013, the statements of comprehensive income, the statements of changes in equity, and the statements of cash flows for the year then ended, a summary of significant accounting policies and other explanatory information as set out on pages 32 to 86.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Directors are responsible for the preparation and fair presentation of these financial statements in accordance with IFRS, and the requirements of the Companies Act of South Africa, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements, based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance that the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements, in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of accounting estimates made by the Directors, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, these financial statements present fairly, in all material respects, the consolidated and separate financial position of the Company as at 31 December 2013, and its consolidated and separate financial performance and cash flows for the year then ended are in accordance with IFRS and in the manner required by the Companies Act of South Africa.

OTHER REPORTS REQUIRED BY THE COMPANIES ACT

As part of our audit of the financial statements for the year ended 31 December 2013, we have read the Audit Committee report and the Directors' report for the purpose of identifying whether there are material inconsistencies between the reports and the audited financial statements. The reports are the responsibility of the respective preparers. Based on reading the reports, we have not identified material inconsistencies between the reports and the audited financial statements. However, we have not audited the reports, and accordingly do not express an opinion on them.

Deloitte & Touche

Deloitte & Touche
Registered Auditors
Per Danie Crowther
Partner

26 February 2014

Building 8, Deloitte Place, The Woodlands, Woodmead Drive, Sandton 2196

AUDIT COMMITTEE REPORT

for the year ended 31 December 2013

The GAC is a committee of the Board and has assumed the responsibilities of an audit committee in respect of all subsidiaries of Mercantile, and therefore a separate GAC has not been formed for the Bank or any other subsidiaries. The GAC assists the Board in fulfilling its monitoring and controlling responsibilities in terms of applicable legislation.

TERMS OF REFERENCE

The GAC is a Board committee appointed by the Board and is accountable to it. Its powers and terms of reference are delegated to it by the Board, and are formalised in its charter, which is reviewed annually and approved by the Board. The GAC has executed its duties during the past financial year in accordance with its charter and the Companies Act.

COMPOSITION

The GAC comprises three Independent Non-Executive Directors. At 31 December 2013, the members were:

- L Hyne(Chairman) CA(SA)
- G P de Kock
- T H Njikizana CA(SA)

The CEO, Executive Director, CFO, heads of Risk and Internal Audit, and representatives from the External Auditors, attend the committee meetings by invitation. The External and Internal Auditors have unrestricted access to the GAC Chairman, or any other member of the committee, as required.

MEETINGS

The GAC held five meetings during the period under review. During their tenure as members of the committee, all members attended each of these meetings.

STATUTORY DUTIES

In execution of its statutory duties during the financial year under review, the GAC:

- nominated for appointment, as external auditor, Deloitte & Touche, which, in its opinion, is independent of the Company;
- determined the fees to be paid to Deloitte & Touche as disclosed in note 26 to the annual financial statements;
- determined Deloitte & Touche's terms of engagement;
- believes the appointment of Deloitte & Touche complies with the relevant provisions of the Companies Act and King III;
- pre-approved all non-audit service contracts with Deloitte & Touche in accordance with its policy;
- received no complaints with regard to accounting practices and the internal audit of the Company, the content or auditing of its financial statements, the internal financial controls of the Company, and any other related matters; and
- advised the Board that regarding matters concerning the Company's accounting policies, financial control, records and reporting, it concurs that the adoption of the going concern premise in the preparation of the financial statements, is appropriate.

INTERNAL FINANCIAL CONTROL AND INTERNAL AUDIT

In the execution of its delegated duties in this area, the GAC has:

- reviewed and recommended the internal audit charter for approval;
- evaluated the independence, effectiveness and performance of the internal audit function;
- reviewed the effectiveness of the Company's system of internal financial controls;
- reviewed significant issues raised by the external and internal audit process, and the adequacy of corrective action in response to such findings; and
- reviewed policies and procedures for preventing and detecting fraud.

The head of Internal Audit functionally reported to the GAC, and had unrestricted access to the GAC Chairman, and is of the opinion that significant internal financial controls operated effectively during the period under review.

Based on the processes and assurances obtained, the GAC believes that significant internal financial controls are effective.

REGULATORY COMPLIANCE

The GAC has complied with all applicable legal, regulatory and other responsibilities.

EXTERNAL AUDIT

Based on processes followed and assurances received, the GAC is satisfied that both Deloitte & Touche and the audit partner, D Crowther, are independent of the Group. The GAC confirmed that no reportable irregularities were identified and reported by the external auditors, in terms of the Auditing Professions Act, No. 26 of 2005.

Based on its satisfaction with the results of the activities outlined above, the GAC has recommended to the Board that Deloitte & Touche should be reappointed for 2014.

FINANCE FUNCTION

The GAC believes that Ms M E L Teixeira, the CFO, who is responsible for Finance, possesses the appropriate expertise and experience to meet her responsibilities in that position. We are also satisfied with the expertise and adequacy of resources within the finance function.

In making these assessments, we have obtained feedback from both external and internal audit.

Based on the processes and assurances obtained, we believe that the accounting practices are effective.

FINANCIAL STATEMENTS

Based on the processes and assurances obtained, we recommend the current annual financial statements be approved by the Board.

On behalf of the GAC

L Hyne
Chairman of the GAC

26 February 2014

DIRECTORS' REPORT

for the year ended 31 December 2013

The Directors have pleasure in presenting their report, which forms part of the audited annual financial statements of the Company and the Group for the year ended 31 December 2013.

1. NATURE OF BUSINESS

The Company is a registered bank controlling and investment holding company incorporated in the Republic of South Africa. Through its subsidiaries, the Company is involved in the full spectrum of domestic and international banking and financial services to niche markets in business, commercial and alliance banking.

2. HOLDING COMPANY

The 100% shareholder of the Company is CGD.

3. FINANCIAL RESULTS

An overview of the financial results is set out in the Group Review, commencing on page 7 of the Integrated Annual Report. Details of the Company and Group financial results are set out on pages 32 to 86, and in the opinion of the Directors, require no further comment.

4. SHARE CAPITAL

There were no changes to the authorised and issued share capital of the Company during the year (2012: 6 576 128 shares were issued and 331 476 457 shares were bought back). The authorised and issued share capital of the Company and the Group is detailed in note 15 to the annual financial statements.

5. DIRECTORS, COMPANY SECRETARY AND REGISTERED ADDRESSES

The Directors of the Company during the year were as follows:

J A S de Andrade Campos *+ (Chairman)
K R Kumbier# (CEO)
D J Brown (resigned 19 August 2013)+
G P de Kock°
L Hyne°
A T Ikalafeng°
J P M Lopes*#
T H Njikizana^°
D Naidoo (resigned 23 August 2013)°

** Portuguese, ^Zimbabwean, #Executive, °Independent Non-Executive, +Non-Executive*

The Directors of the Company, as at 26 February 2014, and details of their backgrounds, are shown on pages 4 and 5.

F J Schutte, who was serving as Acting Company Secretary, was appointed as Company Secretary with effect from 12 April 2013.

The registered addresses of the Company are:

Postal:	**Physical:**
PO Box 782699	1st Floor
Sandton	Mercantile Bank
2146	142 West Street
	Sandown
	2196

6. DIVIDENDS

A dividend of R27.501 million was declared on 26 February 2014 in respect of the year ended 31 December 2013 (2012: R29.672 million).

7. SUBSIDIARY COMPANIES AND COMPANIES NOT CONSOLIDATED

All subsidiary companies are incorporated in the Republic of South Africa. A register containing details of all non-trading companies is available for inspection at the registered office of the Company.

Aggregate income after tax earned by subsidiaries amounted to R167.3 million (2012: R150.2 million), and aggregate losses amounted to R3.6 million (2012: R0.2 million).

The principal consolidated subsidiary companies are as follows:

	Issued share capital	Effective holding	Nature of business	Shares at cost		Owing by subsidiaries	
				2013	2012	**2013**	2012
	R'000	%		**R'000**	R'000	**R'000**	R'000
Company name							
Custom Capital (Pty) Ltd	–	74.9	Rental finance	**–**	–	**–**	–
LSM (Troyeville) Properties (Pty) Ltd	–	100	Property holding	**140**	140	**–**	–
Mercantile Bank Limited	124 969	100	Banking	**1 485 448**	1 485 448	**460**	504
Mercantile Insurance Brokers (Pty) Ltd	250	100	Insurance broking	**294**	294	**–**	–
Portion 2 of Lot 8 Sandown (Pty) Ltd	–	100	Property holding	**8 832**	8 832	**–**	–

Mercantile E-Bureau (Pty) Ltd, in which the Group owns 50%, has not been consolidated into the Group's results, the impact being immaterial.

8. GOING CONCERN

The Directors, in performing their assessment of the Group and Company's ability to continue as a going concern, considered the approved operating budget for the next financial year, as well as the cash flow forecast for the year ahead. The approved operating budget was reviewed and analysed based on the current developments in the market and operating model for the Group and the Company. The Directors believe the Group and the Company will have sufficient capital and cash resources to operate as a going concern in the year ahead.

9. SPECIAL RESOLUTIONS

Three special resolutions were adopted at the AGM, held on 22 May 2013: to adopt the Company's Memorandum of Incorporation, which had been revised to align to the requirements of the Companies Act, 2008; to approve the fees and remuneration respectively payable to Non-Executive Directors and Executive Directors; and to approve the liquidation of Mercantile Registrars Limited.

10. EVENTS AFTER THE REPORTING PERIOD

Following the establishment of a special purpose vehicle in 2013, on 5 February 2014, R260 million of Custom Capital's rental assets were securitised and notes to this value were issued. The A class notes (R180 million) were issued to the International Finance Corporation and the D class notes (R80 million) to Custom Capital. This special purpose vehicle will be consolidated into the Group's results as from 2014.

ACCOUNTING POLICIES

for the year ended 31 December 2013

The principal accounting policies adopted in the preparation of these annual financial statements are set out below:

1. BASIS OF PRESENTATION

The Company and Group annual financial statements have been prepared in accordance with IFRS, issued by the International Accounting Standards Board, using the historical cost convention as modified by the revaluation of certain financial assets, liabilities and properties.

IAS19 Employee Benefits (as revised in 2011), which became effective in the current reporting period, had an impact on the Group and was consequently applied. Detail of the changes are set out in note 31 to the annual financial statements. Other IFRS' that became effective in the current reporting period have had no impact on the Group.

2. BASIS OF CONSOLIDATION

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible, are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated, unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary, to ensure consistency with the policies adopted by the Group.

3. BUSINESS COMBINATIONS

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree, and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss, as incurred. At the acquisition date, the identifiable assets acquired and the liabilities assumed, are recognised at their fair value.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any), over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

The interest of the non-controlling interest in the acquiree is initially measured at the non-controlling interest's proportion of the net identifiable assets of the acquiree.

4. GOODWILL

Goodwill arising on an acquisition of a business is carried at cost, as established at the date of acquisition of the business (see note 3 above), less accumulated impairment losses, if any.

Goodwill is tested for impairment annually. Any impairment loss for goodwill is recognised directly in profit or loss in the consolidated statement of comprehensive income. An impairment loss recognised for goodwill is not reversed in subsequent periods. On disposal of the relevant business, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

5. RECOGNITION OF ASSETS AND LIABILITIES

5.1 ASSETS

The Group recognises assets when it obtains control of a resource as a result of past events, and from which future economic benefits are expected to flow to the Group.

5.2 LIABILITIES

The Group recognises liabilities when it has a present obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

5.3 PROVISIONS

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

5.4 CONTINGENT LIABILITIES

The Group discloses a contingent liability where it has a possible obligation as a result of past events, the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group, or it is possible that an outflow of resources will be required to settle the obligation, or the amount of the obligation cannot be measured with sufficient reliability.

6. FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are recognised in the Group's statement of financial position when the Group has become a party to the contractual provisions of that instrument. Regular way purchases or sales of financial assets are recognised using settlement date accounting.

On initial recognition, financial instruments are recognised at their fair value, and in the case of a financial instrument not at fair value, through profit and loss; transaction costs that are directly attributable to the acquisition or issue of the financial instrument are included.

The Group derecognises a financial asset when:
- the contractual rights to the cash flows arising from the financial assets have expired or have been forfeited by the Group; or
- it transfers the financial asset including, substantially, all the risks and rewards of ownership of the asset; or
- it transfers the financial asset, neither retaining nor transferring substantially, all the risks and rewards of ownership of the asset, but no longer retaining control of the asset.

A financial liability is derecognised when, and only when, the liability is extinguished, that is, when the obligation specified in the contract is discharged, cancelled or has expired.

The difference between the carrying amount of a financial liability (or part thereof) extinguished or transferred to another party and consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit and loss.

6.1 DERIVATIVE FINANCIAL INSTRUMENTS

Derivative financial assets and liabilities are classified as held-for-trading.

The Group uses the following derivative financial instruments to reduce its underlying financial risks and/or to enhance returns:
- forward exchange contracts;
- foreign currency swaps;
- interest rate swaps; and
- unlisted equity options.

Derivative financial instruments ("derivatives") are not entered into for trading or speculative purposes. All derivatives are recognised in the statement of financial position. Derivative financial instruments are recorded at cost, and are measured to fair value, excluding transaction costs, at each reporting date. Changes in the fair value of derivatives are recognised in profit and loss.

Derivatives in unlisted equity options, where the underlying asset does not have a quoted market price in an active market, and whose fair value cannot be reliably measured; and derivatives that are linked to, and must be settled by, delivery of such unquoted equity instruments, are measured at cost, less impairment.

A derivative's notional principal reflects the value of the Group's investment in derivative financial instruments, and represents the amount to which a rate or price is applied to calculate the exchange of cash flows.

6.2 FINANCIAL ASSETS

The Group's principal financial assets are cash and cash equivalents, bank term deposits, other investments, negotiable securities, loans and advances, and other accounts receivable.

Financial assets at fair value through profit and loss
Financial assets are designated at fair value through profit and loss, primarily to eliminate or significantly reduce the accounting mismatch. The Group seeks to demonstrate that, by applying the fair value option, which measures fair value gains and losses in profit and loss, it significantly reduces measurement inconsistency that would otherwise arise from measuring derivatives and such designated financial assets, at amortised cost.

Available-for-sale financial assets
Available-for-sale financial assets are those non-derivatives that are designated as available-for-sale, or are not classified as loans and receivables, held to maturity investments or financial assets at fair value through profit and loss.

Cash and cash equivalents
Cash and cash equivalents comprise cash on hand, deposits held by the Group with the SARB, domestic banks, foreign banks and Money Market funds. These financial assets have been designated as loans and receivables, and are measured at amortised cost.

Bank term deposits
Bank term deposits comprise deposits held by the Group with domestic and foreign banks, with a residual maturity of greater than three months. These financial assets have been designated as loans and receivables, and are measured at amortised cost.

Other investments
Investments consist of unlisted and listed equity investments. Other investments, which are an integral part of the Group's structured loan portfolio, are designated at fair value through profit and loss. All other investments have been designated as available-for-sale. These assets are measured at fair value at each reporting date, with the resultant gains or losses being recognised in other comprehensive income until the financial asset is sold or otherwise disposed of. At that time, the cumulative gains or losses previously recognised in other comprehensive income, are included in profit and loss.

ACCOUNTING POLICIES

for the year ended 31 December 2013 (continued)

Negotiable securities

Negotiable securities consist of government stock, treasury bills, debentures and promissory notes.

Government stock has been designated as available-for-sale. These assets are measured at fair value at each reporting date, with the resultant gains or losses being recognised in other comprehensive income until the financial asset is sold, otherwise disposed of, or found to be impaired. At that time, the cumulative gains or losses previously recognised in other comprehensive income, are included in profit and loss.

All other negotiable securities are classified as loans and receivables, and are carried at amortised cost subject to impairment.

Loans and advances

Loans and advances principally comprise amounts advanced to third parties in terms of certain products. Fixed rate loans and advances are designated at fair value through profit and loss, with resultant gains and losses being included in profit and loss. Variable rate loans and advances are designated as loans and receivables, and are measured at amortised cost.

Interest on non-performing loans and advances is not recognised to profit and loss, but is suspended. In certain instances, interest is also suspended where portfolio impairments are recognised.

Other account receivables

Other accounts receivable comprise items in transit, prepayments and deposits, and other receivables. These assets have been designated as loans and receivables, and are measured at amortised cost.

6.3 FINANCIAL LIABILITIES

The Group's financial liabilities include deposits and other accounts payable, consisting of accruals, product-related credits, and sundry creditors. All financial liabilities, other than liabilities designated at fair value through profit and loss and derivative instruments, are measured at amortised cost. For financial liabilities designated at fair value through profit and loss, and derivative instruments, which are measured at fair value through profit and loss, the resultant gains and losses are included in profit and loss.

6.4 FAIR VALUE ESTIMATION

The fair value of publicly-traded derivatives, securities and investments is based on quoted market values at the reporting date. In the case of an asset held by the Group, the exit price is used as a measure of fair value. In the case of a liability held, the current offer or asking price is used as a measure of fair value. Mid-market prices are used as a measure of fair value, where there are matching asset and liability positions.

In assessing the fair value of non-traded derivatives and other financial instruments, the Group uses a variety of methods and assumptions that are based on market conditions and risks existing at each reporting date. Quoted market prices or dealer quotes for the same or similar instruments are used for the majority of securities, long-term investments, and long-term debt. Other techniques, such as earnings multiples, option pricing models, estimated discounted value of future cash flows, replacement cost, termination cost, and net asset values of underlying investee entities, are used to determine fair value for all remaining financial instruments.

6.5 AMORTISED COST

Amortised cost is determined using the effective interest rate method. The effective interest rate method is a way of calculating amortisation using the effective interest rate of a financial asset or financial liability. It is the rate that discounts the expected stream of future cash flows to maturity, or the next market-based revaluation date, to the current net carrying amount of the financial asset or financial liability.

6.6 IMPAIRMENTS

Specific impairments are made against identified financial assets. Portfolio impairments are maintained to cover potential losses which, although not specifically identified, may be present in the advances portfolio.

Advances which are deemed uncollectible, are written off against the specific impairments. A direct reduction of an impaired financial asset occurs when the Group writes off an impaired account. The Group's policies set out the criteria for write-offs, which involve an assessment of the likelihood of commercially viable recovery of the carrying amount of impaired financial assets. Both the specific and portfolio impairments raised during the year, less the recoveries of advances previously written off, are charged to profit and loss.

The recoverable amount is the sum of the estimated future cash flows, discounted to their present value, using a pre-tax discount rate that reflects the portfolio of advances' effective interest rate.

If the recoverable amount of the advance is estimated to be less than the carrying amount, the carrying amount of the advance is reduced to its recoverable amount by raising a specific impairment, which is recognised as an expense. Where the impairment loss subsequently reverses, the carrying amount of the advance is increased to the revised estimate of its recoverable amount, subject to the increased carrying amount, not exceeding the carrying amount that would have been determined, had no impairment loss been recognised for the advance in prior years.

A reversal of an impairment loss is recognised through profit and loss immediately, except for the reversal of an impairment of equity instruments designated as available-for-sale, which is recognised in other comprehensive income.

7. FOREIGN CURRENCY TRANSACTIONS

Transactions in foreign currencies are converted into the functional currency at prevailing exchange rates on the transaction date. Monetary assets, liabilities and commitments in foreign currencies are translated into the functional currency using the rates of exchange ruling at each reporting date. Gains and losses on foreign exchange are included in profit and loss.

8. SUBSIDIARIES

Investments in subsidiaries in the Company's annual financial statements are designated as available-for-sale assets, and are recognised at fair value. All gains and losses on the sale of subsidiaries are recognised in profit and loss.

9. ASSOCIATED COMPANIES

Associated companies are those companies in which the Group exercises significant influence, but has no control or joint control over their financial and operating policies, and holds between 20% and 50% interest therein.

The carrying values of investments in associated companies represent the aggregate of the cost of the investments, plus post-acquisition equity-accounted income and reserves. These investments are accounted for using the equity method in the Group's annual financial statements. This method is applied from the effective date on which the enterprise became an associated company, up to the date on which it ceases to be an associated company.

The results and assets and liabilities of associated companies are incorporated in the financial statements using the equity method of accounting.

10. PROPERTY AND EQUIPMENT

Owner-occupied properties are held for use in the supply of services or for administrative purposes, and are stated in the statement of financial position at open-market fair value on the basis of their existing use, at the date of revaluation, less any subsequent accumulated depreciation calculated using the straight-line method and subsequent accumulated impairment losses. The open-market fair value is based on capitalisation rates for open-market net rentals for each property. Revaluations are performed annually by independent registered professional valuators.

Any revaluation increase, arising on the revaluation of owner-occupied properties, is credited to other comprehensive income, except to the extent that it reverses a revaluation decrease for the same asset previously recognised as an expense. The increase is credited to profit and loss, to the extent that an expense was previously charged to profit and loss. A decrease in the carrying amount arising on the revaluation of owner-occupied properties, is charged as an expense to the extent that it exceeds the balance, if any, held in the non-distributable reserve relating to a previous revaluation of that asset. On the subsequent sale or retirement of a revalued property, the revaluation surplus relating to that property in the non-distributable reserve, is transferred to distributable reserves. The properties' residual values and useful lives, are reviewed and adjusted, if appropriate, at each reporting date.

All equipment is stated at historical cost, less accumulated depreciation and subsequent accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Subsequent costs are included in the asset's carrying amount, or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group, and the cost of the item can be measured reliably. All other repairs and maintenance are charged to profit and loss as they are incurred.

Depreciation on equipment is calculated using the straight-line method, to allocate cost to residual values over estimated useful lives. Leasehold improvements are depreciated over the period of the lease, or over such lesser period as is considered appropriate. Equipment residual values and useful lives are reviewed for impairment where there are indicators of impairment, and are adjusted, if appropriate, at each reporting date.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value, less costs to sell, or its value in use.

The estimated useful lives of property and equipment are as follows:

Leasehold improvements	5 – 10 years
Computer equipment	3 – 5 years
Furniture and fittings	10 years
Office equipment	5 – 10 years
Motor vehicles	5 years
Owner-occupied properties	50 years
Land	Not depreciated

Gains and losses on disposal of property and equipment are determined by comparing proceeds with the carrying amount, and are recognised in profit and loss. Depreciation of an asset begins when it is available for use, and ceases at the earlier of the dates that the asset is classified as held for sale, or the date the asset is derecognised.

ACCOUNTING POLICIES

for the year ended 31 December 2013 (continued)

11. INTANGIBLE ASSETS

11.1 COMPUTER SOFTWARE

Direct costs associated with purchasing, developing and maintaining computer software programmes, and the acquisition of software licenses, are recognised as intangible assets if they are expected to generate future economic benefits that exceed related costs beyond one year.

Computer software and licenses that are recognised as intangible assets are amortised on the straight-line basis, at rates appropriate to the expected useful lives of the assets, which is usually between three and five years, but where appropriate, over a maximum of 10 years, and are carried at cost less any accumulated amortisation and any accumulated impairment losses.

11.2 INTANGIBLE ASSETS ACQUIRED IN A BUSINESS COMBINATION

Intangible assets acquired in a business combination and recognised separately from goodwill, are initially recognised at their fair value at the acquisition date (which is regarded as their cost). Such assets are amortised on the straight-line basis, at rates appropriate to the expected useful lives of the assets, which is usually between one and five years.

Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost, less accumulated amortisation and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

11.3 DE-RECOGNITION OF INTANGIBLE ASSETS

An intangible asset is de-recognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from de-recognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is de-recognised.

11.4 IMPAIRMENT OF INTANGIBLE ASSETS

At the end of each reporting period, the Group reviews the carrying amounts of intangible assets, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

The recoverable amount is the higher of fair value, less costs to sell or its value in use. If the recoverable amount is estimated to be less than its carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is immediately recognised in profit and loss.

Intangible assets with indefinite useful lives and intangible assets not yet available for use, are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

12. NON-CURRENT ASSETS HELD FOR SALE

Non-current assets are classified as held for sale if their carrying amount will be recovered principally through a sale transaction, rather than through continuing use. This condition is regarded as met only when the sale is highly probable within 12 months, the asset is available for immediate sale in its present condition, and management is committed to the sale.

Non-current assets classified as held for sale are measured at the lower of their carrying amount and fair value, less costs to sell.

13. TAX

Income tax expense represents the sum of the tax currently payable, and deferred tax.

13.1 CURRENT TAX

The tax currently payable is based on taxable profit for the year. Taxable profit differs from profit as reported in the statement of comprehensive income, because it excludes items of income or expense that are taxable or deductible in other years, and it further excludes items that are neither taxable nor deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

13.2 DEFERRED TAX

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements, and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences, to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill, or from the initial recognition (other than in a business combination) of other assets and liabilities, in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference, and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets arising from deductible temporary differences associated with such investments and interests, are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences, and that they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting date, and is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the reporting date, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities, and when they relate to income taxes levied by the same tax authority, and the Group intends to settle its current tax assets and liabilities on a net basis.

13.3 CURRENT AND DEFERRED TAX FOR THE YEAR

Current and deferred tax are recognised as an expense or income in profit or loss, except when they relate to items credited or debited to other comprehensive income, in which case, the tax is recognised in other comprehensive income.

14. INSTALMENT SALES AND LEASES

14.1 GROUP AS THE LESSEE

Leases entered into by the Group (including rental assets) are primarily operating leases. The total payments made under operating leases are charged to profit and loss on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

14.2 THE GROUP AS THE LESSOR

Leases and instalment sale agreements are regarded as financing transactions with rentals and instalments receivable, less unearned finance charges being included in advances. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

15. INTEREST INCOME AND INTEREST EXPENSE

Except where interest is suspended, interest income and expense are recognised in profit and loss for all interest-bearing instruments measured at amortised cost, using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument, but does not consider future credit losses. The calculation includes all fees and basis points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

16. FEE, COMMISSION AND DIVIDEND INCOME

Fees and commissions are recognised on an accrual basis, unless included in the effective interest rate. Dividend income from investments is recognised when the shareholder's right to receive payment has been established.

17. RETIREMENT FUNDS

The Group operates a defined contribution fund, the assets of which are in the process of being transferred to an independent trustee-administered umbrella fund. The retirement fund is funded by payments from employees and by the relevant Group companies. The Group contributions to the retirement funds are based on a percentage of the payroll, and are charged to profit and loss, as accrued.

18. POST-RETIREMENT MEDICAL BENEFITS

The Group provides for post-retirement medical benefits to certain retired employees. These benefits are only applicable to employees who were members of the Group's medical aid scheme prior to May 2000, and who elected to retain the benefits in 2005, and are based on these employees remaining in service up to retirement age. The Group provides for the present value of the obligations in excess of the fair value of the plan assets, which is intended to offset the expected costs relating to the post-retirement medical benefits. The costs of the defined benefit plan are assessed using the projected unit credit method. Under this method, the cost of providing post-retirement medical benefits is charged to profit and loss, so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries, who value the plans annually.

ACCOUNTING POLICIES

for the year ended 31 December 2013 (continued)

The interest cost and expected return on plan assets used in the previous version of IAS19 are replaced with a "net interest" amount under IAS19 (as revised in 2011), as well as the effect of settlements on the liability and plan assets are recognised immediately in profit and loss and any remeasurements of the defined benefit liability and assets (which includes actuarial gains and losses) are recognised immediately through other comprehensive income in order for the net post retirement asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus.

19. KEY ASSUMPTIONS AND ESTIMATES APPLIED BY MANAGEMENT

The Group makes assumptions and estimates that affect the reported amounts of assets and liabilities. Assumptions and estimates are continually evaluated, and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

19.1 IMPAIRMENT LOSSES ON LOANS AND ADVANCES

The Group reviews its loan portfolios to assess impairment on a monthly basis. In determining whether an impairment loss should be recorded in profit and loss, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans, before the decrease can be identified for an individual loan in that portfolio. This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

19.2 FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of financial instruments that are not quoted in active markets is determined by using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. The models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data. However, areas such as credit risk, volatilities and correlations, require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

19.3 IMPAIRMENT OF AVAILABLE-FOR-SALE EQUITY INVESTMENTS

The Group determines that available-for-sale equity investments are impaired when there has been a significant or prolonged decline in the fair value below its cost. This determination of what is significant or prolonged requires judgement. In making this judgement, the Group evaluates, among other factors, the normal volatility in share price. In addition, impairment may be appropriate when there is evidence of deterioration in the financial health of the investee, industry and sector performance, changes in technology, and operational and financing cash flows.

19.4 INCOME TAXES

There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognises liabilities for anticipated tax issues, based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

20. RECENT ACCOUNTING DEVELOPMENTS

There are new and revised standards and interpretations in issue that are not yet effective, and there are no plans to early adopt. These include the following standards and interpretations that could be applicable to the business of the Group, and may have an impact on future financial statements. The impact of initial application of the following standards has not been assessed as at the date of authorisation of the annual financial statements, and will be applied for years ending after 31 December 2013:

	Standard/Interpretation	**Effective date**
IFRS 3 IFRS13 IAS16 IAS 19 IAS 24 IAS 38 IAS 40	Amendments resulting from Annual Improvements 2010 – 2012 cycle	Annual periods beginning on or after 1 July 2014
IFRS 7	Financial Instruments: Disclosures	Unknown as the effective date has been removed but will not be early adopted by the Group
IFRS 8	Amendments resulting from Annual Improvements 2010 – 2012 cycle	Annual periods beginning on or after 1 July 2014
IFRS 9	Financial Instruments	Unknown as the effective date has been removed but will not be early adopted by the Group
IFRS 10	Consolidated financial statements: Amendments for investment entities	Annual periods beginning on or after 1 January 2014
IFRS 12	Disclosure of interest in other entities: Amendments for investment entities	Annual periods beginning on or after 1 January 2014
IFRS 14	Regulatory deferral accounts	Annual periods beginning on or after 1 January 2016
IAS 27	Consolidated and separate financial statements: Amendments for investment entities	Annual periods beginning on or after 1 January 2014
IAS 32	Financial instruments: Amendments relating to the off-setting of financial assets and financial liabilities	Annual periods beginning on or after 1 January 2014
IAS 36	Impairment of assets: Amendments arising from recoverable amount disclosures for non-financial assets	Annual periods beginning on or after 1 January 2014
IAS 39	Financial instruments: Recognition and Measurement: Amendments for novations of derivatives	Annual periods beginning on or after 1 January 2014
IFRIC 21	Levies	Annual periods beginning on or after 1 January 2014

STATEMENTS OF FINANCIAL POSITION

at 31 December 2013

	Note	Group 2013 R'000	Group 2012 R'000 (restated)	Group 2011 R'000 (restated)	Company 2013 R'000	Company 2012 R'000
ASSETS						
Intangible assets	2	**196 468**	197 833	216 086	**–**	–
Property and equipment	3	**188 141**	144 267	129 568	**–**	–
Goodwill	4	**–**	–	49 932	**–**	–
Tax	5	**1 125**	1 251	–	**–**	–
Other accounts receivable	6	**96 908**	82 521	87 434	**–**	–
Interest in subsidiaries	7	**–**	–	–	**1 806 684**	1 688 480
Other investments	8	**5 799**	19 883	63 789	**62**	62
Deferred tax assets	9	**6 068**	2 368	17 737	**–**	–
Non-current assets held for sale	10	**13 470**	13 453	–	**–**	–
Loans and advances	11	**5 227 941**	5 291 748	4 489 863	**–**	–
Derivative financial instruments	12	**10 630**	6 495	15 657	**–**	–
Negotiable securities	13	**496 608**	257 514	192 588	**–**	–
Cash and cash equivalents	14	**1 490 690**	1 223 016	952 621	**4 292**	4 522
Total assets		**7 733 848**	7 240 349	6 215 275	**1 811 038**	1 693 064
EQUITY AND LIABILITIES						
Total equity attributable to equity holders of the parent		**1 793 644**	1 674 091	1 678 774	**1 807 204**	1 688 926
Share capital and share premium	15	**1 207 270**	1 207 270	1 202 948	**1 207 270**	1 207 270
Capital redemption reserve fund		**3 788**	3 788	3 788	**3 788**	3 788
Employee benefits reserve		**(6 186)**	(7 296)	(4 643)	**–**	–
General reserve		**7 478**	7 478	7 478	**–**	–
Property revaluation reserve		**99 364**	76 874	62 433	**–**	–
Available-for-sale reserve		**6 652**	18 533	21 291	**1 060 040**	941 792
Retained earnings/(Accumulated loss)		**475 278**	367 444	385 479	**(463 894)**	(463 924)
Non-controlling interests		**(1 384)**	(187)	(3 185)	**–**	–
Total equity		**1 792 260**	1 673 904	1 675 589	**1 807 204**	1 688 926
Liabilities		**5 941 588**	5 566 445	4 539 686	**3 834**	4 138
Deferred tax liabilities	9	**71 561**	60 016	27 066	**–**	–
Long-term funding	16	**583 173**	581 876	–	**–**	–
Deposits	17	**5 041 649**	4 736 758	4 251 543	**–**	–
Derivative financial instruments	12	**11 459**	7 160	17 130	**–**	–
Provisions and other liabilities	18	**71 733**	71 993	50 191	**–**	–
Tax		**–**	–	920	**–**	–
Other accounts payable	20	**162 013**	108 642	192 836	**3 834**	4 138
Total equity and liabilities		**7 733 848**	7 240 349	6 215 275	**1 811 038**	1 693 064

STATEMENTS OF COMPREHENSIVE INCOME

for the year ended 31 December 2013

		Group		Company	
	Note	**2013 R'000**	2012 R'000 (restated)	**2013 R'000**	2012 R'000
Interest income	22	**586 022**	528 361	**74**	168
Interest expense	23	**(245 469)**	(210 545)	**–**	–
Net interest income		**340 553**	317 816	**74**	168
Net charge for credit losses	11.4	**(19 489)**	(29 185)	**–**	–
Net interest income after credit losses		**321 064**	288 631	**74**	168
Net gain on disposal of designated through profit and loss investments		**–**	26 555	**–**	–
Net gain on disposal of available-for-sale investments		**16 310**	14 832	**–**	277
Net non-interest income		**206 032**	207 111	**29 672**	126 863
Non-interest income	24	**342 599**	334 301	**29 672**	126 863
Fee and commission expenditure	25	**(136 567)**	(127 190)	**–**	–
Net interest and non-interest income		**543 406**	537 129	**29 746**	127 308
Operating expenditure	26	**(354 418)**	(341 219)	**(44)**	(592)
Profit before tax		**188 988**	195 910	**29 702**	126 716
Tax	27	**(52 679)**	(48 868)	**–**	–
Profit after tax from continuing operations		**136 309**	147 042	**29 702**	126 716
Net profit after tax from discontinued operations	30.3	**–**	8 759	**–**	–
Profit after tax		**136 309**	155 801	**29 702**	126 716
Other comprehensive income					
Revaluation of owner-occupied properties		**31 237**	20 110	**–**	–
Remeasurement of defined benefit obligation		**1 541**	(3 685)	**–**	–
Gains on remeasurement to fair value on other investments and negotiable securities		**1 274**	11 625	**118 248**	36 631
Release to profit and loss on disposal of available-for-sale financial assets		**(16 310)**	(14 832)	**–**	(277)
Tax relating to other comprehensive income		**(6 023)**	(4 188)	**–**	–
Other comprehensive income net of tax		**11 719**	9 030	**118 248**	36 354
Total comprehensive income		**148 028**	164 831	**147 950**	163 070
Profit after tax attributable to:					
Equity holders of the parent:		**137 506**	151 017	**29 702**	126 716
From continuing operations		**137 506**	146 424	**29 702**	126 716
From discontinued operations		**–**	4 593	**–**	–
Non-controlling interests:		**(1 197)**	4 784	**–**	–
From continuing operations		**(1 197)**	618	**–**	–
From discontinued operations		**–**	4 166	**–**	–
		136 309	155 801	**29 702**	126 716
Total comprehensive income attributable to:					
Equity holders of the parent:		**149 225**	160 047	**147 950**	163 070
From continuing operations		**149 225**	155 454	**147 950**	163 070
From discontinued operations		**–**	4 593	**–**	–
Non-controlling interests:		**(1 197)**	4 784	**–**	–
From continuing operations		**(1 197)**	618	**–**	–
From discontinued operations		**–**	4 166	**–**	–
		148 028	164 831	**147 950**	163 070

STATEMENTS OF CHANGES IN EQUITY

for the year ended 31 December 2013

	Share capital and share premium R'000	Capital redemption reserve fund R'000	Employee benefits reserve R'000	General reserve R'000	Property revaluation reserve R'000	Available-for-sale reserve R'000	Retained earnings R'000	Attributable to equity holders of the parent R'000	Non-controlling interests R'000	Total R'000
Group										
Balance at 1 January 2012 (previously reported)	1 202 948	3 788	–	7 478	62 433	21 291	380 836	1 678 774	(3 185)	1 675 589
Adjustments (refer to note 31.2)	–	–	(4 643)	–	–	–	4 643	–	–	–
Balance at 1 January 2012 (restated)	1 202 948	3 788	(4 643)	7 478	62 433	21 291	385 479	1 678 774	(3 185)	1 675 589
Net movement for the year	4 322	–	(2 653)	–	14 441	(2 758)	(18 035)	(4 683)	2 998	(1 685)
Total comprehensive income/(loss) for the year	–	–	(2 653)	–	14 441	(2 758)	151 017	160 047	4 784	164 831
Profit after tax (restated)	–	–	–	–	–	–	151 017	151 017	4 784	155 801
Other comprehensive income/(loss) (restated)	–	–	(3 685)	–	20 110	(3 207)	–	13 218	–	13 218
Tax relating to other comprehensive income/loss (restated)	–	–	1 032	–	(5 669)	449	–	(4 188)	–	(4 188)
Non-controlling interest arising from the acquisition of Multi Risk Investment Holdings (Pty) Ltd	–	–	–	–	–	–	–	–	(1 786)	(1 786)
Decrease in treasury shares held within the Group	7 195	–	–	–	–	–	–	7 195	–	7 195
Issue of shares	3 420	–	–	–	–	–	–	3 420	–	3 420
Buy-back of shares	(3 315)	–	–	–	–	–	(169 052)	(172 367)	–	(172 367)
Share buy-back costs	(2 978)	–	–	–	–	–	–	(2 978)	–	(2 978)
Balance at 31 December 2012 (restated)	**1 207 270**	**3 788**	**(7 296)**	**7 478**	**76 874**	**18 533**	**367 444**	**1 674 091**	**(187)**	**1 673 904**
Net movement for the year	**–**	**–**	**1 110**	**–**	**22 490**	**(11 881)**	**107 834**	**119 553**	**(1 197)**	**118 356**
Total comprehensive income/(loss) for the year	**–**	**–**	**1 110**	**–**	**22 490**	**(11 881)**	**137 506**	**149 225**	**(1 197)**	**148 028**
Profit after tax	**–**	**–**	**–**	**–**	**–**	**–**	**137 506**	**137 506**	**(1 197)**	**136 309**
Other comprehensive income/(loss)	**–**	**–**	**1 541**	**–**	**31 237**	**(15 036)**	**–**	**17 742**	**–**	**17 742**
Tax relating to other comprehensive income/loss	**–**	**–**	**(431)**	**–**	**(8 747)**	**3 155**	**–**	**(6 023)**	**–**	**(6 023)**
Dividend paid	**–**	**–**	**–**	**–**	**–**	**–**	**(29 672)**	**(29 672)**	**–**	**(29 672)**
Balance at 31 December 2013	**1 207 270**	**3 788**	**(6 186)**	**7 478**	**99 364**	**6 652**	**475 278**	**1 793 644**	**(1 384)**	**1 792 260**

	Share capital and share premium R'000	Capital redemption reserve fund R'000	Available-for-sale reserve R'000	Accumulated loss R'000	Total R'000
Company					
Balance at 1 January 2012	1 210 143	3 788	1 074 490	(590 640)	1 697 781
Net movement for the year	(2 873)	–	(132 698)	126 716	(8 855)
Total comprehensive income for the year	–	–	36 354	126 716	163 070
Profit after tax	–	–	–	126 716	126 716
Other comprehensive income	–	–	36 354	–	36 354
Issue of shares	3 420	–	–	–	3 420
Buy-back of shares	(3 315)	–	(169 052)	–	(172 367)
Share buy-back costs	(2 978)	–	–	–	(2 978)
Balance at 31 December 2012	**1 207 270**	**3 788**	**941 792**	**(463 924)**	**1 688 926**
Net movement for the year/Total comprehensive income for the year	**–**	**–**	**118 248**	**30**	**118 278**
Profit after tax	**–**	**–**	**–**	**29 702**	**29 702**
Other comprehensive income	**–**	**–**	**118 248**	**–**	**118 248**
Dividend paid	**–**	**–**	**–**	**(29 672)**	**(29 672)**
Balance at 31 December 2013	**1 207 270**	**3 788**	**1 060 040**	**(463 894)**	**1 807 204**

STATEMENTS OF CASH FLOWS

for the year ended 31 December 2013

	Note	Group 2013 R'000	Group 2012 R'000	Company 2013 R'000	Company 2012 R'000
Cash flows from operating activities					
Cash receipts from customers	28.1	**929 287**	886 747	**74**	168
Cash paid to customers, suppliers and employees	28.2	**(693 018)**	(619 113)	**(44)**	(592)
Cash generated from/(utilised in) operations	28.3	**236 269**	267 634	**30**	(424)
Dividends received		**–**	434	**29 672**	126 863
Tax (paid)	28.4	**(51 141)**	(4 374)	**–**	–
Net (increase) in income-earning assets	28.5	**(197 675)**	(854 645)	**–**	–
Net increase/(decrease) in deposits and other accounts	28.6	**343 395**	413 129	**(260)**	9 850
Cash after tax from discontinued operations	28.7	**–**	10 060	**–**	–
Net cash inflow/(outflow) from operating activities		**330 848**	(167 762)	**29 442**	136 289
Cash flows from investing activities					
Purchase of intangible assets	2.1	**(25 402)**	(15 869)	**–**	–
Purchase of property and equipment	3	**(25 745)**	(9 901)	**–**	–
Acquisition of non-current assets held for sale	10	**(17)**	(13 453)	**–**	–
Net cash inflow on disposal of subsidiary	30.4	**–**	52 597	**–**	39 658
Proceeds on disposal of property and equipment		**55**	–	**–**	–
Proceeds on disposal of investments	8	**16 310**	14 832	**–**	277
Net cash (outflow)/inflow from investing activities		**(34 799)**	28 206	**–**	39 935
Cash flows from financing activities					
Proceeds from issue of ordinary shares		**–**	3 420	**–**	3 420
Dividends paid		**(29 672)**	–	**(29 672)**	–
Increase in long-term funding	16	**1 297**	581 876	**–**	–
Payment for buy-back of shares		**–**	(172 367)	**–**	(172 367)
Payment for share buy-back costs		**–**	(2 978)	**–**	(2 978)
Net cash (outflow)/inflow from financing activities		**(28 375)**	409 951	**(29 672)**	(171 925)
Net cash inflow/(outflow) for the year		**267 674**	270 395	**(230)**	4 299
Cash and cash equivalents at the beginning of the year		**1 223 016**	952 621	**4 522**	223
Cash and cash equivalents at the end of the year	14	**1 490 690**	1 223 016	**4 292**	4 522

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
for the year ended 31 December 2012

	Group 2013 Fair value R'000	Group 2013 Carrying amount R'000	Group 2012 Fair value R'000	Group 2012 Carrying amount R'000
1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS				
1.1 Category analysis of financial instruments				
ASSETS				
Available-for-sale	**23 135**	**23 135**	38 523	38 523
Other investments	**5 799**	**5 799**	19 883	19 883
Negotiable securities – Government stock	**17 336**	**17 336**	18 640	18 640
Loans and receivables	**7 269 213**	**7 271 175**	6 804 680	6 805 070
Loans and advances				
Current accounts	**1 219 442**	**1 219 442**	1 082 465	1 082 465
Credit cards	**16 365**	**16 365**	17 607	17 607
Mortgage loans	**2 139 444**	**2 139 444**	2 395 456	2 395 456
Instalment sales and leases	**706 234**	**706 234**	630 166	630 166
Structured loans	**27 158**	**27 158**	35 228	35 228
Medium-term loans	**1 095 662**	**1 095 662**	1 099 737	1 099 737
Negotiable securities				
Treasury bills	**382 881**	**384 812**	238 484	238 874
Land Bank promissory notes	**94 429**	**94 460**	–	–
Cash and cash equivalents	**1 490 690**	**1 490 690**	1 223 016	1 223 016
Other accounts receivable	**96 908**	**96 908**	82 521	82 521
Designated at fair value through profit and loss	**23 636**	**23 636**	31 089	31 089
Loans and advances				
Mortgage loans	**22 741**	**22 741**	29 810	29 810
Medium-term loans	**895**	**895**	1 279	1 279
Held-for-trading				
Derivative financial instruments	**10 630**	**10 630**	6 495	6 495
	7 326 614	**7 328 576**	6 880 787	6 881 177
LIABILITIES				
Held-for-trading				
Derivative financial instruments	**11 459**	**11 459**	7 160	7 160
Amortised cost	**5 786 835**	**5 786 835**	5 427 276	5 427 276
Long-term funding	**583 173**	**583 173**	581 876	581 876
Deposits	**5 041 649**	**5 041 649**	4 736 758	4 736 758
Other accounts payable	**162 013**	**162 013**	108 642	108 642
	5 798 294	**5 798 294**	5 434 436	5 434 436

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
for the year ended 31 December 2013 (continued)

1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

1.1 Category analysis of financial instruments (continued)

	Company 2013		Company 2012	
	Fair value R'000	**Carrying amount R'000**	Fair value R'000	Carrying amount R'000
ASSETS				
Available-for-sale	**1 806 746**	**1 806 746**	1 688 542	1 688 542
Other investments	**62**	**62**	62	62
Interest in subsidiaries	**1 806 684**	**1 806 684**	1 688 480	1 688 480
Loans and receivables				
Cash and cash equivalents	**4 292**	**4 292**	4 522	4 522
	1 811 038	**1 811 038**	1 693 064	1 693 064
LIABILITIES				
Amortised cost				
Other accounts payable	**3 834**	**3 834**	4 138	4 138
	3 834	**3 834**	4 138	4 138

1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

1.2 Valuation techniques and assumptions applied for the purpose of measuring fair value

- Cash and cash equivalents have short terms to maturity and are carried at amortised cost. For this reason, the carrying amounts at the reporting date approximate the fair value.
- Treasury bills and Land Bank promissory notes have short terms to maturity and are carried at amortised cost. Fair value is based on quoted market values at the reporting date.
- The fair value of loans and advances that are carried at amortised cost approximate the fair value reported, as they bear variable rates of interest. The fair value is adjusted for deterioration of credit quality through the application of the credit impairment models.
- Long-term funding is carried at amortised cost and approximates the fair value reported as it bears variable rates of interest.
- Deposits generally have short terms to maturity, thus the values reported approximate the fair value.
- The fair value of publicly traded derivatives, securities and investments, is based on quoted market values at the reporting date.
- The fair value of other financial assets and financial liabilities, excluding derivatives, is determined in accordance with generally accepted pricing models, based on discounted cash flow analysis, using prices from observable current market transactions and adjusted by relevant market pricing.
- Depending on the business and nature of the underlying investment, the fair value of other unlisted investments (which are an integral part of the Group's structured loan portfolio) is calculated in terms of the shareholders' agreement conditions, net asset value or an EBITDA multiple (based on the latest management accounts available). The fair value of other investments and interest in subsidiaries that are unlisted, is determined by reference to the net asset value of the entity and/or the underlying net asset value of its investment holdings.
- The fair value of loans and advances, designated at fair value through profit and loss, is calculated using the credit spread observed at origination. The fair value is adjusted for deterioration of credit quality, through the application of the credit impairment models.

1.3 Fair value measurements recognised in the statement of financial position

Financial instruments that are measured subsequent to initial recognition at fair value are grouped into Levels 1 to 3 based on the degree to which the fair value is observable:

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data (unobservable inputs).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

1.3 Fair value measurements recognised in the statement of financial position (continued)

	Group			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2013				
ASSETS				
Available-for-sale				
Other investments	**–**	**–**	**5 799**	**5 799**
Negotiable securities – Government stock	**17 336**	**–**	**–**	**17 336**
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	**–**	**22 741**	**–**	**22 741**
Medium-term loans	**–**	**895**	**–**	**895**
Held-for-trading				
Derivative financial instruments	**10 630**	**–**	**–**	**10 630**
	27 966	**23 636**	**5 799**	**57 401**
LIABILITIES				
Held-for-trading				
Derivative financial instruments	**11 459**	**–**	**–**	**11 459**
	11 459	**–**	**–**	**11 459**
2012				
ASSETS				
Available-for-sale				
Other investments	14 831		5 052	19 883
Negotiable securities – Government stock	18 640	–	–	18 640
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	29 810	–	29 810
Medium-term loans	–	1 279	–	1 279
Held-for-trading				
Derivative financial instruments	6 495	–	–	6 495
	39 966	31 089	5 052	76 107
LIABILITIES				
Held-for-trading				
Derivative financial instruments	7 160	–	–	7 160
	7 160	–	–	7 160

1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS (CONTINUED)

1.3 Fair value measurements recognised in the statement of financial position (continued)

	Company			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2013				
ASSETS				
Available-for-sale				
Other investments	**–**	**–**	**62**	**62**
2012				
ASSETS				
Available-for-sale				
Other investments	–	–	62	62

There were no transfers between Levels 1 and 2 during the year.

1.4 Reconciliation of Level 3 fair value measurements of financial assets

	Group	
	2013 R'000	2012 R'000
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning of the year	**5 052**	5 028
Gains on remeasurement to fair value in comprehensive income	**747**	24
Balance at the end of the year	**5 799**	5 052
Designated at fair value through profit and loss		
Other investments – unlisted equities		
Balance at the beginning of the year	**–**	39 849
Realisation	**–**	(39 849)
Balance at the end of the year	**–**	–

	Company	
	2013 R'000	2012 R'000
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning and end of the year	**62**	62

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

	Group	
	2013 R'000	2012 R'000
2. INTANGIBLE ASSETS		
2.1 Computer software		
Cost at the beginning of the year	**317 983**	302 548
Additions	**25 402**	15 869
Derecognised on disposal of a subsidiary (refer to note 30)	**–**	(373)
Net transfer (to)/from property and equipment	**(8)**	25
Write-off of obsolete computer software	**(19 999)**	(86)
Cost at the end of the year	**323 378**	317 983
Accumulated amortisation and impairment losses at the beginning of the year	**(120 150)**	(95 638)
Amortisation: Continuing operations	**(26 759)**	(24 875)
Amortisation: Discontinued operations	**–**	(34)
Eliminated on disposal of a subsidiary (refer to note 30)	**–**	314
Net transfer from property and equipment	**–**	(3)
Write-off of obsolete computer software	**19 999**	86
Accumulated amortisation and impairment losses at the end of the year	**(126 910)**	(120 150)
Net carrying amount at the end of the year	**196 468**	197 833
2.2 Intangible asset acquired in a business combination		
Contractual and customer relationships		
Balance at the beginning of the year	**–**	10 598
Derecognised on disposal of a subsidiary (refer to note 30)	**–**	(10 598)
Balance at the end of the year	**–**	–
Accumulated amortisation and impairment losses at the beginning of the year	**–**	(1 422)
Amortisation on discontinued operations	**–**	(1 422)
Derecognised on disposal of a subsidiary (refer to note 30)	**–**	2 844
Accumulated amortisation and impairment losses at the end of the year	**–**	–
Net carrying amount at the end of the year	**–**	–
Total net carrying amount at the end of the year	**196 468**	197 833

During 2012 and 2013, the Group identified no events or circumstances that would indicate that the Group's intangible assets may need to be impaired.

	Owner-occupied properties R'000	Leasehold improvements R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
3. PROPERTY AND EQUIPMENT							
Group							
2013							
Open market value/cost at the beginning of the year	**124 264**	**18 602**	**92 065**	**10 016**	**33 996**	**751**	**279 694**
Revaluations	**28 406**	**–**	**–**	**–**	**–**	**–**	**28 406**
Additions	**8 094**	**1 433**	**10 235**	**2 393**	**3 479**	**111**	**25 745**
Transfer*	**–**		**8**	**(414)**	**414**	**–**	**8**
Write-off of obsolete assets	**–**	**(4 068)**	**(3 382)**	**(2 125)**	**(3 472)**	**–**	**(13 047)**
Disposals	**–**		**(1)**	**(6)**	**(299)**	**(157)**	**(463)**
Open market value/cost at the end of the year	**160 764**	**15 967**	**98 925**	**9 864**	**34 118**	**705**	**320 343**
Accumulated depreciation and impairment losses at the beginning of the year	**–**	**(16 465)**	**(82 647)**	**(9 544)**	**(26 217)**	**(554)**	**(135 427)**
Depreciation	**(2 830)**	**(628)**	**(5 273)**	**(138)**	**(3 545)**	**(84)**	**(12 498)**
Revaluation	**2 830**	**–**	**–**	**–**	**–**	**–**	**2 830**
Transfer*	**–**	**–**	**–**	**266**	**(266)**	**–**	**–**
Write-off of obsolete assets	**–**	**4 031**	**3 032**	**2 152**	**3 370**	**–**	**12 585**
Disposals	**–**	**–**	**–**	**5**	**225**	**78**	**308**
Accumulated depreciation and impairment losses at the end of the year	**–**	**(13 062)**	**(84 888)**	**(7 259)**	**(26 433)**	**(560)**	**(132 202)**
Net carrying amount at the end of the year	**160 764**	**2 905**	**14 037**	**2 605**	**7 685**	**145**	**188 141**
2012							
Open market value/cost at the beginning of the year	106 564	19 663	88 970	11 827	35 338	931	263 293
Revaluations	17 700	–	–	–	–	–	17 700
Additions	–	–	5 576	142	4 029	154	9 901
Derecognised on disposal of a subsidiary (refer to note 30)	–	–	(1 025)	(1 795)	(323)	(305)	(3 448)
Transfer*	–	–	(25)	–	–	–	(25)
Write-off of obsolete assets	–	(1 061)	(1 359)	(158)	(5 048)	–	(7 626)
Disposals	–	–	(72)	–	–	(29)	(101)
Open market value/cost at the end of the year	124 264	18 602	92 065	10 016	33 996	751	279 694
Accumulated depreciation and impairment losses at the beginning of the year	–	(16 846)	(78 619)	(10 512)	(27 174)	(574)	(133 725)
Depreciation: Continuing operations	(2 410)	(680)	(6 299)	(142)	(3 387)	(87)	(13 005)
Depreciation: Discontinued operations	–	–	(65)	(128)	(26)	(11)	(230)
Revaluation	2 410	–	–	–	–	–	2 410
Derecognised on disposal of a subsidiary (refer to note 30)	–	–	974	1 080	199	89	2 342
Transfer*	–	–	3	–	–	–	3
Write-off of obsolete assets	–	1 061	1 359	158	4 171	–	6 749
Disposals	–	–	–	–	–	29	29
Accumulated depreciation and impairment losses at the end of the year	–	(16 465)	(82 647)	(9 544)	(26 217)	(554)	(135 427)
Net carrying amount at the end of the year	124 264	2 137	9 418	472	7 779	197	144 267

*Transfer between various categories of property and equipment and intangible assets.

- G J van Zyl, a valuator with van Zyl Valuers and a Member of the Institute of Valuers of South Africa, independently valued the properties at 31 December 2012 and 31 December 2013.
- The historical cost of owner-occupied properties that have been revalued is R45.004 million (2012: R36.910 million).
- A register containing details of owner-occupied properties, and the revaluation thereof, is available for inspection at the registered office of the Company.
- A mortgage bond in the amount of R90 million has been registered over a property included in owner-occupied properties (refer to note 16).

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

	Group 2013 R'000	Group 2012 R'000
4. GOODWILL		
Carrying value at the beginning of the year	–	49 932
Derecognised on disposal of a subsidiary (refer to note 30)	–	(49 932)
	–	–

Goodwill represented the excess of fair value of certain assets and liabilities acquired by the Group.

Impairment testing of goodwill is done annually, or more frequently if required, by comparing the net carrying value to the stimated value in use. No impairment losses on goodwill were recognised during 2012.

	Group 2013 R'000	Group 2012 R'000
5. TAX		
South African Revenue Services		
Tax overpaid	**1 125**	1 251
6. OTHER ACCOUNTS RECEIVABLE		
Items in transit	**52 604**	24 660
Prepayments and deposits	**14 472**	15 997
Other receivables	**29 832**	41 864
	96 908	82 521

	Company 2013 R'000	Company 2012 R'000
7. INTEREST IN SUBSIDIARIES		
Unlisted		
Shares at fair value	**1 806 224**	1 687 976
Mercantile Bank Limited	**1 804 089**	1 685 939
Mercantile Insurance Brokers (Pty) Ltd	**2 135**	2 037
Loan – amount owing from Mercantile Bank Limited	**460**	504
	1 806 684	1 688 480

A list of principal subsidiary companies is contained in note 7 of the Directors' report. The loan is interest-free and has no fixed terms of maturity.

	Group 2013 R'000	Group 2012 R'000	Company 2013 R'000	Company 2012 R'000
8. OTHER INVESTMENTS				
Available-for-sale				
Unlisted equities	**5 799**	5 052	**62**	62
Listed equities – Visa Inc.*	–	14 831	–	–
	5 799	19 883	**62**	62

* 50% of the shareholding in Visa Inc. was sold during 2013 and the other 50% during 2012.

A register containing details of investments is available for inspection at the registered office of the Company.

	Group 2013 R'000	2012 R'000
9. DEFERRED TAX		
Balance at the beginning of the year	**(57 648)**	(9 329)
Derecognised on disposal of a subsidiary (refer to note 30)	**–**	2 534
Movements relating to prior years provision	**(408)**	–
Current year charge		
Per the statement of comprehensive income (restated)	**(1 412)**	(46 665)
Per the statement of changes in equity/other comprehensive income (restated)	**(6 023)**	(4 188)
	(65 491)	(57 648)
Comprising		
Deferred tax assets	**6 068**	2 368
Deferred tax liabilities	**(71 561)**	(60 016)
	(65 493)	(57 648)
Deferred tax is attributable to the following temporary differences:		
Asset/(Liability)		
Intangible assets	**(48 398)**	(47 273)
Property and equipment	**49**	(42)
Provisions and other liabilities	**16 883**	16 502
Impairments on loans and advances	**(14 212)**	(21 980)
Calculated tax losses	**772**	308
Current assets	**14 742**	25 068
Revaluations	**(44 306)**	(35 049)
Leased assets	**3 349**	2 622
Other	**5 628**	2 196
	(65 493)	(57 648)

Deferred tax assets have been recognised for the carry forward amount of unused tax losses relating to the Group's operations where, inter alia, tax losses can be carried forward, and there is evidence that it is probable that sufficient taxable profits will be available in the future to utilise all tax losses carried forward.

10. NON-CURRENT ASSETS HELD FOR SALE

	2013	2012
Properties in possession	**13 470**	13 453
	13 470	13 453

The Bank intended to dispose of a property during 2013 that was purchased as a result of a loan default. Due to unsatisfactory market conditions, the property was not sold. However, it remains the Bank's intention to dispose of it in the short term. The property has been valued based on an independent valuation obtained and allowing for cost of disposal.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

	Group 2013 R'000	Group 2012 R'000
11. LOANS AND ADVANCES		
11.1 Product analysis		
Amortised cost	**5 245 044**	5 335 873
Current accounts	**1 241 606**	1 109 362
Credit cards	**19 521**	22 227
Mortgage loans	**2 144 070**	2 405 657
Instalment sales and leases	**710 519**	639 819
Structured loans	**27 535**	44 579
Medium-term loans	**1 101 793**	1 114 229
Designated at fair value through profit and loss	**23 644**	31 108
Mortgage loans	**22 748**	29 825
Medium-term loans	**896**	1 283
Gross loans and advances	**5 268 688**	5 366 981
Less: Portfolio impairments for credit losses	**(7 555)**	(12 302)
Specific impairments for credit losses	**(33 192)**	(62 931)
	5 227 941	5 291 748

Loans and advances in foreign currencies are converted into South African rands, at prevailing exchange rates, at the reporting date.

11.2 Maturity analysis

	Group 2013 R'000	Group 2012 R'000
Repayable on demand and maturing within one month	**1 304 919**	1 157 346
Maturing after one month but within six months	**45 110**	12 633
Maturing after six months but within 12 months	**245 499**	410 493
Maturing after 12 months	**3 673 160**	3 786 509
	5 268 688	5 366 981

The maturity analysis is based on the remaining period to contractual maturity at year-end.

11.3 Detailed product analysis of loans and advances

	Gross amount R'000	Portfolio impairments R'000	Specific impairments R'000	Net balance R'000
Group				
2013				
Current accounts	**1 241 606**	**2 139**	**20 025**	**1 219 442**
Credit cards	**19 521**	**1 115**	**2 041**	**16 365**
Mortgage loans	**2 166 818**	**695**	**3 938**	**2 162 185**
Instalment sales and leases	**710 519**	**1 570**	**2 715**	**706 234**
Structured loans	**27 535**	**377**	**–**	**27 158**
Medium-term loans	**1 102 689**	**1 659**	**4 473**	**1 096 557**
	5 268 688	**7 555**	**33 192**	**5 227 941**
2012				
Current accounts	1 109 362	4 163	22 734	1 082 465
Credit cards	22 227	1 282	3 338	17 607
Mortgage loans	2 435 482	1 212	9 004	2 425 266
Instalment sales and leases	639 819	1 381	8 272	630 166
Structured loans	44 579	403	8 948	35 228
Medium-term loans	1 115 512	3 861	10 635	1 101 016
	5 366 981	12 302	62 931	5 291 748

11. LOANS AND ADVANCES (CONTINUED)

11.4 Impairments for credit losses

	Total R'000	Current accounts R'000	Credit cards R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Medium-term loans R'000
Group							
2013							
Balance at the beginning of the year	**75 233**	**26 897**	**4 620**	**10 216**	**9 653**	**9 351**	**14 496**
Movements for the year:							
Credit losses written off	**(50 068)**	**(25 223)**	**(1 038)**	**(8 154)**	**(6 313)**	**(1 080)**	**(8 260)**
Net impairments raised/(released)	**15 582**	**20 490**	**(426)**	**2 571**	**945**	**(7 894)**	**(104)**
Balance at the end of the year	**40 747**	**22 164**	**3 156**	**4 633**	**4 285**	**377**	**6 132**
2012							
Balance at the beginning of the year	76 550	19 896	4 425	12 141	9 530	9 044	21 514
Movements for the year:							
Credit losses written off	(24 287)	(1 001)	(650)	(339)	(848)	(11 000)	(10 449)
Net impairments raised/(released)	22 970	8 002	845	(1 586)	971	11 307	3 431
Balance at the end of the year	75 233	26 897	4 620	10 216	9 653	9 351	14 496

	Group 2013 R'000	Group 2012 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	**(15 582)**	(22 970)
Amounts directly written off to comprehensive income	**(5 460)**	(6 967)
Recoveries in respect of amounts previously written off	**1 553**	752
	(19 489)	(29 185)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

11. LOANS AND ADVANCES (CONTINUED)

11.5 Product analysis of performing loans and advances

	Gross amount R'000	Portfolio impairment R'000	Net balance R'000
Group			
2013			
Current accounts	**1 201 219**	**2 139**	**1 199 080**
Credit cards	**17 480**	**1 115**	**16 365**
Mortgage loans	**2 067 916**	**695**	**2 067 221**
Instalment sales and leases	**703 537**	**1 570**	**701 967**
Structured loans	**27 535**	**377**	**27 158**
Medium-term loans	**1 064 046**	**1 659**	**1 062 387**
	5 081 733	**7 555**	**5 074 178**
2012			
Current accounts	1 070 177	4 163	1 066 014
Credit cards	18 889	1 282	17 607
Mortgage loans	2 360 976	1 212	2 359 764
Instalment sales and leases	631 240	1 381	629 859
Structured loans	29 447	403	29 044
Medium-term loans	1 084 349	3 861	1 080 488
	5 195 078	12 302	5 182 776

	Group 2013 R'000	Group 2012 R'000
11.6 Product analysis of performing loans and advances excluding loans and advances with renegotiated terms		
Current accounts	**1 201 219**	1 069 681
Credit cards	**16 276**	18 889
Mortgage loans	**2 057 189**	2 353 378
Instalment sales and leases	**703 537**	631 240
Structured loans	**27 535**	29 447
Medium-term loans	**934 797**	1 080 869
	4 940 553	5 183 504
11.7 Product analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired		
Current accounts	**–**	496
Credit cards	**1 204**	–
Mortgage loans	**10 727**	7 598
Instalment sales and leases	**–**	–
Structured loans	**–**	–
Medium-term loans	**129 249**	3 480
	141 180	11 574

11. LOANS AND ADVANCES (CONTINUED)

11.8 Product age analysis of loans and advances that are past due but not individually impaired

	Past due for: 1 – 30 days R'000	31 – 60 days R'000	61 – 90 days R'000	Total gross amount R'000	Fair value of collateral and other credit enhancements R'000
Group					
2013					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	**22 037**	**1 505**	**40 291**	**63 833**	**70 899**
Instalment sales and leases	**713**	**–**	**–**	**713**	**359**
Structured loans	**–**	**–**	**–**	**–**	**–**
Medium-term loans	**4 395**	**51 602**	**515**	**56 512**	**9 973**
	27 145	**53 107**	**40 806**	**121 058**	**81 231**
2012					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	24 077	8 755	54 184	87 016	78 893
Instalment sales and leases	242	62	115	419	255
Structured loans	–	–	–	–	–
Medium-term loans	5 590	5 185	7 702	18 477	7 693
	29 909	14 002	62 001	105 912	86 841

11.9 Product analysis of loans and advances that are individually impaired

	Gross amount R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhancements R'000
Group				
2013				
Current accounts	**40 387**	**20 025**	**20 362**	**16 829**
Credit cards	**2 041**	**2 041**	**–**	**–**
Mortgage loans	**98 902**	**3 938**	**94 964**	**95 236**
Instalment sales and leases	**6 982**	**2 715**	**4 267**	**2 145**
Structured loans	**–**	**–**	**–**	**–**
Medium-term loans	**38 643**	**4 473**	**34 170**	**27 112**
	186 955	**33 192**	**153 763**	**141 322**
2012				
Current accounts	39 185	22 734	16 451	11 353
Credit cards	3 338	3 338	–	–
Mortgage loans	74 506	9 004	65 502	66 017
Instalment sales and leases	8 579	8 272	307	329
Structured loans	15 132	8 948	6 184	6 850
Medium-term loans	31 163	10 635	20 528	19 138
	171 903	62 931	108 972	103 687

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
for the year ended 31 December 2013 (continued)

11. LOANS AND ADVANCES (CONTINUED)

11.10 Collateral held as security and other credit enhancements

Fair value of collateral and other credit enhancements is determined with reference to the realisable value of security.

All customers of the Bank are accorded a client risk grading. The risk grading is dependent upon the client's creditworthiness and standing with the Bank, and is subject to ongoing assessment of the client's financial standing and the acceptability of their dealings with the Bank, including adherence to repayment terms and compliance with other set conditions.

Description of collateral held as security and other credit enhancements	Method of valuation
Cession of debtors	15% – 75% of debtors due and payable under 90 days and depending on debtor credit quality
Pledge of shares	50% of listed shares value; nil for unlisted shares
Pledge and cession	variable depending on asset type and value
Cession of life and endowment policies	100% of surrender value
Pledge of call and savings accounts, fixed and notice deposits	100% of asset value
Vacant land	50% of professional valuation
Residential properties	80% of official valuation.
Commercial and industrial properties	70% of professional valuation
Catering, industrial and office equipment	variable depending on asset type and depreciated value
Trucks	variable depending on asset type and depreciated value
Earthmoving equipment	variable depending on asset type and depreciated value
Motor vehicles	variable depending on asset type and depreciated value
General notarial bond	variable depending on asset type and depreciated value
Special notarial bond	variable depending on asset type and depreciated value

All collateral held by the Group in respect of a loan and advance can be realised in accordance with the terms of the agreement or the facility conditions applicable thereto. Cash collateral and pledged assets that can be realised in accordance with the terms of the pledge and cession or suretyship, are applied in reduction of related exposures. Pledged assets, other than cash or cash equivalent collateral, and tangible security articles, are appropriated and disposed of, where necessary, after legal action, in compliance with the applicable Court rules and directives.

A customer in default will be advised of the default, and afforded an opportunity to regularise the arrears. Failing normalisation of the account, legal action and repossession procedures will be followed, and all attached assets disposed of in accordance with the applicable legislation. In the case of insolvent and deceased estates, the duly appointed liquidator/ trustee will dispose of all assets.

11.11 Structured loans

The Group has acquired zero cost equity options attached to certain structured loans that have been recognised at cost in accordance with accounting policy 6.1.

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
12. DERIVATIVE FINANCIAL INSTRUMENTS				
Group				
2013				
Held-for-trading				
Foreign exchange contracts	**422 370**	**10 561**	**507 193**	**10 856**
Interest rate swaps	**3 930**	**69**	**25 203**	**603**
	426 300	**10 630**	**532 396**	**11 459**
2012				
Held-for-trading				
Foreign exchange contracts	395 050	6 495	386 522	5 620
Interest rate swaps	–	–	31 237	1 540
	395 050	6 495	417 759	7 160

	Group	
	2013 R'000	2012 R'000
13. NEGOTIABLE SECURITIES		
Loans and receivables		
Treasury bills	**384 812**	238 874
Land Bank promissory notes	**94 460**	–
Available-for-sale		
Government stock	**17 336**	18 640
	496 608	257 514
Maturity analysis		
Maturing within one month	**36 940**	2 329
Maturing after one month but within six months	**317 236**	125 058
Maturing after six months but within 12 months	**125 096**	111 487
Maturing after one year but within five years	**17 336**	18 640
	496 608	257 514

The maturity analysis is based on the remaining period to contractual maturity at year-end.

	Group		Company	
	2013 R'000	2012 R'000	**2013 R'000**	2012 R'000
14. CASH AND CASH EQUIVALENTS				
Cash on hand	**46 959**	34 417	**–**	–
Central Bank balances	**148 284**	125 565	**–**	–
Money Market funds	**1 084 222**	854 068	**–**	–
Rand denominated domestic bank balances	**3 969**	88 266	**4 292**	4 522
Foreign currency denominated bank balances	**207 256**	120 700	**–**	–
	1 490 690	1 223 016	**4 292**	4 522

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
for the year ended 31 December 2013 (continued)

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
15. SHARE CAPITAL AND SHARE PREMIUM				
15.1 Issued – Group				
Shares in issue net of treasury shares at 1 January 2012	3 912 534 652	32 194	1 170 754	1 202 948
Decrease of treasury shares held within the Group	26 383 872	7 195	–	7 195
Issue of shares	6 576 128	66	3 354	3 420
Buy-back of shares	(331 476 457)	(3 315)	–	(3 315)
Share buy-back costs	–	–	(2 978)	(2 978)
At 31 December 2012 and 31 December 2013	**3 614 018 195**	**36 140**	**1 171 130**	**1 207 270**

During 2012, treasury shares were utilised during the share buy-back, to settle share options exercised by staff of the Bank.

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
15.2 Issued – Company				
Shares in issue at 1 January 2012	3 938 918 524	39 389	1 170 754	1 210 143
Issue of shares	6 576 128	66	3 354	3 420
Buy-back of shares	(331 476 457)	(3 315)	–	(3 315)
Share buy-back costs	–	–	(2 978)	(2 978)
At 31 December 2012 and 31 December 2013	**3 614 018 195**	**36 140**	**1 171 130**	**1 207 270**

15.3 Authorised

The total authorised number of ordinary shares is 4 465 955 440 shares (2012: 4 465 955 440 shares) with a par value of 1 cent each. The total authorised number of preference shares is 15 150 486 shares (2012: 15 150 486 shares) with a par value of 25 cents each.

15.4 Unissued

The unissued ordinary and preference shares are under the control of the Directors until the next AGM.

15.5 Share-based payments

Share option scheme

Due to the share buy-back of the Company's shares in 2012, all options were exercised by the Bank's employees, and in terms of the Scheme of Arrangement for the de-listing of the Company, option holders received 52 cents per share (minus the exercise price per option). The Mercantile Share Incentive Trust, which acted of the Bank in respect of this scheme, was subsequently dissolved during 2012.

The tables below set out the movement in the options and conditional share awards:

	Exercise price (cents)	Options at the beginning of the year	Forfeited/ Lapsed during the year	Exercised during the year	Options at the end of the year
Share option scheme					
Grant date					
2012					
11 February 2002	32	160 000	–	(160 000)	–
5 October 2004	18	5 000 000	–	(5 000 000)	–
7 October 2004	17	250 000	–	(250 000)	–
11 February 2005	20	500 000	–	(500 000)	–
27 July 2005	32	750 000	–	(750 000)	–
9 February 2006	41	750 000	–	(750 000)	–
22 March 2006	40	9 800 000	(150 000)	(9 650 000)	–
26 February 2007	34	15 750 000	(150 000)	(15 600 000)	–
		32 960 000	(300 000)	(32 660 000)	–

	Group 2013 R'000	Group 2012 R'000
16. LONG-TERM FUNDING		
International Finance Corporation (IFC)	**493 173**	491 876
Short-term portion payable in the next 12 months	**30 000**	–
Portion payable after 12 months but within five years	**463 173**	491 876
Standard Bank of South Africa Limited (Standard Bank)	**90 000**	90 000
	583 173	581 876

The loan obtained from the IFC in 2011, with interest repayable quarterly and linked to JIBAR, is repayable between 15 September 2014 and 15 September 2018.

The loan obtained from Standard Bank in 2012, with interest repayable monthly and linked to JIBAR, is repayable from 13 June 2016 to 13 June 2019. The loan is secured by a mortgage over the Group's owner-occupied property (refer to note 3).

	Group 2013 R'000	Group 2012 R'000
17. DEPOSITS		
Call deposits and current accounts	**2 294 517**	2 268 322
Savings accounts	**174 507**	186 767
Term and notice deposits	**2 453 661**	2 145 666
Negotiable certificates of deposit	**30 542**	29 560
Foreign deposits	**88 422**	106 443
	5 041 649	4 736 758
Maturity analysis		
Repayable on demand and maturing within one month	**2 900 317**	2 890 272
Maturing after one month but within six months	**1 318 573**	1 280 268
Maturing after six months but within 12 months	**451 996**	528 932
Maturing after 12 months but within five years	**370 763**	37 286
	5 041 649	4 736 758

The maturity analysis is based on the remaining period to contractual maturity at year-end.

18. PROVISIONS AND OTHER LIABILITIES

	Deferred bonus scheme R'000	Staff incentives R'000	Audit fees R'000	Post-retirement medical benefits R'000	Leave pay R'000	Other risks R'000	Total R'000
Group							
At 1 January 2012	5 793	12 000	4 350	16 049	9 608	2 391	50 191
Derecognised on disposal of a subsidiary	–	–	(550)	–	–	(847)	(1 397)
Provision raised	3 913	16 966	6 260	3 423	2 404	12 936	45 902
Charged to provision	(1 677)	(12 000)	(6 271)	–	(1 729)	(1 026)	(22 703)
At 31 December 2012	**8 029**	**16 966**	**3 789**	**19 472**	**10 283**	**13 454**	**71 993**
Provision raised	**5 733**	**16 000**	**7 394**	**–**	**2 562**	**6 162**	**37 851**
Charged to provision	**(6 655)**	**(16 966)**	**(7 172)**	**(1 202)**	**(1 702)**	**(4 414)**	**(38 111)**
At 31 December 2013	**7 107**	**16 000**	**4 011**	**18 270**	**11 143**	**15 202**	**71 733**

Post-retirement medical benefits
Refer to note 19 for detailed disclosure of this provision.

Leave pay
In terms of Group policy, employees are entitled to accumulate leave not taken during the year within certain limits.

Other risks
Consists of provisions for legal claims and other risks. At any time, there are legal or potential claims against the Group, the outcome of which cannot be foreseen. Such claims are not regarded as material, either on an individual basis, or in aggregate. Provisions are raised for all liabilities that are expected to materialise.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

19. POST-RETIREMENT MEDICAL BENEFITS

The Bank operates a partly funded post-retirement medical scheme. The assets of the funded plans are held independently of the Group's assets in a separate trustee-administered fund. Independent actuaries value this scheme annually (the last valuation was carried out at 31 December 2013). The actuary's opinion is that the plan is in a sound financial position.

	Group				
	2013 R'000	2012 R'000 (restated)	2011 R'000 (restated)	2010 R'000 (restated)	2009 R'000 (restated)
The amounts recognised in the statement of financial position, are as follows (refer to note 18):					
Present value of total service liabilities	**19 900**	21 575	18 577	20 648	19 370
Fair value of plan assets	**(1 630)**	(2 103)	(2 528)	(5 499)	(5 507)
Provident fund	**(782)**	(1 315)	(1 800)	(1 832)	(1 674)
Endowment bond	**(848)**	(788)	(728)	(2 530)	(2 718)
Annuities	**–**	–	–	(1 137)	(1 115)
Liability in the statement of financial position	**18 270**	19 472	16 049	15 149	13 863
The amounts recognised in the statement of comprehensive income, are as follows:					
Staff cost (refer to note 26):	**(1 030)**	(1 494)	(994)	(1 391)	(1 267)
Current service cost	**22**	13	53	50	92
Payments from plan assets	**540**	–	–	–	–
Employer benefit payments	**(1 592)**	(1 507)	(1 533)	(1 441)	(1 359)
Discharge of liability and related plan asset	**–**	–	486	–	–
Net interest cost (refer to note 23):	**1 369**	1 232	1 127	1 189	1 259
Interest costs	**1 502**	1 466	1 636	1 767	1 785
Expected return on plan assets	**(133)**	(234)	(509)	(578)	(526)
Total included in comprehensive income	**339**	(262)	133	(202)	(8)
The amounts recognised in the statement of other comprehensive income, are as follows:					
Remeasurement of defined benefit obligation	**(1 541)**	3 685	767	1 488	(660)
Total included in other comprehensive income	**(1 541)**	3 685	767	1 488	(660)
Reconciliation of the movement in the present value of total service liabilities					
At the beginning of the year	**21 575**	18 577	20 648	19 370	19 664
Current service cost	**22**	13	53	50	92
Interest costs	**1 502**	1 466	1 636	1 767	1 785
Discharge of liability	**–**	–	(1 891)	–	–
Remeasurement of defined benefit obligation	**(1 607)**	3 026	(336)	902	(812)
Employer benefit payments	**(1 592)**	(1 507)	(1 533)	(1 441)	(1 359)
At the end of the year	**19 900**	21 575	18 577	20 648	19 370
Reconciliation of the movement in the fair value of plan assets:					
At the beginning of the year	**2 103**	2 528	5 499	5 507	5 133
Expected return on plan assets	**133**	234	509	578	526
Payments from plan assets	**(540)**	–	–	–	–
Non-qualifying plan assets as a result of discharge of liability	**–**	–	(2 377)	–	–
Remeasurement of defined benefit obligation	**(66)**	(659)	(1 103)	(586)	(152)
At the end of the year	**1 630**	2 103	2 528	5 499	5 507

The principal actuarial assumptions used were as follows:

Discount rate	**8,60%**	(2012: 7.25%) compounded annually
Investment return	**8,60%**	(2012: 8.25%) compounded annually
Rate of medical inflation	**8,30%**	(2012: 7.75%) compounded annually
Salary inflation	**7,80%**	(2012: 7.25%) compounded annually

The effect of a 1% increase/decrease on the assumed rate of medical inflation, would be an increase in the liability in an amount of R1.806 million (2012: R1.674 million) and a decrease of R1.524 million (2012: R1.394 million), respectively.

	Group 2013 R'000	Group 2012 R'000	Company 2013 R'000	Company 2012 R'000
20. OTHER ACCOUNTS PAYABLE				
Accruals	**23 685**	11 971	**–**	–
Product-related credits	**47 399**	39 503	**–**	–
Sundry creditors	**87 095**	53 030	**–**	–
Previous minority shareholders (share buy-back)	**3 834**	4 138	**3 834**	4 138
	162 013	108 642	**3 834**	4 138

21. CONTINGENT LIABILITIES AND COMMITMENTS

21.1 Guarantees, letters of credit and committed undrawn facilities

	Group 2013 R'000	Group 2012 R'000
Guarantees	**400 147**	300 496
Shipping	**117**	117
Lending related	**6 914**	8 219
Mortgage	**111 670**	81 526
Performance	**281 446**	210 634
Letters of credit	**16 024**	15 634
Committed undrawn facilities	**105 747**	66 314
	521 918	382 444

21.2 Commitments under operating leases

The total minimum future lease payments under operating leases are as follows:

	Group 2013 R'000	Group 2012 R'000
Property rentals		
Due within one year	**4 301**	4 144
Due between one and five years	**4 113**	5 538
	8 414	9 682
After-tax effect on operating leases	**6 058**	6 971

A register containing details of the existence and terms of renewal and escalation clauses, is available for inspection at the registered office of the Company.

	Group 2013 R'000	Group 2012 R'000	Company 2013 R'000	Company 2012 R'000
22. INTEREST INCOME				
Loans and receivables	**583 298**	524 172	**74**	168
Cash and cash equivalents	**64 579**	45 627	**74**	168
Negotiable securities	**19 520**	13 381	**–**	–
Loans and advances	**499 199**	465 164	**–**	–
Loans and receivables designated at fair value through profit and loss				–
Loans and advances	**2 724**	4 189	**–**	–
	586 022	528 361	**74**	168

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	Group 2013 R'000	Group 2012 R'000 (restated)
23. INTEREST EXPENSE		
Deposits	**193 984**	178 387
Long-term funding	**44 869**	27 725
Held-for-trading		
Interest rate swaps	**816**	1 304
Net interest on defined benefit obligation	**1 369**	1 232
Other	**4 431**	1 897
	245 469	210 545

	Group 2013 R'000	Group 2012 R'000	Company 2013 R'000	Company 2012 R'000
24. NON-INTEREST INCOME				
Fee and commission income	**263 778**	262 653	–	–
Loans and receivables	**263 597**	262 418	–	–
Insurance-related products	**181**	235	–	–
Trading income	**78 821**	71 214	–	–
Held-for-trading	**70 379**	71 225	–	–
Foreign currency	**69 401**	70 950	–	–
Derivative liabilities	**978**	275	–	–
Designated at fair value through profit and loss	**8 442**	(11)	–	–
Loans and advances	**(583)**	(11)	–	–
Other investments	**9 025**	–	–	–
Investment income	–	434	**29 672**	126 863
Dividends	–	434	**29 672**	126 863
	342 599	334 301	**29 672**	126 863

	Group 2013 R'000	Group 2012 R'000
25. FEE AND COMMISSION EXPENDITURE		
Foreign currency	**29 926**	27 114
Commissions and transactions	**106 641**	100 076
	136 567	127 190

	Group		Company	
	2013 R'000	2012 R'000 (restated)	**2013 R'000**	2012 R'000
26. OPERATING EXPENDITURE				
Amortisation (refer to note 2)	**26 759**	24 875	**–**	–
Auditors' remuneration				
Audit fees – Current year	**7 166**	6 260	**–**	–
Fees for other services – Tax advisory fees	**207**	180	**–**	–
– Regulatory reviews	**118**	–	**–**	–
– Accounting services	**382**	–	**–**	–
– Share buy-back advisory costs	**–**	180	**–**	180
– Less amounts written-off against share premium	**–**	(180)	**–**	(180)
– Other	**44**	20		–
	7 917	6 460	**–**	–
Depreciation (refer to note 3 – from continued operations)	**12 498**	13 005	**–**	–
Directors' remuneration (refer to note 29.3)				
Executive Directors	**16 350**	14 388	**–**	–
Non-Executive Directors' fees	**8 482**	4 429	**–**	–
	24 832	18 817	**–**	–
Indirect tax				
Non-claimable Value-Added Tax	**9 911**	9 271	**–**	–
Skills development levy	**1 688**	1 538	**–**	–
	11 599	10 809	**–**	–
Loss/(Profit) on sale of property and equipment	**100**	(20)	**–**	–
Marketing	**2 430**	2 396	**44**	387
Operating leases for premises and related costs	**12 917**	12 509	**–**	–
Other operating costs	**46 038**	53 088	**–**	205
Professional fees				
Consulting	**2 230**	2 535	**–**	–
Securitisation set-up costs	**2 486**	–	**–**	–
Legal and collection	**2 752**	1 480	**–**	–
Computer consulting and services	**36 278**	38 026	**–**	–
	43 746	42 041	**–**	–
Staff costs				
Salaries, allowances and incentives	**158 801**	150 650	**–**	–
Post-retirement medical benefits (refer to note 19)	**(1 030)**	(1 494)	**–**	–
Deferred bonus scheme expense including Directors	**5 113**	3 864	**–**	–
Other	**2 698**	4 219	**–**	–
	165 582	157 239	**–**	–
Total operating expenditure	**354 418**	341 219	**44**	592
Number of persons employed by the Group at year-end	**421**	433		

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

	Group		Company	
	2013 R'000	2012 R'000 (restated)	**2013 R'000**	2012 R'000
27. TAX				
South African normal tax	**51 267**	2 203	**–**	–
Current year	**51 267**	2 203	**–**	–
Prior year	**–**	–	**–**	–
Deferred tax	**1 412**	46 665	**–**	–
Current year	**1 009**	46 622	**–**	–
Prior year	**403**	43	**–**	–
	52 679	48 868	**–**	–
Direct tax				
South African normal tax	**51 267**	2 203	**–**	–
South African tax rate reconciliation				
South African standard tax rate (%)	**28,00**	28,00	**28,00**	28,00
Exempt income (%)	**–**	(0,04)	**(27,97)**	(28,03)
Expenses not deductible for tax purposes (%)	**0,75**	4,39	**0,00**	0,00
Additional allowances for tax purposes (%)	**(0,09)**	(0,06)	**0,00**	0,00
Capital gain inclusion on unrealised portion not taxable (%)	**(4,18)**	(4,37)	**0,00**	0,00
Capital gain not taxable on realised portion (%)	**(0,81)**	(3,98)	**0,00**	0,00
Under/(Over) provision prior years (%)	**0,21**	(0,02)	**0,00**	0,00
Tax losses (%)	**3,99**	0,97	**(0,03)**	0,03
Effective tax rate (%)	**27,87**	24,89	**0,00**	(0,00)
Estimated tax losses available for offset against future taxable income	**9 313**	9 128	**6 557**	6 587

28. NOTES TO STATEMENTS OF CASH FLOWS

	Group		Company	
	2013 R'000	2012 R'000	**2013 R'000**	2012 R'000
28.1 Cash receipts from customers				
Interest income	**586 022**	528 361	**74**	168
Non-interest income and gains on disposal of investments	**358 909**	375 688	**29 672**	127 140
Adjusted for: Dividends received	**–**	(434)	**(29 672)**	(126 863)
Net (gain) on disposal of available-for-sale investments	**(16 310)**	(14 832)	**–**	(277)
Revaluation of fair value financial instruments	**(887)**	(2 788)	**–**	–
Recoveries in respect of amounts previously written off	**1 553**	752	**–**	–
	929 287	886 747	**74**	168
28.2 Cash paid to customers, suppliers and employees		(restated)		
Interest expense	**(245 469)**	(210 545)	**–**	–
Operating expenditure and fee and commission expenditure	**(490 985)**	(468 409)	**(44)**	(592)
Adjusted for: Amortisation	**26 759**	24 875	**–**	–
Depreciation	**12 498**	13 005	**–**	–
Write-off of obsolete property and equipment	**617**	–	**–**	–
Loss/(Profit) on sale of property and equipment	**100**	(20)	**–**	–
Deferred bonus scheme expense	**5 113**	3 864	**–**	–
Remeasurement of defined benefit obligation	**–**	(3 685)	**–**	–
(Decrease)/Increase in provisions and other liabilities	**(1 651)**	21 802	**–**	–
	(693 018)	(619 113)	**(44)**	(592)

28. NOTES TO STATEMENTS OF CASH FLOWS (continued)

	Group 2013 R'000	Group 2012 R'000 (restated)	Company 2013 R'000	Company 2012 R'000
28.3 Reconciliation of profit before tax to cash generated from/(utilised in) continuing operations				
Profit before tax	**188 988**	195 910	**29 702**	126 716
Profit before tax adjusted for:				
Dividends received	**–**	(434)	**(29 672)**	(126 863)
Net (gain) on disposal of available-for-sale investments	**(16 310)**	(14 832)	**–**	(277)
Revaluation of fair value financial instruments	**(887)**	(2 788)	**–**	–
Net impairments raised	**21 042**	29 937	**–**	–
Amortisation	**26 759**	24 875	**–**	–
Depreciation	**12 498**	13 005	**–**	–
Write-off of obsolete property and equipment	**617**	–	**–**	–
Loss/(Profit) on sale of property and equipment	**100**	(20)	**–**	–
Deferred bonus scheme expense	**5 113**	3 864	**–**	–
Remeasurement of defined benefit obligation	**–**	(3 685)	**–**	–
(Decrease)/Increase in provisions and other liabilities	**(1 651)**	21 802	**–**	–
Cash generated from/(utilised in) continuing operations	**236 269**	267 634	**30**	(424)
28.4 Tax				
Amounts paid at the beginning of the year	**1 251**	(920)	**–**	–
Statement of comprehensive income (charge)	**(51 267)**	(2 203)	**–**	–
Less: Amounts (overpaid) at the end of the year	**(1 125)**	(1 251)	**–**	–
Total tax (paid)	**(51 141)**	(4 374)	**–**	–
28.5 Net movement in income-earning assets				
Increase in negotiable securities	**(240 045)**	(64 652)	**–**	–
Decrease/(Increase) in loans and advances	**42 370**	(789 993)	**–**	–
Net (increase) in income-earning assets	**(197 675)**	(854 645)	**–**	–
28.6 Net movement in deposits and other accounts				
Increase in deposits	**304 891**	485 215	**–**	–
Decrease of treasury shares held within the Group	**–**	7 195	**–**	–
Decrease in subsidiary loans	**–**	–	**44**	5 738
(Increase)/Decrease in other accounts receivable	**(14 387)**	4 913	**–**	7
Increase/(Decrease) in other accounts payable	**52 891**	(84 194)	**(304)**	4 105
Net increase/(decrease) in deposits and other accounts	**343 395**	413 129	**(260)**	9 850
28.7 Cash after tax from discontinued operations				
Net profit after tax from discontinued operations	**–**	8 759	**–**	–
Adjusted for: Amortisation	**–**	1 422	**–**	–
Depreciation	**–**	277	**–**	–
Tax	**–**	(398)	**–**	–
Cash generated after tax from discontinued operations	**–**	10 060	**–**	–

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

29. RELATED PARTY INFORMATION

29.1 Identity of related parties with whom transactions have occurred

The holding Company and material subsidiaries of the Group are identified on pages 30 and 31 in the Directors' report. All of these entities and the Directors are related parties. There are no other related parties with whom transactions have taken place, other than as listed below.

29.2 Related party balances and transactions

The Company, its subsidiaries and joint venture, in the ordinary course of business, enter into various financial services transactions with the ultimate holding company and its subsidiaries and other entities within the Group. Except for the interest-free loan between the Company and the Bank, and the interest-free shareholder loan from the Company to Multi Risk (subsidiary disposed of effective 29 June 2012), transactions are governed by commercial terms.

	2013 R'000	2012 R'000
Balances between the ultimate holding company (CGD) and the Bank:		
CGD – Lisbon (Branch of CGD)	**64 950**	(960)
Nostro accounts	**3 500**	400
Vostro accounts	**(934)**	(1 360)
Deposits	**(149)**	–
Foreign currency placements	**62 533**	–
CGD – Paris (Branch of CGD)		
Vostro accounts	**(28)**	(36)
CGD – London (Branch of CGD)		
Vostro accounts	**(12)**	(14)
Total CGD branches	**64 910**	(1 010)
Banco Comercial e de Investimentos – Mozambique (BCI) (Subsidiary of CGD)	**(100 662)**	(133 984)
Vostro accounts	**(405)**	(3 656)
Fixed deposits	**(100 256)**	(130 085)
Call and notice deposits	**(1)**	(243)
Total CGD	**(35 752)**	(134 994)
Transactions between the ultimate holding company (CGD) and the Bank:		
Interest paid by the Bank to BCI	**6 569**	8 708
Interest paid by the Bank to CGD	**2**	–
Interest received by the Bank from CGD	**7**	–

29. RELATED PARTY INFORMATION (CONTINUED)

29.2 Related party balances and transactions (continued)

		2013 R'000	2012 R'000
Balances with the Company, its subsidiaries and joint venture:			
Loan to:	**Loan from:**		
Mercantile Bank Limited	Mercantile Bank Holdings Limited	**460**	504
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown (Pty) Ltd	**4 608**	7 128
LSM (Troyeville) Properties (Pty) Ltd	Mercantile Bank Limited	**7 819**	7 618
Mercantile Insurance Brokers (Pty) Ltd	Mercantile Bank Limited	**94**	25
Custom Capital (Pty) Ltd	Mercantile Bank Limited	**391 718**	328 599
Mercantile E-Bureau (Pty) Ltd	Mercantile Bank Limited	**1 556**	1 367
Deposit with:	**Deposit by:**		
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Ltd	**2 262**	2 055
Mercantile Bank Limited	Mercantile Bank Holdings Limited	**4 292**	222
Mercantile Bank Limited	Mercantile E-Bureau (Pty) Ltd	**446**	27
Mercantile Bank Limited	The Mercantile Bank Foundation (NPC)	**65**	–
Transactions with the Company, its subsidiaries and joint venture:			
Interest received by:	**Interest paid by:**		
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown (Pty) Ltd	**–**	1 295
Portion 2 of Lot 8 Sandown (Pty) Ltd	Mercantile Bank Limited	**984**	363
Mercantile Bank Limited	LSM (Troyeville) Properties (Pty) Ltd	**810**	805
Mercantile Insurance Brokers (Pty) Ltd	Mercantile Bank Limited	**79**	78
Mercantile Bank Limited	Custom Capital (Pty) Ltd	**34 582**	18 108
Mercantile Bank Limited	Multi Risk Investment Holdings (Pty) Ltd	**–**	391
Non-interest income earned by:	**Operating expenditure paid by:**		
Portion 2 of Lot 8 Sandown (Pty) Ltd	Mercantile Bank Limited	**17 345**	16 648
LSM (Troyeville) Properties (Pty) Ltd	Mercantile Bank Limited	**1 188**	1 134
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Ltd	**1**	9
Mercantile Bank Limited	Custom Capital (Pty) Ltd	**281**	163
Mercantile Bank Limited	Multi Risk Investment Holdings (Pty) Ltd	**–**	31
Mercantile Bank Limited	Mercantile E-Bureau (Pty) Ltd	**29 553**	25 521
Donations received by:	**Donations paid by:**		
The Mercantile Bank Foundation (NPC)	Mercantile Bank Limited	**1 000**	–
Dividends earned by:	**Dividends paid by:**		
Mercantile Bank Holdings Limited	Mercantile Bank Limited	**29 672**	117 683
Mercantile Bank Holdings Limited	Multi Risk Investment Holdings (Pty) Ltd	**–**	9 180

Other

Post-retirement medical plan

Details of the post-retirement medical plan are disclosed in note 19.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

29. RELATED PARTY INFORMATION (CONTINUED)

29.3 Director and Director-related activities

There were no material transactions with Directors other than the following loans fees and salary related costs:

	Directors' fees R'000	Salary R'000	Fringe benefits R'000	Retirement funds and medical aid contri-butions R'000	Perfor-mance bonus R'000	Total R'000
Group						
2013						
Non-Executive Directors						
J A S de Andrade Campos	**1 712**	**–**	**–**	**–**	**–**	**1 712**
D J Brown (resigned 19 August 2013)	**3 782**	**–**	**–**	**–**	**–**	**3 782**
G P de Kock	**704**	**–**	**–**	**–**	**–**	**704**
L Hyne	**664**	**–**	**–**	**–**	**–**	**664**
A T Ikalafeng	**562**	**–**	**–**	**–**	**–**	**562**
T H Njikizana	**633**	**–**	**–**	**–**	**–**	**633**
D Naidoo (resigned 23 August 2013)	**425**	**–**	**–**	**–**	**–**	**425**
Executive Directors						
D J Brown (tenure as CEO ended 31 March 2013)	**–**	**892**	**–**	**272**	**6 400**	**7 564**
K R Kumbier	**–**	**2 900**	**–**	**294**	**2 500**	**5 694**
J P M Lopes	**–**	**2 010**	**496**	**86**	**500**	**3 092**
	8 482	**5 802**	**496**	**652**	**9 400**	**24 832**
2012						
Non-Executive Directors						–
J A S de Andrade Campos	1 625	–	–	–	–	1 625
G P de Kock	667	–	–	–	–	667
L Hyne	629	–	–	–	–	629
A T Ikalafeng	533	–	–	–	–	533
T H Njikizana	600	–	–	–	–	600
D Naidoo (appointed 23 May 2012)	375	–	–	–	–	375
Executive Directors						
D J Brown	–	3 186	–	341	3 570	7 097
K R Kumbier	–	2 464	–	260	1 950	4 674
J P M Lopes	–	1 977	463	77	100	2 617
	4 429	7 627	463	678	5 620	18 817

	2013 R'000	2012 R'000
Deferred bonus scheme expense relating to Executive Directors		
D J Brown (tenure as CEO ended 31 March 2013)	**806**	1 039
K R Kumbier	**1 220**	995
Loans to Executive Directors		
J P M Lopes	**165**	154
Amounts paid by CGD to Executive Directors		
J P M Lopes	**736**	544

29. RELATED PARTY INFORMATION (CONTINUED)

29.3 Director and Director-related activities (continued)

Service agreements and deferred bonus scheme awards

D J Brown, CEO

D J Brown's tenure as CEO of the Group ended on 31 March 2013 and he remained on the Board as a Non-Executive Director until 19 August 2013.

In consideration for the rendering of his services under the service agreement as CEO, Mr Brown received a bonus payment of R6.4 million. In terms of the change in the contractual conditions relating to Mr Brown's employment contract, the unvested deferred bonus scheme awards were settled for a consideration of R2.8 million in April 2013.

K R Kumbier, CEO

Mr Kumbier was employed by Mercantile as Executive Director: Finance and Business on 1 June 2010. He was subsequently appointed as Deputy CEO (effective 1 April 2012), and was appointed as CEO from 1 April 2013.

During 2013, of the 10 000 000 phantom awards granted in 2010 to K R Kumbier, 2 500 000 phantom awards were settled at a proxy price of 64.2 cents each. The balance of awards (7 500 000) were forfeited as performance conditions in terms of the plan were not achieved.

In terms of the deferred bonus scheme, phantom awards in the Company granted to K R Kumbier which have not yet vested as at 31 December 2013, are as follows:

- 5 000 000 at an estimated proxy price of 69 cents each (of which approximately 35% will vest in 2014);
- 3 500 000 at an estimated proxy price of 71 cents each (vesting in 2015); and
- 5 000 000 at an estimated proxy price of 80 cents each (vesting in 2016).

J P M Lopes, Executive Director

Mr Lopes has been seconded to Mercantile by CGD.

Mr Lopes' employment contract was extended by the Board in 2011 to July 2014. In terms of his service agreement, Mr Lopes has agreed to perform such duties, functions and services as are assigned to him from time to time by the Board of Directors and which are consistent and commensurate with his position as Executive Director.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

30. DISPOSAL OF A SUBSIDIARY

On 29 June 2012 the Company disposed of its 51% share in Multi Risk Investment Holdings (Pty) Ltd resulting in an effective return of 20% on its investment.

		2012 R'000
30.1	**Consideration received**	
	Consideration received in cash	45 900
	Dividends received pre disposal of investment	9 180
30.2	**Gain on disposal of a subsidiary**	
	Consideration received	55 080
	Net assets disposed of	(52 597)
	Gain on disposal	2 483
30.3	**Net profit after tax from discontinued operations**	
	Interest income	358
	Interest expense	–
	Net interest income	358
	Net non-interest income	39 876
	Net interest and non-interest income	40 234
	Operating expenditure	(30 529)
	Profit before tax	9 705
	Tax	(3 429)
	Net profit after tax	6 276
	Gain on disposal of a subsidiary	2 483
	Net profit after tax from discontinued operations	8 759
	Net profit after tax from discontinued operations attributable to:	
	Equity holders of the parent	4 593
	Non-controlling interests	4 166
		8 759
30.4	**Net cash inflow on disposal of a subsidiary**	
	Consideration received in cash	45 900
	Dividends received pre disposal of investment	9 180
	Less: Gain on disposal	(2 483)
		52 597

31. APPLICATION OF NEW AND REVISED IFRSs

31.1 New and revised IFRSs affecting amounts reported and/or disclosures in the financial statements

Amendments to IAS 1 Presentation of Financial Statements.

(as part of the Annual Improvements to IFRSs 2009 – 2011 Cycle issued in May 2012)

The Annual improvements to IFRSs 2009 – 2011 have made a number of amendments to IFRSs. The amendments that are relevant to the Group are the amendments to IAS 1 regarding when a statement of financial position as at the beginning of the preceding period (third statement of financial position is required when a) an entity applies an accounting policy retrospectively, or makes a retrospective restatement or reclassification of items in its financial statements, and b) the retrospective application, restatement or reclassification has a material effect on the information in the third statement of financial position. The amendments specify that the related notes are not required to accompany the third statement of financial position.

IAS19 *Employee Benefits* (as revised in 2011)

In the current year, the Group has applied one new revised IFRS (IAS19), Employee Benefits (as revised in 2011) and the related consequential amendments for the first time, which has had an effect on the information in the consolidated statement of financial position as at 1 January 2012. In accordance with the amendments to IAS1, the Group has presented a third statement of financial position as at 1 January 2012 without the related notes except for the disclosure requirements of IAS 8, Accounting policies, changes in Accounting Estimates and Errors, as detailed below.

IAS 19 (as revised in 2011) changes the accounting for defined benefit plans and termination benefits. The most significant accounting changes related to defined benefit obligations and plan assets. The amendments require all actuarial gains and losses to be recognised immediately through other comprehensive income in order for the net post retirement asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus.

Furthermore, the interest cost and expected return on plan assets used in the previous version of IAS19 are replaced with a "net interest" amount under IAS19 (as revised in 2011), which is calculated by applying the discount rate to the net defined benefit liability or asset. These changes have had no impact on the amounts recognised in profit or loss and other comprehensive income in prior years, except that they are no longer accounted for under staff costs, but rather under other interest expenses.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2013 (continued)

31. APPLICATION OF NEW AND REVISED IFRSs (CONTINUED)

31.1 New and revised IFRSs affecting amounts reported and/or disclosures in the financial statements (continued)

Specific transitional provisions are applicable to first-time application of IAS19 (as revised in 2011). The Group has applied the relevant transitional provisions and restated the comparative amounts on a retrospective basis, as set out below:

	Group 2013 R'000	Group 2012 R'000
31.2 Impact on total comprehensive income for the year of application of IAS19 (as revised in 2011)		
Impact on profit for the year:		
(Increase)/Decrease in staff costs expenses – related to actuarial (gains)/losses	**(1 541)**	3 685
Decrease in staff costs expenses – related to reallocation as other interest expense	**(1 369)**	(1 232)
Increase in other interest expense	**1 369**	1 232
Decrease/(Increase) in tax expenses	**431**	(1 032)
Net (decrease)/increase in profit for the year	**(1 110)**	2 653
Impact on other comprehensive income for the year:		
Increase/(Decrease) in remeasurement of defined benefit obligation – related to actuarial (gains)/losses	**1 541**	(3 685)
(Decrease)/Increase in tax relating to other comprehensive income	**(431)**	1 032
Net increase(decrease) in other comprehensive income for the year	**1 110**	(2 653)
Change in total comprehensive income for the year	**–**	–
(Decrease)/Increase in profit for the year attributable to:	**(1 110)**	2 653
Equity holders of the parent:	**(1 110)**	2 653
Non-controlling interests:	**–**	–
Increase/(Decrease) in total comprehensive income for the year attributable to:	**1 110**	(2 653)
Equity holders of the parent:	**1 110**	(2 653)
Non-controlling interests:	**–**	–

31.3 Impact on assets, liabilities and equity as at 1 January 2012 of the application of IAS19 (as revised in 2011)

	As at 1 January previously reported R'000	IAS19 adjustments R'000	As at 1 January (restated) R'000
Employee benefits reserve	–	**(4 643)**	**(4 643)**
Retained earnings	**380 836**	**4 643**	**385 479**
Total effect on equity	**380 836**	**–**	**380 836**

The accumulated actuarial loss adjustment as at 1 January 2012, related to the net defined benefit liability, was R6.448 million that was no longer recognised as profit or loss, but rather through other comprehensive income as an "employee benefits reserve". After the recognition of deferred tax on the employee benefits reserve of R1.806 million, the net opening balance adjustment amounted to R4.643 million.

RISK MANAGEMENT AND CONTROL

GROUP RISK MANAGEMENT PHILOSOPHY

The Group recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks that have become all too evident during the extended global financial crisis. Risk management is a key focus of the Group, and addresses a wide spectrum of risks that are continually evaluated, and policies and procedures reviewed and stress-tested to adapt to changing circumstances. In any economy, there are sectors that are more vulnerable to cyclical downturns than others. Changing economic variables are monitored to assist in managing exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a balanced portfolio. However, the Group acknowledges the potential of concentration risk in being a niche bank – this is carefully monitored and, where appropriate, corrective action is taken. Our business development efforts are focused on the stronger companies and individuals within established policy criteria, which policy serves to eliminate weaker credit from the portfolio. The Group remains well positioned to effectively manage identified threats in a way that minimises risks to the Group. Continuous risk management and control reviews are undertaken by senior staff members to identify material control weaknesses and action is taken as required to address any areas of weakness.

A philosophy of enterprise-wide risk management within a Risk Management Monitoring and Control Framework has been implemented to ensure that all business and operational risks are managed effectively within acceptable risk profiles, policies and parameters. Risk management policies are essentially conservative, with proper regard to the mix of risk and reward. Existing policies, methodologies, processes, systems and infrastructure are frequently evaluated for relevance, to ensure that they remain at the forefront of risk management, and in line with regulatory developments and emerging best practices. The Group takes all necessary steps to safeguard its depositors' funds, its own asset base, and shareholder's funds.

A number of risk initiatives were implemented and others further entrenched during the year. These included:

- further enhancements to the Asset Liability Management monitoring and reporting process;
- enhancements to the Risk Tolerance Framework approved by the Board;
- additions to the prudential management schedule, wherein all risk-related ratios are monitored and reported to the ALCO and Board on a monthly basis;
- enhancements to the Card and Treasury Back Office risk control self-assessment templates;
- streamlining of risk management methodologies and techniques in subsidiary companies together with rewrites of processes and procedures in use;
- expansion of stress testing;
- review and enhancement to the application of the Principles for the Sound Management of Operational Risk;
- expanded utilisation of an online training application to ensure that staff stay abreast with regulatory and other changes;
- re-engineering and review of Treasury back office processes to ensure effective mitigation of identified risks
- Bank-wide review of the Enterprise-Wide Risk Management Framework to factor in changes in risk profiles; and
- review of the Funding Policy and Contingent Funding plan.

ENTERPRISE-WIDE RISK MANAGEMENT

An Enterprise-wide Risk Management Framework is adopted to ensure appropriate and focused management of all risks. Risk assessment is a dynamic process and is reviewed regularly in line with changing circumstances. Risk dimensions vary in importance, depending upon the business activities of an organisation and the related risks. The overall objective of enterprise-wide risk management is to ensure an integrated and effective risk management framework where all risks are identified, quantified and managed, in order to achieve an optimal risk reward profile. The presence of accurate measures of risk makes risk-adjusted performance measurement possible, creates the potential to generate increased shareholder returns, and allows risk-taking behaviour to be more closely aligned with strategic objectives.

Risk management is performed on a Group-wide basis, involving the Board and its various committees, credit management, senior management, risk management, business line management, finance and control, legal/compliance, treasury, and operations, with support from information technology. Independent oversight and validation by internal audit functions ensure a high standard of assurance across methodology, operational and process components of the Group's risk and capital management processes.

RISK MANAGEMENT LIFECYCLE/ PROCESS

All of the Group's policies and procedures manuals are subject to ongoing review and are signed off by the relevant business unit heads. These standards are an integral part of the Group's governance structure and risk management profile, reflecting the expectations and requirements of the Board in respect of key areas of control. The standards and effective maintenance of the risk control self-assessment process ensures alignment and consistency in the way that prevalent risk types are identified and managed, and form part of the various phases of the risk management lifecycle, defined as:

RISK MANAGEMENT AND CONTROL
(continued)

RISK IDENTIFICATION (AND COMPREHENSION)

Risk identification focuses on recognising and understanding existing risks, or risks that may arise from positions taken, and future business activity as a continuing practice.

RISK MEASUREMENT (AND EVALUATION USING A RANGE OF ANALYTICAL TOOLS)

Once risks have been identified, they need to be measured. Certain risks will lend themselves more easily to determination and measurability than others, but it is necessary to ascertain the magnitude of each risk to the extent it is quantifiable, whether direct or indirect.

To consider risk appetite and the alignment against broader financial targets, the Group mainly considers the level of earnings, growth and volatility that it is willing to accept from certain risks that are core to its business. Economic and regulatory capital required for such transactions is also considered, together with the resultant return on the required capital. The Group also maintains a capital buffer for unforeseen events and business expansion.

RISK MANAGEMENT (AS AN INDEPENDENT FUNCTION)

The Group's principal business focuses on the management of liabilities and assets in the statement of financial position. Major risks are managed and reviewed by an independent risk function. The ALCO, RMC and CREDCOM meet on a regular basis to collaborate on risk control, process review, establish how much risk is acceptable, and to decide how the Group will stay within targets laid down in risk tolerance thresholds.

RISK MONITORING (AND COMPLIANCE WITH DOCUMENTED POLICIES)

Open, two-way communication between the Group and the SARB is fundamental to the entire risk monitoring and supervisory process. To achieve this, responsible line heads are required to document conclusions and communicate findings to the ALCO, RMC and CREDCOM, and to the SARB (through Banks Act returns and periodic meetings).

RISK CONTROL (STRESS AND BACK-TESTING)

The Group follows a policy of ongoing stress-testing. Critical variables are sensitive to market changes, both domestic and international. These are identified and modelled to determine the possible impact of any deterioration of such identified variables on the Group's results. Both internal and external events are considered in formulating appropriate modelling criteria. A policy of back-testing for identified key variables has been approved by the Board and deployed within the Group.

MANAGEMENT OF RISK

Principal risk categories have been identified, defined and categorised into direct and indirect risks. This set of risk definitions forms the basis of management and control relative to each unit within the Group, and also forms a consistent common language for outside examiners and/or regulators to follow.

Direct risks are found in most banking transactions. They are quantifiable and can be clearly defined. These risks are evaluated through examination of our databases, statistics and other records.

Indirect risks are considered to ensure that a complete risk assessment is carried out. They are present in almost every decision made by management and the Board and, thus, impact on the Group's reputation and success. These decisions are usually intended to enhance the Group's long-term viability or success and are therefore difficult to quantify at a given point in time.

Board committees monitor various aspects of the identified risks within the Enterprise-wide Risk Management Framework, which include:

Direct Risks	Indirect Risks
Credit Risk	Strategic Risk
Counterparty Risk	Reputation Risk
Currency Risk	Legal Risk
Liquidity Risk	Fraud Risk
Interest Rate Risk	International Risk
Market (Position) Risk	Political Risk
Solvency Risk	Competitive Risk
Operational Risk	Pricing Risk
Technology Risk	Compliance Risk

The responsibility for understanding the risks incurred by the Group, and ensuring that they are appropriately managed, lies with the Board. The Board approves risk management strategies and delegates the power to take decisions on risks, and to implement strategies on risk management and control, to the RMC. Discretionary limits and authorities are, in turn, delegated to line heads and line managers within laid-down parameters, to enable them to execute the Group's strategic objectives within predefined risk management policies and tolerance levels. Major risks are managed, controlled and reviewed by an independent risk function.

The Board fully recognises that it is accountable for the process of risk management and the system of internal control. Management reports regularly to the Board on the effectiveness of internal control systems and on any significant control weaknesses identified.

A process is in place whereby the Top 10 risks faced by the Group are identified. These risks are assessed and evaluated in terms of a risk score attached to inherent risk and residual risk.

Action plans are put in place to reduce the identified inherent risks to within acceptable residual risk parameters. The Top 10 risks are re-evaluated quarterly and any changes are approved by the RMC. Business and Operating units are integrally involved in the process in both risk identification and evaluation.

The Group subscribes to the Principles for the Sound Management of Operational Risk as defined by the Basel Committee on Banking Supervision.

Business Continuity Management continues to be an area of focus. Business Continuity Management ensures the availability of key staff and processes required to support essential activities in the event of an interruption to or disruption of business. Business Continuity Management is an important aspect of risk management, and its value has been proven in creating a more resilient operational platform through activities such as business impact assessments, business continuity planning and implementation, testing of business continuity, and implementing corrective actions. Comprehensive simulations are conducted on an ongoing basis, with identified gaps addressed and/or plans put in place to resolve the identified issues.

The Capital Management Committee, under the auspices of the RMC, proactively evaluates and manages the capital requirements of the Group as determined by Basel requirements. A comprehensive re-evaluation of the capital requirements under the Internal Capital Adequacy Assessment Process is regularly undertaken with consideration being given to all risks impacting on the need for capital reserves within the Group. The outcome of these assessments resulted in the Group identifying different levels of risk related to specific characteristics of the business where it was deemed prudent to hold a capital buffer in addition to the regulatory capital requirements. Such buffer requirements are re-evaluated half-yearly and adjusted where appropriate.

The Group employs a size-appropriate approach to stress testing that is a component of business planning. Stress testing measures potential volatility of earnings under various scenarios.

Under the Enterprise-wide Risk Management Framework, the direct risks of the Group have been categorised and those deemed to be of the most significance are reported on below:

CREDIT RISK

Credit parameters and tolerance levels are clearly defined and reflected in governing procedures and policies. The Group offers a spread of banking products common to the banking industry, with a specific focus on small- and medium-sized businesses, across a wide variety of industries. While personal market products are also offered, no specific targeting of the broader personal retail-based market is undertaken. The primary risks encountered are associated with the lending of money and the issuing of contingent financial or performance guarantees to third parties on behalf of customers.

Dependent upon the risk profile of the customer, the risk inherent in the product offering and the track record/payment history of the client, varying types and levels of security are taken to mitigate credit-related risks. Clean or unsecured lending will only be considered for financially strong borrowers.

Counterparties to derivatives expose the Group to credit-related losses in the event of non-performance. The counterparties to these contracts are financial institutions. The Group continually monitors its positions and the credit ratings of its counterparties, and limits the value of contracts it enters into with any one party to within pre-approved transactional limits.

At year-end, the Group did not have any significant concentration of risk that had not been adequately provided for. There were no material exposures in advances made to foreign entities at year-end.

A portfolio analysis report is prepared and presented to the RMC analysing the performance and make-up of the book, including customer, geographic and segment concentration.

The Group has adopted a conservative approach to credit granting, within a specifically defined and structured approval process. The granting of credit is managed via a mandated approval process, whereby levels of credit approval are determined by the experience of the mandated individual, with dual or multiple sign-off on all material values. An ongoing weekly review is also undertaken by the CREDCOM of all new and renewal proposals for lending in excess of R2 million (in aggregate). In addition, an early warning system is applied to actively manage all accounts within the risk structure. The system identifies a number of characteristics relating to the performance of the accounts and, based on various predefined algorithms, flags issues of concern. Monitoring is done by the Portfolio Management Department, and any concerns are raised with the Credit Department and Business or Commercial banking units.

There have been no material changes in the credit approval structure or overall make-up of the book from the prior reporting period.

A philosophy of enterprise-wide risk management within a Risk Management Monitoring and Control Framework has been implemented to ensure that all business and operational risks are managed effectively within acceptable risk profiles, policies and parameters. Risk management policies are conservative, with proper regard to the mix of risk and reward. The Group takes all necessary steps to safeguard its depositors' funds, its own asset base, and shareholder funds.

RISK MANAGEMENT AND CONTROL
(continued)

The table below summarises the Group's maximum exposure to credit risk at reporting date:

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2013				
Current accounts	**1 241 606**	**–**	**–**	**1 241 606**
Credit cards	**19 521**	**13 019**	**–**	**32 540**
Mortgage loans	**2 166 818**	**92 728**	**–**	**2 259 546**
Instalment sales and leases	**710 519**	**–**	**–**	**710 519**
Structured loans	**27 535**	**–**	**–**	**27 535**
Medium-term loans	**1 102 689**	**–**	**–**	**1 102 689**
Negotiable securities	**–**	**–**	**496 608**	**496 608**
Cash and cash equivalents	**–**	**–**	**1 490 690**	**1 490 690**
Guarantees	**–**	**–**	**400 147**	**400 147**
Letters of credit	**–**	**–**	**16 024**	**16 024**
	5 268 688	**105 747**	**2 403 469**	**7 777 904**
2012				
Current accounts	1 109 362	–	–	1 109 362
Credit cards	22 227	13 702	–	35 929
Mortgage loans	2 435 482	52 612	–	2 488 094
Instalment sales and leases	639 819	–	–	639 819
Structured loans	44 579	–	–	44 579
Medium-term loans	1 115 512	–	–	1 115 512
Negotiable securities	–	–	257 514	257 514
Cash and cash equivalents	–	–	1 223 016	1 223 016
Guarantees	–	–	300 496	300 496
Letters of credit	–	–	15 634	15 634
	5 366 981	66 314	1 796 660	7 229 955

OPERATIONAL RISK

Operational risks faced by the Group are extensive and include robbery, fraud, theft of data, unauthorised systems access, legal challenges, statutory and legislative non-compliance, ineffective operational processes, and business continuity. Operational risk can also cause reputational damage and, therefore, efforts to identify, manage and mitigate operational risk are equally sensitive to reputational risk, as well as the risk of financial loss.

Operational risk management's aim is to enhance the level of risk maturity across the Group, by implementing and embedding process-based risk and control identification and assessments, and integrating the operational risk management process in all business units to ensure adequate risk management in an ever-changing business and financial industry. The Operational Risk Committee meets at least quarterly and has representation from all business units.

Strategies, procedures and action plans to monitor, manage and limit the risks associated with operational processes, systems and external events, include:

- documented operational policies, processes and procedures with segregation of duties;
- ongoing training and up-skilling of staff on operational procedures and legislative compliance;
- an internal operational loss database, wherein all losses associated with operational issues, including theft and robbery, are recorded and evaluated to facilitate corrective action;
- ongoing improvements to the Disaster Recovery and Business Continuity plans, including conducting a variety of simulation exercises in critical operations environments;
- conducting monitoring and reviews by both the Compliance and Internal Audit functions, in line with annual plans approved by the Board;
- comprehensive data security and protection;
- ongoing review of the Group-wide risk control self-assessment process, rolled out to job functional level in high-risk operational processing areas;
- ongoing review of key risk indicators, as a tool to further assist with risk identification and assessment;
- limiting access to systems and enforcing strong password controls; and
- a comprehensive insurance programme to safeguard the Group's financial and non-financial assets.

Disaster recovery and business continuity management facilities were outsourced to specialist service providers during the year.

The Group further benchmarks itself and stays abreast with developments regarding operational risk by actively participating as a member of the Banking Association of South Africa's operational risk forum and task group as well as being a member of the industry working group on accounting impact events.

The Group subscribes to the Principles for the Sound Management of Operational Risk. Compliance with the principles has been reviewed, and action plans put in place to ensure compliance with the principles.

TECHNOLOGY RISK

Technology risk management forms a key component of the Enterprise-wide Risk Management Framework, and is effectively managed under the auspices of the IT Steering Committee, a Board-appointed committee. The compliance and governance aspects are independently managed within the risk environment and are reported on independently to the Technology Committee.

The Group successfully implemented a new treasury system (BaNCS Treasury) during March 2013. This system interfaces with the core banking system (BaNCS).

The Group replaced its IT services partners during the year under review and also outsourced the disaster recovery and business continuity facilities to specialist service providers.

A number of IT-related initiatives were implemented, and others further entrenched during the year. These included:

- enhancement of IT governance and information security frameworks;
- new DR documentation standard;
- comprehensive revamp of a portion of the head office infrastructure;
- ODS enhancement project in progress;
- relocation of the Group's disaster-recovery capabilities to a specialist environment;
- new treasury system;
- evaluation and review of PCI-DSS compliance on card applications;
- replacement of desktop computers;
- upgrade of Prime (credit card system) software in progress; and
- new service partners.

MARKET RISK

Market risk is the risk of revaluation of any financial instrument as a consequence of changes in market prices or rates, and can be quantified as the potential change in the value of the banking book, as a result of changes in the financial environment between now and a future point in time. The Board determines market risk limits. These limits are reviewed at least annually, depending on market events.

The Group does not currently take proprietary trading positions and therefore has minimal exposure to market risk. Should the Group consider entering into a proprietary trading position, the Trading Committee and RMC will have to evaluate and approve entering into such positions. The Trading Committee will ensure that the Group is prudently positioned, taking into account agreed limits, policies, prevailing markets, available liquidity, and the relationship between risk and reward, primarily to the financial risks of changes in foreign currency exchange rates and interest rates.

The Group enters into derivative financial instruments to manage its exposure to interest rate and foreign currency risk, including:

- forward exchange contracts;
- interest rate and foreign currency swaps; and
- fully hedged currency options.

Market risk reports are produced on a daily basis, which allows for monitoring against prescribed prudential and regulatory limits. In the unlikely event of an unauthorised limit violation, the ALM forum records such violation, and it is immediately corrected and reported to the ALCO, which is a management committee accountable to the RMC.

The Group does not perform a detailed sensitivity analysis on the potential impact of a change in exchange rates on a daily basis, due to the fact that the Group does not currently have any proprietary trading positions. The impact of changes in open foreign currency client positions is modelled to take cognisance of credit risks associated with volatility in foreign currency exchange rates, with the purpose of covering adverse positions through calling for initial and variation margins. A detailed sensitivity analysis is performed for liquidity and interest rate risk (described on pages 80 to 84).

There has been no significant change to the Group's exposure to market risks, or the manner in which it manages and measures the risk. Additional controls were put in place to monitor foreign exchange exposures on a real-time basis subsequent to the implementation of BaNCS Treasury. Various conservative prudential risk limits are in place. Exposures under prudential risk limits and various sensitivities relating thereto are reported to the ALCO, RMC and Board on a regular basis.

FOREIGN CURRENCY RISK

The Group, in terms of approved limits, manages short-term foreign currency exposures relating to trade imports, exports and interest flows on foreign liabilities.

The Group has conservative limits in terms of net open foreign currency positions that are well below the limits allowed by the SARB. For the year under review, the highest net open position recorded for any single day, was R53.6 million (2012: R7.5 million). An adverse movement in the exchange rate of 10% would reduce the Group's income by R5.4 million (2012: R0.6 million).

RISK MANAGEMENT AND CONTROL
(continued)

The transaction exposures and foreign exchange contracts at the reporting date are summarised as follows:

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2013					
Total foreign exchange assets	**199 414**	**568**	**4 608**	**3 849**	**208 439**
Total foreign exchange liabilities	**(79 672)**	**(8 542)**	**(1 428)**	**–**	**(89 642)**
Commitments to purchase foreign currency	**87 414**	**70 641**	**5 208**	**2 752**	**166 015**
Commitments to sell foreign currency	**(207 672)**	**(62 630)**	**(6 877)**	**(4 256)**	**(281 435)**
Year-end effective net open foreign currency positions	**(516)**	**37**	**1 511**	**2 345**	**3 377**
2012					
Total foreign exchange assets	86 031	23 781	3 724	7 164	120 700
Total foreign exchange liabilities	(87 604)	(16 970)	(1 773)	(96)	(106 443)
Commitments to purchase foreign currency	143 367	42 352	17 271	4 480	207 470
Commitments to sell foreign currency	(141 499)	(50 117)	(18 861)	(7 079)	(217 556)
Year-end effective net open foreign currency positions	295	(954)	361	4 469	4 171

INTEREST RATE RISK

Interest rate risk is the impact on net interest earnings and the sensitivity to economic value, as a result of increases or decreases in interest rates arising from the execution of the core business strategies and the delivery of products and services to customers. Interest margins may increase as a result of such changes, but may reduce or create losses in the event that unexpected adverse movements arise. The ALM forum monitors interest rate re-pricing on a daily basis, and reports back to the ALCO, RMC and the Board.

The Group is exposed to interest rate risk as it takes deposits from clients at both fixed- and floating interest rates. The Group manages the risk by maintaining an appropriate mix between fixed- and floating rate funds, as well as by using interest rate swap contracts, and matching the maturities of deposits and assets, as appropriate.

The objective in management of interest rate risk is to ensure a higher degree of interest rate margin stability and lower interest rate risk over an interest rate cycle. This is achieved by hedging material exposures and by not allowing any proprietary interest rate positions. Under interest rate swap contracts, the Group agrees to exchange the difference between fixed- and floating interest rate amounts, calculated on agreed notional principal amounts. Such contracts enable the Group to mitigate the risk of changing interest rates on the fair value of issued fixed rate debt, and the cash flow exposures on the issued variable rate debt. The floating rate on the interest rate swaps is based on the three-month JIBAR and/or prime rate. The Group will settle the difference between the fixed- and floating interest rate, on a net basis.

Sources of interest rate risk include volatility and changes in interest rate levels, yield curves and spreads. These affect the interest rate margin realised between lending income and borrowing costs, when applied to rate-sensitive assets and liabilities. The Group is also exposed to basis risk, which is the difference in re-pricing characteristics of two floating-rate indices, such as the South African prime rate and three-month JIBAR.

To measure interest rate risk, the Group aggregates interest rate-sensitive assets and liabilities into fixed-time bands, in accordance with the respective interest re-pricing dates. The Group uses both dynamic maturity gap and duration analysis, which measures the mismatch level between the average time over which the cash inflows are generated and cash outflows are required. Various reports are prepared taking alternative strategies and interest rate forecasts into consideration. These reports are presented to the ALCO and RMC on a regular basis.

To monitor the effect of the gaps on net interest income, a regular forecast of interest rate-sensitive asset and liability scenarios is produced. It includes relevant banking activity performance and trends, different forecasts of market rates, and expectations reflected in the yield curve.

The yield on assets remained under pressure during 2013, as a result of the low interest rate environment in South Africa. South Africa was also not immune to the global credit and liquidity crisis or market uncertainty in respect of the longer-term interest rate trends. Net interest income was adversely impacted by the negative endowment effect due to the current high levels of excess capital of the Group and the high level of non-interest-bearing customer deposits. Pressure on margins is likely to continue during 2014.

For regulatory purposes, the assessment and measurement of interest rate risk is based on the accumulated impact of interest rate-sensitive instruments, resulting from a parallel movement of plus or minus 200 basis points in the yield curve.

The impact on equity and profit and loss resulting from a change in interest rates is calculated monthly based on management's forecast of the most likely change in interest rates. In addition to the above, the impact of a static bank-specific favourable and unfavourable interest rate movement of 50 and 200 basis points respectively, is calculated and monitored by the ALM forum. Various approved prudential limits are in place and monitored by the ALM forum. The results are reported to the ALCO and Board regularly.

At the reporting date, a 50 basis point change in prevailing interest rates was applied as a sensitivity analysis, to determine the impact on earnings as a result of a change in interest rates. If interest rates increased/decreased by 50 basis points, and all other variables remained constant, the Group's net profit and equity at year-end would increase by R8.4 million, or decrease by R11.9 million (2012: increase/decrease by R8.9 million/R5.1 million). This is mainly attributable to the Group's exposure to interest rates on its surplus capital and lending and borrowings in the banking book.

The table below summarises the Group's exposure to interest rate risk. Assets and liabilities are included at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates, and also indicate their effective interest rates at year-end. The re-pricing profile indicates that the Group remains asset-sensitive as interest-earning assets re-price sooner than interest-paying liabilities, before and after derivative hedging activities. Thus, future net interest income remains vulnerable to a decrease in market interest rates.

	Up to 1 month R'000	1 – 3 months R'000	4 – 12 months R'000	1 – 5 years R'000	Non-interest sensitive R'000	Total R'000	Effective interest rate %
2013							
Assets							
Intangible assets	–	–	–	–	196 468	196 468	–
Property and equipment	–	–	–	–	188 141	188 141	–
Tax	–	–	–	–	1 125	1 125	–
Other accounts receivable	–	–	–	–	96 908	96 908	–
Other investments	–	–	–	–	5 799	5 799	–
Deferred tax assets	–	–	–	–	6 068	6 068	–
Non-current assets held for sale	–	–	–	–	13 470	13 470	–
Loans and advances	5 269 318	–	–	22 082	(63 459)	5 227 941	9.24
Derivative financial instruments	–	–	–	–	10 630	10 630	–
Negotiable securities	36 940	106 820	335 512	17 336	–	496 608	5.52
Cash and cash equivalents	1 087 235	62 533	–	–	340 922	1 490 690	4.61
Total assets	**6 393 493**	**169 353**	**335 512**	**39 418**	**796 072**	**7 733 848**	
Equity and liabilities							
Total equity	–	–	–	–	1 792 260	1 792 260	–
Deferred tax liabilities	–	–	–	–	71 561	71 561	–
Long–term funding	90 000	495 103	–	–	(1 930)	583 173	7.71
Deposits	3 122 323	477 580	512 813	55 522	873 411	5 041 649	3.95
Derivative financial instruments	–	–	–	–	11 459	11 459	–
Provisions and other liabilities	–	–	–	–	71 733	71 733	–
Other accounts payable	–	–	–	–	162 013	162 013	–
Total equity and liabilities	**3 212 323**	**972 683**	**512 813**	**55 522**	**2 980 507**	**7 733 848**	
Financial position interest sensitivity gap	**3 181 170**	**(803 330)**	**(177 301)**	**(16 104)**		**2 184 435**	
Derivative financial instruments	**(232)**	**21 505**	**–**	**(21 273)**		**–**	
Total net interest sensitivity gap	**3 180 938**	**(781 825)**	**(177 301)**	**(37 377)**		**2 184 435**	

RISK MANAGEMENT AND CONTROL
(continued)

	Up to 1 month R'000	1 – 3 months R'000	4 – 12 months R'000	1 – 5 years R'000	Non-interest sensitive R'000	Total R'000	Effective interest rate %
2012							
Assets							
Intangible assets	–	–	–	–	197 833	197 833	–
Property and equipment	–	–	–	–	144 267	144 267	–
Tax	–	–	–	–	1 251	1 251	–
Other accounts receivable	–	–	–	–	82 521	82 521	–
Other investments	–	–	–	–	19 883	19 883	–
Deferred tax assets	–	–	–	–	2 368	2 368	–
Non-current assets held for sale	–	–	–	–	13 453	13 453	–
Loans and advances	5 356 689	–	–	30 794	(95 735)	5 291 748	9.37
Derivative financial instruments	–	–	–	–	6 495	6 495	–
Negotiable securities	2 330	36 076	200 468	18 640	–	257 514	5.77
Cash and cash equivalents	1 026 221	–	–	–	196 795	1 223 016	4.24
Total assets	6 385 240	36 076	200 468	49 434	569 131	7 240 349	
Equity and liabilities							
Total equity	–	–	–	–	1 673 904	1 673 904	–
Deferred tax liabilities	–	–	–	–	60 016	60 016	–
Long–term funding	584 983	–	–	–	(3 107)	581 876	7.80
Deposits	3 037 165	370 941	465 216	26 674	836 762	4 736 758	4.01
Derivative financial instruments	–	–	–	–	7 160	7 160	–
Provisions and other liabilities	–	–	–	–	71 993	71 993	–
Other accounts payable	–	–	–	–	108 642	–	
Total equity and liabilities	3 622 148	370 941	465 216	26 674	2 755 370	7 240 349	
Financial position interest sensitivity gap	2 763 092	(334 865)	(264 748)	22 760		2 186 239	
Derivative financial instruments	2 271	27 814	–	(30 085)		–	
Total net interest sensitivity gap	2 765 363	(307 051)	(264 748)	(7 325)		2 186 239	

LIQUIDITY RISK

Liquidity risk is the risk of being unable to meet current and future cash flow and collateral requirements when they become due, without negatively affecting the normal course of business. The Group is exposed to daily cash needs from overnight deposits, current accounts, maturing deposits, loan drawdowns and guarantees.

To measure liquidity risk, the Group aggregates assets and liabilities into fixed time-bands in accordance with the respective maturity dates, which measure the mismatch level between the average time over which the cash inflows are generated and cash outflows are required.

The ALM forum monitors liquidity risk on a daily basis, and reports back to the ALCO and RMC. Ultimate responsibility for liquidity risk management rests with the Board. An appropriate liquidity risk management framework has been developed for the management of the Group's short-, medium- and long-term funding and liquidity requirements.

Through active liquidity management, the Group seeks to preserve stable, reliable and cost-effective sources of funding. To accomplish this, management uses a variety of liquidity risk measures that consider market conditions, prevailing interest rates, liquidity needs, and the desired maturity profile of liabilities.

To manage this risk, the Group performs, among others, the following:

- the maintenance of a stock of readily available, high-quality liquid assets in excess of the statutory requirements, as well as a strong statement of financial position liquidity ratios;
- an assumptions-based sensitivity analysis to assess potential cash flows at risk;
- the management of concentration risk (i.e. undue reliance on any single counterparty or counterparty group, sector, market, product, instrument, currency and tenor;
- the maintenance of sources of funding for contingency funding needs;

- the monitoring of daily cash flow movements/cash flow requirements, including daily settlements and collateral management processes;
- targeting a diversified funding base to avoid undue concentrations by investor, market source and maturity;
- the creation and monitoring of prudential liquidity risk limits; and
- the maintenance of an appropriate term mix of funding.

Overall, the Group's key liquidity risk metrics, which have been formulated to achieve a prudent liquidity profile, were maintained at acceptable levels. Through increased stress-testing, scenario analysis and contingency planning, the Group continues to actively manage its stress funding sources and liquidity buffers, to ensure that it exceeds the estimated stress funding requirements that could emanate from moderate- to high-stressed liquidity events. The Group subscribe to BIS's Principles for Sound Liquidity Risk Management and Supervision. Overall, the Group's liquidity position remains strong.

Macro-economic conditions continued to hinder growth in advances and specifically in deposits as the banking sector in South Africa is characterised by certain structural features, such as a low discretionary savings rate, and a higher degree of contractual savings that are captured by institutions such as pension funds, provident funds and providers of asset management services. The Group will continue to focus on gathering retail customer and longer-term deposits to reshape the structure of the balance sheet, and to ensure compliance with the Basel III liquidity requirements, which will be effective in 2015.

The two key liquidity ratios that were introduced by Basel III are the Liquidity Coverage Ratio ("LCR"), which is designed to promote short-term resilience of the one-month liquidity profile by ensuring that banks have sufficient high-quality liquid assets to meet potential outflows in a stressed environment; and the Net Stable Funding Ratio ("NSFR"), which is designed to measure the stability of long-term structural funding.

Both the LCR and the NSFR are subject to a monitoring period, which commenced in January 2013, with full implementation and compliance of the LCR and NSFR in 2015 and 2018 respectively. The Group also monitors other Basel III-related ratios, such as the Leverage Ratio, which is a measure of qualifying capital to both on- and off-balance-sheet exposures. The Group currently meets all the requirements of the new regulations.

There were no significant changes in the Group's liquidity position during the current financial year, or in the manner in which it manages and measures the risk. The Group is adequately funded and able to meet all of its current and future obligations. During 2011, the Bank entered into a R491 million seven-year term loan with the IFC. The facility has been fully utilised.

In 2014, the Group has raised long-term funding through the securitisation of Custom Capital's rental finance book. The first notes were issued to the IFC in February 2014 with a further R60 million to be issued during the second half of the year. This has a further positive impact on the liquidity ratios as required by Basel III.

The table below summarises assets and liabilities of the Group into relevant maturity groupings, based on the remaining period to the contractual maturity at the reporting date:

	Assets R'000	Liabilities R'000	Total mismatch R'000
2013			
Maturing up to one month	**2 875 244**	**3 102 738**	**(227 494)**
Maturing between one and three months	**191 014**	**1 033 680**	**(842 666)**
Maturing between three and six months	**236 437**	**287 410**	**(50 973)**
Maturing between six and one year	**371 037**	**452 466**	**(81 429)**
Maturing after one year	**3 690 580**	**954 539**	**2 736 041**
Non-contractual	**369 536**	**110 755**	**258 781**
	7 733 848	**5 941 588**	**1 792 260**
2012			
Maturing up to one month	2 469 494	3 037 555	(568 061)
Maturing between one and three months	41 912	964 353	(922 441)
Maturing between three and six months	98 668	318 340	(219 672)
Maturing between six and one year	522 557	529 075	(6 518)
Maturing after one year	3 805 149	620 701	3 184 448
Non-contractual	302 569	96 421	206 148
	7 240 349	5 566 445	1 673 904

RISK MANAGEMENT AND CONTROL
(continued)

The remaining period to contractual maturity of financial liabilities of the Group at the reporting date, which includes the interest obligation on un-matured deposits and derivatives calculated up to maturity date, is summarised in the table below:

	Up to 1 month R'000	1 – 3 months R'000	4 – 6 months R'000	7 – 12 months R'000	Over 1 year R'000
2013					
Deposits	**2 900 934**	**1 040 249**	**292 350**	**472 154**	**401 990**
Long-term funding	–	–	–	–	**720 552**
Derivative financial instruments	**7 869**	**1 581**	**936**	**470**	**603**
Other accounts payable	**124 070**	–	–	–	–
Guarantees letters of credit and committed undrawn facilities	**521 918**	–	–	–	–
Operating lease commitments	**417**	**763**	**1 101**	**2 020**	**4 113**
	3 555 208	**1 042 593**	**294 387**	**474 644**	**1 127 258**
2012					
Deposits	2 890 818	969 078	324 947	552 727	41 160
Long-term funding	–	–	–	–	835 870
Derivative financial instruments	3 054	2 329	96	142	1 540
Other accounts payable	72 238	–	–	–	–
Guarantees letters of credit and committed undrawn facilities	382 444	–	–	–	–
Operating lease commitments	496	960	1 180	1 507	5 539
	3 349 050	972 367	326 223	554 376	884 109

BASEL III – INFLUENCING RISK MANAGEMENT DEVELOPMENTS

In today's complex environment, combining effective bank-level management with market discipline and regulatory supervision best achieves systemic safety and soundness. The Group recognises the significance of Basel III in aligning regulatory capital to risk, and further entrenching risk-reward principles and practices in bank management and decision-making. This framework focuses on strengthening and harmonising global liquidity standards to ensure that internationally active banks are adequately capitalised.

South Africa embraced the principles of the Basel III capital framework, which was successfully implemented by the Group on 1 January 2013. Full compliance with all the regulations will only be required in January 2019.

The Group's capital adequacy was largely unaffected by the new regulations, which impose tighter restrictions on the quality and type of capital that qualifies as Tier 1 capital. The Group's capital still consists almost entirely of Tier 1 capital. The new regulations also increase the required minimum regulatory capital.

The Group's internal capital targets remains well in excess of the new minimum requirements.

The other most significant changes introduced by Basel III are the Liquidity Coverage Ratio ("LCR") and the Net Stable Funding Ratio ("NSFR"). The banking industry in South Africa will find it difficult to fully meet the new liquidity ratios ("LCR" and the "NSFR") as a result of the structural characteristics and constraints with regards to qualifying liquid assets in South Africa.

The SARB made committed liquidity facilities available to banks with insufficient High Quality Liquid Assets ("HQLA") due to the fact that South Africa has virtually no Level II HQLA. This will enable banks to meet the LCR requirement by 2015. The cost for this facility ranges from 15 to 30 basis points if not utilised. Utilisation of this facility will be limited to 30 days at a cost of SARB's repo rate plus 100 basis points for the utilisation period.

The Group currently complies with the requirements of the LCR and NSFR but continues to monitor these ratios on a monthly basis. The Group also calculates various sensitivities on these ratios to identify potential constraints in meeting the requirements timeously.

The Group will continue to seek and adopt market best-practice in accordance with these regulatory requirements. The focus in 2014 will remain on lengthening the maturity of the Group's deposits and putting appropriate funding structures in place to further enhance these ratios.

CAPITAL MANAGEMENT

The Group is subject to minimum capital requirements, as defined in the Banks Act and Regulations. The management of the Group's capital takes place under the auspices of the RMC through the ALCO. The capital management strategy is focused on maximising shareholder value over time, by optimising the level and mix of capital resources while ensuring sufficient capital is available to support the growth objectives of the Group. Decisions on the allocation of capital resources, conducted as part of the strategic planning and budget review, are based on a number of factors, including growth objectives, return on economic- and regulatory capital, and the residual risk inherent to specific business lines. This is conducted on a regular basis as part of the Internal Capital Adequacy Assessment Process and strategic planning review. The RMC considers the various risks faced by the Group and analyses the need to hold capital against these risks while taking account of the regulatory requirements.

Capital adequacy and the use of regulatory capital are monitored by employing techniques based on the guidelines documented in the Bank Regulations and implemented by the SARB for supervisory purposes. The SARB uses the capital adequacy ratio of banks as a key supervisory tool. In terms of regulation, the Group is able to consider different tiers of capital. The capital of the Bank consists almost entirely of tier 1 capital. Following the recapitalisation of the Group in 2004, it has remained capitalised well beyond regulatory and internal requirements.

Risk-weighted capital is allocated to the different business units in line with their assessed operational risk profile and targeted growth requirements.

Capital to support the Group's needs is currently generated by retained earnings and the surplus capital held.

The approach to capital management has been further enhanced over the past year in line with Basel III, and will remain a focus area for the future. The Group was largely unaffected by the new regulations, which impose tighter restrictions on the quality and type of capital that qualifies as Tier 1 capital and raised the minimum required regulatory capital. The Group's capital still consists almost entirely of Tier 1 capital.

The Group complies with the provisions of section 46 of the Companies Act, whereby all dividends and distributions are authorised by the Board. The Board authorises a distribution after satisfying itself that the Group will satisfy the solvency and liquidity test immediately after completing the distribution.

The level of capital for the Bank is as follows:

	2013 R'000	2012 R'000
Risk-weighted assets – Banking book		
Credit risk	**6 584 195**	4 993 711
Operational risk	**1 019 149**	952 817
Market risk	**59 925**	33 813
Equity	**5 737**	19 822
Other assets	**138 997**	126 424
	7 808 003	6 126 587
Net qualifying capital and reserves		
Primary capital	**1 587 623**	1 450 291
Share capital and share premium	**1 483 300**	1 483 300
Retained earnings	**249 058**	152 583
Other reserves	**51 731**	12 231
Less: Deductions	**(196 466)**	(197 823)
Secondary capital	**5 587**	9 054
General allowance for credit impairment	**5 587**	9 020
Surplus resulting from a revaluation of specified assets	**–**	34
	1 593 210	1 459 345
Capital adequacy ratio (%)	**20.4**	23.8
Primary capital (%)	**20.3**	23.7
Secondary capital (%)	**0.1**	0.1

RISK MANAGEMENT AND CONTROL
(continued)

FRAUD

PAYMENT CARD FRAUD

The Bank is an issuer of MasterCard and Visa cards and has, in line with the card associations' regulations, adopted proactive measures to prevent fraudulent use of these products. The Group makes use of monitoring fraud reports, based on a set of parameters prescribed by the card associations, and which are reviewed on a daily basis with the aim of identifying suspicious transactional behaviour.

In addition to standard monitoring measures, the Bank offers an SMS notification service on both its credit and debit card products. Since its introduction, this service has contributed to the early detection of fraudulent transactions and mitigation of losses.

If fraudulent activity is confirmed, action is taken to prevent further use of the card/card number. Confirmed fraudulent transactions are investigated and reported to the relevant card associations and the South African Banking Risk Information Centre ('SABRIC"), which determines common trends and then alerts the industry accordingly.

The Bank will start issuing integrated circuit cards (also known as "smart" or "chip" cards) during the second quarter of 2014. These cards use advanced encryption, embedded card risk analysis capabilities, and online and offline authentication. The traditional methods used to steal card data or to clone cards using magstripe technology are rendered worthless by implementing these cards. Another functionality to be implemented at the end of the first quarter is Verified by Visa. Verified by Visa is a unique service offered by Visa International that uses a One Time PIN (OTP) or personal password to protect a cardholder against unauthorised use when making online purchases (also known as e-Commerce transactions).

The Bank recently launched merchant acquiring, and offers merchants point-of-sale devices to acquire transactions on behalf of VISA and MasterCard. In order to address the fraud risks associated with merchant acquiring, the Bank has implemented fraud prevention systems and merchant account monitoring tools that comply with the relevant card associations' requirements.

FRAUD OTHER THAN PAYMENT CARD FRAUD

The Group has adopted a zero tolerance approach toward all types of fraud and theft. The Forensic Investigator investigates all incidents relating to external fraud while internal fraud is investigated by the Internal Audit function.

If an incident of fraud is brought to the Bank's attention, it is investigated immediately, evidence is collected, and statements are taken. If the incident was perpetrated externally, criminal charges are laid. If the incident was perpetrated internally, disciplinary action is instituted in addition to criminal charges being laid. All incidents are reported to the SABRIC and the South African Police Service.

FRAUD AWARENESS

Fraud awareness training is conducted on a regular basis and awareness newsletters are compiled and disseminated to all staff. These newsletters address a wide range of topics and are not limited to payment card fraud only. Fraud awareness newsletters are also compiled and distributed to clients. Fraud awareness material on prevalent modus operandi is also made available to clients and staff members on the Bank's website in the Fraud Prevention webpage.

During 2013, the Fraud Department discarded the issuance of additional modules of the Fraud Awareness User Guide and replaced it with Fraud Alerts. These Fraud Alerts contain warnings of the recently identified fraud trends as well as relevant Fraud Prevention and Awareness material related to the incident. The aim of the Fraud Alerts is to cover specific and current fraud trends as, and when, they are identified as well as create awareness on the most prevalent fraud incidents.

Fraud Department staff members attend meetings of industry role players and use Internet-based sources to stay abreast of fraud trends and the prevention thereof. The Bank also works closely with SABRIC, the Payment Association of South Africa, and card associations.

WHISTLE-BLOWING

The Group has a comprehensive Protected Disclosures Policy based on the Act of the same name. The policy addresses the reporting of corrupt activities, as well as any improper conduct, under a section on whistle-blowing. Employees are encouraged to make disclosures in good faith and on reasonable grounds.

All employees receive, twice annually, an electronic step-by-step guide on what to report and how to report it.

To this end, an enhanced anonymous reporting system is in place to enable employees to report directly to Compliance and Internal Audit, using a web-based tool. This system simplifies the anonymous reporting procedure, and encourages employees to make use of the process.

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GLOSSARY OF TERMS

ABBREVIATION:	DEFINITION/DESCRIPTION:
AGM	Annual General Meeting
ALCO	Asset and Liability Committee
ALM	Asset and Liability Management
Banks Act	Banks Act, No. 94 of 1990, as amended
Bank Regulations	Regulations relating to banks issued under section 90 of the Banks Act, No.94 of 1990, as amended
BEE	Black Economic Empowerment
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGD	Caixa Geral de Depósitos S.A., a company registered in Portugal
Companies Act	Companies Act, No.71 of 2008
CREDCOM	Credit Committee
Custom Capital	Custom Capital (Pty) Ltd
DAC	Directors' Affairs Committee
EXCO	Executive Committee
FAIS	The Financial Advisory and Intermediary Services Act, No. 37 of 2002
FICA	The Financial Intelligence Centre Act, No.38 of 2001
GAC	Group Audit Committee
IFRS	International Financial Reporting Standards and Interpretations
JSE	Johannesburg Stock Exchange Limited
King III	King Report on Corporate Governance for South Africa 2009
Mercantile	Mercantile Bank Holdings Limited and its subsidiaries
NCA	The National Credit Act, No. 34 of 2005
RMC	Risk and Capital Management Committee
SARB	South African Reserve Bank
the Bank	Mercantile Bank Limited
the Board	Where applicable, the Board of Directors of Mercantile Bank Holdings Limited or collectively the Board of Directors of Mercantile Bank Holdings Limited and Mercantile Bank Limited
the Company	Mercantile Bank Holdings Limited
the Group	Mercantile Bank Holdings Limited and its subsidiaries