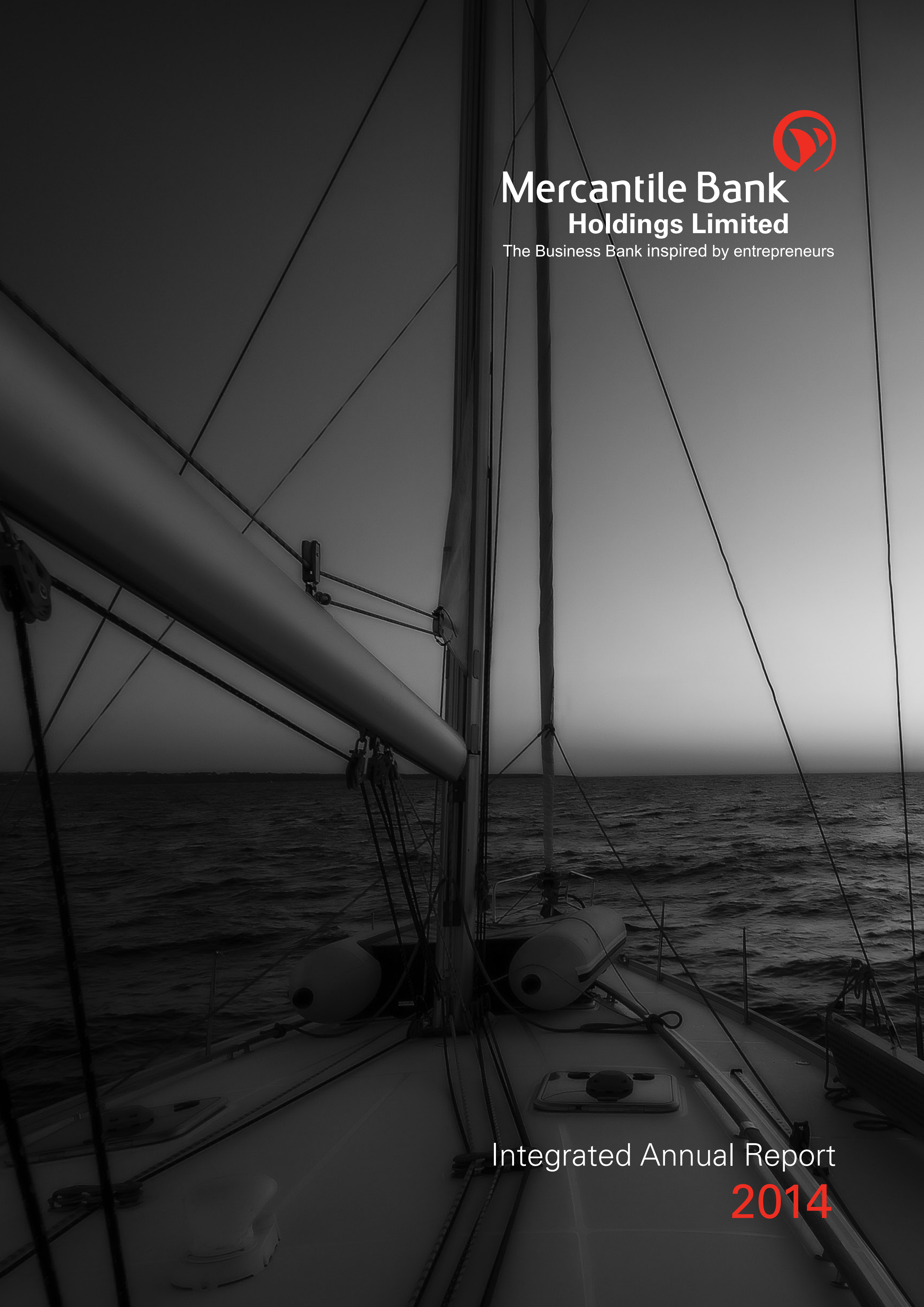


Mercantile Bank Holdings Limited

The Business Bank inspired by entrepreneurs

Integrated Annual Report 2014

Mercantile Bank
Holdings Limited
The Business Bank inspired by entrepreneurs

COMPANY SECRETARY
T Singh

REGISTERED OFFICE
1st Floor, Mercantile Bank
142 West Street, Sandown 2196

POSTAL ADDRESS
PO Box 782699, Sandton 2146

This report is prepared in accordance with the provisions of King III. The aim of this report is to provide effective and transparent communication with all stakeholders.

www.mercantile.co.za

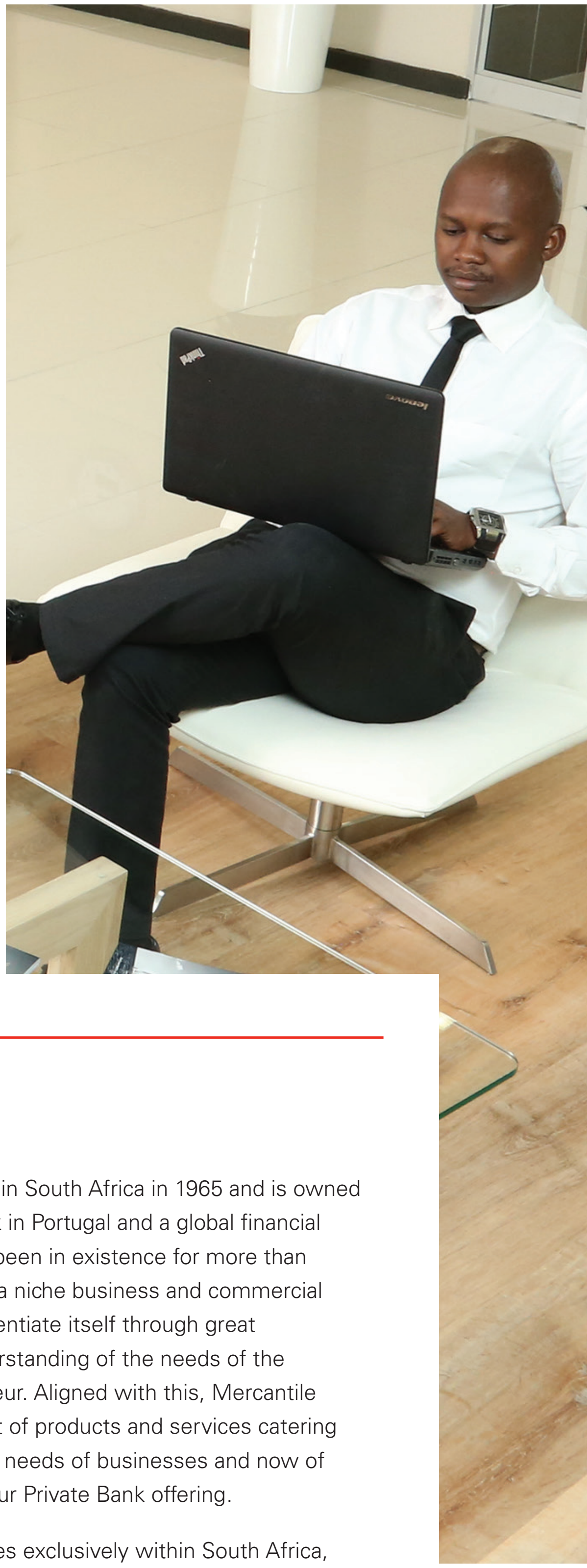
"We are all at risk of stagnating if we don't pursue the future, vigorously. But if you pursue the future, you have to accept that not everybody will agree with your vision."

Mark Shuttleworth

MERCANTILE BANK HOLDINGS LIMITED
Registration number: 1989/000164/06
Member of CGD Group

BANK REGULATIONS PUBLIC DISCLOSURE: The December 2014 disclosure, required in terms of Regulation 43 of the Banks Act Regulations, is published on the Group's website.

Head office, Sandton



PROFILE

Mercantile was founded in South Africa in 1965 and is owned by CGD, the largest bank in Portugal and a global financial services group that has been in existence for more than 120 years. Mercantile is a niche business and commercial bank that seeks to differentiate itself through great service and a deep understanding of the needs of the South African entrepreneur. Aligned with this, Mercantile has a comprehensive set of products and services catering for the everyday banking needs of businesses and now of entrepreneurs through our Private Bank offering.

While Mercantile operates exclusively within South Africa, it has reach into other key African markets through its parent company and fellow subsidiaries in Angola and Mozambique. There is an ongoing focus on capturing trade flows between these fast-growing economies.

OUR BRAND VALUE AND PROPOSITION

MERCANTILE BANK

The Business Bank **inspired** by entrepreneurs

S Panos *Head of Treasury*

OUR MISSION

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

OUR VALUES

We are CURIOUS

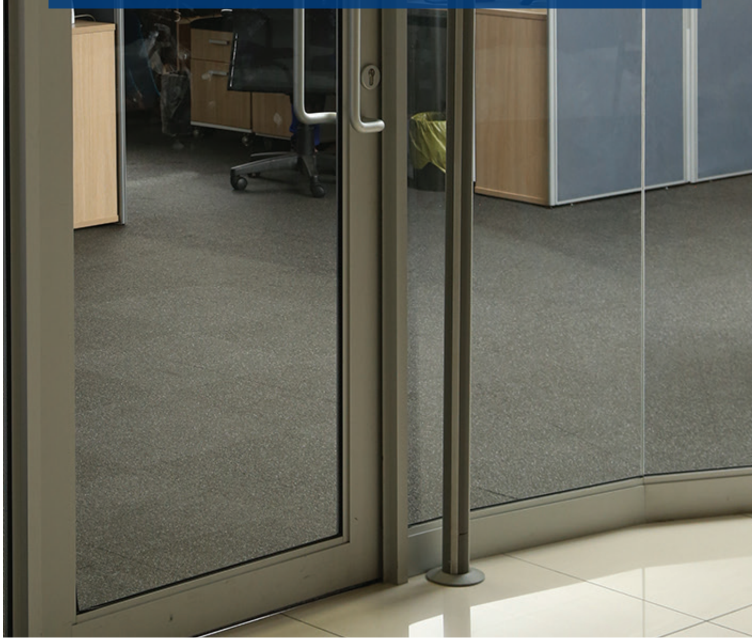
We are visionary and innovative, dynamic and unconventional. We know that innovative thinking and action requires boldness, determination, passion and daring, and the courage to do things differently.

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 beneficial 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.



OUR VISION

We grow entrepreneurs through successful partnerships.

GROUP STRUCTURE

as at 31 December 2014 (excluding dormant/non-trading companies)

Mercantile Bank Holdings Limited

A registered bank-controlling and investment holding company.
Its holding company is CGD and its principal operating entities are:

100%

MERCANTILE BANK LIMITED

Operates in selected business, commercial, private and alliance banking niches, and offers a full range of international and domestic banking, financial and investment services.

100%

MERCANTILE INSURANCE BROKERS (PTY) LTD

An insurance brokerage company. Its only source of revenue at present is the collection of legacy commission for insurance written in the past.

100%

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.

74,9%

MERCANTILE RENTAL FINANCE (PTY) LTD

Previously known as Custom Capital (Pty) Ltd, a rental finance business that offers financing of office automation and allied equipment.

50%

MERCANTILE E-BUREAU (PTY) LTD

A joint venture company that processes and administers electronic financial transactions on behalf of customers.

100%

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.

100%

MERCANTILE ACQUIRING (PTY) LTD

Previously known as LSM (Troyeville) Properties (Pty) Ltd, a property-owning company, located in Troyeville, which leased office space to the Bank. The underlying property has been sold and is in the process of being transferred.

Equity: one preference share

COMPASS SECURITISATION (RF) LTD

The securitisation arm providing term funding for Mercantile Rental Finance.

2014 SALIENT FEATURES

MEL Teixeira *Chief Financial Officer*

GROWTH IN LOANS AND ADVANCES
19%

GROWTH IN DEPOSITS
15%

INCREASE IN NET NON-INTEREST **INCOME**
19%

STRONG LEVEL OF CASH AND CASH EQUIVALENTS
R1,5 billion

INCREASE IN **OPERATING** EXPENDITURE
6,9%

PROFIT AFTER TAX
R128 million

NON-PERFORMING LOANS AS A PERCENTAGE OF LOANS AND ADVANCES
3,4%

CREDIT LOSS RATIO
0,6%

ROE
6,9%

ROA
1,5%

COST TO **INCOME**
63%

"The first step is to establish that something is possible; then probability will occur."

Elon Musk

2014 ACHIEVEMENTS

LAUNCH OF PRIVATE BANK – the first private bank in South Africa exclusively for entrepreneurs.

WE RAISED FUNDING OF R240 MILLION FROM THE INTERNATIONAL FINANCE CORPORATION – R202 million of this was issued in 'A' notes from the Group's securitisation vehicle and the balance will be issued in 2015.

The implementation of **EMV-COMPLIANCE** (i.e. through chip-and-pin cards) for card-present transactions; and

3D-Secure for card-not-present transactions (for example, online shopping), to provide improved security to our credit- and debit card customers when transacting using the Group's card products.

We **COMPLETED THE REFURBISHMENT** of the Group's Head Office building in Sandown. 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.

The **FIRST** of its kind **BUSINESS CENTRE LOOK AND FEEL** specifically made for entrepreneurs and is a great place to work in.

FOUR additional new layout business centres were opened in 2014.

We implemented a NEW WORKFLOW SOLUTION to improve efficiencies and enhance processes in Treasury Back Office, Credit (origination, assessment and fulfilment) and Private Banking. This project will continue into 2015 and beyond.

We REBRANDED Custom Capital to MERCANTILE RENTAL FINANCE.

Training and development – We not only focus on superior service to customers, but also emphasise "LIVING THE MERCANTILE WAY", which has become an integral part of how management and employees conduct themselves on a day-to-day basis. This has been a key driver in the improved climate within the Bank, in support of the Bank's growth ambitions, a highly skilled Private Banking team has been established.

In terms of leadership development, the Bank has launched a customised, accredited leadership development programme, "LEADING THE MERCANTILE WAY".

37 MIDDLE MANAGERS successfully completed the "Leading the Mercantile Way" first programme held in 2014 and it will be held at least twice in 2015.

We implemented a NEW TREASURY SYSTEM – LandoByte platform to enable intermediaries to trade and upload supporting documents online.

Foreign exchange profits grew by 30% year-on-year.

BOARD OF DIRECTORS

at 27 February 2015

NF THOMAZ (46)

Chairman, Non-Executive Director, Portuguese

Chairman with effect from 28 May 2014

Registered with the Securities and Futures Authority

Degree in Business Administration and Management from the Instituto Superior de Gestão in Lisbon, is a graduate of the Harvard Business School

Member of: DAC

Nuno has been a member of the board of directors of CGD since July 2011 and was appointed as deputy CEO in 2013. He also holds directorships on several of the CGD subsidiaries' boards globally and has been appointed chairman of several of them.

GP DE KOCK (60)

Deputy Chairman, Independent Non-Executive Director

Deon retired in 2004 as managing director of Woolworths Financial Services (Pty) Ltd 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.

Currently operating as an independent consultant in the retail- and financial services industries

Attended executive programmes at the Business Schools of the Universities of Cape Town and Stanford, California (SEP)

Appointed as Non-Executive since 23 November 2000

Member of: GAC, RMC, DAC, RC and SETC

GAC	*Group Audit Committee*
RMC	*Risk and Capital Management Committee*
DAC	*Directors' Affairs Committee*
RC	*Remuneration Committee*
SETC	*Social, Ethics and Transformation Committee*
TC	*Technology Committee*

KR KUMBIER (43)

CEO

Karl 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. Karl was appointed to the board and the board executive committee of the Banking Association of South Africa in November 2014, as the chief executive representing the independent banks.

Joined Mercantile in 2010 and was appointed as CEO of the Group with effect from 1 April 2013

BCompt degree from the University of South Africa and a PGDA from the University of Cape Town

Member of: RMC, SETC and TC

AT IKALAFENG (48)

Independent Non-Executive Director

BSc (Bus Admin) and MBA degrees from Marquette University in the USA

A Chartered Marketer (CM (SA))

Appointed as an Independent Non-Executive since 16 November 2004

Completed executive development courses in Finance at the University of the Witwatersrand and Harvard Business School

Member of: DAC, RC and SETC

Thebe 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 non-executive director of the Brand Council of South Africa, The World Wide Fund for Nature in SA, Car Track Holdings Limited and South African Tourism. He was named one of the 100 most influential Africans by *New Africa* magazine.

BOARD OF DIRECTORS continued

at 27 February 2015

DR MOTSEPE (57)

Independent Non-Executive Director

Appointed as a Non-Executive Director of the Group on 1 October 2014

BCompt degree and an MBA from De Montfort University in the United Kingdom

Member of: GAC, RC and SETC

Daphne was the chief executive for card and the unsecured lending cluster at Absa until her retirement in June 2012. Prior to joining Absa, Daphne was managing director of the South African PostBank. She has a long track record in unsecured lending, mass market banking and SMME finance. She serves as a non-executive director on the boards of Rand Mutual Assurance Limited, Kapela Investment Holdings Limited (and its investee companies XON Holdings (Pty) Ltd and SPX Flow Technology South Africa) and is a member of the executive committee of the Consultative Group to Assist the Poor (CGAP), an international organisation headquartered in Washington DC and which promotes responsible and inclusive financial markets. She is also a trustee on the Alexander Forbes Community Trust.

L HYNE (71)

Independent Non-Executive Director

Louis 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.

BCom (Hons) degree and is a Chartered Accountant (SA)

Attended executive programmes at the University of the Witwatersrand's Graduate School of Business and Stanford University, California

Appointed as an Independent Non-Executive since 1 June 2003

Member of: GAC, RMC, DAC and RC

GAC Group Audit Committee
RMC Risk and Capital Management Committee
DAC Directors' Affairs Committee
RC Remuneration Committee
SETC Social, Ethics and Transformation Committee
TC Technology Committee

RS CALICO (42)

Executive Director, Portuguese

Ricardo has been employed by CGD since 2001 and, from 2010 to 2014, he was general manager of the CGD New York Branch and regional general manager of the CGD Grand Cayman Branch.

Joined Mercantile as Executive Director of the Mercantile Group in July 2014

Postgraduate qualifications in Investments and Financial Markets (ISCTE Business School) and Global Asset Management (Harvard Business School)

Degree in Economics from the Universidade Nova de Lisboa

Member of: RMC, TC and SETC

TH NJIKIZANA (39)

Independent Non-Executive Director, Zimbabwean

Chartered Accountant (SA)

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

Appointed as an Independent Non-Executive since 6 November 2008

JSE-registered IFRS Adviser

Member of: GAC, RMC, DAC, RC and TC

Tapiwa's 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 various professional services across Africa, the United Kingdom and Australia. Tapiwa also serves as an independent non-executive director on the board of Iliad Africa Limited.

FIVE-YEAR GROUP SALIENT FEATURES

years ended 31 December

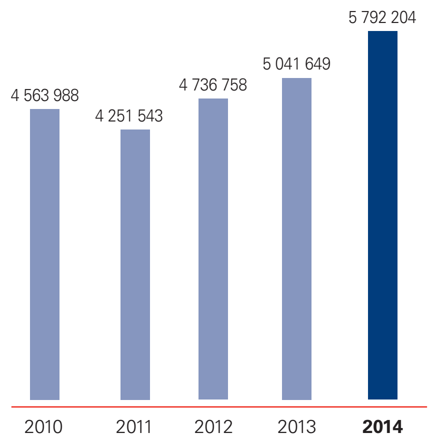
	2014	2013	2012	2011	2010
	R'000	R'000	R'000	R'000	R'000
STATEMENT OF FINANCIAL POSITION					
Total assets	**8 767 662**	7 733 848	7 240 349	6 215 275	6 254 311
Loans and advances	**6 223 991**	5 227 941	5 291 748	4 489 863	3 720 907
Cash and cash equivalents	**1 518 444**	1 490 690	1 223 016	952 621	1 759 897
Total equity attributable to equity holders of the parent	**1 901 981**	1 793 644	1 674 091	1 678 774	1 539 394
Long-term funding	**527 559**	583 173	581 876	–	–
Debt securities	**202 764**	–	–	–	–
Deposits	**5 792 204**	5 041 649	4 736 758	4 251 543	4 563 988
STATEMENT OF COMPREHENSIVE INCOME					
Profit before tax (from continuing operations)	**180 675**	188 988	195 910	163 919	144 071
Profit after tax (from continuing operations)	**127 653**	136 309	147 042	119 119	101 026
Profit after tax attributable to equity holders of the parent (from continuing operations)	**128 339**	137 506	146 424	119 924	101 026
Profit after tax attributable to equity holders of the parent (including from discontinued operations)	**128 339**	137 506	151 017	124 150	101 026
FINANCIAL PERFORMANCE RATIOS (%)					
Return on average equity (ROE)	**6,9**	7,9	9,0	7,7	6,8
Return on average assets (ROA)	**1,5**	1,8	2,3	2,1	1,7
Cost to income	**63,2**	62,3	60,3	64,9	65,5
SHARE STATISTICS (CENTS)					
Net asset value per share	**52,6**	49,6	46,3	42,9	39,4
Tangible net asset value per share	**47,4**	44,2	40,8	36,1	33,6

"It was strange because I never planned to build an empire or create a huge organisation. I would have been quite happy being an artist and just paying my bills."

Carrol Boyes

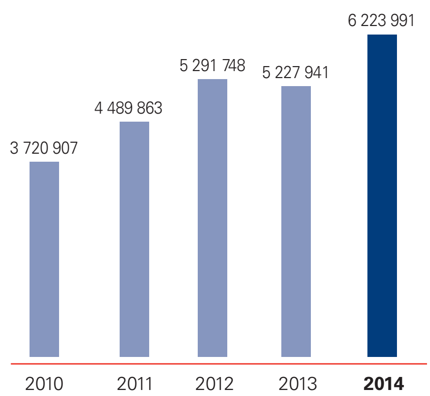
DEPOSITS

R'000



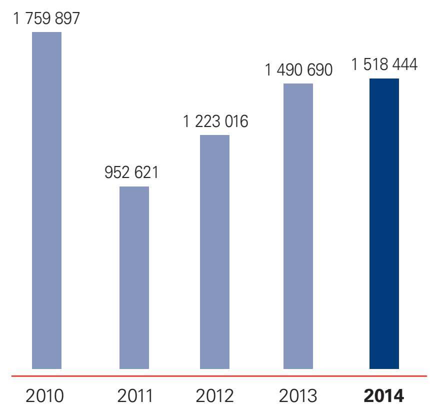
LOANS AND ADVANCES

R'000



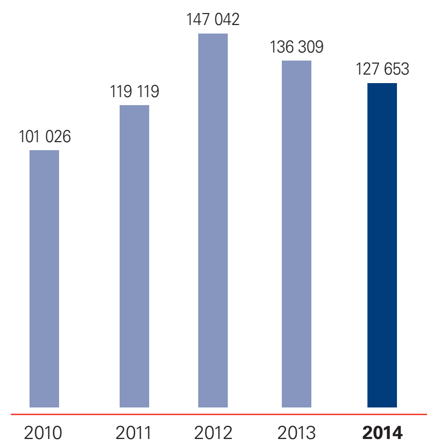
CASH AND CASH EQUIVALENTS

R'000



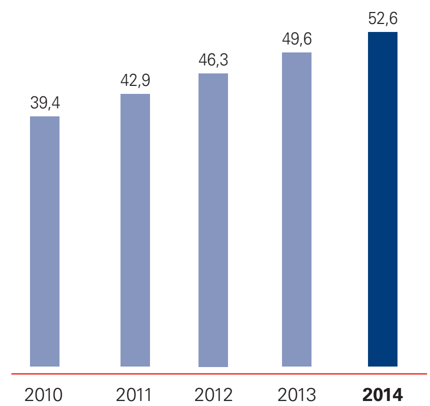
PROFIT AFTER TAX

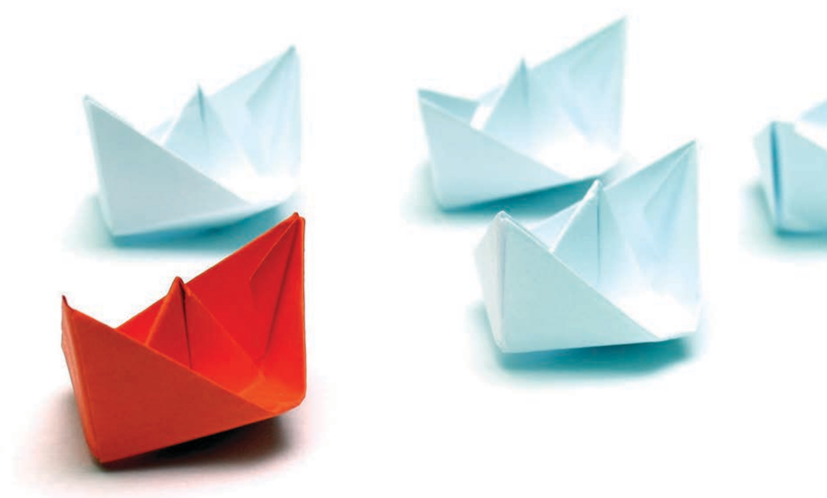
R'000 (continuing operations)



NET ASSET VALUE PER SHARE

Cents





GROUP REVIEW

HOLDING COMPANY

CGD, a Portuguese state-owned banking corporation as well as the largest bank in Portugal, with a presence in 23 countries spanning four continents, is the Group's 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 market share of banking entrepreneurs in their personal capacity through our new private bank offering;
- 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, Mercantile Rental Finance.

TRADING CONDITIONS

Local trading conditions have remained difficult for the third consecutive year; growth in the South African economy has been lower than predicted, while global conditions have remained weaker than previously anticipated. The threat of a rising interest rate cycle did not help matters and we continue to see the currency under pressure on the back of weak commodity prices, social unrest, and a rising US dollar. Consequently, business confidence has been low and trading activity subdued. Despite all of these factors, Mercantile has managed to grow its lending by 19%, mostly as a result of the initiatives discussed below. Entrepreneurs are resilient and will look at other avenues, such as expanding into the rest of Africa, to grow their businesses. Our philosophy of growing entrepreneurs has worked in our favour because we are able to provide them with innovative solutions. Our key differentiator remains building great relationships with our customers and this is the main reason we are able to attract customers away from our competitors and grow the Bank.

FINANCIAL OVERVIEW

The Group had a very good year despite the difficult trading environment. Our strategy of growing sustainable non-funded revenue is starting to pay off with an increase of 19% in non-interest income. This was mainly driven by a 30% increase in foreign exchange profits on the back of our goal to become the number one player in the foreign exchange intermediary market. We on-boarded several new key intermediaries during 2013, which created a strong foundation for growth in 2014, and also implemented the LandoByte FX online trading platform.

Our E-Bureau business also had a fantastic year – growing revenue by 37% year-on-year. We believe that we have one of the best bureau products in the market and we will continue to aggressively target new-to-Bank customers.

Net interest income was slightly less than the previous year, mainly as a result of higher credit losses and the fact that two very large exposures were settled toward the end of 2013. During 2014, we set up an Integrated Sales Team, consisting of highly skilled individuals specialising in structuring complicated lending transactions in the Commercial Banking space. The team was hugely successful and assisted Mercantile in growing its lending by 19% year-on-year.

Maintaining liquidity and raising deposits are always difficult tasks for a small bank. We designed some innovative deposit products, launched our Mercantile Online Invest Product ("MOI"), and ran a focused deposit campaign – all of which resulted in us growing our deposit base by 15% year-on-year.

Even with the numerous strategic initiatives implemented during 2014, we kept a tight control over costs and managed to limit cost growth year-on-year to less than 7%.

Our net profit after tax was 6,7% lower than the previous year, mainly as a result of the R16 million profit recognised in 2013 from the sale of our investment in VISA Inc., which was a once-off item. We believe that, with our growth in lending, deposits and non-interest income, we have a solid foundation from which to grow the Bank in 2015.

INITIATIVES AND PROJECTS

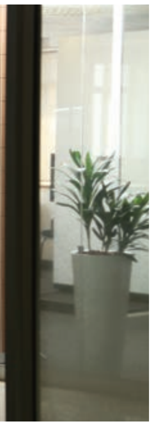
The Group embarked on several projects in 2014 to enable it to meet its objective of better serving its stakeholders and becoming the number one business bank in South Africa. Some of the strategic highlights for 2014 are:

- launching the first South African Private Bank to focus on entrepreneurs. The strategic purpose of the Private Bank offering is to provide entrepreneurs, who may or may not already have a relationship with us through their business with a personal banking solution, with a view to further consolidating our business, banking relationship or acquiring such a relationship where it does not already exist;
- securing R240 million in funding from the International Finance Corporation ("IFC") through a securitisation of our rental finance book. This is a very exciting deal for both Mercantile and the IFC. For Mercantile, it

GROUP REVIEW continued

creates a long-term sustainable funding mechanism for our rental finance business (the rental finance book has grown from R34 million since acquisition four years ago to its present value of R480 million). Prior to securitisation, Mercantile had been funding the rental book growth; the transaction therefore allows the Bank to fund its other growth initiatives. It was a landmark development for the IFC as this was the first transaction of its kind on the African continent and goes a long way toward assisting SMEs in South Africa to gain much needed access to finance;

- completing the refurbishment of the Group's Head Office building in Sandown. 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;
- implementing the new business centre concept. Menlyn Business Centre was the first business centre opened under the new business centre concept in 2013. This concept allows for smaller, more modern and more automated business centres to be opened quickly and cost effectively. An additional three business centres were revamped during 2014 and another two business centres were moved to better locations. We opened our first business centre in a major shopping centre, i.e. Bedford Shopping Centre in Bedfordview. In 2015, we will continue to revamp, or move, our existing business centres as and when the leases are up for renewal;
- implementing Chip and PIN (EMV-compliant) credit cards and 3D-Secure for card-not-present transactions (for example, online shopping). This will result in improved security to our credit- and debit card customers and lead to lower fraud and losses on our card products;
- rebranding Custom Capital to Mercantile Rental Finance;
- implementing a new workflow solution to improve efficiencies and enhance processes in Treasury Operations, Credit (origination, assessment and fulfilment) and Private Banking. This project will continue into 2015 and beyond; and
- building a highly motivated workforce; banking is all about people and we believe that, with passionate and highly motivated staff, service levels must improve. Our staff turnover rate last year was just under 9%, compared to an industry average of more than double that figure. We will continue to look at ways of improving staff morale and growing our people and two of the initiatives we implemented during the year were:
  - doubling our training budget and, in conjunction with industry experts, custom designing leadership development programmes, and credit skills and sales training courses for our staff; and
  - the aforementioned renovation of our Head Office building into a world-class, open-plan and highly professional environment, with a newly-built canteen and outside entertainment area, which has had a significant positive impact on staff morale.



"We should encourage the integration of black and white businesses in SA. It's the same model of partnership I've employed in my own businesses. I deal with people according to the value they add, rather than on the basis of their skin colour or race. For business partnerships to work effectively, racial myths need to be discredited."

Herman Mashaba

DIRECTORATE AND COMPANY SECRETARY

At the 2014 AGM, our long-serving chairman, Dr Campos, retired from service. We are grateful for his wisdom and advice over the years and his steadfast belief in what the Bank could achieve – we wish him happiness and good health. At the same AGM, we welcomed Nuno Fernandes Thomaz, deputy CEO of CGD, as the new chairman of the Bank. We look forward to building a closer relationship with our parent company through Nuno. In addition, Deon de Kock, an existing Independent Non-Executive Director was appointed Deputy Chairman of the Bank at the same AGM. Deon has vast experience in financial services and has a long history with the Bank.

At the end of July 2014, Julio Lopes, an Executive Director and CGD representative, accepted a transfer from Mercantile to Caixa Totta Angola. Julio had been with the Bank for nine years and had been instrumental in implementing the core banking system and the new treasury system; initiating the ANSAMO initiative (a business collaboration between Mercantile and CGD's operations in Angola and Mozambique), building relationships with Portuguese businesses investing in South Africa, and in designing the Bank's growth strategy. We wish Julio and his family well on this new adventure.

Julio was replaced by CGD representative Ricardo Calico. Ricardo joined the Bank from CGD's New York Office. He brings a wealth of experience and we anticipate him playing an important role in growing the Bank.

We also welcomed Daphne Motsepe as an Independent Non-Executive Director. Daphne has many years' banking experience. She retired from the Absa Group in 2012, where she had been the executive responsible for card and unsecured lending. We believe Daphne will add enormous value to our business.

Trisha Singh was appointed Group Company Secretary, effective 1 August 2014. Fred Schutte, who had performed the dual role of Head: Legal Services and Group Company Secretary for approximately 19 months, resumed his former role as Head: Legal Services. We wish Trisha well in her role and would like to thank Fred for his hard work and commitment.

CREDIT RATING

Moody's issued the following RSA national scale issuer ratings for the Bank on 22 December 2014:

- 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

We are very excited about the future prospects for Mercantile and believe that we can build the number one niche business bank in the

GROUP REVIEW continued

country. We see ourselves as a small bank with big bank capability in that we are able to offer a personalised service as well as all the products a big bank can offer to the business banking market. We have a great core banking system, strong levels of capital, and a clean lending book, and we believe in the value of lifelong relationships. 2014 is the first year that the Bank participated in the Business Enterprises Customer Satisfaction Index survey (facilitated by Consulta). When compared to the Big Four banks, we ranked number one in the Business Banking Segment and number three in the Commercial Banking segment. The 2015 goal will be to rank number one in both segments and the following strategic initiatives should assist us in achieving this:

- launching a Mobile Banking Application;
- enhancing our electronic banking offering – we have had numerous workshops with our customers and have had excellent feedback on what needs to change to improve our customer experience;
- launching a Card Acquiring business – we have just appointed a leading expert in the Point-of-Sale industry to build a class-leading acquiring business for us; and
- implementation of a workflow solution throughout our business with the aim of removing paperwork and improving efficiencies that will lead to a better customer experience.

Funding remains a critical part of our business as, without funding, we are not able to grow our lending. We are busy with various initiatives to raise at least R500 million in medium-term funding.

2015 marks a milestone as Mercantile officially turns 50 years old in November 2015. We will run deposit campaigns using the 50th birthday theme and we will ensure that the market is aware of the fact that we have been around for 50 years – this should further improve the confidence of our depositors and other stakeholders.

We are also starting to see the added benefits of being part of a large international Group. CGD is the largest bank in Portugal and owns a majority share in Banco Comercial e de Investimentos, the largest bank in Mozambique; a controlling share in Caixa Totta Angola, the fifth largest bank in Angola by profits; and 100% of a large bank in Macau. There is a big drive to capture trade flows between South Africa, Angola, Mozambique and Macau/China and we are very well positioned to offer South African SMEs access to banking solutions in those countries.

We are, of course, acutely aware of the fact that the economy will continue to take strain over the next year. Load-shedding could have a detrimental effect on many SMEs, especially in the manufacturing, retail and restaurant space. We are starting to see more and more businesses applying for business rescue. Mercantile has implemented robust early warning systems to identify customers in financial difficulty. We have also increased resources in our collections area and up-skilled our staff with regard to business rescues and liquidations.

We are confident, though, that Mercantile will have a successful 2015. A strong foundation for growth was built in 2014 with a number of initiatives that were implemented to improve processes, expand our footprint, offer new banking solutions, and raise deposits now beginning to show results.

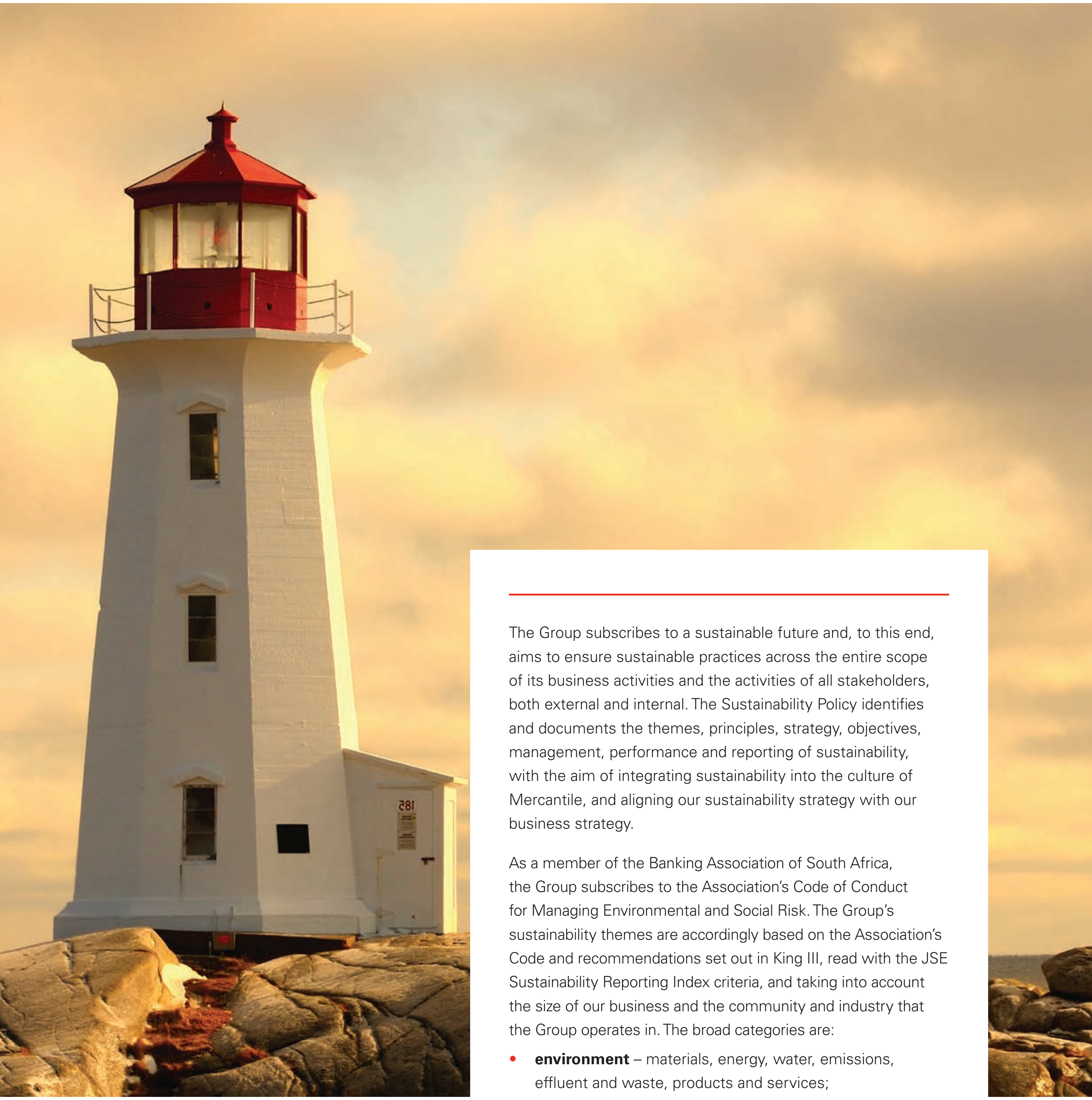
APPRECIATION

Our sincere thanks go to all our stakeholders. Mercantile has implemented a stakeholder relationship management model whereby we build unbelievable relationships with 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 that we were able to grow our business and deliver a good set of results.

NF Thomaz	**KR Kumbier**
Chairman	*Chief Executive Officer*

27 February 2015

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.

SUSTAINABILITY continued

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 customer 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 International Finance Corporation's Sustainability Framework (which includes the global Equator Principles) into its Environmental Risk Management Policy. The Equator Principles have three categories of projects, viz. Category A (high risk) involves projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented. Issues relating to these risks may lead to work stoppages, legal authorisations being withdrawn, and reputational damage. Category B (medium risk) projects have potential limited adverse social or environmental impacts that are few in number, generally site-specific, largely reversible and readily addressed through mitigation measures. Category C (low risk) projects have minimal or no social or environmental impacts. 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 and would only finance category A projects in exceptional circumstances and only after due consideration of all related risk and reputational concerns.

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

"Success is a process to reach a destination. For instance, hard work is important – but it is not only hard work that counts. Among others you have to be aware of the business environment and be smart enough to identify opportunities. You should also have the courage to take risks if you want to start a new venture."

Jannie Mouton

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. The Compliance function undertakes an annual exercise whereby all staff and the Board are required to re-affirm their commitment to the standards enshrined in the Code of Conduct to ensure 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 through adoption of best banking and financial practice, and transparent, responsible and prudent business- and risk management. This 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.

SAFETY AND HEALTH

The Group continues to strive to improve its facilities 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 action 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, culminating in promotion opportunities for employees and driving retention of these key individuals.

In terms of leadership development, the Bank has launched a customised, accredited leadership development programme, "Leading the Mercantile Way". In 2014, 37 middle managers successfully completed the first programme and it will be held at least twice in 2015.

The BANKSETA International Executive Development Programme provides an opportunity for our senior managers to participate in a robust learning process that aims to fast-track development into executive positions. Two female senior managers participated in 2014 and had exposure to the Retail and Investment Banking learning tracks.

During 2014, Mercantile provided training and up-skilling to 15 BANKSETA learners (a group of five matriculants and 10 graduates). We have retained approximately 47% of these learners.

SUSTAINABILITY continued

The Bank's culture has transformed significantly. We not only focus on superior service to customers, but also emphasise "**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 align to the values, i.e. **Committed**, **Curious** and **Connected**.

EMPLOYEE ENGAGEMENT

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, which showed an increase in the overall engagement score from 72% in 2013 to 77% in 2014.

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, and 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 2014 is 8,5%, 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, the Wings Awards, through which employees have the opportunity to nominate their colleagues who show commitment and exceptional performance. The programme allows for three winners to be selected per month. In November 2014, 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 proactive stance. It supports the effective utilisation of the Employee Assistance Programme to address potential external drivers causing absenteeism, and timely 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 was recorded at 1,57% for 2014 (2013: 1,5%).

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 and is a level 7 Broad-Based Black Economic Empowerment ("B-BBEE") contributor.

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, toward reflecting the demographic profile of the country and prioritising the development and career advancement of 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 Senior Management, Junior Management and Semi-skilled categories. The overall level of representation of black people in the Bank has increased from 35% in 2004 to 62% in 2014. 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 positions – see tables on page 37.

PROCUREMENT

A targeted procurement strategy to enhance B-BBEE 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 will also focus on Enterprise Development as a means to increasing its empowerment supplier base where appropriate. The Group has successfully

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"He who does not believe in miracles is not a realist."

Anthony Edward Rupert

met the DTI and FSC procurement targets since 2008, and has achieved 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 Group's projected portion of the Industry Target Growth has been confirmed by the Banking Association during 2014: BEE SME Financing to be R198,3 million and BEE Transaction Financing to be R132,2 million, to be achieved by the end of 2017.

In 2014, the Group achieved R57 million (2013: R13,8 million) and R345 million (2013: R387 million), respectively, of the projected targets. The 2013 figures were restated to align with the certification by the rating agency, Empowerdex.

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:

- 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.

The new CSR approach adopted in 2012 continues to optimise the benefits for all stakeholders from these investments. For 2014, the budgeted funding was allocated on an 80:20 split, where 80% was used for formal entrepreneurial development and socio-economic 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 2014 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 the year in review, a total of 80 black-owned businesses received mentorship and other service offerings. The organisation has also introduced new service offerings for the entrepreneurs in the programme. While mentorship remains the key and compulsory element of every programme, the eight new offerings are available to facilitate further growth during the four-year journey with the entrepreneur. These included:

- **networking** – to facilitate interaction among entrepreneurs both internally and externally;
- **access to markets** – to develop sustainable businesses by facilitating the integration of the entrepreneurs into the mainstream economy;
- **industry expertise and professional services** – to improve the knowledge and growth of businesses by facilitating the link between industry experts (with years of experience) with entrepreneurs who need that experience to make sound business decisions;
- **business development workshops** – to provide insights and create awareness regarding the important functions of the business;
- **specialist training** – to improve the competence of the entrepreneurs by providing them with the opportunities to upskill themselves in their area of business;
- **financial mentoring and services** – to allow entrepreneurs to achieve their strategic financial goals and objectives and make sound financial decisions for their businesses;
- **business analysis and review** – an in-depth business analysis to develop intervention strategies that are reviewed quarterly; and
- **operational investments** – providing the entrepreneurs with a form of a grant to cover certain operational needs of the business.

This holistic approach has shown the following notable successes:

- 48% of businesses in the programme have created new jobs;
- 70% of the businesses have achieved increased turnover;
- on average, 67% growth in profit margin has been experienced;
- 51% of businesses have grown in profitability; and
- 67% of businesses have seen increased owners' salaries.

SUSTAINABILITY continued

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 and, therefore, make a meaningful contribution to the country's economy.

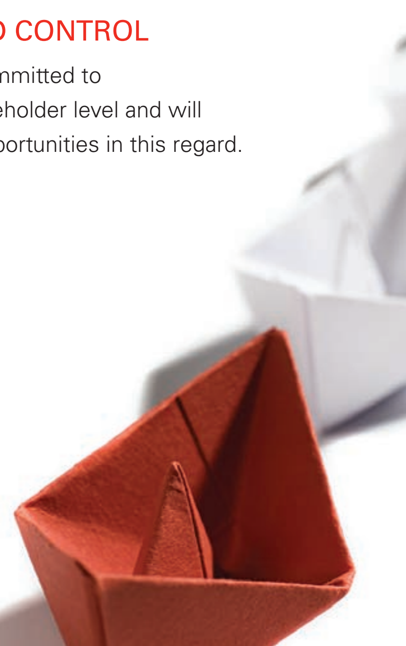
Employee initiatives

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 R200 000, of which R186 011 was used for the following initiatives:

- **Bring-a-Child-to-Work** – the new campaign ran in February and gave 22 children (mostly from disadvantaged backgrounds) an opportunity to spend the day with professionals from various departments to gather information on available careers. Each child received a fully equipped tablet computer that they can use to access the Internet for school-related programmes;
- **CANSA Shavathon** – new initiative that the staff participated in by shaving or spray-painting their hair. R13 000 was raised;
- **Winter Warmer Blanket Drive** – the campaign started in 2011 and has gained traction by creating huge excitement, increased competitive spirit between departments, and anticipation of the final results. A total of 725 blankets was donated to the Salvation Army;
- **Boys and Girls Town** – Mercantile Bank employees participated in the Discovery 702 Walk the Talk annual event and the Foundation matched their entrance fees to donate R11 000 to the Boys and Girls Town organisation;
- **Dove's Nest, Pretoria** – the Electronic Services team spent their eight-hour allocation painting and refurbishing this home for abandoned children. The Foundation also donated over R7 000 worth of nappies and milk formula;
- **Canned food drive** – this campaign was launched in October 2013 to assist beneficiaries requiring food donations. The 2014 beneficiaries were Vuyelwa Home for the mentally and physically disabled in Orange Farm and House of Grace in Tygerberg – 2 123 cans of food were distributed;
- **Charities Aid Foundation (Southern Africa)** – a sum of R40 000 was donated to the organisation to build classrooms at the Kliptown Youth Centre. The staff participated in building new classrooms and painting existing ones;
- **Compass** – a donation of R10 000 was made to purchase carpets for the homes run by the organisation in Edenvale and Johannesburg;
- **Isithebe Day Care Centre** – in partnership with one of our customers, we donated stationery to the centre, which receives continued support from ITB Manufacturing (Pty) Ltd; and
- **Azuriah Foundation** – an annual donation was made by the Mercantile Bank Foundation to purchase 354 pairs of school shoes and stationery packs for disadvantaged children in the Newclare/Westbury area.

OWNERSHIP AND CONTROL

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



CORPORATE GOVERNANCE

T Singh *Company Secretary*

"Good governance involves fairness, accountability, responsibility and transparency on a foundation of intellectual honesty."

Mervyn King

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 2014.

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 of 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.

CORPORATE GOVERNANCE continued

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, as Deputy CEO of the CGD Group, is not seen as independent and, in line with the recommendations of King III, an independent Non-Executive Deputy Chairman (Lead Independent Director) has been appointed.

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. In terms of the Company's Memorandum of Incorporation ("MOI"), one-third of the non-executive directors are required to retire at each AGM and may offer themselves for re-election.

Mr KR Kumbier was appointed CEO for the Company and the Bank, effective 1 April 2013. The service contract of Mr JPM Lopes, an Executive Director seconded by the shareholder, which had been extended in 2011, terminated on 31 July 2014. He was replaced by Mr RS Calico, who was appointed as an Executive Director, effective from 1 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 the 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 2014, the Board, which has a unitary board structure, comprised eight 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 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.

Ms T Singh, who had served as Deputy Company Secretary, was appointed as Company Secretary with effect from 1 August 2014.

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, is 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 38.

All Directors who are not members of the Board Committees may attend Board Committee meetings; however, they 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 four 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 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.

CORPORATE GOVERNANCE continued

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 38). 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 pages 46 to 47) 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 (one of whom acts as chairman), the CEO, and the Executive Director.

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 and External 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 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 96 to 111.

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 (excluding 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. The Deputy Chairman, who is 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 three Non-Executive Directors, of which one acts as Chairman, and the CEO and the Executive Director. 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:

CORPORATE GOVERNANCE continued

- 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 IT 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.

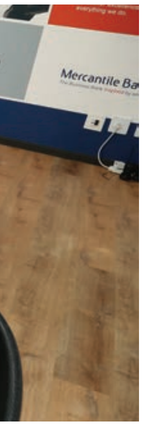
All of these committees operate in terms of their charters, which define their duties and responsibilities. Directors may attend any Management Committee meetings.

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,



"If you want to create five million new jobs by 2020 you need one million new businesses to be created. This will require active and entrepreneurial citizenry of the highest order backed by supportive government working in partnership with big business." *Clem Sunter*

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 income tax regulations), and have the option of two medical aid schemes to choose from. It also includes a retirement contribution, where 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 the 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 R300 000, payment is split into tranches (April and October, i.e. the higher of R300 000 or 50% in the first tranche). Measurement criteria are aligned to 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 the Bank's 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

CORPORATE GOVERNANCE continued

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's 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 R300 000 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. PwC Remchannel provided expert input to the Remuneration Committee as part of the design of the CSP and the CPSP schemes. In July 2014 the short- and long-term schemes were independently reviewed by PwC Remchannel, who concluded that both schemes were still meeting the original objectives and were in alignment with industry trends.

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.

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)	362
Sign on awards (number of employees)	7
Value of sign-on awards	819
Severance payments (number of employees)	3
Value of severance awards	209
Portion of 2014 compensation not deferred	
Guaranteed compensation	157 878
Variable compensation	6 384
Portion of 2014 compensation deferred: Incentive bonus	19 140
2011 CPSP awards vested and settled in cash in 2014	3 203
Estimated value of CPSP awards awarded in 2014, not yet forfeited at 31 December 2014 and assuming 100% vesting	17 360

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.

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 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 CREDCOM 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 operate in accordance with the provisions of the Banks Act and Regulations, as well as industry best practices and King III requirements and are effectively independent and are compensated appropriately. 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.

IMPACT OF EUROPEAN REGULATION IN 2014

The Capital Requirements Directive ("CRD") IV ("the Directive") is a European regulation that became effective on 1 January 2014. From a remuneration perspective, it imposes a maximum ratio between variable and fixed remuneration for identified senior managers and material risk takers of European banking organisations (including their international subsidiaries). We were informed by our parent company, headquartered in Europe, that we were required to comply with the Directive as well as the Portuguese legal standards arising from the Directive.

During 2014, we considered the maximum ratio and the corresponding impact on our remuneration structure and it was found that our CEO was the only employee that fell within the scope of the Directive. We comply with the spirit and letter of the regulation in a

CORPORATE GOVERNANCE continued

simple and transparent manner and, in 2014, the CEO's remuneration was re-structured to ensure compliance with the Directive. The CEO's long-term incentive awarded in 2014 was cancelled and a role-based, non-pensionable allowance was introduced as compensation for the cancellation of the long-term incentive. The role-based, non-pensionable allowance has the flexibility to be increased or decreased to reflect changes in role and to maintain cost control. Role-based pay will not be adjusted for performance and will not be considered as salary for pension and benefits purposes. It will be reviewed and fixed annually. Our approach will assist us to remain competitive in terms of total remuneration, which is essential when considering that this regulatory requirement does not apply to the majority of our local competitors and the competitive market for talent in financial services.

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 R250 000 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 R250 000, 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 customers. 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, customers, competitors, employees, shareholder, suppliers and the community at large, by striving for high service levels, 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 2014:

	Male				Female				Foreign nationals		
Occupational levels	**A**	**C**	**I**	**W**	**A**	**C**	**I**	**W**	**Male**	**Female**	**Total**
Top management	0	0	0	1	0	0	0	0	1	0	2
Senior management	0	2	1	13	1	0	2	3	0	0	22
Middle management	8	3	9	34	6	5	3	45	0	0	113
Junior management	30	8	11	11	52	26	20	58	0	0	216
Semi-skilled	8	7	0	1	32	18	5	13	0	0	84
Unskilled	4	0	0	0	2	0	1	0	0	0	7
Total permanent	**50**	**20**	**21**	**60**	**93**	**49**	**31**	**119**	**1**	**0**	**444**
Temporary employees	1	0	0	1	0	2	0	3	0	0	7
Grand total	**51**	**20**	**21**	**61**	**93**	**51**	**31**	**122**	**1**	**0**	**451**

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

The effective management of key talent and succession planning remains a focus 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 benefited 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	259	416
Management/Leadership training	8	37
In-house training	259	416

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ANNUAL FINANCIAL STATEMENTS

Accounting policies, and the basis of accounting on which the annual financial statements are prepared, are set out on pages 50 to 111 of this report.

REGULATION

The Bank Supervision Department 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 shareholders 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.

Attendance of meetings by Directors

			Board Committees					
Name	Date of appointment to Mercantile Board	Board (joint meetings)	GAC	RMC	DAC	Remu-neration	Social, Ethics and Transfor-mation	Technology
Number of meetings held during the year under review		4	5	4	4	3	4	4
Director								
JAS de Andrade Campos (resigned 28 May 2014)	26.07.2002	2 C	▲	2 C	2 C	▲	2	▲
NF Thomaz	28.05.2014	2 C^^	▲	▲	2	▲	▲	▲
GP de Kock	23.11.2000	4	5	4	4	3 C	2^	4
L Hyne	01.06.2003	4	5 C	4C^^	4	3	▲	▲
AT Ikalafeng	16.11.2004	4	▲	▲	4	3	4C	▲
KR Kumbier	01.06.2010	4	▲	4	▲	▲	4	4
JPM Lopes (resigned 1 July 2014)	09.11.2005	2	▲	2	▲	▲	▲	2
RS Calico	01.07.2014	2	▲	2	▲	▲	2	2
TH Njikizana	06.11.2008	4	5	2#	4	3	▲	4 C
DR Motsepe	01.10.2014	1	1	▲	1	1	1	▲

▲ *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*
^ *Appointed as member on 22 July 2014*
^^ *Appointed as Chairman on 28 May 2014*
# *Appointed as member on 28 May 2014*

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 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.

COMPLIANCE OFFICER'S REPORT continued

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 GAC 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 – through 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");
- The Occupational Health and Safety Act, No. 85 of 1993 ("OHS"); and
- The Protection of Personal Information Act, No. 4 of 2013 ("POPI").

The most notable development and focus area in respect of regulatory reforms, during the upcoming year continues to be the anticipated implementation of the Protection of Personal Information Act, No. 4 of 2013 ("POPI"); the Foreign Account Tax Compliance Act ("FATCA"), and the Retail Distribution Review as part of the FAIS Act.

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 effective and enforceable at a date to be set by the President.

FATCA is intended to detect and deter the evasion of US tax by US persons who hold money outside the US. FATCA creates greater transparency by strengthening information reporting and compliance by providing rules around the processes of documenting, reporting and withholding on a payee. These rules greatly impact the South African financial services sector due to the Inter-Governmental Agreement ("IGA") that was signed between South Africa and the USA. The South African Revenue Service will submit financial reports received from all financial institutions on US indicia onto the Internal Revenue Service of the USA. 2015 has been earmarked as the first year for trial reporting.

The results of the Retail Distribution Review ("RDR") carried out by the Financial Services Board ("FSB") and documented in the latter part of 2014, propose far-reaching reforms to the regulatory framework for distributing retail financial products to customers in South Africa. The review was undertaken in response to the fact that, despite the significant progress achieved through the FAIS Act in raising intermediary professionalism, improving disclosure to customers and mitigating certain conflicts of interest, significant concerns about poor customer outcomes and mis-selling of financial products remain. The review outlines a more proactive and interventionist regulatory approach; it proposes a shift away from a purely rules-based compliance approach to one that also sees the introduction of a set of structural interventions designed to change incentives, relationships and business models in the market in a way that supports the consistent delivery of fair outcomes to customers.

The other focus area for 2014 was 'Treating Customers Fairly' under the ambit of FAIS. 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 six '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. 2015 will see further focus on the TCF approach.

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 customer 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 customers against international databases consisting of adverse customer 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 used to discharge Mercantile's cash threshold reporting obligation. In accordance with the

COMPLIANCE OFFICER'S REPORT continued

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.

The SARB conducted an on-site inspection of Mercantile's policies and procedures concerning anti-money laundering and combating the financing of terrorism during March/April 2014. Some deficiencies were identified but ultimately the inspection confirmed that Mercantile is successful in meeting its anti-money laundering and anti-terror financing obligations and no further action on the part of the regulator is expected.

Consumer protection regulation continued to be a key focus in 2014, 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.

The business of Mercantile is built on trust and integrity as perceived by our stakeholders, especially our customers, the Board, CGD and the regulators. An important element of trust and integrity is ensuring that Mercantile conducts its business in accordance with the values and Code of Ethics that the Bank has adopted, in compliance with applicable laws, rules and standards. In 2014, a Market Conduct Policy was introduced to comply with applicable statutory and regulatory obligations across the Bank. This policy forms part of the Bank's Enterprise Wide Risk Management Framework.

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

27 February 2015

ANNUAL FINANCIAL STATEMENTS

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 the CFO, MEL Teixeira (CA)SA.

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

"I have never been afraid to take a step backwards in the present if it meant future growth. But the real reward was that this trust in myself paid off."

Vusi Sithole

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 judgements 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 48 to 111, have been approved by the Board of Mercantile Bank Holdings Limited, and are signed on their behalf by:

NF Thomaz
Chairman

KR Kumbier
Chief Executive Officer

27 February 2015

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 2014, 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.

T Singh
Company Secretary

27 February 2015

INDEPENDENT AUDITOR'S REPORT

To the shareholder of Mercantile Bank Holdings Limited

REPORT ON THE FINANCIAL STATEMENTS

We have audited the consolidated and separate financial statements of the Company set out on pages 50 to 111, which comprise the statements of financial position at 31 December 2014, and the statements of comprehensive income, statements of changes in equity, and statements of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Company's Directors are responsible for the preparation and fair presentation of these consolidated and separate 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 consolidated and separate 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 consolidated and separate 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 about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the 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 control 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 management, 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, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of Mercantile Bank Holdings Limited as at 31 December 2014, and its consolidated and separate financial performance and consolidated and separate cash flows for the year then ended in accordance with IFRS and the requirements of the Companies Act of South Africa.

OTHER REPORTS REQUIRED BY THE COMPANIES ACT

As part of our audit of the consolidated and separate financial statements for the year ended 31 December 2014, we have read the Directors' report and the Audit Committee's report for the purpose of identifying whether there are material inconsistencies between these reports and the audited financial statements. These reports are the responsibility of the respective preparers. Based on reading these reports we have not identified material inconsistencies between these reports and the audited consolidated and separate financial statements. However, we have not audited these reports and accordingly do not express an opinion on these reports.

Deloitte & Touche

Deloitte & Touche
Registered Auditor
Per: Danie Crowther
Partner

27 February 2015

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

National Executive: *LL Bam Chief Executive, *AE Swiegers Chief Operating Officer, *GM Pinnock Audit, DL Kennedy Risk Advisory, *NB Kader Tax, TP Pillay Consulting, *K Black Clients & Industries, *JK Mazzocco Talent & Transformation, *MJ Jarvis Finance, *M Jordan Strategy, S Gwala Managed Services, *TJ Brown Chairman of the Board, *MJ Comber Deputy Chairman of the Board

A full list of partners and directors is available on request

* *Partner and Registered Auditor*

B-BBEE rating: Level 2 contributor in terms of the Chartered Accountancy Profession Sector Code

Member of Deloitte Touche Tohmatsu Limited

AUDIT COMMITTEE REPORT

for the year ended 31 December 2014

The GAC's duties include its statutory duties in terms of the Companies Act as well as additional duties assigned to it by the Board. It 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 both a statutory and a Board committee. Its powers and terms of reference are derived from the Companies Act 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 four Independent Non-Executive Directors. At 31 December 2014, the members were:

- L Hyne *(Chairman)* CA(SA)
- GP de Kock
- TH Njikizana CA(SA)
- DR Motsepe

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, 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 2015.

FINANCE FUNCTION

The GAC believes that the CFO, Ms MEL Teixeira, 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

27 February 2015

DIRECTORS' REPORT

for the year ended 31 December 2014

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 2014.

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 14 of the Integrated Annual Report. Details of the Company and Group financial results are set out on pages 50 to 111 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 current and previous year. The authorised and issued share capital of the Company and the Group is detailed in note 14 to the annual financial statements.

5. DIRECTORS, COMPANY SECRETARY AND REGISTERED ADDRESSES

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

NF Thomaz*⁺ (appointed 28 May 2014) *(Chairman)*
JAS de Andrade Campos*⁺ (retired 28 May 2014)
GP de Kock° *(Deputy Chairman)*
KR Kumbier# *(CEO)*
L Hyne°
AT Ikalafeng°
TH Njikizana^°
JPM Lopes*# (resigned 1 July 2014)
RS Calico*# (appointed 1 July 2014)
DR Motsepe° (appointed 1 October 2014)

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

The Directors of the Company, as at 27 February 2015, and details of their backgrounds, are shown on pages 8 to 11.

T Singh, who had served as Deputy Company Secretary, was appointed as Company Secretary with effect from 1 August 2014.

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 R25,668 million was declared on 27 February 2015 in respect of the year ended 31 December 2014 (2013: R27,501 million).

7. GROUP COMPANIES

All Group 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 Group companies consolidated, amounted to R133,8 million (2013: R167,3 million), and aggregate losses amounted to R2,1 million (2013: R3,6 million).

The principal consolidated companies are as follows:

	Issued share capital R'000	Effective holding %	Nature of business	Shares at cost 2014 R'000	Shares at cost 2013 R'000	Owing by subsidiaries 2014 R'000	Owing by subsidiaries 2013 R'000
Company name							
Compass Securitisation (RF) Ltd	–	74,9	Securitisation SPV	**–**	–	**–**	–
Mercantile Acquiring (Pty) Ltd	–	100	Property holding	**140**	140	**–**	–
Mercantile Bank Ltd	124 969	100	Banking	**1 485 448**	1 485 448	**347**	460
Mercantile Rental Finance (Pty) Ltd	–	74,9	Rental finance	**–**	–	**–**	–
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

Two special resolutions were adopted at the AGM held on 28 May 2014: to approve the amendment correcting the authorised share capital on the Company's Memorandum of Incorporation; and to approve the fees and remuneration respectively payable to Non-Executive Directors and Executive Directors.

10. EVENTS AFTER THE REPORTING PERIOD

No material events have occurred between the accounting date and the date of this report that require adjustment to the disclosure in the annual financial statements.

ACCOUNTING POLICIES

for the year ended 31 December 2014

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.

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 exposure to variable returns and power to direct relevant activities. 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 deconsolidated 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 initially recorded at cost, and are subsequently 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.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

6. FINANCIAL INSTRUMENTS continued

6.2 Financial assets continued

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.

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.

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 accounts receivable

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 that 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.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

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.

11. INTANGIBLE ASSETS

11.1 Computer software

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

Computer software and licences 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 are 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 are 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 Derecognition 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 derecognised.

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 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.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

13. TAX continued

13.2 Deferred tax continued

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 The 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 rate 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. The interest cost and expected return on plan assets, 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.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

19. KEY ASSUMPTIONS AND ESTIMATES APPLIED BY MANAGEMENT continued

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 2014:

	Standard/Interpretation	Effective date
IFRS 2 IFRS 3 IFRS 8 IAS16 IAS 24 IAS 38	Amendments resulting from annual improvements 2010 – 2012 cycle	Annual periods beginning on or after 1 July 2014
IFRS 3 IFRS 13 IAS 40	Amendments resulting from annual improvements 2011 – 2013 cycle	Annual periods beginning on or after 1 July 2014
IFRS 5 IFRS 7 IAS 19 IAS 34	Amendments resulting from September 2014 annual improvements to IFRS	Annual periods beginning on or after 1 January 2016
IFRS 7	**Financial instruments:** Disclosures	Annual periods beginning on or after 1 January 2018
IFRS 9	Financial instruments	Annual periods beginning on or after 1 January 2018
IFRS 10	**Consolidated financial statements:** Amendments regarding the sale or contribution of assets between an investor and its associate or joint venture; and amendments regarding the application of the consolidation exception	Annual periods beginning on or after 1 January 2016
IFRS 11	**Joint arrangements:** Amendments regarding the accounting for acquisitions of an interest in a joint operation	Annual periods beginning on or after 1 January 2016
IFRS 12	**Disclosure of interests in other entities:** Amendments regarding the application of the consolidation exception	Annual periods beginning on or after 1 January 2016

	Standard/Interpretation	Effective date
IFRS 14	Regulatory deferral accounts	Annual periods beginning on or after 1 January 2016
IFRS 15	Revenue from contracts with customers	Annual periods beginning on or after 1 January 2017
IAS 1	**Presentation of financial statements:** Amendments resulting from the disclosure initiative	Annual periods beginning on or after 1 January 2016
IAS 16	**Property, plant and equipment:** Amendments regarding the clarification of acceptable methods of depreciation and amortisation; and Amendments bringing bearer plants into the scope of IAS 16	Annual periods beginning on or after 1 January 2016
IAS 19	**Employee benefits:** Amended to clarify the requirements that relate to how contributions from employees or third parties are linked to service should be attributed to periods of service	Annual periods beginning on or after 1 July 2014
IAS 27	**Separate financial statements:** Amendments reinstating the equity method as an accounting option for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements	Annual periods beginning on or after 1 January 2016
IAS 28	**Investments in associates and joint ventures:** Amendments regarding the application of the consolidation exception	Annual periods beginning on or after 1 January 2016
IAS 38	**Intangible assets:** Amendments regarding the clarification of acceptable methods of depreciation and amortisation	Annual periods beginning on or after 1 January 2016
IAS 41	**Agriculture:** Amendments bringing bearer plants into the scope of IAS 16	Annual periods beginning on or after 1 January 2016

STATEMENTS OF FINANCIAL POSITION

at 31 December 2014

		GROUP		COMPANY	
	Note	**2014 R'000**	2013 R'000	**2014 R'000**	2013 R'000
ASSETS					
Intangible assets	2	**188 476**	196 468	**–**	–
Property and equipment	3	**214 994**	188 141	**–**	–
Tax	4	**133**	1 125	**–**	–
Other accounts receivable	5	**154 359**	96 908	**–**	–
Interest in subsidiaries	6	**–**	–	**1 916 328**	1 806 684
Other investments	7	**6 388**	5 799	**62**	62
Deferred tax assets	8	**496**	6 068	**–**	–
Non-current assets held-for-sale	9	**13 482**	13 470	**–**	–
Loans and advances	10	**6 223 991**	5 227 941	**–**	–
Derivative financial instruments	11	**6 132**	10 630	**–**	–
Negotiable securities	12	**440 767**	496 608	**–**	–
Cash and cash equivalents	13	**1 518 444**	1 490 690	**4 166**	4 292
Total assets		**8 767 662**	7 733 848	**1 920 556**	1 811 038
EQUITY AND LIABILITIES					
Total equity attributable to equity holders of the parent		**1 901 981**	1 793 644	**1 916 887**	1 807 204
Share capital and share premium	14	**1 207 270**	1 207 270	**1 207 270**	1 207 270
Capital redemption reserve fund		**3 788**	3 788	**3 788**	3 788
Employee benefits reserve		**(7 453)**	(6 186)	**–**	–
General reserve		**7 478**	7 478	**–**	–
Property revaluation reserve		**110 147**	99 364	**–**	–
Available-for-sale reserve		**4 635**	6 652	**1 169 797**	1 060 040
Retained earnings/(accumulated loss)		**576 116**	475 278	**(463 968)**	(463 894)
Non-controlling interests		**(2 070)**	(1 384)	**–**	–
Total equity		**1 899 911**	1 792 260	**1 916 887**	1 807 204
Liabilities		**6 867 751**	5 941 588	**3 669**	3 834
Deferred tax liabilities	8	**66 115**	71 561	**–**	–
Long-term funding	15	**527 559**	583 173	**–**	–
Debt securities	16	**202 764**	–	**–**	–
Deposits	17	**5 792 204**	5 041 649	**–**	–
Derivative financial instruments	11	**8 727**	11 459	**–**	–
Provisions and other liabilities	18	**79 085**	71 733	**–**	–
Tax	4	**5 213**	–	**–**	–
Other accounts payable	20	**186 084**	162 013	**3 669**	3 834
Total equity and liabilities		**8 767 662**	7 733 848	**1 920 556**	1 811 038

STATEMENTS OF COMPREHENSIVE INCOME

for the year ended 31 December 2014

		GROUP		COMPANY	
	Note	**2014 R'000**	2013 R'000	**2014 R'000**	2013 R'000
Interest income	22	**640 240**	586 022	**40**	74
Interest expense	23	**(290 858)**	(245 469)	**–**	–
Net interest income		**349 382**	340 553	**40**	74
Net charge for credit losses	11.4	**(34 029)**	(19 489)	**–**	–
Net interest income after credit losses		**315 353**	321 064	**40**	74
Net gain on disposal of available-for-sale investments		**–**	16 310	**–**	–
Net non-interest income		**234 100**	196 495	**27 501**	29 672
Non-interest income	24	**418 179**	342 599	**27 501**	29 672
Fee and commission expenditure	25	**(184 079)**	(146 104)	**–**	–
Net interest and non-interest income		**549 453**	533 869	**27 541**	29 746
Operating expenditure	26	**(368 778)**	(344 881)	**(114)**	(44)
Profit before tax		**180 675**	188 988	**27 427**	29 702
Tax	27	**(53 022)**	(52 679)	**–**	–
Profit after tax		**127 653**	136 309	**27 427**	29 702
Other comprehensive income					
Revaluation of owner-occupied properties		**14 492**	31 237	**–**	–
Remeasurement of defined benefit obligation		**(1 760)**	1 541	**–**	–
Gains on remeasurement to fair value on other investments and negotiable securities		**(688)**	1 274	**109 757**	118 248
Release to profit and loss on disposal of available-for-sale financial assets		**–**	(16 310)	**–**	–
Tax relating to other comprehensive income		**(4 545)**	(6 023)	**–**	–
Other comprehensive income net of tax		**7 499**	11 719	**109 757**	118 248
Total comprehensive income		**135 152**	148 028	**137 184**	147 950
Profit after tax attributable to:					
Equity holder of the parent		**128 339**	137 506	**27 427**	29 702
Non-controlling interests		**(686)**	(1 197)	**–**	–
		127 653	136 309	**27 427**	29 702
Total comprehensive income attributable to:					
Equity holder of the parent		**135 838**	149 225	**137 184**	147 950
Non-controlling interests		**(686)**	(1 197)	**–**	–
		135 152	148 028	**137 184**	147 950

STATEMENTS OF CHANGES IN EQUITY

for the year ended 31 December 2014

	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 31 December 2012	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**
Net movement for the year	**–**	**–**	**(1 267)**	**–**	**10 783**	**(2 017)**	**100 838**	**108 337**	**(686)**	**107 651**
Total comprehensive income/(loss) for the year	**–**	**–**	**(1 267)**	**–**	**10 783**	**(2 017)**	**128 339**	**135 838**	**(686)**	**135 152**
Profit after tax	**–**	**–**	**–**	**–**	**–**	**–**	**128 339**	**128 339**	**(686)**	**127 653**
Other comprehensive income/(loss)	**–**	**–**	**(1 760)**	**–**	**14 492**	**(688)**	**–**	**12 044**	**–**	**12 044**
Tax relating to other comprehensive income/loss	**–**	**–**	**493**	**–**	**(3 709)**	**(1 329)**	**–**	**(4 545)**	**–**	**(4 545)**
Dividend paid	**–**	**–**	**–**	**–**	**–**	**–**	**(27 501)**	**(27 501)**	**–**	**(27 501)**
Balance at 31 December 2014	**1 207 270**	**3 788**	**(7 453)**	**7 478**	**110 147**	**4 635**	**576 116**	**1 901 981**	**(2 070)**	**1 899 911**

	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 31 December 2012	1 207 270	3 788	941 792	(463 924)	1 688 926
Net movement for the year	–	–	118 248	30	118 278
Total comprehensive income for the year	–	–	118 248	29 702	147 950
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**
Net movement for the year	**–**	**–**	**109 757**	**(74)**	**109 683**
Total comprehensive income for the year	**–**	**–**	**109 757**	**27 427**	**137 184**
Profit after tax	**–**	**–**	**–**	**27 427**	**27 427**
Other comprehensive income	**–**	**–**	**109 757**	**–**	**109 757**
Dividend paid	**–**	**–**	**–**	**(27 501)**	**(27 501)**
Balance at 31 December 2014	**1 207 270**	**3 788**	**1 169 797**	**(463 968)**	**1 916 887**

STATEMENTS OF CASH FLOWS

for the year ended 31 December 2014

		GROUP		COMPANY	
	Note	**2014 R'000**	2013 R'000	**2014 R'000**	2013 R'000
Cash flows from operating activities					
Cash receipts from customers	28.1	**1 063 734**	929 287	**40**	74
Cash paid to customers, suppliers and employees	28.2	**(788 943)**	(693 018)	**(114)**	(44)
Cash generated from/(utilised in) operations	28.3	**274 791**	236 269	**(74)**	30
Dividends received		**103**	–	**27 501**	29 672
Tax (paid)	28.4	**(51 236)**	(51 141)	**–**	–
Net (increase) in income-earning assets	28.5	**(979 167)**	(197 675)	**–**	–
Net increase in deposits and other accounts	28.6	**711 065**	343 395	**(52)**	(260)
Net cash (outflow)/inflow from operating activities		**(44 444)**	330 848	**27 375**	29 442
Cash flows from investing activities					
Purchase of intangible assets	2.1	**(15 697)**	(25 402)	**–**	–
Purchase of property and equipment	3	**(32 417)**	(25 745)	**–**	–
Acquisition of non-current assets held-for-sale	9	**(12)**	(17)	**–**	–
Proceeds on disposal of property and equipment		**675**	55	**–**	–
Proceeds on disposal of investments		**–**	16 310	**–**	–
Net cash (outflow) from investing activities		**(47 451)**	(34 799)	**–**	–
Cash flows from financing activities					
Dividends paid		**(27 501)**	(29 672)	**(27 501)**	(29 672)
(Decrease)/Increase in long-term funding	15	**(55 614)**	1 297	**–**	–
Increase in debt securities	16	**202 764**	–	**–**	–
Net cash inflow/(outflow) from financing activities		**119 649**	(28 375)	**(27 501)**	(29 672)
Net cash inflow/(outflow) for the year		**27 754**	267 674	**(126)**	(230)
Cash and cash equivalents at the beginning of the year		**1 490 690**	1 223 016	**4 292**	4 522
Cash and cash equivalents at the end of the year	13	**1 518 444**	1 490 690	**4 166**	4 292

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2014

	GROUP			
	2014		2013	
	Fair value R'000	**Carrying amount R'000**	Fair value R'000	Carrying amount R'000
1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS				
1.1 Category analysis of financial instruments				
ASSETS				
Available-for-sale	**185 262**	**185 262**	23 135	23 135
Other investments	**6 388**	**6 388**	5 799	5 799
Negotiable securities – Government stock	**178 874**	**178 874**	17 336	17 336
Loans and receivables	**8 144 378**	**8 144 281**	7 269 213	7 271 175
Loans and advances				
Current accounts	**1 314 639**	**1 314 639**	1 219 442	1 219 442
Credit cards	**15 744**	**15 744**	16 365	16 365
Mortgage loans	**2 431 852**	**2 431 852**	2 139 444	2 139 444
Instalment sales and leases	**819 115**	**819 115**	706 234	706 234
Structured loans	**80 539**	**80 539**	27 158	27 158
Medium-term loans	**1 547 696**	**1 547 696**	1 095 662	1 095 662
Negotiable securities				
Treasury bills	**205 633**	**205 565**	382 881	384 812
Land Bank promissory notes	**56 357**	**56 328**	94 429	94 460
Cash and cash equivalents	**1 518 444**	**1 518 444**	1 490 690	1 490 690
Other accounts receivable	**154 359**	**154 359**	96 908	96 908
Designated at fair value through profit and loss	**14 406**	**14 406**	23 636	23 636
Loans and advances				
Mortgage loans	**14 406**	**14 406**	22 741	22 741
Medium-term loans	**–**	**–**	895	895
Held-for-trading				
Derivative financial instruments	**6 132**	**6 132**	10 630	10 630
	8 350 178	**8 350 081**	7 326 614	7 328 576
LIABILITIES				
Held-for-trading				
Derivative financial instruments	**8 727**	**8 727**	11 459	11 459
Amortised cost	**6 505 847**	**6 505 847**	5 786 835	5 786 835
Long-term funding	**527 559**	**527 559**	583 173	583 173
Deposits	**5 792 204**	**5 792 204**	5 041 649	5 041 649
Other accounts payable	**186 084**	**186 084**	162 013	162 013
	6 514 574	**6 514 574**	5 798 294	5 798 294

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	COMPANY			
	2014		2013	
	Fair value R'000	**Carrying amount R'000**	Fair value R'000	Carrying amount R'000
1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued				
1.1 Category analysis of financial instruments continued				
ASSETS				
Available-for-sale	**1 916 390**	**1 916 390**	1 806 746	1 806 746
Other investments	**62**	**62**	62	62
Interest in subsidiaries	**1 916 328**	**1 916 328**	1 806 684	1 806 684
Loans and receivables				
Cash and cash equivalents	**4 166**	**4 166**	4 292	4 292
	1 920 556	**1 920 556**	1 811 038	1 811 038
LIABILITIES				
Amortised cost				
Other accounts payable	**3 669**	**3 669**	3 834	3 834
	3 669	**3 669**	3 834	3 834

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 and debt securities are carried at amortised cost and approximate the fair value reported as they bear variable rates of interest.
- Deposits generally have short terms to maturity and 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 shareholder's 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. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

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).

	GROUP			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2014				
ASSETS				
Available-for-sale				
Other investments	**–**	**–**	**6 388**	**6 388**
Negotiable securities – Government stock	**178 874**	**–**	**–**	**178 874**
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	**–**	**14 406**	**–**	**14 406**
Medium-term loans	**–**	**–**	**–**	**–**
Held-for-trading				
Derivative financial instruments	**6 132**	**–**	**–**	**6 132**
	185 006	**14 406**	**6 388**	**205 800**
LIABILITIES				
Held-for-trading				
Derivative financial instruments	**8 727**	**–**	**–**	**8 727**
	8 727	**–**	**–**	**8 727**
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

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	COMPANY			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued				
1.3 Fair value measurements recognised in the statement of financial position continued				
2014				
ASSETS				
Available-for-sale				
Other investments	**–**	**–**	**62**	**62**
2013				
ASSETS				
Available-for-sale				
Other investments	–	–	62	62

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

	2014 R'000	2013 R'000
1.4 Reconciliation of Level 3 fair value measurements of financial assets		
GROUP		
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning of the year	**5 799**	5 052
Gains on remeasurement to fair value in comprehensive income	**589**	747
Balance at the end of the year	**6 388**	5 799
COMPANY		
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning and end of the year	**62**	62

	GROUP	
	2014 R'000	2013 R'000
2. INTANGIBLE ASSETS		
Computer software		
Cost at the beginning of the year	**323 378**	317 983
Additions	**15 697**	25 402
Net transfer from/(to) property and equipment	**5 955**	(8)
Write-off of obsolete computer software	**(27 258)**	(19 999)
Cost at the end of the year	**317 772**	323 378
Accumulated amortisation and impairment losses at the beginning of the year	**(126 910)**	(120 150)
Amortisation	**(29 238)**	(26 759)
Write-off of obsolete computer software	**26 852**	19 999
Accumulated amortisation and impairment losses at the end of the year	**(129 296)**	(126 910)
Net carrying amount at the end of the year	**188 476**	196 468

During 2013 and 2014, the Group identified no events or circumstances that would indicate that the Group's intangible assets may need to be impaired.

3. PROPERTY AND EQUIPMENT

	GROUP						
	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
2014							
Open market value/cost at the beginning of the year	160 764	15 967	98 925	9 864	34 118	705	320 343
Revaluations	11 229	–	–	–	–	–	11 229
Additions	16 555	783	3 081	6 215	5 401	382	32 417
Transfer*	–	–	(5 955)	–	–	–	(5 955)
Write-off of obsolete assets	–	(2 454)	(65 795)	(4 772)	(13 132)	–	(86 153)
Disposals	–	–	–	–	–	(144)	(144)
Open market value/cost at the end of the year	188 548	14 296	30 256	11 307	26 387	943	271 737
Accumulated depreciation and impairment losses at the beginning of the year	–	(13 062)	(84 888)	(7 259)	(26 433)	(560)	(132 202)
Depreciation	(3 847)	(628)	(4 058)	(601)	(3 034)	(123)	(12 291)
Revaluation	3 263	–	–	–	–	–	3 263
Write-off of obsolete assets	–	1 977	65 301	4 719	12 346	–	84 343
Disposals	–	–	–	–	–	144	144
Accumulated depreciation and impairment losses at the end of the year	(584)	(11 713)	(23 645)	(3 141)	(17 121)	(539)	(56 743)
Net carrying amount at the end of the year	187 964	2 583	6 611	8 166	9 266	404	214 994

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

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for the year ended 31 December 2014

	GROUP						
	Owner-occupied properties R'000	**Leasehold improve-ments 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 continued							
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

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

The historical cost of owner-occupied properties that have been revalued is R59,642 million (2013: R45,004 million).

GJ 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 2013 and 31 December 2014. Although independently valued, one of the owner-occupied properties was reported at the more conservative offer-to-purchase value.

A mortgage bond in the amount of R90 million has been registered over a property included in owner-occupied properties (refer to note 15).

A register containing details of owner-occupied properties, and the revaluation thereof, is available for inspection at the registered office of the Company.

	GROUP 2014 R'000	GROUP 2013 R'000
4. TAX		
South African Revenue Service		
Tax overpaid	**133**	1 125
Tax owing	**5 213**	–

	GROUP 2014 R'000	GROUP 2013 R'000
5. OTHER ACCOUNTS RECEIVABLE		
Items in transit	**72 595**	52 604
Prepayments and deposits	**18 726**	14 472
Other receivables	**63 038**	29 832
	154 359	96 908

	COMPANY 2014 R'000	COMPANY 2013 R'000
6. INTEREST IN SUBSIDIARIES		
Unlisted		
Shares at fair value	**1 915 981**	1 806 224
Mercantile Bank Limited	**1 915 578**	1 804 089
Mercantile Insurance Brokers (Pty) Ltd	**403**	2 135
Loan – Mercantile Bank Limited	**347**	460
	1 916 328	1 806 684

A list of principal subsidiary companies is contained in note 7 of the Directors' report. The loan is interest-free and repayable on demand.

	GROUP 2014 R'000	GROUP 2013 R'000	COMPANY 2014 R'000	COMPANY 2013 R'000
7. OTHER INVESTMENTS				
Available-for-sale				
Unlisted equities	**6 388**	5 799	**62**	62
	6 388	5 799	**62**	62

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

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for the year ended 31 December 2014

	GROUP	
	2014 R'000	2013 R'000
8. DEFERRED TAX		
Balance at the beginning of the year	**(65 493)**	(57 648)
Movements relating to IAS 19 adjustments	**–**	(410)
Current year charge		
Per the statement of comprehensive income	**4 419**	(1 412)
Per the statement of changes in equity/other comprehensive income	**(4 545)**	(6 023)
	(65 619)	(65 493)
Comprising		
Deferred tax assets	**496**	6 068
Deferred tax liabilities	**(66 115)**	(71 561)
	(65 619)	(65 493)
Deferred tax is attributable to the following temporary differences:		
Asset/(Liability)*		
Intangible assets	**(41 862)**	(48 398)
Property and equipment	**(2 302)**	49
Provisions and other liabilities	**18 286**	16 883
Impairments on loans and advances	**2 311**	1 485
Calculated tax losses	**1 246**	772
Current assets	**(1 502)**	(2 031)
Revaluations	**(51 371)**	(44 306)
Leased assets	**3 258**	3 349
Other	**6 317**	6 704
	(65 619)	(65 493)

**The comparative amounts have been reconstituted to more appropriately represent the underlying nature of the line items included in the deferred tax breakdown.*

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.

	GROUP	
	2014 R'000	2013 R'000
9. NON-CURRENT ASSETS HELD-FOR-SALE		
Properties in possession	**13 482**	13 470
	13 482	13 470

The Bank intended, during 2013, to dispose of a property that it purchased as a result of a loan default but, due to unsatisfactory market conditions, the property has yet to be sold – it remains the Bank's intention to dispose of it in the short term. The property has been valued based on an independent valuation and allowing for cost of disposal.

	GROUP 2014 R'000	2013 R'000
10. LOANS AND ADVANCES		
10.1 Product analysis		
Amortised cost	**6 249 304**	5 245 044
Current accounts	**1 326 272**	1 241 606
Credit cards	**17 942**	19 521
Mortgage loans	**2 441 378**	2 144 070
Instalment sales and leases	**822 632**	710 519
Structured loans	**85 691**	27 535
Medium-term loans	**1 555 389**	1 101 793
Designated at fair value through profit and loss	**14 412**	23 644
Mortgage loans	**14 412**	22 748
Medium-term loans	**–**	896
Gross loans and advances	**6 263 716**	5 268 688
Less: Portfolio impairments for credit losses	**(11 727)**	(7 555)
Specific impairments for credit losses	**(27 998)**	(33 192)
	6 223 991	5 227 941

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

10.2 Maturity analysis

	2014 R'000	2013 R'000
Repayable on demand and maturing within one month	**1 386 169**	1 304 919
Maturing after one month but within six months	**19 721**	45 110
Maturing after six months but within 12 months	**288 924**	245 499
Maturing after 12 months	**4 568 902**	3 673 160
	6 263 716	5 268 688

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

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for the year ended 31 December 2014

10. LOANS AND ADVANCES continued

10.3 Detailed product analysis of loans and advances

	GROUP			
	Gross amount R'000	Portfolio impair-ments R'000	Specific impair-ments R'000	Net balance R'000
2014				
Current accounts	**1 326 272**	**(4 197)**	**(7 436)**	**1 314 639**
Credit cards	**17 942**	**(840)**	**(1 358)**	**15 744**
Mortgage loans	**2 455 790**	**(1 050)**	**(8 482)**	**2 446 258**
Instalment sales and leases	**822 632**	**(2 124)**	**(1 393)**	**819 115**
Structured loans	**85 691**	**(57)**	**(5 095)**	**80 539**
Medium-term loans	**1 555 389**	**(3 459)**	**(4 234)**	**1 547 696**
	6 263 716	**(11 727)**	**(27 998)**	**6 223 991**
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

10. LOANS AND ADVANCES continued

10.4 Impairments for credit losses

	GROUP						
	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
2014							
Balance at the beginning of the year	**(40 747)**	**(22 164)**	**(3 156)**	**(4 633)**	**(4 285)**	**(377)**	**(6 132)**
Movements for the year							
Credit losses written off	**31 797**	**23 372**	**962**	**163**	**1 339**	**–**	**5 961**
Net impairments (raised)/released	**(30 775)**	**(12 841)**	**(4)**	**(5 062)**	**(571)**	**(4 775)**	**(7 522)**
Balance at the end of the year	**(39 725)**	**(11 633)**	**(2 198)**	**(9 532)**	**(3 517)**	**(5 152)**	**(7 693)**
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)

	GROUP	
	2014 R'000	2013 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	**(30 775)**	(15 582)
Amounts written off directly to comprehensive income	**(7 500)**	(5 460)
Recoveries in respect of amounts previously written off	**4 246**	1 553
	(34 029)	(19 489)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

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for the year ended 31 December 2014

10. LOANS AND ADVANCES continued

10.5 Product analysis of performing loans and advances

	GROUP Gross amount R'000	Portfolio impairment R'000	Net balance R'000
2014			
Current accounts	**1 309 412**	**(4 197)**	**1 305 215**
Credit cards	**16 584**	**(840)**	**15 744**
Mortgage loans	**2 323 572**	**(1 050)**	**2 322 522**
Instalment sales and leases	**813 629**	**(2 124)**	**811 505**
Structured loans	**69 547**	**(57)**	**69 490**
Medium-term loans	**1 520 893**	**(3 459)**	**1 517 434**
	6 053 637	**(11 727)**	**6 041 910**
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

	GROUP 2014 R'000	2013 R'000
10.6 Product analysis of performing loans and advances excluding loans and advances with renegotiated terms		
Current accounts	**1 255 394**	1 201 219
Credit cards	**16 584**	16 276
Mortgage loans	**2 274 028**	2 057 189
Instalment sales and leases	**813 629**	703 537
Structured loans	**69 547**	27 535
Medium-term loans	**1 505 604**	934 797
	5 934 786	4 940 553
10.7 Product analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired		
Current accounts	**54 018**	–
Credit cards	**–**	1 204
Mortgage loans	**49 544**	10 727
Instalment sales and leases	**–**	–
Structured loans	**–**	–
Medium-term loans	**15 289**	129 249
	118 851	141 180

10. LOANS AND ADVANCES continued

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

	GROUP				
	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 enhance-ments R'000
2014					
Current accounts	**–**	**–**	**–**	**–**	**–**
Credit cards	**–**	**–**	**–**	**–**	**–**
Mortgage loans	**12 365**	**2 673**	**1 645**	**16 683**	**13 148**
Instalment sales and leases	**1 206**	**–**	**–**	**1 206**	**961**
Structured loans	**–**	**–**	**–**	**–**	**–**
Medium-term loans	**6 959**	**466**	**406**	**7 831**	**6 511**
	20 530	**3 139**	**2 051**	**25 720**	**20 620**
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

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for the year ended 31 December 2014

10. LOANS AND ADVANCES continued

10.9 Product analysis of loans and advances that are individually impaired

	GROUP			
	Gross amount R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhancements R'000
2014				
Current accounts	**16 860**	**(7 436)**	**9 424**	**8 609**
Credit cards	**1 358**	**(1 358)**	**–**	**–**
Mortgage loans	**132 218**	**(8 482)**	**123 736**	**127 036**
Instalment sales and leases	**9 003**	**(1 393)**	**7 610**	**5 411**
Structured loans	**16 144**	**(5 095)**	**11 049**	**10 851**
Medium-term loans	**34 496**	**(4 234)**	**30 262**	**29 460**
	210 079	**(27 998)**	**182 081**	**181 367**
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

10. LOANS AND ADVANCES continued

10.10 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 risk grading. The risk grading is dependent upon the customer's creditworthiness and standing with the Bank, and is subject to ongoing assessment of their 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 of assets (specific and general)	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 will be 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.

10.11 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.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

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for the year ended 31 December 2014

	GROUP			
	Notional principal of assets R'000	**Fair value of assets R'000**	**Notional principal of liabilities R'000**	**Fair value of liabilities R'000**
11. DERIVATIVE FINANCIAL INSTRUMENTS				
2014				
Held-for-trading				
Foreign exchange contracts	**282 285**	**6 049**	**341 281**	**8 558**
Interest rate swaps	**183 963**	**83**	**14 888**	**169**
	466 248	**6 132**	**356 169**	**8 727**
2013				
Held-for-trading				
Foreign exchange contracts	422 370	10 561	507 193	10 856
Interest rate swaps	–	69	25 203	603
	422 370	10 630	532 396	11 459

	GROUP	
	2014 R'000	2013 R'000
12. NEGOTIABLE SECURITIES		
Loans and receivables		
Treasury bills	**205 565**	384 812
Land Bank promissory notes	**56 328**	94 460
Available-for-sale		
Government stock	**178 874**	17 336
	440 767	496 608
Maturity analysis		
Maturing within one month	**–**	36 940
Maturing after one month but within six months	**244 374**	317 236
Maturing after six months but within 12 months	**22 924**	125 096
Maturing after one year but within five years	**173 469**	17 336
	440 767	496 608

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

	GROUP		COMPANY	
	2014 **R'000**	2013 R'000	**2014** **R'000**	2013 R'000
13. CASH AND CASH EQUIVALENTS				
Cash on hand	**31 836**	46 959	**–**	–
Central Bank balances	**261 651**	148 284	**–**	–
Money market funds	**784 745**	1 084 222	**–**	–
Rand denominated domestic bank balances	**33 094**	3 969	**4 166**	4 292
Foreign currency denominated bank balances	**407 118**	207 256	**–**	–
	1 518 444	1 490 690	**4 166**	4 292

14. SHARE CAPITAL AND SHARE PREMIUM

14.1 Issued – Group and Company

	GROUP			
	Number of issued ordinary shares	**Share capital R'000**	**Share premium R'000**	**Total R'000**
At 31 December 2013 and 31 December 2014	**3 614 018 195**	**36 140**	**1 171 130**	**1 207 270**

14.2 Authorised

The total authorised number of ordinary shares is 4 465 955 440 shares (2013: 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 (2013: 15 150 486 shares) with a par value of 25 cents each.

14.3 Unissued

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

	GROUP	
	2014 **R'000**	2013 R'000
15. LONG-TERM FUNDING		
International Finance Corporation ("IFC")	**437 539**	493 173
Short-term portion payable in the next 12 months	**117 845**	59 602
Portion payable after 12 months but within five years	**319 694**	433 571
Standard Bank of South Africa Limited ("Standard Bank")	**90 020**	90 000
	527 559	583 173

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).

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	GROUP	
	2014 R'000	2013 R'000
16. DEBT SECURITIES		
Unrated class A notes	**202 764**	–
	202 764	–

The notes, of R1 000 000 each, are unsubordinated, secured, compulsorily redeemable and asset-backed.

The notes were issued in 2014, with interest repayable quarterly and linked to JIBAR, and mature on 15 March 2017.

	GROUP	
	2014 R'000	2013 R'000
17. DEPOSITS		
Call deposits and current accounts	**2 921 627**	2 294 517
Savings accounts	**172 436**	174 507
Term and notice deposits	**2 543 482**	2 453 661
Negotiable certificates of deposit	**18 346**	30 542
Foreign deposits	**136 313**	88 422
	5 792 204	5 041 649
Maturity analysis		
Repayable on demand and maturing within one month	**3 592 354**	2 900 317
Maturing after one month but within six months	**1 082 529**	1 318 573
Maturing after six months but within 12 months	**389 230**	451 996
Maturing after 12 months but within five years	**728 091**	370 763
	5 792 204	5 041 649

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

18. PROVISIONS AND OTHER LIABILITIES

	GROUP						
	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
At 1 January 2013	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**
Provision raised	**3 620**	**19 030**	**7 198**	**–**	**4 354**	**2 334**	**36 536**
Reversal of provision	**–**	**–**	**(82)**	**–**	**–**	**(3 570)**	**(3 652)**
Charged to provision	**(3 203)**	**(16 000)**	**(5 370)**	**2 219**	**(2 717)**	**(461)**	**(25 532)**
At 31 December 2014	**7 524**	**19 030**	**5 757**	**20 489**	**12 780**	**13 505**	**79 085**

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.

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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 2014). The actuary's opinion is that the plan is in a sound financial position.

	GROUP				
	2014 R'000	2013 R'000	2012 R'000	2011 R'000	2010 R'000
The amounts recognised in the statement of financial position are as follows (refer to note 18):					
Present value of total service liabilities	**21 715**	19 900	21 575	18 577	20 648
Fair value of plan assets	**(1 226)**	(1 630)	(2 103)	(2 528)	(5 499)
Provident fund	**(914)**	(782)	(1 315)	(1 800)	(1 832)
Endowment bond	**(312)**	(848)	(788)	(728)	(2 530)
Annuities	**–**	–	–	–	(1 137)
Liability in the statement of financial position	**20 489**	18 270	19 472	16 049	15 149
The amounts recognised in the statement of comprehensive income, are as follows:					
Staff cost (refer to note 26):	**(1 060)**	(1 030)	(1 494)	(994)	(1 391)
Current service cost	**19**	22	13	53	50
Payments from plan assets	**540**	540	–	–	–
Employer benefit payments	**(1 619)**	(1 592)	(1 507)	(1 533)	(1 441)
Discharge of liability and related plan asset	**–**	–	–	486	–
Net interest cost (refer to note 23):	**1 519**	1 369	1 232	1 127	1 189
Interest costs	**1 636**	1 502	1 466	1 636	1 767
Expected return on plan assets	**(117)**	(133)	(234)	(509)	(578)
Total included in comprehensive income	**459**	339	(262)	133	(202)
The amounts recognised in the statement of other comprehensive income are as follows:					
Remeasurement of defined benefit obligation	**1 760**	(1 541)	3 685	767	1 488
Total included in other comprehensive income	**1 760**	(1 541)	3 685	767	1 488

	GROUP				
	2014	2013	2012	2011	2010
	R'000	R'000	R'000	R'000	R'000

19. POST-RETIREMENT MEDICAL BENEFITS continued

Reconciliation of the movement in the present value of total service liabilities:	**2014 R'000**	2013 R'000	2012 R'000	2011 R'000	2010 R'000
At the beginning of the year	**19 900**	21 575	18 577	20 648	19 370
Current service cost	**19**	22	13	53	50
Interest costs	**1 636**	1 502	1 466	1 636	1 767
Discharge of liability	**–**	–	–	(1 891)	–
Remeasurement of defined benefit obligation	**1 779**	(1 607)	3 026	(336)	902
Employer benefit payments	**(1 619)**	(1 592)	(1 507)	(1 533)	(1 441)
At the end of the year	**21 715**	19 900	21 575	18 577	20 648

Reconciliation of the movement in the fair value of plan assets:	**2014 R'000**	2013 R'000	2012 R'000	2011 R'000	2010 R'000
At the beginning of the year	**1 630**	2 103	2 528	5 499	5 507
Expected return on plan assets	**117**	133	234	509	578
Payments from plan assets	**(540)**	(540)	–	–	–
Non-qualifying plan assets as a result of discharge of liability	**–**	–	–	(2 377)	–
Remeasurement of defined benefit obligation	**19**	(66)	(659)	(1 103)	(586)
At the end of the year	**1 226**	1 630	2 103	2 528	5 499

The principal actuarial assumptions used were as follows:	**2014**	
Discount rate	**7,8%**	(2013: 8,6%) compounded annually
Investment return	**7,8%**	(2013: 8,6%) compounded annually
Rate of medical inflation	**7,6%**	(2013: 8,3%) compounded annually
Salary inflation	**7,1%**	(2013: 7,8%) 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 R1,791 million (2013: R1,806 million) and a decrease of R1,510 million (2013: R1,524 million), respectively.

20. OTHER ACCOUNTS PAYABLE

	GROUP		COMPANY	
	2014 R'000	2013 R'000	**2014 R'000**	2013 R'000
Accruals	**29 599**	23 685	**–**	–
Product-related credits	**33 975**	47 399	**–**	–
Sundry creditors	**118 841**	87 095	**–**	–
Previous minority shareholders (share buy-back)	**3 669**	3 834	**3 669**	3 834
	186 084	162 013	**3 669**	3 834

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	GROUP	
	2014 R'000	2013 R'000
21. CONTINGENT LIABILITIES AND COMMITMENTS		
21.1 Guarantees, letters of credit and committed undrawn facilities		
Guarantees	**468 748**	400 147
Shipping	**–**	117
Lending-related	**6 762**	6 914
Mortgage	**153 739**	111 670
Performance	**308 247**	281 446
Letters of credit	**42 567**	16 024
Committed undrawn facilities	**174 292**	105 747
	685 607	521 918
21.2 Commitments under operating leases		
The total minimum future lease payments under operating leases are as follows:		
Property rentals		
Due within one year	**5 477**	4 301
Due between one and five years	**5 732**	4 113
	11 209	8 414
After tax effect on operating leases	**8 070**	6 058

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		COMPANY	
	2014 R'000	2013 R'000	**2014 R'000**	2013 R'000
22. INTEREST INCOME				
Loans and receivables at amortised cost	**638 331**	583 298	**40**	74
Cash and cash equivalents	**68 255**	64 579	**40**	74
Negotiable securities	**26 138**	19 520	**–**	–
Loans and advances	**543 938**	499 199	**–**	–
Loans and receivables designated at fair value through profit and loss				**–**
Loans and advances	**1 909**	2 724	**–**	–
	640 240	586 022	**40**	74

	GROUP	
	2014 R'000	2013 R'000
23. INTEREST EXPENSE		
Deposits	**221 552**	193 984
Debt securities	**13 962**	–
Long-term funding	**48 713**	44 869
Held-for-trading		
Interest rate swaps	**552**	816
Net interest on defined benefit obligation	**1 519**	1 369
Other	**4 560**	4 431
	290 858	245 469

	GROUP		COMPANY	
	2014 R'000	2013 R'000	**2014 R'000**	2013 R'000
24. NON-INTEREST INCOME				
Fee and commission income	**316 456**	263 778	**–**	–
Loans and receivables	**316 246**	263 597	**–**	–
Insurance-related products	**210**	181	**–**	–
Trading income	**101 620**	78 821	**–**	–
Held-for-trading	**94 070**	70 379	**–**	–
Foreign currency	**93 657**	69 401	**–**	–
Derivative assets and liabilities	**413**	978	**–**	–
Designated at fair value through profit and loss	**7 550**	8 442	**–**	–
Loans and advances	**(1 007)**	(583)	**–**	–
Other investments	**8 557**	9 025	**–**	–
Investment income	**103**	–	**27 501**	29 672
Dividends	**103**	–	**27 501**	29 672
	418 179	342 599	**27 501**	29 672

	GROUP	
	2014 R'000	2013 R'000
25. FEE AND COMMISSION EXPENDITURE		
Relating to non-interest income earned from:		
Foreign currency	**42 393**	29 926
Fees and commissions*	**141 686**	116 178
	184 079	146 104

** VISA and MasterCard fees, which are directly attributable to fee and commission income, were previously included under operating expenditure but are now disclosed under fee and commission expenditure. Comparatives for 2013 (totalling R9,537 million) have been adjusted accordingly (refer to note 26).*

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for the year ended 31 December 2014

	GROUP		COMPANY	
	2014 R'000	2013 R'000	**2014 R'000**	2013 R'000
26. OPERATING EXPENDITURE				
Amortisation (refer to note 2)	**29 238**	26 759	**–**	–
Auditors' remuneration				
Audit fees – Current year	**7 117**	7 166	**–**	–
Fees for other services – Tax advisory fees	**230**	207	**–**	–
– Regulatory reviews	**–**	118	**–**	–
– Securitisation vehicle reviews	**373**	–	**–**	–
– Accounting services	**–**	382	**–**	–
– Other	**–**	44	**–**	–
	7 720	7 917	**–**	–
Depreciation (refer to note 3)	**12 291**	12 498	**–**	–
Directors' remuneration (refer to note 29.3)				
Executive Directors	**13 531**	16 350	**–**	–
Non-Executive Directors' fees	**3 819**	8 482	**–**	–
	17 350	24 832	**–**	–
Indirect tax				
Non-claimable value-added tax	**10 659**	9 911	**–**	–
Skills development levy	**1 720**	1 688	**–**	–
	12 379	11 599	**–**	–
Loss on sale and write-off of intangible assets and property and equipment	**1 135**	100	**–**	–
Marketing	**4 840**	2 430	**114**	44
Operating leases for premises and related costs	**13 633**	12 917	**–**	–
Other operating costs*	**42 899**	36 501	**–**	–
Professional fees				
Consulting	**3 748**	2 230	**–**	–
Securitisation set-up costs	**911**	2 486	**–**	–
Legal and collection	**5 599**	2 752	**–**	–
Computer consulting and services	**35 715**	36 278	**–**	–
	45 973	43 746	**–**	–
Staff costs				
Salaries, allowances and incentives	**174 355**	158 801	**–**	–
Post-retirement medical benefits (refer to note 19)	**(1 060)**	(1 030)	**–**	–
Deferred bonus scheme expense including Directors	**3 619**	5 113	**–**	–
Other	**4 406**	2 698	**–**	–
	181 320	165 582	**–**	–
Total operating expenditure	**368 778**	344 881	**114**	44
Number of persons employed by the Group at year-end	**451**	421		

** VISA and MasterCard fees, which are directly attributable to fee and commission income, were previously included under operating expenditure but are now disclosed under fee and commission expenditure. Comparatives for 2013 (totalling R9,537 million) have been adjusted accordingly (refer to note 25).*

27. TAX

	GROUP 2014 R'000	GROUP 2013 R'000	COMPANY 2014 R'000	COMPANY 2013 R'000
South African normal tax	**57 441**	51 267	**–**	–
Current year	**57 214**	51 267	**–**	–
Prior year	**227**	–	**–**	–
Deferred tax	**(4 419)**	1 412	**–**	–
Current year	**(5 226)**	1 009	**–**	–
Prior year	**807**	403	**–**	–
	53 022	52 679	**–**	–
Direct tax				
South African normal tax	**57 441**	51 267	**–**	–
South African tax rate reconciliation				
South African standard tax rate (%)	**28,00**	28,00	**28,00**	28,00
Exempt income (%)	**(0,02)**	0,00	**(27,97)**	(27,97)
Expenses not deductible for tax purposes (%)	**0,68**	0,75	**0,00**	0,00
Additional allowances for tax purposes (%)	**(0,11)**	(0,09)	**0,00**	0,00
Capital gain inclusion on unrealised portion not taxable (%)	**(1,79)**	(4,18)	**0,00**	0,00
Capital gain not taxable on realised portion (%)	**–**	(0,81)	**0,00**	0,00
Underprovision prior years (%)	**0,13**	0,21	**0,00**	0,00
Tax losses (%)	**2,46**	3,99	**(0,03)**	(0,03)
Effective tax rate (%)	**29,35**	27,87	**0,00**	0,00
Estimated tax losses available for offset against future taxable income	**11 220**	9 313	**6 770**	6 557

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for the year ended 31 December 2014

	GROUP		COMPANY	
	2014 R'000	2013 R'000	**2014 R'000**	2013 R'000
28. NOTES TO STATEMENTS OF CASH FLOWS				
28.1 Cash receipts from customers				
Interest income	**640 240**	586 022	**40**	74
Non-interest income and gains on disposal of investments	**418 179**	358 909	**27 501**	29 672
Adjusted for:				
Dividends received	**(103)**	–	**(27 501)**	(29 672)
Net (gain) on disposal of available-for-sale investments	**–**	(16 310)	**–**	–
Revaluation of fair value financial instruments	**1 172**	(887)	**–**	–
Recoveries in respect of amounts previously written off	**4 246**	1 553	**–**	–
	1 063 734	929 287	**40**	74
28.2 Cash paid to customers, suppliers and employees				
Interest expense	**(290 858)**	(245 469)	**–**	–
Operating expenditure and fee and commission expenditure	**(552 857)**	(490 985)	**(114)**	(44)
Adjusted for:				
Amortisation	**29 238**	26 759	**–**	–
Depreciation	**12 291**	12 498	**–**	–
Write-off of obsolete computer software	**406**	–	**–**	–
Write-off of obsolete property and equipment	**1 810**	617	**–**	–
Loss on sale and write-off of obsolete intangible assets and property and equipment	**1 135**	100	**–**	–
Deferred bonus scheme expense	**3 619**	5 113	**–**	–
Increase/(Decrease) in provisions and other liabilities	**6 273**	(1 651)	**–**	–
	(788 943)	(693 018)	**(114)**	(44)

28. NOTES TO STATEMENTS OF CASH FLOWS

continued

	GROUP		COMPANY	
	2014 R'000	2013 R'000	**2014 R'000**	2013 R'000
28.3 Reconciliation of profit before tax to cash generated from/(utilised in) operations				
Profit before tax	**180 675**	188 988	**27 427**	29 702
Profit before tax adjusted for:				
Dividends received	**(103)**	–	**(27 501)**	(29 672)
Net (gain) on disposal of available-for-sale investments	**–**	(16 310)	**–**	–
Revaluation of fair value financial instruments	**1 172**	(887)	**–**	–
Net impairments raised	**38 275**	21 042	**–**	–
Amortisation	**29 238**	26 759	**–**	–
Depreciation	**12 291**	12 498	**–**	–
Write-off of obsolete computer software	**406**	–	**–**	–
Write-off of obsolete property and equipment	**1 810**	617	**–**	–
Loss on sale and write-off of obsolete intangible assets and property and equipment	**1 135**	100	**–**	–
Deferred bonus scheme expense	**3 619**	5 113	**–**	–
Increase/(Decrease) in provisions and other liabilities	**6 273**	(1 651)	**–**	–
Cash generated from/(utilised in) operations	**274 791**	236 269	**(74)**	30
28.4 Tax				
Amounts paid at the beginning of the year	**1 125**	1 251	**–**	–
Statement of comprehensive income (charge)	**(57 441)**	(51 267)	**–**	–
Less: Amounts owing/(overpaid) at the end of the year	**5 080**	(1 125)	**–**	–
Total tax (paid)	**(51 236)**	(51 141)	**–**	–
28.5 Net movement in income-earning assets				
Decrease/(Increase) in negotiable securities	**54 564**	(240 045)	**–**	–
(Increase)/Decrease in loans and advances	**(1 033 731)**	42 370	**–**	–
Net (increase) in income-earning assets	**(979 167)**	(197 675)	**–**	–
28.6 Net movement in deposits and other accounts				
Increase in deposits	**750 555**	304 891	**–**	–
Decrease in subsidiary loans	**–**	–	**113**	44
(Increase) in other accounts receivable	**(60 654)**	(14 387)	**–**	–
Increase in other accounts payable	**21 164**	52 891	**(165)**	(304)
Net increase in deposits and other accounts	**711 065**	343 395	**(52)**	(260)

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29. RELATED PARTY INFORMATION

29.1 Identity of related parties with whom transactions have occurred

The parent company and material subsidiaries of the Group are identified on pages 48 and 49 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 parent company ("CGD") and its subsidiaries and other entities within the Group. Except for the interest-free loan between the Company and the Bank, transactions are governed by commercial terms.

	GROUP	
	2014 R'000	2013 R'000
Balances between the parent company ("CGD") and the Bank:		
CGD – Lisbon (Branch of CGD)	**69 083**	64 950
Nostro accounts	**682**	3 500
Vostro accounts	**(953)**	(934)
Call deposit	**(152)**	(149)
Foreign currency placements	**69 506**	62 533
CGD – Paris (Branch of CGD)		
Vostro accounts	**(114)**	(28)
CGD – New York (Branch of CGD)		
Foreign currency placements	**80 968**	–
CGD – London (Branch of CGD)		
Vostro accounts	**(11)**	(12)
Total CGD branches	**149 926**	64 910
Banco Comercial e de Investimentos – Mozambique ("BCI") (Subsidiary of CGD)	**(52 029)**	(100 662)
Foreign currency placements	**92 577**	–
Vostro accounts	**(3 900)**	(405)
Fixed deposits	**(136 806)**	(100 256)
Call and notice deposits	**(3 900)**	(1)
Banco Caixa Geral Totta Angola SA ("BCGTA") (subsidiary of CGD)		
Call deposit	**(5 053)**	(3 744)
Total placements with/(deposits from) CGD	**92 844**	(39 496)
Transactions between the parent company ("CGD") and the Bank:		
Interest paid by the Bank to CGD – Lisbon	**–**	2
Interest paid by the Bank to BCI	**8 851**	6 569
Interest paid by the Bank to BCGTA	**115**	69
Interest received by the Bank from CGD – Lisbon	**613**	7
Interest received by the Bank from CGD – New York	**14**	–
Interest received by the Bank from BCI	**59**	–

29. RELATED PARTY INFORMATION continued

29.2 Related party balances and transactions continued

		GROUP 2014 R'000	GROUP 2013 R'000
Balances with the Company, its subsidiaries and joint venture:			
Loan to:	**Loan from:**		
Mercantile Bank Limited	Mercantile Bank Holdings Limited	**347**	460
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown (Pty) Ltd	**–**	4 608
Portion 2 of Lot 8 Sandown (Pty) Ltd	Mercantile Bank Limited	**6 877**	–
Mercantile Acquiring (Pty) Ltd	Mercantile Bank Limited	**7 266**	7 819
Mercantile Insurance Brokers (Pty) Ltd	Mercantile Bank Limited	**146**	94
Mercantile Rental Finance (Pty) Ltd	Mercantile Bank Limited	**275 197**	391 718
Mercantile E-Bureau (Pty) Ltd	Mercantile Bank Limited	**4 071**	1 556
Compass Securitisation (RF) Limited	Mercantile Rental Finance (Pty) Ltd	**13 897**	–
Debt securities issued by:	**Invested in debt securities by:**		
Compass Securitisation (RF) Limited	Mercantile Rental Finance (Pty) Ltd	**95 495**	–
Deposit with:	**Deposit by:**		
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Ltd	**648**	2 262
Mercantile Bank Limited	Mercantile Bank Holdings Limited	**4 166**	4 292
Mercantile Bank Limited	Mercantile E-Bureau (Pty) Ltd	**1 966**	446
Mercantile Bank Limited	The Mercantile Bank Foundation (NPC)	**84**	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	**201**	–
Portion 2 of Lot 8 Sandown (Pty) Ltd	Mercantile Bank Limited	**185**	984
Mercantile Bank Limited	Mercantile Acquiring (Pty) Ltd	**837**	810
Mercantile Insurance Brokers (Pty) Ltd	Mercantile Bank Limited	**59**	79
Mercantile Bank Limited	Mercantile Rental Finance (Pty) Ltd	**27 828**	34 582
Mercantile Rental Finance (Pty) Ltd	Compass Securitisation (RF) Limited	**11 716**	–
Non-interest income earned by:	**Operating expenditure paid by:**		
Portion 2 of Lot 8 Sandown (Pty) Ltd	Mercantile Bank Limited	**18 546**	17 345
Mercantile Acquiring (Pty) Ltd	Mercantile Bank Limited	**1 897**	1 188
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Ltd	**1**	1
Mercantile Bank Limited	Mercantile Rental Finance (Pty) Ltd	**90**	143
Mercantile Bank Limited	Mercantile E-Bureau (Pty) Ltd	**44 174**	29 553
Mercantile Rental Finance (Pty) Ltd	Compass Securitisation (RF) Limited	**4 835**	–
Portion 2 of Lot 8 Sandown (Pty) Ltd	Mercantile Rental Finance (Pty) Ltd	**176**	138
Donations received by:	**Donations paid by:**		
The Mercantile Bank Foundation (NPC)	Mercantile Bank Limited	**1 000**	1 000
Dividends earned by:	**Dividends paid by:**		
Mercantile Bank Holdings Limited	Mercantile Insurance Brokers (Pty) Ltd	**1 800**	–
Mercantile Bank Holdings Limited	Mercantile Bank Limited	**25 701**	29 672

Other

Post-retirement medical plan

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

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29. RELATED PARTY INFORMATION continued

29.3 Director and Director-related activities

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

	GROUP						
	Directors' fees R'000	Salary* R'000	Role-based allowance** R'000	Fringe benefits R'000	Retirement funds and medical aid contribu-tions R'000	Perfor-mance bonus R'000	Total R'000
2014							
Non-Executive Directors							
NF Thomaz							
(appointed 28 May 2014)*	**–**	**–**	**–**	**–**	**–**	**–**	**–**
JAS de Andrade Campos							
(resigned 28 May 2014)	**740**	**–**	**–**	**–**	**–**	**–**	**740**
GP de Kock	**858**	**–**	**–**	**–**	**–**	**–**	**858**
L Hyne	**762**	**–**	**–**	**–**	**–**	**–**	**762**
AT Ikalafeng	**594**	**–**	**–**	**–**	**–**	**–**	**594**
DR Motsepe							
(appointed 1 October 2014)	**153**	**–**	**–**	**–**	**–**	**–**	**153**
TH Njikizana	**712**	**–**	**–**	**–**	**–**	**–**	**712**
Executive Directors							
RS Calico (appointed 1 July 2014)	**–**	**1 350**	**–**	**212**	**39**	**500**	**2 101**
KR Kumbier	**–**	**3 440**	**2 550**	**–**	**322**	**3 500**	**9 812**
JPM Lopes (resigned 1 July 2014)	**–**	**1 265**	**–**	**305**	**48**	**–**	**1 618**
	3 819	**6 055**	**2 550**	**517**	**409**	**4 000**	**17 350**
2013							
Non-Executive Directors							
JAS de Andrade Campos	1 712	–	–	–	–	–	1 712
DJ Brown							
(resigned 19 August 2013)	3 782	–	–	–	–	–	3 782
GP de Kock	704	–	–	–	–	–	704
L Hyne	664	–	–	–	–	–	664
AT Ikalafeng	562	–	–	–	–	–	562
TH Njikizana	633	–	–	–	–	–	633
D Naidoo							
(resigned 23 August 2013)	425	–	–	–	–	–	425
Executive Directors							
DJ Brown (tenure as CEO							
ended 31 March 2013)	–	892	–	–	272	6 400	7 564
KR Kumbier	–	2 900	–	–	294	2 500	5 694
JPM Lopes	–	2 010	–	496	86	500	3 092
	8 482	5 802	–	496	652	9 400	24 832

* *In line with CGD policy, an executive director of CGD will not be paid a fee for holding a directorship on the Board of a subsidiary entity within the Group. Accordingly Mr Thomaz does not receive a fee for his Chairmanship of the Mercantile Board.*

** *Refer below for nature of the role-based allowance.*

	GROUP 2014 R'000	GROUP 2013 R'000
29. RELATED PARTY INFORMATION continued		
29.3 Director and Director-related activities continued		
Deferred bonus scheme expense relating to Executive Directors		
DJ Brown (tenure as CEO ended 31 March 2013)	**–**	806
KR Kumbier	**483**	1 220
Loans to Executive Directors		
RS Calico (appointed 1 July 2014)	**956**	–
JPM Lopes (resigned 1 July 2014)	**–**	165
Amounts paid by CGD to Executive Directors		
RS Calico (appointed 1 July 2014)	**757**	–
JPM Lopes (resigned 1 July 2014)	**477**	736

Service agreements and deferred bonus scheme awards

KR 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 thereafter as CEO from 1 April 2013. The Remuneration Committee's annual bonus decision for Mr Kumbier considered performance during the year against Group and individual performance measures. The Remuneration Committee noted performance against key financial and non-financial measures contained in the balanced scorecard and the strong personal contribution made by Mr Kumbier during 2014, particularly in building and embedding a strong leadership team.

During 2014, of the 5 000 000 phantom awards granted in 2011 to Mr Kumbier, 1 775 000 phantom awards were cash settled at a proxy price of 64,9 cents each. The balance of awards (3 225 000) were forfeited as performance conditions in terms of the plan were not achieved.

In terms of the deferred bonus scheme, phantom awards granted to Mr Kumbier, which have not yet vested as at 31 December 2014, are as follows:

- 3 500 000, awarded in 2012, at an estimated proxy price of 71 cents each (of which 25% will vest in 2015); and
- 5 000 000, awarded in 2013, at an estimated proxy price of 80 cents each (vesting in 2016).

In 2014, Mercantile amended elements of the CEO's remuneration structure in response to the remuneration regulations outlined under the Capital Requirements Directive IV, a European Union legislative requirement impacting our parent company, CGD (and consequently MBHL). The CEO's 7 000 000 phantom awards granted under the deferred bonus scheme for 2014 were cancelled and a role-based non-pensionable allowance of R2,55 million was paid to the CEO in the 2014 financial year (refer to the remuneration table on page 94).

R Calico, Executive Director

Mr Calico has been seconded to Mercantile by CGD and took up office at Mercantile on 1 July 2014. In terms of his service agreement, Mr Calico 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.

JPM Lopes, Executive Director

Mr Lopes was seconded to Mercantile by CGD. Mr Lopes' employment contract was extended by the Board in 2011 to July 2014 and his effective resignation date was 1 July 2014. In terms of his service agreement, Mr Lopes performed such duties, functions and services that were assigned to him from time to time by the Board of Directors and which were consistent and commensurate with his position as Executive Director.

RISK MANAGEMENT AND CONTROL

"No action is too small when it comes to changing the world…
I'm inspired every time I meet an entrepreneur who is succeeding against all odds"

Cyril Ramaphosa

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 are 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;
- compliance with amended regulations introduced as part of Basel III implementation;
- 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;
- further improvements to the Treasury operations' 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;
- review and enhancement to the application of the Principles for Sound Liquidity Risk Management and Supervision;
- 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 mitigation of identified risks;
- implementation of a workflow solution in various departments;
- enhancements to operational risk data collection and reporting;
- comprehensive documentation and amalgamation of information relating to the Group's ICAAP ("Internal Capital Adequacy Assessment Process");
- Group-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 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,

RISK MANAGEMENT AND CONTROL continued

business line management, finance and control, legal/ compliance, treasury, and operations, with support from information technology. Independent oversight and validation by internal audit ensures a high standard of assurance across methodology, operational and process components of the Group's risk and capital management processes.

RISK MANAGEMENT LIFE CYCLE/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 ensure 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 life cycle, defined as:

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 and process review, to 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 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 and 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 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 at least 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. No specific targeting of the broader personal retail-based market is done. However, the Private Bank was launched during the year and it will specifically target entrepreneurs with the view to ultimately acquiring their business accounts. To manage the related credit risk, a new Head of Credit: Private Bank was appointed at the beginning of the year with the post reporting to the Head of Credit.

Dependent upon the risk profile of the customer, the risk inherent in the product offering and the track record/payment history of the customer, 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. The Bank does not lend to foreign registered companies but does provide banking to a number of locally-registered companies that have foreign

RISK MANAGEMENT AND CONTROL continued

shareholding and, occasionally, to CGD Group companies operating in certain African countries.

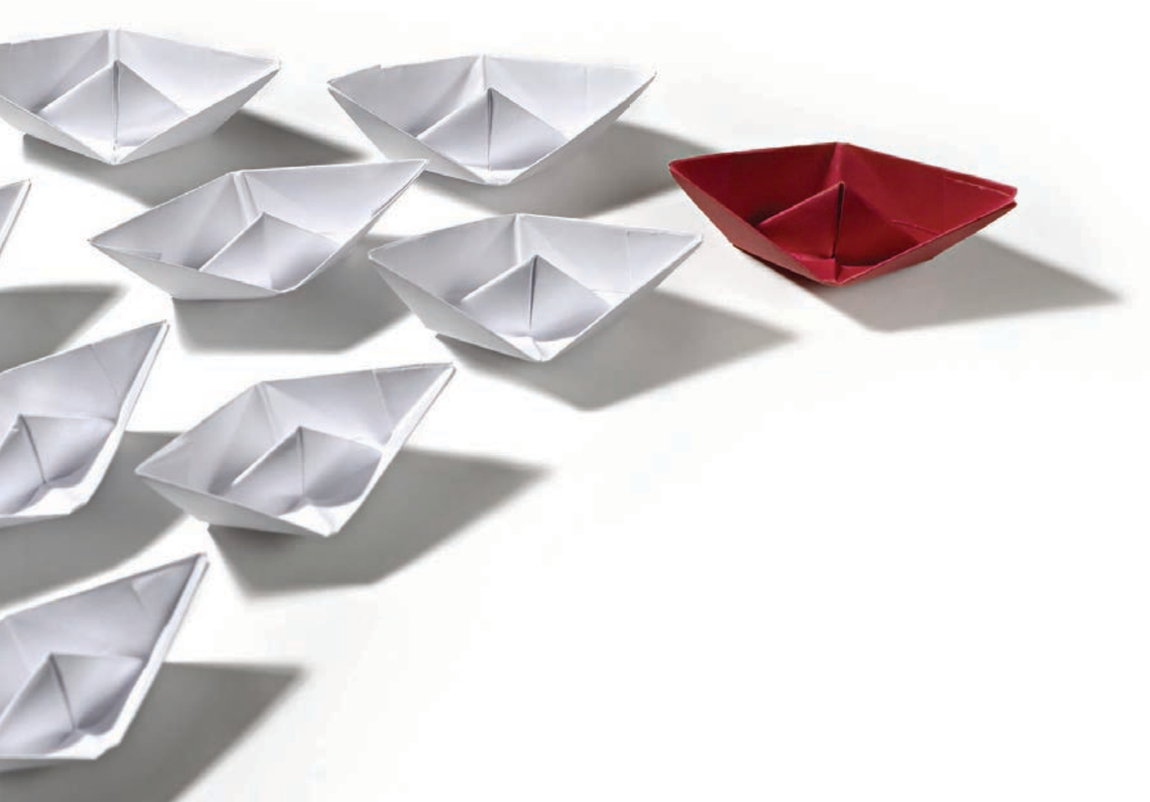
A portfolio analysis report is prepared and presented to the RMC analysing the performance and make-up of the book, including customer, geographic, segment and product concentration.

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). Adverse behavioural patterns such as continual excesses above approved limits are monitored closely by the Credit Department and discussed at the weekly CREDCOM meeting with appropriate actions being taken.

During the year, the following changes/reviews were implemented in the Credit Department:

- the RMC approved some changes to the sanctioning levels of various posts. These changes will not have any impact on the risk profile of the Group;
- a retired banker was engaged on a temporary basis to undertake a comprehensive review of collateral documentation. Certain shortcomings have been identified and the relevant departments are in process of rectifying where necessary. This is expected to be completed by 31 March 2015; and
- the Group implemented a workflow solution in the Credit Origination, Assessment and Fulfilment departments, allowing credit applications to be completed and formalised electronically, while managing the decision-making process in accordance with approved mandate levels.

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.



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
2014				
Current accounts	**1 326 272**	**–**	**–**	**1 326 272**
Credit cards	**17 942**	**13 643**	**–**	**31 585**
Mortgage loans	**2 455 790**	**160 649**	**–**	**2 616 439**
Instalment sales and leases	**822 632**	**–**	**–**	**822 632**
Structured loans	**85 691**	**–**	**–**	**85 691**
Medium-term loans	**1 555 389**	**–**	**–**	**1 555 389**
Negotiable securities	**–**	**–**	**440 767**	**440 767**
Cash and cash equivalents	**–**	**–**	**1 518 444**	**1 518 444**
Guarantees	**–**	**–**	**468 748**	**468 748**
Letters of credit	**–**	**–**	**42 567**	**42 567**
	6 263 716	**174 292**	**2 470 526**	**8 908 534**
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

Operational risk

Operational risk is defined as the risk of loss from inadequate or failed internal processes, people, and systems, or from external events. 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;
- development of appropriate risk mitigation actions in line with the Group's Risk Appetite as approved by the Board;
- 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;

RISK MANAGEMENT AND CONTROL continued

- 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 are outsourced to specialist service providers.

The Group further benchmarks itself and stays abreast of developments with regard to 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 have been put in place to ensure ongoing compliance.

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 launched the Private Bank Product with Loyalty and Airport lounge access during the year.

The Group implemented the high availability platform for BaNCS (Mercantile Bank's core banking system) which enables better servicing of customers.

A number of IT-related initiatives were implemented. These included:

- Prime integration into Bank@bility (online banking);
- Mercantile Online Investment (MOI) enhancements on BaNCS;
- Intermediary Trading Platform integration into BaNCS Treasury (Landobyte);
- SWIFT vendor replacement (to BankservAfrica);
- Prime 2 PCI-DSS version upgrade and infrastructure implementation;
- Verified-By-Visa for credit cards;
- backup technology upgrade;
- full network upgrade and overhaul (LAN and WAN); and
- COBIT Minimum Controls Framework phase 1 implementation.

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, which are reviewed at least annually, or more often, depending on prevailing market conditions.

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 a position. The Trading Committee will ensure that the Group is sensibly positioned, taking into account agreed limits, policies, prevailing market conditions, available liquidity, and the risk-reward trade-off, mainly in respect 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 event of a limit violation, the ALM forum records same, and it is immediately corrected and reported to the ALCO (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 because the Group does not currently have any proprietary trading positions. The impact of changes in foreign currency customer positions is, however, modelled to take cognisance of credit risks associated with volatility in foreign currency exchange rates, with the purpose of covering adverse positions by calling for initial and variation margins. A detailed sensitivity analysis is performed for interest rate and liquidity risk (described on pages 104 to 108).

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. Controls are in place to monitor foreign exchange exposures on a real-time basis through the Treasury system (BaNCS Treasury). Various conservative prudential risk limits are in place and associated exposures 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 net open foreign currency position limits 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 R15,7 million (2013: R53,6 million). An adverse movement in the exchange rate of 10% would reduce the Group's income by R1,6 million (2013: R5,4 million).

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

GROUP

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2014					
Total foreign exchange assets	**372 055**	**31 074**	**1 370**	**2 434**	**406 933**
Total foreign exchange liabilities	**(113 700)**	**(18 500)**	**(1 478)**	**(327)**	**(134 005)**
Commitments to purchase foreign currency	**116 601**	**87 306**	**8 881**	**13 942**	**226 730**
Commitments to sell foreign currency	**(370 251)**	**(96 740)**	**(7 254)**	**(14 416)**	**(488 661)**
Year-end effective net open foreign currency positions	**4 705**	**3 140**	**1 519**	**1 633**	**10 997**
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

RISK MANAGEMENT AND CONTROL continued

Interest rate risk

Interest rate risk is the impact on net interest earnings and 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 customers 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/receive 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 rates, 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 defined 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 2014 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. Pressure on margins is likely to continue during 2015.

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 R11,1 million, or decrease by R16,3 million respectively (2013: increase/decrease by R8,4 million/R11,9 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 on pages 105 and 106 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.

	GROUP						
	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 %
2014							
ASSETS							
Intangible assets	–	–	–	–	188 476	188 476	–
Property and equipment	–	–	–	–	214 994	214 994	–
Tax	–	–	–	–	133	133	–
Other accounts receivable	–	–	–	–	154 359	154 359	–
Other investments	–	–	–	–	6 388	6 388	–
Deferred tax assets	–	–	–	–	496	496	–
Non-current assets held-for-sale	–	–	–	–	13 482	13 482	–
Loans and advances	6 284 317	–	2 241	11 616	(74 183)	6 223 991	9,7
Derivative financial instruments	–	–	–	–	6 132	6 132	–
Negotiable securities	–	215 074	52 223	173 470	–	440 767	6,1
Cash and cash equivalents	976 536	–	69 506	–	472 402	1 518 444	4,7
Total assets	**7 260 853**	**215 074**	**123 970**	**185 086**	**982 679**	**8 767 662**	
EQUITY AND LIABILITIES							
Total equity	–	–	–	–	1 899 911	1 899 911	–
Deferred tax liabilities	–	–	–	–	66 115	66 115	–
Long-term funding	90 020	437 212	–	–	327	527 559	8,1
Debt securities	–	202 764	–	–	–	202 764	8,3
Deposits	3 577 053	336 299	603 321	79 776	1 195 755	5 792 204	4,2
Derivative financial instruments	–	–	–	–	8 727	8 727	–
Provisions and other liabilities	–	–	–	–	79 085	79 085	–
Tax	–	–	–	–	5 213	5 213	–
Other accounts payable	–	–	–	–	186 084	186 084	–
Total equity and liabilities	**3 667 073**	**976 275**	**603 321**	**79 776**	**3 441 217**	**8 767 662**	
Financial position interest sensitivity gap	**3 593 780**	**(761 201)**	**(479 351)**	**105 310**		**2 458 538**	
Derivative financial instruments	**180 281**	**(166 143)**	**(2 241)**	**(11 897)**		**–**	
Total net interest sensitivity gap	**3 774 061**	**(927 344)**	**(481 592)**	**93 413**		**2 458 538**	

RISK MANAGEMENT AND CONTROL continued

	GROUP						
	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	9,5
Derivative financial instruments	–	–	–	–	10 630	10 630	–
Negotiable securities	36 940	106 820	335 512	17 336	–	496 608	5,5
Cash and cash equivalents	1 087 235	62 533	–	–	340 922	1 490 690	4,6
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	7,7
Debt securities	–	–	–	–	–	–	–
Deposits	3 122 323	477 580	512 813	55 522	873 411	5 041 649	4,0
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)	21 504	–	(21 272)		–	
Total net interest sensitivity gap	3 180 938	(781 826)	(177 301)	(37 376)		2 184 435	

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 draw-downs and guarantees.

To measure liquidity risk, the Group aggregates assets and liabilities into defined 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 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 and 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 subscribes to the Bank of International Settlement's Principles for Sound Liquidity Risk Management and Supervision. Overall, the Group's liquidity position remains strong.

Macro-economic conditions continued to impede growth in advances and deposits as the South African banking sector is characterised by certain structural features, such as a low discretionary propensity to save, and a higher degree of contractual savings with institutions such as pension funds, provident funds and 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 (effective 2015).

The two key liquidity ratios that were introduced by Basel III are the liquidity coverage ratio ("LCR"), 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"), 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 phased-in implementation and compliance of the LCR and NSFR commencing 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 International Finance Corporation that has been fully utilised.

In 2014, the Group raised long-term funding through the securitisation of Mercantile Rental Finance's rental finance book. The first notes (R202 million) were issued to the International Finance Corporation in 2014, with a further R38 million to be issued during 2015. This has a further positive impact on the liquidity ratios as required by Basel III.

RISK MANAGEMENT AND CONTROL continued

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:

	GROUP		
	Assets R'000	Liabilities R'000	Total mismatch R'000
2014			
Maturing up to one month	**2 992 494**	**3 823 686**	**(831 192)**
Maturing between one and three months	**221 542**	**800 026**	**(578 484)**
Maturing between three and six months	**115 054**	**288 705**	**(173 651)**
Maturing between six months and one year	**312 005**	**389 355**	**(77 350)**
Maturing after one year	**4 742 439**	**1 458 559**	**3 283 880**
Non-contractual	**384 128**	**107 420**	**276 708**
	8 767 662	**6 867 751**	**1 899 911**
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 months 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

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

	GROUP				
	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
2014					
Deposits	**3 593 005**	**804 138**	**291 218**	**408 566**	**786 504**
Long-term funding	**–**	**–**	**–**	**–**	**649 534**
Debt securities	**–**	**–**	**–**	**–**	**237 988**
Derivative financial instruments	**2 257**	**1 935**	**4 266**	**124**	**145**
Other accounts payable	**144 777**	**–**	**–**	**–**	**–**
Guarantees, letters of credit and committed undrawn facilities	**685 607**	**–**	**–**	**–**	**–**
Operating lease commitments	**514**	**1 031**	**1 527**	**2 404**	**5 733**
	4 426 160	**807 104**	**297 011**	**411 094**	**1 679 904**
2013					
Deposits	2 900 934	1 040 249	292 350	472 154	401 990
Long-term funding	–	–	–	–	720 552
Debt securities	–	–	–	–	–
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

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 remain 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 regard 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 phased-in LCR requirement by 2015. The cost for this facility ranges from 15 to 30 basis points (weighted average) if not utilised. Utilisation of this facility will be 31 calendar days at a cost of SARB's repo rate plus 100 basis points.

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 2015 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 specific 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 ("ICAAP") 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.

A comprehensive review of the ICAAP was undertaken during the year under review, in line with suggestions made by the SARB following an on-site inspection of the former ICAAP. This review has seen the merging and streamlining of separate, but related, documents into an encompassing ICAAP document.

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 signal. Despite the regulations allowing the Group 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.

RISK MANAGEMENT AND CONTROL continued

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 assuring itself that the Group will fulfil the solvency and liquidity test immediately after completing the distribution.

The level of capital for the Bank is as follows:

	2014 R'000	2013 R'000
Risk-weighted assets – Banking book		
Credit risk	**6 450 327**	6 584 195
Operational risk	**1 055 502**	1 019 149
Market risk	**11 000**	59 925
Equity	**71 464**	5 737
Other assets	**164 357**	138 997
	7 752 650	7 808 003
Net qualifying capital and reserves		
Tier 1 capital	**1 708 073**	1 587 623
Share capital and share premium	**1 483 300**	1 483 300
Retained earnings	**311 188**	249 058
Other reserves	**60 199**	51 731
Less: Deductions	**(146 614)**	(196 466)
Tier 2 capital	**11 006**	5 587
General allowance for credit impairment	**11 006**	5 587
	1 719 079	1 593 210
Capital adequacy ratio (%)	**22,2**	20,4
Tier 1 capital (%)	**22,0**	20,3
Tier 2 capital (%)	**0,2**	0,1

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 fraud monitoring 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 first quarter of 2015. 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.

Verified-by-Visa functionality was implemented in the second quarter of 2014. 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 currently offers merchants point-of-sale devices to acquire transactions on behalf of VISA and MasterCard.

Fraud other than payment card fraud

The Group has adopted a zero tolerance approach toward all types of fraud and theft. The Forensic Investigators investigate 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 fraud 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 customers. Fraud awareness material on prevalent modus operandi is also made available to customers and staff members on the Bank's website in the Fraud Prevention webpage.

The issuance of additional modules of the Fraud Awareness User Guide was discarded and replaced 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 to create awareness of 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.

GLOSSARY OF TERMS

ABBREVIATION	DEFINITION/DESCRIPTION
AGM	Annual General Meeting
ALCO	Asset and Liability Committee
ALM	Asset and Liability Management
Bank Regulations	Regulations relating to banks issued under section 90 of the Banks Act, No. 94 of 1990, as amended
Banks Act	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, parent company of the Mercantile Bank Holdings Limited
Companies Act	Companies Act, No. 71 of 2008
CREDCOM	Credit Committee
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
Mercantile Rental Finance	Mercantile Rental Finance (Pty) Ltd, previously known as Custom Capital (Pty) Ltd
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

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Germiston Business Centre

The Lake Shopping Centre
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Horizon Business Centre

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