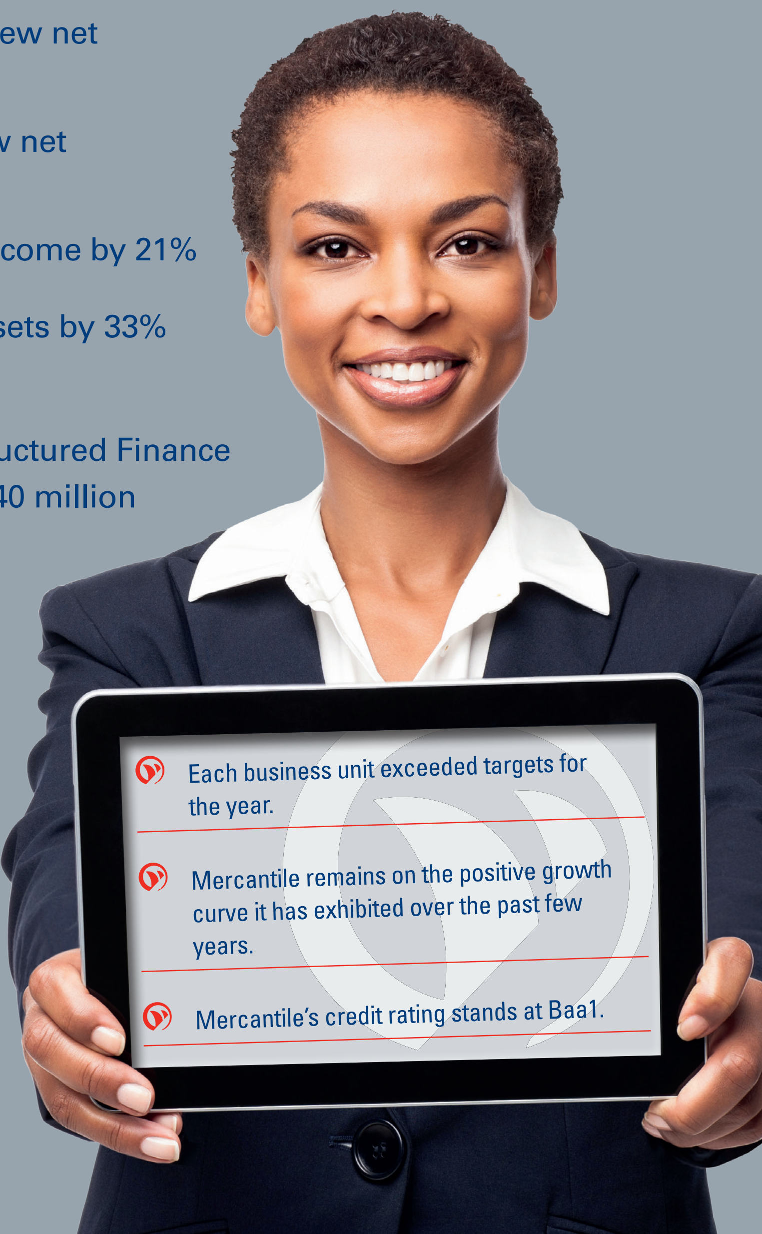
Mercantile Bank
Holdings Limited
The Business Bank inspired by entrepreneurs

2017 INTEGRATED ANNUAL REPORT

for the year ended 31 December

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 140 years. The Group provides niche business and commercial banking that is differentiated through great service underpinned by a deep understanding of the banking needs of the South African entrepreneur. While it operates exclusively within South Africa, Mercantile has reach into other key African markets through its parent company's subsidiaries in Angola and Mozambique.
There is an ongoing focus on capturing trade flows between these fast-growing economies.

- Rated #1 in service for Business and Commercial Banking (Consulta)
- Achieved double-digit growth of 15% in net non-interest income
  - Mercantile Payment Solutions grew net non-interest income by 26%
  - Mercantile Card Acceptance grew net non-interest income by 50%
  - Treasury grew net non-interest income by 21%
- Mercantile Rental Finance grew assets by 33% to R918 million
- Won the IFC award for the Best Structured Finance Deal in Emerging Markets for a R240 million securitisation transaction
- Signed a 7-year R740 million loan agreement with the IFC for funding to grow SME lending book
- One of only two South African banks to be upgraded (and by two notches) by Moody's in 2017
- The only bank in the Middle East and Africa region to win the MasterCard Data Integrity Award three years in a row



Contents

The December 2017 disclosure, required in terms of Regulation 43 of the Banks Act Regulations, is published on the Group's website.

Our approach to integrated reporting

Scope of the report

Our 2017 integrated report provides a comprehensive overview of the Group's activities and its financial and non-financial performance. The report also gives a detailed overview of the Group's value-creating operating model and strategy, and all financial and non-financial matters that are considered to be material for stakeholders to make an informed assessment of the historic performance and the forward-looking prospects of the Group.

Material matters

In determining the content to be included in this report, we consider factors that impact value creation for our stakeholders over the short, medium and long term. We also consider factors that affect the economic growth and social development of the environment we operate in. We regard an issue as material when it impacts our ability to achieve our strategy and create value.

Mercantile regards as material to the Group the successful execution of the Group's strategy, i.e. to grow entrepreneurs through successful partnerships. Our focus on this is underpinned by ongoing efforts to reinforce our values: being curious, committed and connected.

The capitals

Mercantile has identified financial capital, manufactured capital, intellectual capital, human capital and social capital as imperatives for our ability to create value for our business and our stakeholders. Although not a major consumer of natural capital, the Group acknowledges the role of business in protecting natural capital and acts accordingly. This report is not structured according to capitals, but the capitals are embedded and discussed within the relevant sections of the integrated report.

Reporting framework

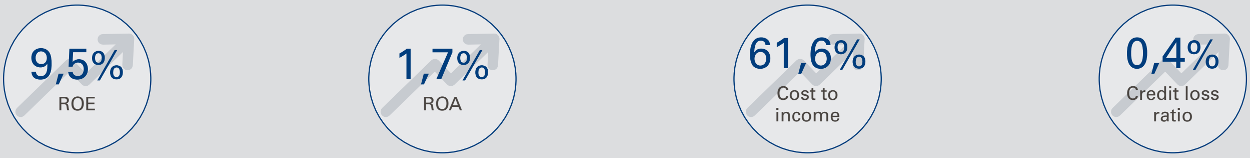
The integrated report has been prepared in accordance with the following frameworks:

- International Integrated Reporting Council (IIRC) Framework;
- King III Report on Corporate Governance;
- Companies Act, 71 of 2008;
- International Financial Reporting Standards (IFRS); and
- Banks Act, 94 of 1990.

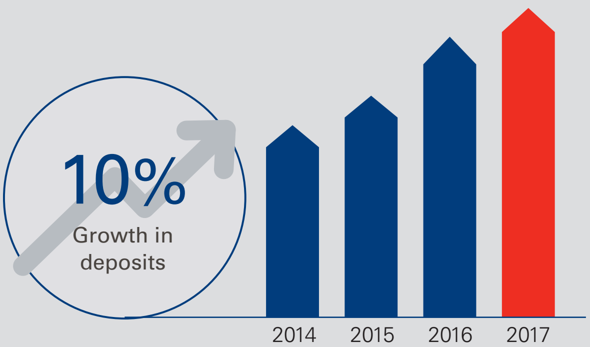
Five-year Group salient features

years ended 31 December

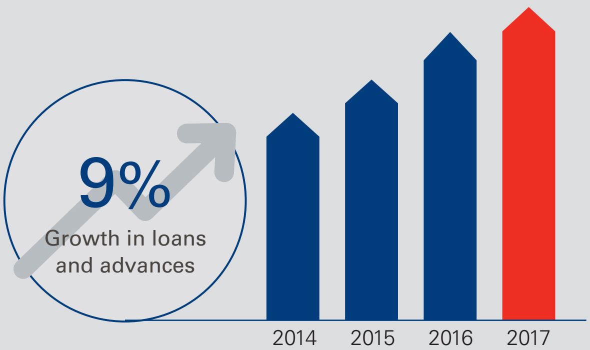
	2017 R'000	2016 R'000	2015 R'000	2014 R'000	2013 R'000
Statement of financial position					
Total assets	**13 350 170**	12 216 009	10 034 386	8 767 662	7 733 848
Loans and advances	**9 459 819**	8 661 812	7 250 043	6 223 991	5 227 941
Cash and cash equivalents	**1 750 165**	2 247 070	1 586 798	1 518 444	1 490 690
Total equity	**2 336 026**	2 155 878	2 020 612	1 899 911	1 792 260
Long-term funding	**609 395**	837 699	646 215	527 559	583 173
Debt securities	**241 594**	241 009	202 810	202 764	–
Deposits	**9 337 177**	8 473 034	6 721 913	5 792 204	5 041 649
Statement of comprehensive income					
Profit before tax	**293 085**	247 184	205 227	180 675	188 988
Profit after tax	**212 742**	177 018	146 889	127 653	136 309
Financial performance ratios (%)					
Return on average equity (ROE)	**9,5**	8,4	7,4	6,9	7,9
Return on average assets (ROA)	**1,7**	1,6	1,6	1,5	1,8
Cost to income	**61,6**	63,2	63,6	63,2	62,3
Share statistics (cents)					
Net asset value per share	**64,6**	59,7	55,9	52,6	49,6
Tangible net asset value per share	**60,4**	54,7	50,6	47,4	44,2



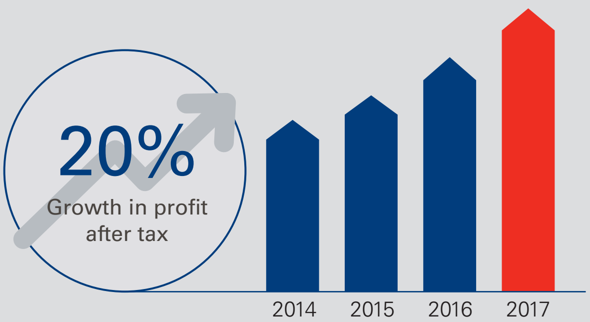
DEPOSITS



LOANS AND ADVANCES

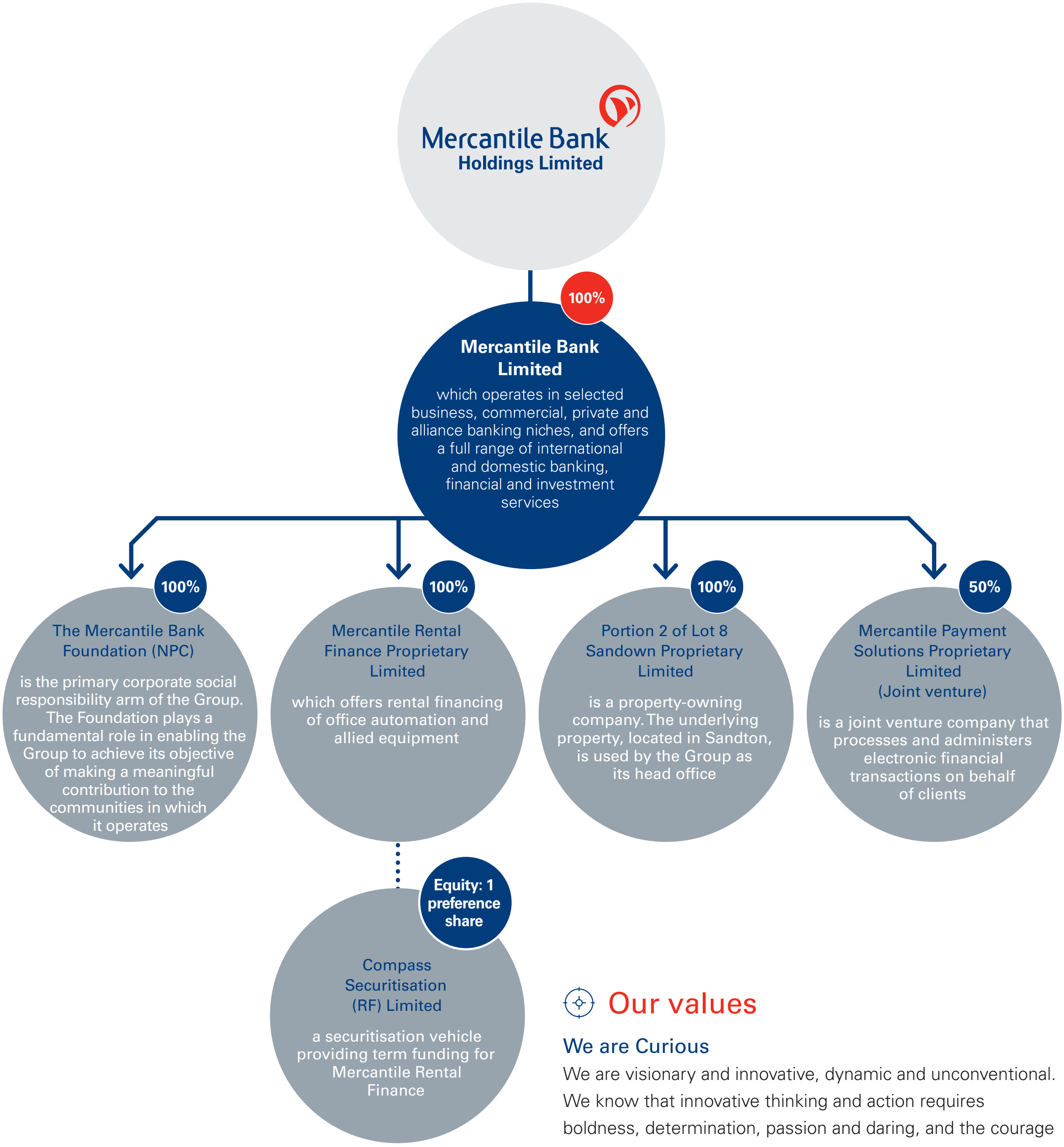


PROFIT AFTER TAX



About us

Mercantile Bank Holdings Limited is a registered bank-controlling and investment-holding company. Its holding company is CGD and its principal operating entities are:



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 and understand that success is ultimately built not on profit but on mutually beneficial partnerships.

We are Connected

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

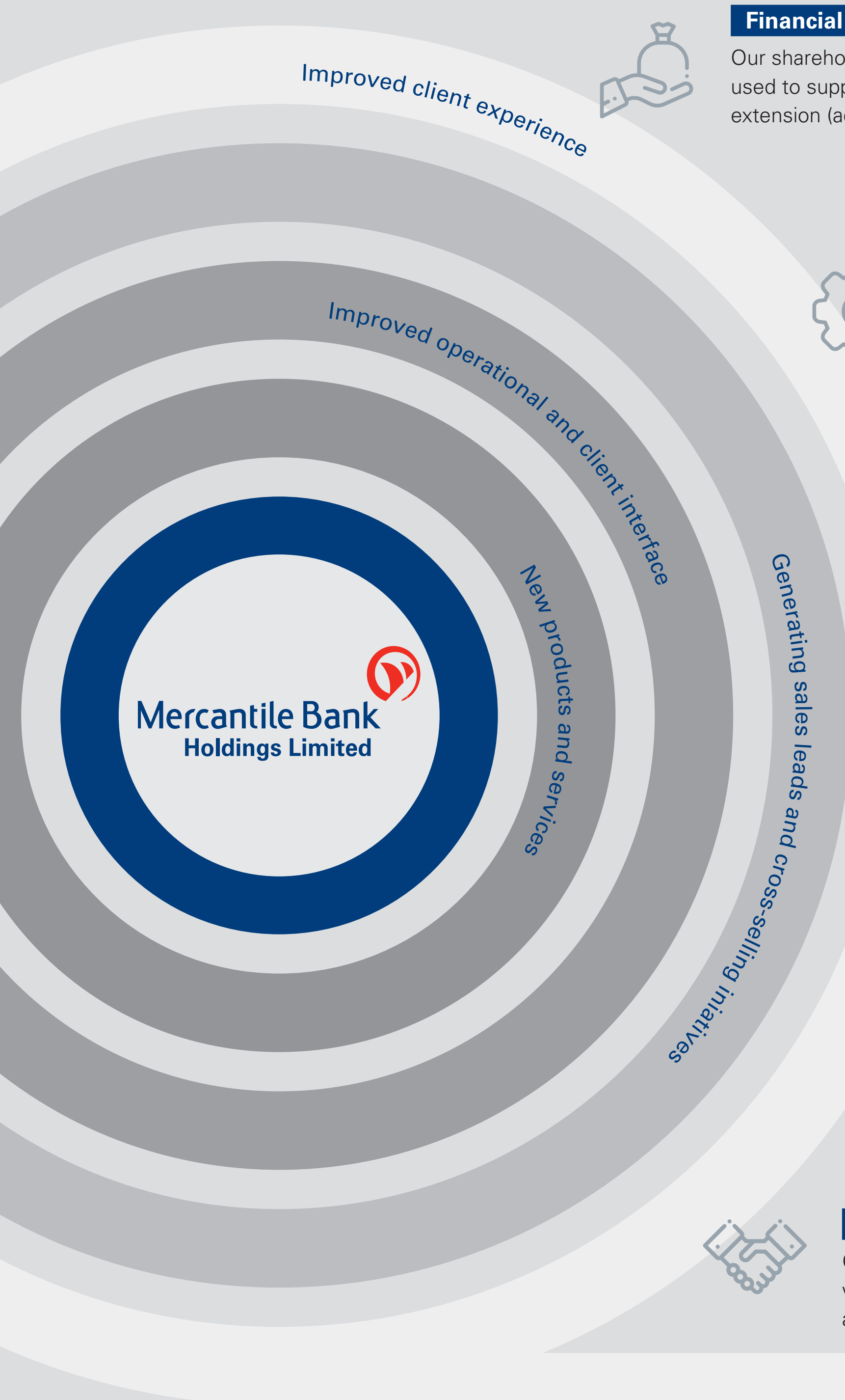
Our mission

We financially partner with entrepreneurs on their journey in creating successful businesses

Our vision

We grow entrepreneurs through successful partnerships.

Our value-creating business model



Financial capital

Our shareholders' equity and funding from investors and clients that are used to support our business and operational activities, including credit extension (advances)

Manufactured capital

Our business structure and operational processes, including our physical and digital infrastructure, our products, as well as our IT that provides the framework and mechanics of how we do business and make money

Human capital

Our people, investing in their development and our collective knowledge, skills and experience to enable innovative and competitive solutions for our clients

Natural capital

Our positive and negative impact on natural resources through our operations and business activity

Intellectual capital

Our brand and franchise value, research and development, innovation capacity, reputation and strategic partnerships

Social and relationship capital

Our citizenship and strong stakeholder relationships, including with the communities we serve, as we recognise that banks play an important role in building an economically thriving society

Outcomes at the end of 2017

- Profits are shared between ordinary shareholders (R42,458 million in dividends) and retained earnings for future growth (R170,284 million)
- Contributed to societal growth through the goods and services bought (R1,343 billion), taxes paid (R91,305 million) and employment (R289,291 million in employee compensation)
- Sound credit rating

- Operate 12 business centres nationally
- Property and equipment of R244,176 million
- Enhanced digital portfolio with new online platforms, mobile and other banking applications; transactional and trading platforms
- Call centres, data centres and premises for support functions

- 502 skilled and experienced employees with improved transformation (i.e. the percentage of black employees increased from 69% in 2016 to 71% in 2017). In addition, in respect of the senior management team, 43% are women and 48% are black
- An experienced leadership team
- R1,85 million in direct training spend on ongoing skills and development
- 37% of vacancies filled internally
- Employee engagement at 74% and attrition at a low 10%
- Corporate culture based on clear ethics and values

- Only small bank to have implemented the International Finance Corporation's Environmental and Social Risk Management performance standards and exclusion list

- Enterprise risk management framework
- IT capabilities, including innovation of new technologies. Invested R75,856 million in IT capital and operating expenditure, to deliver greater stability, ongoing resilience, increased protection against cyber risk, and delivery of new products and solutions
- Proprietary knowledge
- Specialised skills and expertise of employees, our Board and external advisers

- Collaboration with partners and service providers within agreed service level agreements
- Increased client satisfaction – the Bank managed to further increase its very high overall level of service for Business Banking from 81,2% in 2016 to 82,1% in 2017 and for Commercial Banking from 85,5% in 2016 to 86% in 2017. These achievements exceed the satisfaction levels of our major competitors
- R1 million spent on education and skills development in society
- Provided R1,135 billion of new financing for SMEs

"These results show that Mercantile remains on the positive growth curve it has exhibited over the past few years. We have worked hard to develop a clear strategy for our business and to ensure we create an organisational culture to support it. I believe we are reaping the benefits of the investments we have made."

Karl Kumbier,
CEO of Mercantile

Strategy

100% ZERO 2018

Why do we exist?

We **GROW** entrepreneurs

in

Established businesses

MARKET FOCUS

to deliver

Key products

- Transactional banking
- Lending
- Forex
- Deposits
- Payment services

achieving

Goal

GROWTH in PROFIT

driven by

Culture

"We **grow** entrepreneurs, build great relationships with all our stakeholders and **love what we do**" through

Great relationships

based on

Fantastic service

Service standards

- Do more than expected
- Make a plan
- Here when needed
- Quick and efficient

Strategic drivers

focused on

- Business & Commercial Banking
- Treasury
- Mercantile Payment Solutions
- Mercantile Rental Finance
- Card Services

through

We do our **talking** on the field

approach

great value …

Stakeholders

Clients
Community
Employees
Regulators
Shareholders
Suppliers

resulting in

Board of Directors

GP DE KOCK (63)
ACTING CHAIRMAN, INDEPENDENT NON-EXECUTIVE DIRECTOR

Deon attended executive programmes at the Business Schools of the Universities of Cape Town and Stanford, California (SEP). He retired in 2004 as managing director of Woolworths Financial Services Proprietary Limited and as an executive director of Woolworths Holdings Limited. Before that, he was the general manager of the credit card division of Edgars Stores Limited. He is currently working as an independent consultant in the retail and financial services industries.

KR KUMBIER (46)
CEO

Karl holds a BCompt degree from the University of South Africa and a PGDA from the University of Cape Town. He is a Chartered Accountant (South Africa) 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 joined Mercantile in 2010 and was appointed as CEO with effect from 1 April 2013. He is also a member of the board and the board executive committee (as the chief executive representing the independent banks) of the Banking Association of South Africa.

RS CALIÇO (45)
DEPUTY CEO, PORTUGUESE

Ricardo holds a degree in Economics from the Nova School of Business and Economics, as well as postgraduate qualifications in Investments and Financial Markets (ISCTE Business School) and Global Asset Management (Harvard Business School). Ricardo has 21 years' work experience in the financial services industry and has been employed by the CGD group since 2001, where he has held various positions including executive director in the CGD Asset Management Unit, general manager of the CGD New York branch, and regional general manager of the CGD Grand Cayman branch. Ricardo joined Mercantile in July 2014 as an executive director and, on 1 July 2015, was appointed Deputy CEO of the Mercantile Group.

DR MOTSEPE (60)
INDEPENDENT NON-EXECUTIVE DIRECTOR

Daphne holds a Baccalaureus Rationis degree (upgraded to a BCompt degree) as well as an MBA from De Montfort University in the United Kingdom. She 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 Kapela Investment Holdings Limited (and its investee companies XON Holdings Proprietary Limited and SPX Flow Technology South Africa), the Lewis Group and Edcon Limited. Daphne is a member of the executive committee of the Consultative Group to Assist the Poor (CGAP), an international organisation headquartered in Washington DC, which promotes responsible and inclusive financial markets. She is also a trustee on the Alexander Forbes Community Trust.

DEON KARL RICARDO DAPHNE

AT IKALAFENG (51)
INDEPENDENT NON-EXECUTIVE DIRECTOR

Thebe holds BSc (Bus Admin) and MBA degrees from Marquette University in the USA, has completed executive development courses in Finance at the University of the Witwatersrand and Harvard Business School, and is a Chartered Marketer (CM (SA)). He has occupied various marketing positions in the USA and Africa. He is the founder of the Brand Leadership Group, Brand Africa, and Public Sector Excellence. Thebe is a non-executive director of the World-Wide Fund for Nature in SA and Car Track Holdings Limited; deputy chairman of South African Tourism; and chairman of Brand Finance Africa. He is a member of the Henley Africa Business School advisory board and the founder of Brand Africa 100: Africa's Best Brands. Thebe has been named one of the 100 most influential Africans by *New Africa* magazine and "*Mr Brand*" by the *Mail and Guardian*. He has also been recognised with an American Marketing Association Award for Marketing Excellence.

TH NJIKIZANA (42)
INDEPENDENT NON-EXECUTIVE DIRECTOR, ZIMBABWEAN

Tapiwa is a Chartered Accountant (South Africa) and his professional career includes international experience in Africa, the United Kingdom and the Republic of Ireland. He currently serves as a director of W Consulting, which offers various professional services across Africa, the Middle East, the United Kingdom, Mauritius and Australia. Tapiwa has over 22 years' experience in public practice. He is a member of the Association for the Advancement of Black Accountants in Southern Africa, chairman of the South African Chapter of the Institute of Chartered Accountants of Zimbabwe, and sits on various SAICA committees, including the Accounting Practices Committee (since 2007). His industry experience includes financial services, mining, manufacturing, tourism, telecommunications, and transport and logistics. He is a Johannesburg Stock Exchange-registered IFRS Adviser. Tapiwa was named the 'Top Consulting Professional' at the 2018 South African Professional Services Awards.

L HYNE (74)
INDEPENDENT NON-EXECUTIVE DIRECTOR

Louis holds a BCom (Hons) degree and is a Chartered Accountant (South Africa). He has attended executive programmes at the University of the Witwatersrand's Graduate School of Business and Stanford University, California. He was appointed as a partner with Deloitte & Touche in 1970 and later became chief operating officer and deputy chairman, from which position he retired in May 2003. He holds directorships with various companies.

ADMINISTRATION

GROUP SECRETARY
T SINGH

Registered office
1st Floor, Mercantile Bank, 142 West Street, Sandown 2196

Postal address
PO Box 782699, Sandton 2146

Group review

CGD, a Portuguese state-owned banking corporation established in 1876, is the Group's sole shareholder.

CGD is the largest bank in Portugal, with four million clients in that country, a presence in 21 other countries spanning four continents, a global network of 1 139 branches, and consolidated assets of €93,2 billion (as at December 2017).

GP DE KOCK / ACTING CHAIRMAN

Trading conditions

2017 was an especially challenging year for South Africa. Key events included personal income tax hikes in February 2017; the rate cut by the SARB in July (the first in five years); and the surprise removal of the then Minister of Finance (Pravin Gordhan) in March 2017, which culminated in downgrades to junk status for the sovereign by two of the three ratings agencies. While the impact of this downgrade was felt in relatively low gross domestic product growth and long-term international investment, on the upside, inflation dropped within the SARB range of between 3% and 6%.

From a currency perspective, the Rand started the year at 13,7 against the US Dollar, depreciated to a low of 14,6, and closed the year at a high of 12,4 – a range of 15% over the period.

Considering all of these factors, the year ended on a positive note and there is cautious optimism for 2018 and beyond, particularly with the changes in the ruling party leadership during December 2017 and, more recently, the election of South Africa's new State President, Mr Cyril Ramaphosa.

Financial overview

In fairly difficult trading conditions, Mercantile has, for the third year in a row, delivered very good results. The growth in profit after tax for 2017 is 20%, following growth of 21% in 2016 and 15% in 2015. During 2017, Mercantile consolidated its growth path and each business unit exceeded targets for the year. Some of the highlights for the various business units are as follows:

- Business and Commercial Banking achieved a lending book of R9 billion and deposits of R6,9 billion at year-end, while maintaining credit losses at levels below the average in the South African banking industry;
- Treasury showed growth of 21% in non-interest income and USD3 billion turnover in foreign exchange deals;
- Card grew non-interest income by 50% and is now managing 33 000 merchants;
- Electronic Services grew non-interest income by 26% and processed monthly transaction values of R3 billion; and
- Mercantile Rental Finance increased its rental finance assets by 33% to R918 million and its profit after tax by over 200%.

Growth in profit after tax
↑20%

Growth in non-interest income
↑15%

For Mercantile to maintain high liquidity levels throughout the year and at the same time narrow the maturity mismatch between assets and liabilities, net interest income came under pressure. Added to this, the decrease in the repo rate during 2017 had a negative endowment effect. In spite of this, Mercantile grew its net interest income by 9% in 2017.

In an economic climate of high lending defaults due to difficult trading conditions, the charge for credit losses has remained unchanged from 2016. The credit loss ratio of 0,4% (charge for credit losses as a percentage of average lending) is slightly lower than the 0.5% for 2016. Non-performing loans as a percentage of total loans and advances increased from 2,1% in 2016 to 3,4% for 2017. This increase was mainly as a result of one large exposure that was placed into business rescue during December 2017. In line with the Bank's policy, this account was risk-graded to "non-performing"; however, based on information available at reporting, full recovery of the outstanding balance is expected.

Growing net non-interest income has been and will continue to be a key focus for the Group and we are proud of having achieved a second consecutive year of double-digit growth in this line, i.e. 15% in 2017 (2016: 16%).

KR KUMBIER / CEO

Following an 18% increase in operating expenditure in the 2016 financial year, Mercantile was able to contain the 2017 increase at 8%, resulting in higher growth in revenue than expenses. This was achieved by applying stringent cost control without compromising necessary expenditure on strategic initiatives to sustain future growth.

A focused effort went into growing our deposit base by 10% and, in December 2017, Mercantile concluded a committed R740 million seven-year term loan with the International Finance Corporation (IFC). The main purpose of this loan is to enable growth in SME lending, with a specific focus on black-owned and/or women-owned enterprises. This is the third significant investment in the Group by the IFC, which we see as recognition of the manner in which the Bank is managed.

As at December 2016, Mercantile had two loans totalling USD35 million from its sister company in Macau, Banco National Ultramarino S.A. Due to its strong and stable liquidity position, the Bank repaid USD15 million of the loan in 2017 and will settle the balance in March 2018. All foreign currency long-term funding is hedged against currency risk.

In 2014, Mercantile Rental Finance set up a securitisation structure that was listed on the JSE and issued R240 million of notes to a single investor, the IFC. That issue of R240 million unrated Class A notes matured and was repaid in 2017. The replacement notes were rated as "AAA" by Global Credit Ratings Company Proprietary Limited in June 2017 and were issued to two South African investors. Market conditions permitting, Mercantile plans to issue an additional tranche of A notes in 2018.

Group review continued

Strategic achievements

The strategic intent for 2017 was to capitalise on investments in projects and initiatives to enable growth through increased sales and cross-selling, and improved service. As an imperative, all regulatory project requirements were met. Some of the key projects/initiatives undertaken were as follows:

- Improving client experience through increased operational efficiencies in processes and procedures, workflow methodology, and risk management practices. Automation of certain key services has enabled the Group to significantly increase processing capacity with minimal impact on staff numbers;
- Generating sales leads and cross-selling initiatives by leveraging established client accounts in Mercantile Rental Finance, Foreign Exchange Intermediaries, and Card. Further, providing all staff access to a referral system and automating follow-up and tracking mechanisms enabled the opening of more than a thousand business accounts;
- Mercantile Rental Finance improved operational and client interface efficiencies through the introduction of workflow automation, credit scoring and improved business processes. These improvements are already reflected in faster processing of applications and decision-making; reduced paper usage, manual processing, duplications and errors; and a better client experience. This was achieved without negatively affecting the credit quality of the deals approved. Full implementation is planned for first quarter 2018;
- In 2015, Mercantile commenced its analysis of the impact of IFRS 9 (effective from 1 January 2018) as relates to credit impairments. During 2016, we assessed the requirements of building a credit impairment model that would be compliant with IFRS 9 requirements and identified a partner to assist us in building it. The model build commenced in February 2017 and, while largely complete, is still subject to calibration and external audit review (for the 2018 financial year). Other IFRS 9 requirements were also assessed but, due to the nature and size of Mercantile, any changes required to be implemented were minor and are not expected to have a significant impact;
- In partnership with VISA, Mercantile has launched a world-first fleet "chip" card, the Drive Card. This new card product has all the standard features of an industry fleet card, as well as additional unique functionalities; and
- The secure electronic document signing (electronic signatures) project was rolled out to various business units in the Bank. This enhancement has been well received by clients. Convenience, savings in time and cost, and significant productivity improvements are some of the rewards of this service.

Other achievements

We are very proud of the following awards and achievements earned in 2017:

- The MasterCard Data Integrity Award for the Middle East and Africa region was awarded to the Bank for the third consecutive year. Mercantile is the only bank, out of approximately 1 100 banks, that has received this prestigious award for three years in a row;
- The Bank received the IFC's "Emerging Markets Structured Finance Deal of the Year" award for the Mercantile Rental Finance securitisation deal;
- The Bank again participated in the annual Consulta customer service measurement survey with the four largest banks in the business and commercial banking space and was, once again, rated number 1 in service. The main objective of the study was to gain insight into the level of service delivered by the Bank and its clients' level of satisfaction therewith. The Bank managed to further increase its already very high overall levels of service; and
- In an environment where ratings agencies were downgrading the credit status of the sovereign and certain South African banks, Mercantile was one of only two local banks to be upgraded two notches during 2017.

Directorate and Company Secretary

There were no changes to the Board or Company Secretariat during the period under review.

Credit rating

Moody's issued the following RSA national-scale issuer ratings for the Bank on 14 June 2017:

Short-term	P-2.za (2016: P-3.za)
Long-term	Baa1.za (2016: Baa3.za)
Outlook	Stable (2016: Stable)

The Bank's ratings do not incorporate any parental support uplift. At the same time, Moody's also does not incorporate any government support uplift for the Bank given its relatively low potential systemic impact.

On 28 November 2017, Moody's placed the Bank's national-scale issuer ratings on review for upgrade. This was driven by the possible downgrade of the South African government's issuer rating, which would likely trigger a revision of the national-scale issuer ratings mapping and an upward repositioning of the Bank's national-scale issuer ratings because, relative to other South African entities, the Bank's creditworthiness would be expected to improve.

Sale of Mercantile

In March 2017, CGD announced its intention to dispose of its entire shareholding in Mercantile. The announcement generated significant interest with expressions of interest received from companies in various industries, both locally and internationally. However, as CGD is a Portuguese state-owned entity, the sale of Mercantile constitutes a privatisation of state-owned assets and, therefore, a decree law was required to be passed in Portugal to authorise the sale. The decree law was passed and promulgated in December 2017.

CGD (and its financial advisors, Caixa Banco de Investimento (Caixa BI) and Deutsche Bank AG (Deutsche Bank)) formally commenced the process to sell Mercantile in January 2018. Mercantile has been informed by CGD that the process will be formal and transparent and will incorporate at least two phases. In the first phase, interested parties, having signed a non-disclosure agreement, will be given access to information in relation to Mercantile on which to base a non-binding offer. These non-binding offers will be reviewed by CGD, Caixa BI and Deutsche Bank, against agreed criteria and shortlisted. The shortlist of bidders will be reviewed by the Portuguese state and the contenders' names will be published. In the second phase, the shortlisted contenders will have an opportunity to conduct their own due diligence into Mercantile and make binding offers. These offers will then be reviewed by CGD, Caixa BI and Deutsche Bank and, once a successful bidder has been officially approved by the Portuguese state, the name of the successful bidder will be announced (this is expected early in the third quarter of 2018). The successful bidder will be subject to Regulatory approval in South Africa. We expect the transaction to be concluded by the end of 2018.

As CGD is the seller and this is a CGD run process, the detailed terms of the non-binding offers, the ultimate determination of who makes the shortlist of prospective purchasers and who is the successful bidder will be determined by CGD. The Board's role in this process shall be to review the shortlisted bidders and to confirm whether it has any objections to any of the shortlisted bidders, in determining whether it has any such objections, the Board will consider the interests of all stakeholders, the most important of whom are Mercantile's clients and staff.

Outlook

Unlike in the past few years, there seems to be growing optimism, albeit cautious, that global growth is on the up and that this will have a positive impact on South Africa. This optimism is tempered by the fact that there will be a general election in 2019 and, in the run-up, there will be much repartee. We can expect more clarity in regard to policy and a growth strategy for the country and, if the country does manage to hold onto its investment grade (via Moody's) through 2019, it may encourage international investment, which will provide a much-needed stimulus to the economy.

We endorse the stated objectives of our new State President to grow the economy at a faster rate, to reduce the very high unemployment rate and to continue to transform the country that will enable all who live in it to have a better life. Given our positioning as the Bank for entrepreneurs, we welcome the focus on growth and development of SMEs to grow the economy and create employment. We also welcome the focus on eradicating corruption at all levels and embedding ethical leadership.

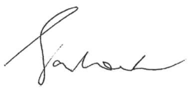
Over the past few years, Mercantile has proven that it is possible to achieve double-digit growth in a tough economic environment. Strategic initiatives put in place over the past five years are paying off pleasingly and we will hopefully continue the momentum and deliver a good set of results in 2018.

2018 will also be a very exciting year for Mercantile as a result of the impending sale. We are positive that we will attract the right buyer, who will provide us with the necessary capital and expertise to help take this Bank to the next level. It is for this reason that, from a strategic initiative point of view, 2018 will be a year of consolidation. We will not embark on any new large initiatives. We will rather focus on projects that are currently underway and continue to look at improving systems and processes that will result in a better client experience and deliver on our goal of being the best business and commercial bank in the country.

Appreciation

Mercantile continues to believe in building extraordinary relationships with its stakeholders. It is substantially as a result of these relationships that we have seen outstanding growth in our business and have been able to deliver a very good set of results for the 2017 year. We extend our sincere thanks to all our stakeholders for partnering with us in driving our goals, and especially to the SARB for their oversight and guidance.

We are very proud of the Mercantile team! Ours is a group of people whose excellent service ethos and commitment to quality exemplify the culture we have striven to build. It is in large part because of them that we have achieved and exceeded our goals for 2017 and we thank them for their efforts.



GP de Kock	KR Kumbier
Acting Chairman	*CEO*

28 February 2018

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. Our Sustainability Policy identifies and documents the themes, principles, strategy, objectives, management, performance and reporting of sustainability, with the aim of integrating sustainability into Mercantile's culture, and aligning our sustainability strategy with our business strategy. In 2015, the Group adopted a new sustainability reporting framework which, while aligned to CGD's sustainability reporting framework, remains cognisant of South Africa's unique nuances, including transformation of the economy and society.

The Group's sustainability programme is based on three themes: responsible business, community and environment.

Responsible business

1 Ethics and compliance

Areas of action | Indicators

- Definition of Corruption Prevention Policy
- Review of the Code of Conduct
- Prevention Plan Against Corruption Risks and Related Offences
- Reporting of breaches to the Code of Conduct
- Training and internal communication on ethics and conduct

- Practices against corruption and money laundering
- Code of Conduct

What we did in 2017

The King Reports on Corporate Governance indicate that corporate governance is rooted in an ethical foundation and also set guidelines on the management of ethics in organisations. The Group is committed to high moral, ethical and legal standards. It expects all of its representatives to observe 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: shareholders, clients, employees, alliance partners, service providers, joint venture partners, the community, government, and society at large.

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

The Group is a member of The Ethics Institute and two of its employees are certified as Ethics Officers by The Ethics Institute in partnership with the University of Stellenbosch Business School. The Group has also taken up membership of the Coalition for Ethical Operations, an organisation whose aim is to promote ethical business and reduce bribery and corruption across sub-Saharan Africa. The specific objectives of the Coalition for Ethical Operations are to: share best practices, promote training of SMEs (including company suppliers), and engage in occasional and voluntary collective/collaborative action.

The Board's Social, Ethics and Transformation Committee plays an active oversight role in respect of the Group's Ethics management framework and is confident that the Group has adhered to Mercantile's ethical standards during the year under review.

Fraud prevention measures

Payment card fraud

The Bank is an issuer of MasterCard and VISA payment cards and an acquirer of MasterCard, VISA, Diners Club and American Express payment cards and has, in line with the card associations' regulations, adopted proactive measures to prevent fraudulent use of these products. The Bank makes use of a real-time fraud monitoring system. Rules based on a set of parameters prescribed by the card associations and industry best practices are reviewed regularly with the aim of identifying suspicious transactional behaviour. Issuing banks and cardholders are contacted to confirm the validity of transactions whenever an alert is raised.

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 Fraud Department is actively involved in industry fraud prevention collaborations and makes use of knowledge acquired from the banking industry to assist with fraud prevention and detection within the Bank.

For any Internet or mobile transactions (also known as e-Commerce transactions), the approval of the transaction requires a One-Time PIN (OTP) to be entered by the cardholder to validate and authenticate that it is the cardholder approving a valid transaction.

The Bank has also implemented the VISA risk management solution to detect and automatically block certain fraudulent ATM transaction attacks before the transactions reach the Bank.

Fraud other than on payment cards

The Group has adopted a zero-tolerance approach toward all types of fraud and theft. The Group's Compliance Management Department investigates all incidents relating to external fraud, while internal fraud and/or staff misconduct is investigated by Internal Audit.

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 laying of criminal charges. All fraud incidents are reported to SABRIC and the South African Police Service.

Merchant acquiring fraud

The Bank offers Merchant Services allowing merchants to accept card-based client purchases. These merchants are thoroughly vetted during the on-boarding process and site visits are performed to confirm the location of the Bank's point-of-sale devices. Merchants are trained on the card association requirements concerning payment card acceptance and use of point-of-sale terminals. Real-time monitoring of merchant activity is performed seven days per week and action is taken to protect the merchant and the Bank against possible losses emanating from fraud and non-compliance with the card association rules. Actions taken to prevent such losses include further merchant training or termination of the merchant relationship should the training not have the desired outcome.

Fraud awareness

Fraud awareness training is conducted on a regular basis and awareness newsletters and/or alerts on topical issues and trends are compiled and disseminated to all staff. Fraud awareness newsletters are also compiled and distributed to clients when required. Fraud awareness material on prevalent modus operandi is also made available to clients and staff members on the Bank's website on the Fraud Prevention link.

Compliance Management staff members attend industry meetings and use Internet-based sources to stay abreast of external fraud trends and the prevention thereof. The Bank also works closely with SABRIC on various forums, as well as with the Payment Association of South Africa and the card associations.

Whistle-blowing

The Group has a comprehensive Protected Disclosures (whistle-blowing) Policy (based on the Act of the same name), which addresses the requirement for employees to report on or disclose corrupt activities, as well as any improper conduct, in good faith and based on reasonable grounds.

On an annual basis, all employees receive an electronic step-by-step guide on what, and how, to report and also participate in an online training exercise. Further, a web-based reporting system is available to enable employees to easily make anonymous reports directly to Internal Audit and Compliance Management for investigation and/or actioning.

Sustainability continued

2 Client relationship management

Areas of action Indicators

Areas of action

- Definition of the Privacy Policy
- Measurement of the relationship between income and client retention
- Integration of environmental, social and governance (ESG) aspects into investment products

Indicators

- Service quality and client satisfaction
- Safety of clients and their financial assets
- Clarity of information provided to clients on products and services

What we did in 2017

Client confidentiality policies are in place and the processes have been largely embedded through the Group's compliance with the Banking Association of South Africa's Code of Banking Practice.

The Bank participated again in the annual Consulta customer service measurement survey with the four largest banks in the business and commercial banking space and was, once again, rated number 1 in service. The main objective of the study was to gain insight into the level of service delivered by the Bank and its clients' level of satisfaction therewith. The Bank managed to further increase its already very high overall levels of service.

3 Risk management

Areas of action Indicators

Areas of action

- Integration of social and environmental risks into risk policies, including training the teams involved
- Integration of environmental and social criteria into credit risk assessment

Indicators

- Risk management
- Monitoring and prevention of non-compliance risks over responsibilities
- Environmental and social criteria in the analysis of credit risks
- Sector financing policies
- Environmental and social criteria in the analysis of Project Finance risks

What we did in 2017

A robust risk management policy is in place and monitored on a regular basis (see the Enterprise-wide Risk Management Framework and the Group's 'Top 10 Risks').

An Environmental Risk Management Policy is in place and environmental and social risk criteria, aligned to the International Finance Corporation's standards, are in place for certain lending portfolios.

4 Human capital development

Areas of action Indicators

Areas of action

- Leadership Development Programme
- Training the sales network
- Definition of sustainability objectives in the performance management system
- Assessment of the effectiveness of training
- Monitoring the return on investment in human capital
- Assessing employee satisfaction
- Transformation
- Employment equity
- Safety and health

Indicators

- Human capital development
- Career management, compensations and incentives
- Balancing personal and professional life
- Diversity and equal opportunities
- Occupational health and safety
- Talent attraction and retention

What we did in 2017

Talent review discussions take place annually to identify growth opportunities and implement succession planning for talented employees to move into senior roles; some employees to be transferred to different roles aligned to their skills; and for nominating employees for specific initiatives sponsored by Mercantile and BANKSETA, thereby driving development, motivation and retention of key individuals.

In terms of leadership development, the Bank continued with its customised, accredited leadership development programme for "First Line Managers – Leading the Mercantile Way". A total of 20 junior and middle managers enrolled for the programme and their graduation is planned for 2018.

In an effort to enhance the managerial talent pool, three talented employees were nominated to participate in the BANKSETA International Executive Development Programme. This programme creates an opportunity where senior managers spend time learning from senior executives of selected companies, supplemented with formal learning through business schools operating locally and in the host countries. All three participants successfully completed their programmes.

For the first time, Mercantile implemented a Sales Learnership to create a pipeline of sales employees. A group of 14 internal employees and 'unemployed' graduates participated in the maiden programme, which will conclude in early 2018. We also continued with the maiden learnership programme in the Internal Audit Department with one internal employee and one 'unemployed' learner. In 2017, Mercantile provided training and workplace experience to 20 BANKSETA graduate learners, including Kuyasa learners, Business Analyst learners and IT learners, who will complete their learnerships in January 2018.

The employee engagement score for 2017 is 74% (against 76% in 2016). While slightly down year-on-year, these still-high levels of engagement led to measured improved levels of client satisfaction and productivity.

On our culture journey, we continue to emphasise Living the Mercantile Way, which has become an integral part of the way in which management and employees conduct themselves on a day-to-day basis when engaging with internal and external clients. The Mercantile Way entails the following behaviours:

- Teamwork
- Trust
- Mutual respect
- Empowerment
- Appropriate risk-taking
- Continuous improvement
- (Having a) sense of urgency
- Keeping things simple
- Having fun
- Making money

Mercantile continues to have a sustained focus on a Total Reward approach. In this regard, the flexible work arrangement policy provides employees the flexibility to address family needs and personal obligations. For the Group, it increases morale, engagement and commitment while, at the same time, reducing absenteeism and employee turnover.

The Wings Awards reward and recognition programme provides an opportunity for employees to recognise their colleagues who show commitment, exceptional performance and superior client service. Monthly winners are selected from three categories (Service, Sales, and Living the Mercantile Way) and there is also a quarterly team award. The annual winners are announced at Mercantile's year-end function.

We continue to offer a comprehensive Employee Assistance Programme, facilitated through external specialists, to all employees and their immediate family members residing with them because the health, wellbeing and productivity of our employees are essential to our business. This programme contributes to a reduction in healthcare costs and absenteeism; potentially increasing productivity. The programme consists of a 24-hour telephone counselling service that is supplemented by face-to-face counselling (if required), life management services, and health information sent via email. Health and Wellness days were held during 2017 to give employees the opportunity to benefit from services such as health screening assessments, employee wellness information, fitness experts and other offerings. Employees are continuously encouraged to live healthily and be active.

The Group monitors absenteeism on a monthly basis and provides training to assist managers and employees in understanding the impact of absenteeism. The programme monitors trends month by month and we engage with employees to potentially reduce the impact. We support the effective use of the Employee Assistance Programme to address potential external drivers causing absenteeism and timeously identify incapacity cases, thereby reducing the direct and indirect costs of absenteeism and working toward creating a wellness culture. The absenteeism rate was 1,7% in December 2017 compared to 1,1% in December 2016.

The Group is fully committed to social and economic transformation and regards it as a key national and 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 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 FSC. During the year under review, the Group remained a level 4 Broad-Based Black Economic Empowerment (B-BBEE) contributor. During 2018, the Group will review its transformation strategy to ensure alignment with the revised FSC. The B-BBEE performance was independently verified by a registered agency, Empowerdex.

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

Sustainability continued

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 (EE) plan are to improve 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 aligned to the EE plan of the Group.

As EE is regarded as a key business imperative, targets have been set for 2015 to 2018 and progress is monitored on a quarterly basis. Good progress has been made in the employment of black people in the Junior Management and Semi-skilled categories. We have seen positive progress on the Middle and Senior Management level due to a concerted focus on recruitment. The overall level of representation of black people in the Company has increased from 69% in 2016 to 71% in 2017 (please refer to the tables on page 33). New targets will be set for the period 2018 to 2021.

The Group continues to strive to improve its facilities to ensure the safety and wellbeing of its employees in 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 and others.

5 Responsible supplier management

Areas of action | Indicators

Areas of action

- Identification of suppliers with greater exposure to environmental and social risks in the Group's supply chain and definition of social and environmental criteria to be included in contracts
- Implementation of a supplier monitoring and compliance process with regard to the Group's requirements
- Involvement of strategic suppliers

Indicators

- Responsible supplier management

What we did in 2017

A targeted procurement strategy to enhance B-BBEE has been adopted, with its principles 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 FSC and the Department of Trade and Industry's (DTI) Broad-Based BEE Codes of Good Practice. The Group will also, where appropriate, focus on enterprise development as a means of increasing its empowerment supplier base.

The Group has successfully met the DTI and FSC procurement targets since 2008 and has achieved the 2017 targets in respect of procurement spend with BEE enterprises.

During 2017, the Group commenced work to implement a supplier monitoring process to identify and limit relations with any suppliers in the Group's supply chain that might be exposed to environmental and social risks.

Community

6 Social and financial inclusion

Areas of action Indicators

Areas of action

- Promotion of banking products that contribute toward fighting social and financial exclusion
- Development of a platform for centralising applications for entrepreneurs (including training to the teams involved)
- Quantification of the impact of measures to support entrepreneurship
- Development of corporate volunteering of skills to support establishment of entrepreneurial businesses

Indicators

- Financial inclusion practices
- Support to SMEs, institutional clients and answers to society's emerging challenges

What we did in 2017

Loan approval to black-owned SMEs and BEE transaction financing

Black-owned SMEs play a critical role in job creation, income generation and the economic growth of the country. The Group extends support to such SMEs across the country, giving them access to dedicated, skilled bankers who are supported by a team of finance and business specialists.

The Group's projected share of the Industry Target Growth was confirmed by the Banking Association of South Africa during 2014: BEE SME Financing to be R198 million and BEE Transaction Financing to be R132 million (to be achieved by the end of 2017). In 2017, the Group achieved R299 million (2016: R285 million) and R396 million (2016: R410 million), respectively, against the projected targets. These empowerment financing initiatives exclude the Group's investments into Transformational Infrastructure, i.e. the second leg of the Empowerment Financing commitment by the financial services sector. The Group also invested R904 million (2016: R510 million) in Transformational Infrastructure through its investments in government bonds and treasury bills.

The Group has a Corporate Social Responsibility (CSR) Policy in place and various initiatives are undertaken through the Mercantile Bank Foundation.

Through the CSR programme and the Bank's partnership with the Hope Factory, the Group engages in various initiatives that support, train and develop entrepreneurs.

7 Financial education and literacy

Areas of action Indicators

Areas of action

- Promoting financial education of a broad group of clients, and non-clients, individuals and companies
- Strengthening the financial education of children and youths
- Developing a corporate plan for financial education and literacy
- Development of corporate volunteering of skills in the field of financial literacy

Indicators

- Financial literacy practices

What we did in 2017

The Group, through its CSR programme partner, The Hope Factory, engages in financial and other education of entrepreneurs.

Sustainability continued

8 Support to the social economy

Areas of action Indicators

- Creation of a pool of internal volunteers and implementation of training initiatives

- Social-oriented activities for the benefit of the community

What we did in 2017

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 CSR Policy ensures a close link to its market positioning so that the various initiatives it supports are aligned to all 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 FSC 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;
- Making a meaningful contribution to the society in which we operate and the market we serve;
- Creating a targeted and focused outlet point for staff-led community outreach projects;
- Optimising the value of our Group CSR spend in our core focus areas; and
- Ensuring close alignment with the agreed strategy of the Group.

In the year under review, Mercantile supported a number of enterprise development and socio-economic development initiatives through financial contributions, direct and/or matched funding, as well as employee volunteerism.

Financial contributions were made to the Hope Factory. Further contributions were divided between enterprise development and socio-economic development programmes, as well as contributions to various staff and/or Bank-initiated programmes, which were measured under socio-economic development.

Employees' time is precious – it represents a sacrifice for both the employees and the Bank. Employees often have to put considerable effort into the projects they are supporting and, for the employer, this means time away from business. Every employee is allocated a number of hours that may be "taken as leave" so that the contribution can be accurately measured.

Enterprise development and socio-economic development: The Hope Factory

As part of an existing three-year contract, Mercantile contributed R0,8 million to the Hope Factory's enterprise development and socio-economic development programmes in 2017. The Hope Factory continued to sow seeds of hope this year, despite the environment being one of slow economic growth. Its goal and purpose are still set on seeing real economic transformation through advancing the growth of entrepreneurial black businesses. While mentorship remains the key and compulsory element of every programme, the following new initiatives were introduced to facilitate growth during the organisation's four-year journey with entrepreneurs:

- The Mentorship model has been restructured to clarify the service offering and improve entrepreneur development during the business life cycle;
- A new campaign – BuildHopeSA – has been developed and has assisted the organisation to increase brand awareness and give clarity on what the brand is about;
- Business development workshops have been hosted to provide insights and create awareness regarding the important functions of business;
- Specialist training has been arranged to improve the competence of entrepreneurs by providing them with the opportunities to up-skill themselves in their areas of business;
- Financial mentoring and services have been provided to allow entrepreneurs to achieve their strategic financial goals and objectives and make sound financial decisions for their businesses;
- The first specialised Enterprise Development Programme tailored specifically for disabled entrepreneurs has been developed;
- In-depth business analysis has been undertaken to develop intervention strategies that are reviewed quarterly; and
- Operational investments that provide entrepreneurs with a type of grant to cover certain operational needs have been introduced. To date, over R0,8 million has been invested in qualifying businesses.

Socio-economic development: employee initiatives

During 2017, Mercantile participated in a number of CSR projects initiated by employees and/or the Bank. A cross-section of staff from different levels and business units participated and R0,7 million was allocated for this purpose.

Education

Education is a key priority in Mercantile's CSR programme as it is essential to creating and developing future leaders. Mercantile and its staff contributed to or participated in the following initiatives during the year under review:

- 'Partners for Possibility', where our head of IT took part in the programme to uplift Reiger Park Primary School. The organisation partners business leaders with principals from struggling schools to grow the school into a community anchor;
- Lelethu Zulu Trust, which is a new trust that was formed to assist with educating the infant daughter of Gugu Zulu, who died tragically in 2016, and, in the long run, other deserving South African children;
- Mampoti, an early childhood development centre based in Diepsloot;
- Sparrow Schools, which cater for children from disadvantaged backgrounds with learning disabilities;
- Action for the Blind, a school that provides training to the blind and disabled on computer-related courses;
- Afrika Tikkun, an organisation that provides for holistic development of the youth in the areas of education, health and social services; and
- Thuthuka Education Upliftment Fund (Ikusasa Student Financial Aid Programme), which is a successful multi-sector partnership between the private sector and various arms of government (Departments of Labour, Education, Science and Technology) aimed at ensuring disadvantaged youth with potential are able to receive the education they cannot afford.

Vulnerable and orphaned children

South Africa has an extremely high rate of abuse and abandonment of children from disadvantaged backgrounds. Organisations that help to prevent or relieve this plight are critical and need considerable assistance. To this end, Mercantile and its staff contributed to the following worthy initiatives:

- Dove's Nest, a foster home for abandoned and orphaned babies;
- Azuriah Foundation, a feeding scheme and community upliftment programme based in Westbury/Newclare; and
- Baby Moses Baby Sanctuary, which cares for abused, neglected, abandoned and orphaned children.

Health

Mercantile made donations to the following organisations working in the health services sector:

- Sunflower Fund, which raises funds and creates awareness for the South African Bone Marrow registry; and
- Lady Fatima, which is part of the Portuguese Welfare Society, to raise funds for elderly Portuguese persons in various centres.

Entrepreneurship and community development

These are initiatives that create enterprise opportunities in communities with a high level of unemployment:

- Gogos of Hope, under the umbrella of Rays of Hope, cares for grandmothers in the Alexandra township and gives them an opportunity to do beadwork to earn an extra income. One of the Sales Learnership teams, as part of their entrepreneurship module, partnered with the organisation to make bracelets that were sold to Mercantile and other companies and the profits from these sales were then donated to Gogos of Hope.

Chartered Accountant Graduate Programme

Mercantile launched the graduate programme in 2015, when the first recipient started her studies at the University of Johannesburg. The bursary includes tuition and residence fees, textbooks and a laptop computer. A second student, recruited in 2016, is studying at the University of the Witwatersrand. A third student, recruited in 2017 and being sponsored by a client, is studying at the University of Pretoria. These students complete vacation work at the Bank and/or at the client's premises. Once they complete their degrees and postgraduate diplomas in accounting, they will start their three-year trainee accountant contracts at Deloitte and thereafter they will join Mercantile (or the client) on a two-year working contract.

Sustainability continued

Environment

9 Eco-efficiency

Areas of action Indicators

- Promoting eco-efficiency of the Group's operations
- Promoting energy efficiency in the data centre
- Promoting energy efficiency at corporate level
- Environmental training and awareness for employees and suppliers at corporate level

- Environmental Management System
- Eco-efficiency

What we did in 2017

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 its office infrastructure. Systems aimed at reducing resource consumption over time are in place. The Group continuously explores ways to reduce paper, energy and water usage.

The Group is also cognisant of the fact that, through its lending practices, it impacts indirectly on the environment. Assessment and management of environmental risks associated with a particular client or credit application is integral to the credit decision-making process. To apply these environmental standards, the Group adheres to its Environmental Risk Management Policy, which adopts elements of the International Finance Corporation's Sustainability Framework (including the global Equator Principles). The Equator Principles have three categories of projects: Category A (high risk), includes projects with potential for 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 for 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 then only after due consideration of all related risk and reputation concerns.

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

10 Adapting to climate change

Areas of action Indicators

- Knowledge of suppliers' practices to adapt to climate change
- Active support of environmental awareness initiatives
- Review of the criteria for the creation of the service fleet, integrating environmental criteria

- Environmental Management System
- Eco-efficiency

What we did in 2017

A process to investigate an environmental management system that will include adapting to climate change has commenced.

11 Sustainability management

Areas of action Indicators

Areas of action

- Operation and monitoring of the Corporate Sustainability Programme
- Integration of sustainability indicators in the current management information systems in the Group
- Monitoring the definition of the sustainability strategy for the Group's international structures
- Extension of the scope of the strategy of engaging stakeholders, and measurement of the respective performance

Indicators

- Brand and reputation management
- Governance model
- Sustainability strategy and commitments
- Systematic practices of dialogue with stakeholders

What we did in 2017

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 consider the Association's Code and recommendations set out in the King Reports, read with the Johannesburg Stock Exchange Sustainability Reporting Index criteria, and take into account the size of our business and the community and industry in which the Group operates.

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, incorporating key focus areas covering the short, medium and long term. The monitoring of an integrated sustainability programme continued during 2017.

12 Communication and training

Areas of action Indicators

Areas of action

- Internal and external communication on sustainability
- Training on sustainability
- Development of an integrated report
- Enlargement of the scope of information reported at corporate level

Indicators

- Environmental training and awareness for employees, community and clients

What we did in 2017

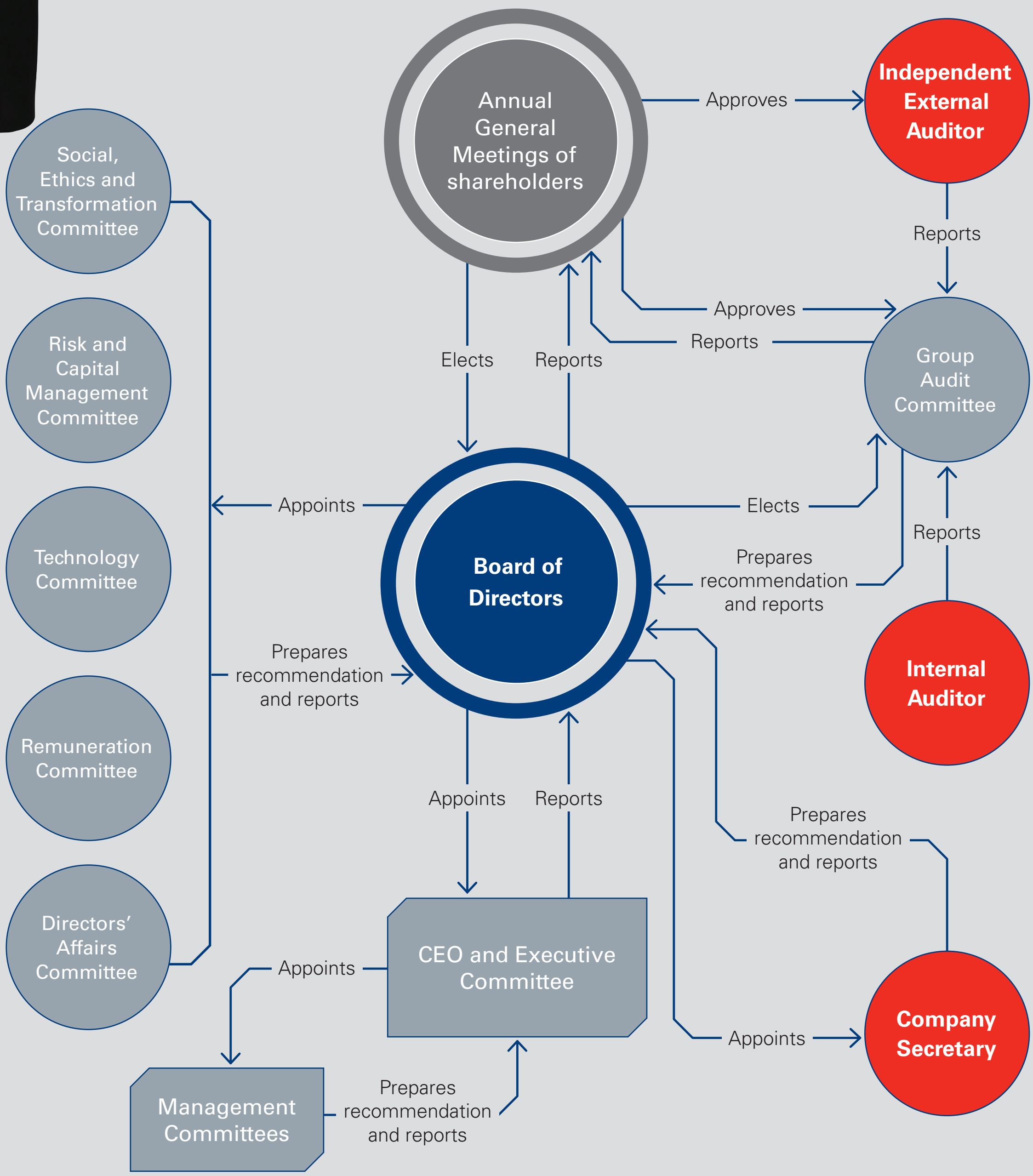
The Integrated Annual Report includes sustainability reporting and the scope of reporting is being increased in a phased-in manner as the Group's Sustainability Framework matures.

The environmental training and awareness for employees, community and clients was investigated in 2017 and will be adopted, to the extent possible, going forward.

Corporate governance

T SINGH
GROUP SECRETARY

Overview of the corporate governance system



The Boards of Directors of the Company and the Bank (collectively, 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 the King Code of Corporate Governance.

The Board has commenced its journey to adopt the principles of King IV as closely as possible and is specifically focusing on sustaining the following:

- An ethical culture and effective leadership;
- Performance and value creation in a sustainable manner;
- Adequate and effective controls; and
- Trust, good reputation and legitimacy.

The corporate governance processes of the Group for the year ended 31 December 2017 are summarised below.

Board of Directors

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

The Board of Directors has a collective responsibility to create and deliver sustainable value for our stakeholders in a manner that is supported by the right culture, values and behaviour throughout the Group. To support our role in determining the strategic objectives and policies of the Group, there exists a well-defined Corporate Governance framework.

We aim to achieve long-term and sustainable value and it is our responsibility as the Board to ensure that management delivers effectively on short-term objectives, while promoting the long-term growth of the Group. In addition, we have further responsibility for ensuring that management maintains both an effective system of internal control and an effective risk management and oversight process. In carrying out these responsibilities, we consider the Group's business and reputation, the materiality of risks that are inherent in the business and the relevant costs and benefits of implementing controls. The Group's internal control system provides assurance of the effective operation of adequately designed internal financial controls, compliance with law and regulation, and efficient operations.

The Board is the decision-making body for those matters that are considered of significance to the Group owing to their strategic, financial or reputational implications or consequences. To retain control of these key decisions, certain matters have been identified that only we as the Board can approve and there is in place a formal schedule of powers reserved to the Board. Directors act in accordance with the Group's constitution and only exercise powers for the purposes for which they have been conferred. These matters include the approval of Group strategy, interim and full-year financial statements, and any major acquisitions, mergers, disposals or capital expenditure. Specific responsibilities have been delegated to Board Committees and each Committee has its own terms of reference.

Composition, date of appointment and attendance

Name	Date of appointment	Meeting attendance
GP de Kock *(Acting Chairman) (appointed 1 June 2016 as Acting Chairman, formerly appointed as Deputy Chairman)*	23 November 2000	4/4
KR Kumbier *(CEO)*	1 June 2010	4/4
RS Caliço *(Deputy CEO)*	1 July 2014	4/4
L Hyne	1 June 2003	4/4
AT Ikalafeng	16 November 2004	4/4
TH Njikizana	6 November 2008	4/4
DR Motsepe	1 October 2014	4/4

Responsibility

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 this for approval and ratification by the shareholder at the AGM;
- consider, approve, govern and review long-term incentive remuneration policies 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, and codes of business practice and ethics;
- appoint appropriate Board Committees and determine the composition thereof; and
- annually review and approve the Board and Board Committees' self-evaluations of their effectiveness.

Corporate governance continued

The Board comprises Non-Executive and Executive Directors with different skills, professional knowledge and experience. Non-Executive Directors comprise the majority on the Board, thereby ensuring that no individual director has unfettered powers of decision-making. The roles of the Chairman of the Board and the CEO are clearly defined and separated, thereby making a clear division of responsibilities at the head of the Group. At 31 December 2017, the Board, which has a unitary board structure, comprised seven Directors, of which two were executive.

Independence

The cyclical and specialist nature of banking necessitates the retention of directors with long-serving Board experience, making it impractical, and not in stakeholders' best interests, for Directors to resign after nine years of service. A robust annual evaluation of director independence is undertaken in accordance with the criteria set out in King III, and the requirements of the Companies Act. The evaluation process includes the completion of a comprehensive self-assessment questionnaire and personal declaration by each Director, as well as, where circumstances deem it appropriate, deliberation by the Board to consider the results of the self-assessment with the overarching yardstick being "independence of mind".

Non-Executive Directors offer independent and objective judgement. Independent Board members have no other financial or business relationships with the Group, other than to act in their capacities as Directors, which 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. All the Non-Executive Directors are classified as independent. The Board is satisfied that its composition currently reflects an appropriate balance in this respect.

Board appointments

The process of identification of suitable candidates to fill vacancies on the Board and to reappoint 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, one-third of the Non-Executive Directors are required to retire at each AGM and may offer themselves for re-election.

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. The Board has invoked its discretion in this regard in respect of Mr L Hyne. Such Director is still subject to retirement by the rotation provisions as set out above.

Board and Director evaluations

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 the performance of individual Non-Executive Directors is conducted by the other Directors and, on a bilateral basis, between the Chairman and each Director.

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, the Group's corporate governance processes, and emerging topics of which the Directors should be aware. The Group Secretary assists the Board in developing an annual training framework 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 and maintains an arm's length relationship with the Board members as far as is reasonably possible.

Board objectives for 2017

Since 2015, in addition to measuring the effectiveness of the performance of the Board, the Board has set objectives for measuring its performance. The Board objectives for 2017, together with an overview of its performance, follow:

Rating | What we did in 2017

#	Objective / What we did in 2017	Rating
1	**Review the progress of the implementation of the Group strategy, with a particular focus on our growth objectives, within the framework of a sound control and risk management environment, and ethical and transparent leadership**	
	While there was no 'standalone' offsite strategy session held in 2017, the Board engaged with management in strategy sessions. Updates on the execution of the strategy agreed upon in 2016 were presented by management at every Board meeting, thus enabling the Board to fulfil its responsibilities in regard to reviewing the progress of the implementation of the Group strategy Relevant committees played a key role in monitoring the risks with input from management forums. The Board continued to build an organisational culture based on ethical values, transparency and accountability An Ethics management framework was approved by the Board and the progress of the implementation of the framework was reviewed at every Board meeting	Fully achieved
2	**Ensure that the risk management and capital management processes are appropriate in the context of a challenging local and global economy, the current risk environment and a changing business landscape**	
	The risk and capital management frameworks were updated, when required, in the context of changing regulatory, risk and business environments. The annual assessment of the top ten risks facing the Bank was reviewed and approved by the Board for enhanced monitoring The 2017 top ten risks included: funding risk; cybercrime; credit risk; regulatory and legal risk; operational risk; IT risk; business continuity management and disaster recovery; strategic risk; human resource risk; and capital risk Major projects being monitored include IFRS 9 accounting standards and the Basel Committee on Banking Supervision's regulation number 239 (BCBS 239) on risk data aggregation and risk reporting (RDARR) The Board reviewed and approved the ICAAP. During 2017, the capital adequacy ratio remained well above the prudential requirement of 15% (including buffer). The ICAAP was reviewed quarterly by the Board	Fully achieved
3	**Monitor the implementation of the Group's IT strategy and the ongoing development of the IT governance and cyber security frameworks**	
	The Technology Committee has oversight of the execution of the Bank's IT strategy, and continued to focus on reviewing and endorsing the plans to implement/maintain the Bank's cyber security framework and to monitor developments in the area of cybercrime	Substantively achieved
4	**Monitor the impact and implementation of legislative and regulatory changes. The Board will continue to follow a philosophy of continuous improvement as regards governance practices and structures to ensure the reasonable expectations of stakeholders are met**	
	In 2017, the Board paid significant attention to the following key regulatory themes: Combating money laundering, corruption and terrorist financing; protecting personal information; Twin Peaks; King IV; IFRS 9, Risk Data Aggregation and Risk Reporting; the increase in regulatory costs (emanating from the payments systems, e.g. authenticated collections, etc); adherence to all statutory requirements in the Exchange Control environment; and current and potential litigation against the Bank	Fully achieved
5	**The sale of MBHL. The Board's role in the sale was to ensure: (1) the process was properly managed; (2) the impact on the normal operations of the Bank was minimised; and (3) stakeholder management, specially to ensure that the interests of depositors and staff were adequately protected.**	
	The Board has, to the extent possible, been proactively engaging with the Shareholder (CGD) and the Lead Regulator (SARB) in regard to the sale process. To the extent that the Mercantile Board of Directors is requested to confirm whether it has any objections to any of the shortlisted bidders, in determining whether it has any such objections, the board will consider the interests of all stakeholders, the most important of whom are Mercantile's clients and staff.	Fully achieved

Corporate governance continued

The Board has set the following objectives for 2018:

- Review the progress of the implementation of the Group strategy, with a particular focus on our growth objectives, within the framework of a sound control and risk management environment, and ethical and transparent leadership;
- Ensure that the risk management and capital management processes are appropriate in the context of a challenging local and global economy, the current risk environment and a changing business landscape;
- Monitor the implementation of the Group's IT strategy and the ongoing development of the IT governance and cyber security frameworks;
- Monitor the impact and implementation of legislative and regulatory changes; and
- The successful sale of MBHL.

The Board will continue to follow a philosophy of continuous improvement as regards governance practices and structures to ensure the reasonable expectations of stakeholders are met.

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. Each committee reports to the Board and the minutes of committee meetings are shared with the Board. The main Board Committees are the GAC; the RMC; the DAC; the Social, Ethics and Transformation Committee (SETCom); the Remuneration Committee; and the Technology Committee.

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

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.

Further details on the Board Committees are provided below.

GAC

Composition and attendance

Name	Meeting attendance
TH Njikizana *(Chair)*	5/5
L Hyne	5/5
GP de Kock	5/5
DR Motsepe	5/5

The GAC comprises four Independent Non-Executive Directors, one of whom acts as Chairman. The Acting Chairman of the Board is a member of the GAC. Condonation for this temporary arrangement was granted by the SARB. The CEO, Deputy CEO, CFO, heads of Internal Audit, Risk, Compliance Management, and Treasury and the External Auditors attend GAC meetings as permanent attendees.

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, Risk, and Compliance Management, the CEO, the Deputy CEO, and the External Auditors have unrestricted access to the Chairman of the GAC. During 2017, the GAC's charter was amended to include the CGD Group heads of Internal Audit and Compliance as permanent attendees, 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.

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 including, but not limited to, the Banks Act, Companies Act, common law, IFRS and tax legislation;
- corporate governance;
- risk management; and
- stakeholder 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 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 may provide. The GAC meets with the External Auditors, separately 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. The Group continues to face an unprecedented level of change and it will be critical to ensure that a culture of strong control is maintained as the Group implements its strategy and also as it positions itself for growth. The GAC will continue to seek to ensure that management maintains its focus on building personal accountability for upholding a strong and effective control environment.

The GAC's performance during 2017 was evaluated as part of the annual Board effectiveness review and the outcomes were positive. The GAC was regarded as effective and considered to be very thorough and detailed. 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 41 and 42 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 Finance function and financial reporting.

The GAC will continue, in 2018, to review and consider management's plans in respect of future changes to IFRS and other regulations, focus on ensuring that the Group's financial systems, processes and internal controls are operating effectively, are consistent with the Group's complexity and are responsive to changes in the environment and industry.

RMC

Composition and attendance

Name	Meeting attendance
L Hyne *(Chair)*	4/4
GP de Kock	4/4
TH Njikizana	4/4
KR Kumbier	4/4
RS Caliço	4/4

The RMC comprises five members, three of whom are Non-Executive Directors (one of whom acts as Chairman), the CEO and the Deputy CEO.

RMC meetings are held at least four times per annum. The RMC meetings are attended by the heads of Risk, Credit, Treasury, and Internal Audit, the CFO and External Audit.

As defined in its charter, the RMC's objectives are to:

- assist the Board to fulfil its responsibilities in the discharge of its duties relating to risk and control management, and 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, Risk, Compliance Management and other parties engaged in 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; and
- 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.

The RMC ensured that the Group operated in a strong control environment and assumed primary responsibility for assessing and tracking the progress of embedding the Enterprise-wide Risk Management Framework, which is the way in which the Group approaches enterprise-wide risk management and is the bedrock of our management of internal risk and control. In terms of specific control issues, areas of focus for the RMC during 2017 were credit risk, operations and technology. Risk appetite as well as country, sector and individual exposures were carefully monitored to ensure that business activity and limits appropriately reflected external risks. The RMC has concluded that there are no control issues that are considered to be a material weakness and that would merit specific disclosure.

The RMC's performance during 2017 was evaluated as part of the annual Board effectiveness review and the outcomes were positive. The Committee was regarded as effective and as taking a thorough and detailed approach to its responsibilities. The RMC has fulfilled its responsibilities in terms of its charter during the year under review.

The RMC will continue, in 2018, to supervise the level and deployment of risk appetite, as well as the Group's funding and capital position, as we respond to regulatory requirements and our expectations of continued volatility in external conditions.

For more detailed information relating to the risk management of the Group, refer to pages 86 to 97.

DAC

Composition and attendance

Name	Meeting attendance
GP de Kock *(Acting Chair)*	4/4
L Hyne	4/4
TH Njikizana	4/4
AT Ikalafeng	4/4
DR Motsepe	4/4

The DAC comprises all the Non-Executive Directors. The Acting 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 so doing, 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 reviewed the Board and Board Committee composition, including potential new Non-Executive Directors, during 2017. In addition, the DAC monitored the skills and experience the Group needed to be able to deliver its strategic aims, to govern the Group appropriately, to ensure that risks threatening performance were identified and addressed or mitigated, and to set 'the tone from the top' in terms of the Group's corporate culture and values.

Corporate governance continued

The DAC is responsible for considering new appointments to the Board and, when doing so, relies on assessments of the current Board and Board Committee composition to assess the timeline for appointments, and a skills matrix that identifies the core competencies, skills, experience and diversity required for the Board to function effectively. The approach to recruiting new Non-Executive Directors is to create an individual specification with reference to the role requirements, including time commitment, the key competencies and behaviours, and the desired key skills and experience identified from the skills matrix.

The Directors in office at the end of 2017 were subject to an effectiveness review. Based on the results of the review, the Board accepted the view of the DAC that each Director proposed for re-election continued to be effective and that they had each demonstrated the level of commitment required in connection with their role on the Board and the needs of the business.

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

Remuneration Committee

Composition and attendance

Name	Meeting attendance
AT Ikalafeng *(Chair)*	4/4
GP de Kock	4/4
L Hyne	4/4
TH Njikizana	4/4
DR Motsepe	4/4

The Remuneration Committee, which comprises all of the Independent Non-Executive Directors, monitors and strengthens the credibility of the Group's executive remuneration system. The CEO attends the meetings by invitation. In terms of its charter, 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;
- 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, shareholder's 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 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 for the Deputy CEO and Company Secretary;
  - ensure full disclosure of Directors' 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; and
  - approve guaranteed and performance-based individual remuneration, including CPSP and other long-term award allocations for senior management; and
- assist the Board in reviewing the Non-Executive Directors' fees.

The Remuneration Committee's priorities were to ensure that the Group pays for sustainable performance, aligns remuneration with risk, and aligns to the shareholder's remuneration policies and practices. The Remuneration Committee's 2017 reward decisions took full consideration of financial performance and non-financial performance.

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

Social, Ethics and Transformation Committee (SETCom)

Composition and attendance

Name	Meeting attendance
DR Motsepe *(Chair)*	4/4
GP de Kock	4/4
AT Ikalafeng	4/4
KR Kumbier	4/4
RS Caliço	4/4

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

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

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

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

Technology Committee

Composition and attendance

Name	Meeting attendance
GP de Kock *(Chair)*	4/4
TH Njikizana	4/4
KR Kumbier	4/4
RS Caliço	4/4

This committee is mandated to assist the Board in its duties with regard to the governance of IT in accordance with the provisions of King III. The Technology Committee comprises two Independent Non-Executive Directors, the CEO and the Deputy CEO. An Independent Non-Executive Director chairs this committee. The heads of IT, Risk and Internal Audit, and the Managers of IT Security and Governance are permanent attendees.

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.

Directors' conflicts of interest

The Group requires Directors to declare any potential or actual conflict of interest that could interfere with their ability to act in the best interests of the Group. The Board has adopted procedures for ensuring that its powers to authorise Directors' conflicts operate effectively. A register of actual and potential conflicts and of any authorisation of a conflict granted by the Board is maintained by the Company Secretary and is reviewed annually by the Board.

How the Board engages with business

- The CEO, Deputy CEO and CFO participate in all Board meetings. Other members of management are invited to present on relevant topics or about their businesses.
- The Board interrogates and approves the business strategy, multiyear strategy and relevant risk appetites. Members of the Board are invited to onsite visits to various bank operations and business units, while one-on-one meetings may be requested by individual Directors.
- A monthly Directors' Flash Report provides timely and comprehensive feedback to the Board.
- There is increased interaction between the Board and our stakeholders (for example, Board members are invited to client functions).

Management Committees

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

- Group Executive Committee;
- ALCO;
- CREDCOM;
- Employment Equity Committee;
- Human Resources Committee;
- IT Steering Committee;
- Procurement Committee; and
- Project Executive 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 purpose of the remuneration philosophy is to enable the attraction, motivation and retention of suitably qualified staff to achieve strategic objectives of the Group. In addition to this, specific remuneration practices are required for executives and senior management as they make a direct impact on driving business results, profitability and increased stakeholder value.

The guiding principles of the remuneration philosophy are to:

- support the achievement of the Group's strategic objectives;
- help communicate the Group's values and performance expectations;
- drive and support desired employee behaviour and actions;
- achieve and maintain market competitiveness of pay;
- motivate and engage all employees in the organisation;
- manage remuneration costs;
- reward high performers;
- recruit and retain high performers; and
- ensure internal equity.

These policy objectives are achieved by ensuring remuneration is reflective of applicable market conditions, the Company's statutory obligations, the level of accountability (responsibility, objectives, goals etc.) assigned to individuals, and the provision of incentives to deliver outstanding performance, while providing organisational flexibility and operational efficiency.

The policy furthermore aligns to the CGD Group Remuneration Policy, which is based on the following guiding principles:

- The structure of the remuneration does not encourage excessive and imprudent risk-taking;
- The decision-making process on remuneration is robust (well-reasoned, compliant with relevant laws and regulations and approved by competent corporate bodies);
- The applicability to identified employees:
  - Ensuring that the total remuneration and respective composition of remuneration are coherent with the Group's governing structure and aligned to the risk profile tolerated by the Company and CGD; and

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  - Safeguarding the ratio between fixed and variable components of remuneration, indexing it to the achievements of quantifiable and specific objectives, aligned with the long-term interests of the Group and CGD;
- The balance of remuneration composition through:
  - adequacy between remuneration and performance; and
  - alignment between remuneration and long-term corporate interest; and
- Disclosure of remuneration policy and specific objectives, complying with transparency as required by relevant competent authorities.

All remuneration elements are reviewed periodically and monitored to align with the Group's risk management strategy. The review and recommendations take into account changes in legislation, competitive practices in the market and the results of comprehensive research on the factors driving employee satisfaction, commitment and productivity in the organisation. The focus is therefore on pay for position, competence and performance. The Remuneration Policy has been drafted taking into account the European Union Regulations and applicable South African labour legislation. The Group aims to ensure that remuneration practices are fair, equitable and competitive, and align risk and reward.

The remuneration philosophy encapsulates five elements: 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. The four main components of remuneration are described below:

The total guaranteed package

The total guaranteed package includes the monthly salary plus non-cash fringe benefits and 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 includes medical aid and retirement contributions.

Short-term incentives

Short-term incentives form an important component of variable pay. The objective of the short-term incentive scheme is to reward superior performance, and to motivate employees to perform beyond expectations and drive the Group 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.

Measurement criteria are aligned to strategic objectives and financial growth and performance targets, as well as client service satisfaction targets and culture transformation. Whereas the Group'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 (of total guaranteed pay) that is awarded within the determined range.

Periodic reviews of the short-term incentive scheme take place at the discretion of the Board Remuneration Committee and/or Executive Directors to ensure market competitiveness and alignment to regulatory requirements/good governance.

Long-term incentives

The third component 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.

Mercantile has introduced a long-term incentive scheme, the CPSP, which is a deferred bonus scheme. Conditional awards are made annually to participants on the basis of their job grade and as a percentage of their total guaranteed packages. Participants are selected from eligible employees who can have an impact on the future strategic growth of the Group. 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.

The long-term incentive scheme is reviewed periodically, within the context of best practices and corporate governance considerations, at the discretion of the Remuneration Committee.

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. The Remuneration Committee advises the Board on appropriate remuneration for Non-Executive Directors and, if in agreement, will recommend to the shareholder for approval at the AGM. 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. The shareholder annually approves all Directors' fees.

For 2017, the compensation for senior managers and material risk-takers, including the CEO and Deputy CEO, is:

Total value of remuneration	Senior managers Number	Unrestricted R'000	Deferred R'000
Fixed remuneration			
Cash-based guaranteed compensation	25	44 344	–
Variable remuneration			
Cash-based performance incentive relating to the 2017 financial year paid in 2018	24	18 570	–
– Of which converted into shares or an equivalent ownership instrument	1	–	2 303
Performance incentive deferred portion in prior years paid in 2017	1	2 306	–
CPSP awards granted in 2014 and cash settled in 2017	15	11 398	–
Estimated value of CPSPs awarded in 2017 and vesting/payable in 2020 (assuming that 100% of the awards will vest)	21	18 280	–

The Chairman of the Remuneration Committee's fee for 2017 was R169 664 and the fee for each of the other four members was R89 888. The Acting Chairman of Mercantile, who is also a member of this committee, is not remunerated per committee meeting but earns an aggregate fee.

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 Area 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 Credit, to the mandates of the CREDCOM and the approval by the RMC of the Board. All these risk mandates are informed by the risk appetite defined by the Group.

Management and the employees of the Risk, Compliance Management and Internal Audit functions operate in accordance with the provisions of the Banks Act and Regulations, as well as industry best practices and governance requirements and are effectively independent of sales, 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 Group; hence, if no bonus pool is approved for the Group, there can be no bonus participation for these functions – there are no guaranteed bonuses. This reflects our commitment to achieving a balance between the prudent management of remuneration within the context of both our risk appetite and risk profile, and the need to attract, retain and motivate key talent to enable the delivery of our strategic objectives.

Impact of European regulation

As CGD, the Group's parent company, is headquartered in Europe, Capital Requirements Directive (CRD) IV (the Directive) is applicable to the Group. In terms of the CGD Group Remuneration Policy, the maximum ratio of the fixed to variable components may not exceed half of the amount of the fixed component of remuneration for identified senior managers and material risk-takers. In addition, 50% of the variable component of remuneration for both Executive Directors and identified employees has to be deferred over a three-year period. Deferral of the 50% of the variable component of remuneration may be waived, at the discretion of the Board, should the employee be reaching retirement age within the next three years. The total variable remuneration will be subject to reversion and reduction in the event where the performance of the Group takes a turn downward or where the identified employee participated in or was responsible for an action that resulted in significant losses for the Group or no longer meets the required competence criteria for the function.

The Group complies with the spirit and letter of the regulation in a simple and transparent manner and the CEO's remuneration was restructured to ensure compliance with the Directive. The CEO's long-term incentive awards were 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. 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 by the Remuneration Committee. This approach allows us to remain competitive in terms of total remuneration, which is essential considering that this regulatory requirement does not apply to the majority of our local competitors and against the increasingly competitive market for talent in financial services.

Corporate governance continued

Internal Audit activity

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

The Internal Audit Charter, which governs Internal Audit activities in the Group, was reviewed and revised by the Board during the year. The charter defines the purpose, authority and responsibility of the Internal Audit activity in line with the Standards 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 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 at least quarterly or as needed to reflect any changes in the risk profile of the Group. Updated plans are 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 approved internal audit planning.

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 services that may be 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 adviser 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 Mercantile Group will not contract its auditors on services prohibited in terms of section 90(2) of the Companies Act, 2008 and under the code of professional conduct mentioned in the Auditing Profession Act, 2005 as amended from time to time. To ensure that such is complied with:

- The External Auditors confirm in writing, prior to providing a service for non-audit services, that such does not impair their independence and that they may provide such service;
- The CEO may approve non-auditing services projects up to R250 000;
- The GAC approves non-auditing services projects of more than R250 000;
- The cumulative total of non-audit services fees paid to the External Auditor may not exceed 25% of the audit fee for that year. Where the engagement of services would take the cumulative total of non-audit services fees paid to the External Auditor over 25% of the audit fee for that year, the engagement must be approved by the GAC in advance of the engagement commencing;
- Management includes a report on non-audit services provided by the External Auditors for notification at GAC meetings; and
- Services rendered by other audit firms are not subject to the above and the CEO can approve such from time to time in accordance with the Group's general limits of authorities.

The Code of Banking Practice

As a member of the Banking Association of South Africa, the Group subscribes to the Code that promotes good banking practices by setting standards for disclosure and conduct, thereby providing valuable safeguards for its clients. The Group aims to conduct its business with uncompromising integrity and fairness to promote complete trust and confidence. In meeting this fundamental objective, the Group conducts its relationships with the regulatory authorities, clients, competitors, employees, shareholder, suppliers and the community at large, by striving for high service levels, 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 2017:

	Male				Female				Foreign nationals		
Occupational levels	A	C	I	W	A	C	I	W	Male	Female	Total
Top management	–	–	–	1	–	–	–	–	1	–	2
Senior management	1	2	1	8	2	1	3	3	–	–	21
Middle management	17	8	14	32	9	7	11	36	–	–	134
Junior management	46	17	9	12	114	37	29	46	–	1	311
Semi-skilled	6	–	–	–	9	5	1	4	–	1	26
Unskilled	3	–	–	–	1	–	–	–	–	–	4
Total permanent	73	27	24	53	135	50	44	89	1	2	498
Temporary employees	1	1	–	1	1	–	–	–	–	–	4
Grand total	74	28	24	54	136	50	44	89	1	2	502

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

Talent management and succession planning are key focus areas for the achievement of the Group's strategic objectives. The attraction and retention of talent remain a priority to ensure the Group transformation goals are achieved in relation to the FSC targets and employment equity plan.

Skills development

A substantial number of employees benefited from (internal and external) training programmes, as reflected in the skills development statistics schedule below:

Training category	Number of EE employees trained	Number of employees trained
Changing client expectations development	254	313
Management, leadership and change management	33	44
Risk management with a key focus on cyber security	354	492
Regulatory compliance	318	443
Bursaries	15	17
In-house	308	362

During 2017 employees participated in the following initiatives:

BANKSETA initiative	Number of learners enrolled
BANKSETA Kuyasa Learnership	12
BANKSETA Business Analyst Learnership	5
BANKSETA IT Learnership	3
International Executive Development Programme	3
Operational Risk Management Learnership	2

Mercantile initiative	Number of learners enrolled
Internal Audit Technician Learnership	2 (1 employed and 1 unemployed)
Sales Learnership	14 (9 employed and 5 unemployed)
Leadership and Management	20 (20 employed)

Corporate governance continued

Mercantile currently sponsors two Chartered Accountant (South Africa) bursary students and has facilitated another student being sponsored by a client. Following the completion of their studies, the students will embark on a three-year training contract at Deloitte and, thereafter, will join Mercantile (or the client) on a two-year working contract.

Mercantile launched its first Sales Learnership in December 2016 and, upon completion, the learners will receive an Advanced Certificate in Banking, NQF level 6, through Milpark Education. The purpose of the Learnership is to create a pipeline of talent in the sales environment. We continued with the Internal Audit Department Learnership programme in co-operation with the Institute of Internal Auditors South Africa. On completion of this learnership, the two learners will achieve the Internal Audit Technician professional designation.

Compulsory training initiatives were continued and/or launched for all employees in 2017, including ethics, anti-money laundering, cyber security and fraud awareness.

Annual financial statements

Accounting policies and the basis of preparation for the annual financial statements are set out on pages 44 to 49 of this report.

Regulation

The Bank Supervision Department of the SARB is the lead regulator of the Group. The Financial Surveillance Department of the SARB, 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 reports regularly 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 it operates.

Communication with stakeholders

The Board communicates with its stakeholders in accordance with the Companies Act and with the employees of Mercantile from time to time, as appropriate. 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.

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 to advise and report to senior management and the Board on these risks.

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

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

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

The head of Compliance reports to the CEO and has unrestricted and unfettered access to 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 two Money Laundering Reporting Officers. The Compliance function at Mercantile follows a centralised structure that coordinates 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, against which it monitors the progress in training, monitoring and review of compliance with the regulatory requirements of the Group.

A successful compliance function is built on relationships with senior management, the Board, and staff as well as with industry bodies, the regulators, and other governance functions (such as Internal Audit and Risk). 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 of, and their responsibilities relating 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 Compliance and Anti-Money Laundering/Combating the Financing of Terrorism 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.

The key Acts of focus for the Compliance function during the year under review were:

- The Banks Act, No. 94 of 1990;
- The Companies Act, No. 71 of 2008;
- The National Payment Systems Act, No. 78 of 1998 (NPS);
- 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);
- The Financial Sector Regulation Act, No. 9 of 2017;
- The Protection of Personal Information Act, No. 4 of 2013 (POPI);
- The Foreign Account Tax Compliance Act (FATCA) and The Common Reporting Standard (CRS); and
- The Financial Services Sector Code (FSC).

The most notable development and focus area in respect of regulatory reforms during the upcoming year continues to be the anticipated implementation of the FICA Amendment Act, POPI, the review of the PASA/NPS Act, the FATCA and the OECD's CRS, and the Twin Peaks model 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. The Regulator was appointed and assumed office from 1 December 2016. The Regulations have been published and are currently undergoing the consultation process. We anticipate that the commencement date of the Act will be in 2019.

Compliance Officer's report continued

A review of the Payments Association of South Africa's (PASA) mandate as held in the NPS Act was initiated to assess its effectiveness as a payment system management body due to a number of factors, one of them being the reform of the financial sector regulatory architecture through the implementation of the Twin Peaks Model. SARB also identified issues during its ongoing oversight over the affairs of PASA and various matters raised by payment industry stakeholders in respect of the current PASA model. The aim of the review is directed at PASA's institutional, governance and regulatory frameworks to ensure its effectiveness and alignment with international standards and best practices as well as other key developments.

FATCA is intended to detect and deter the evasion of US tax by US persons who hold money outside the US. FATCA has greatly impacted the South African financial services sector due to the Inter-Governmental Agreement (IGA) that was signed between South Africa and the USA in June 2014, which now requires mandatory annual reporting by financial institutions to avoid a 30% withholding tax should FATCA not be adhered to.

The OECD is a unique forum where governments work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and help governments respond to new developments and potential risks. The OECD's CRS is the standard for Automatic Exchange of Financial Account Information among member countries. CRS focuses on tax residency as opposed to US citizenship and the main purpose of the CRS is to obtain financial account information of member countries' citizens that hold bank accounts in foreign financial institutions and automatically exchange that information with the revenue office of the account holder's country of citizenship on an annual basis. The FATCA and CRS remediation project is ongoing.

The amended FSC was gazetted in December 2017 and the implementation of the revised FSC will be a major focus for Mercantile during the course of 2018. The amendment to the FSC is a response to the call for the promotion of transformation and global competitiveness in the financial services industry. This will result in accessible financial services and direct investment into targeted sectors of the economy.

The Financial Sector Regulation Act was signed into law during the course of August 2017 and envisages the Twin Peaks model of regulation. This will see the creation of a prudential regulator – the Prudential Authority – housed in the SARB, while the Financial Services Board will be transformed into a dedicated market conduct regulator – the Financial Sector Market Conduct Authority. The implementation of the Twin Peaks model in South Africa has two fundamental objectives:

- To strengthen South Africa's approach to consumer protection and market conduct in financial services; and
- To create a more resilient and stable financial system.

The Prudential Authority's objective will be to promote and enhance the safety and soundness of regulated financial institutions; while the Financial Sector Market Conduct Authority will be tasked with protecting clients by:

- ensuring that financial institutions Treat Customers Fairly (TCF);
- enhancing the efficiency and integrity of the financial system; and
- providing clients and potential clients with financial education programmes and otherwise promoting financial literacy and capability.

Compliance with anti-money laundering and combating of the financing of terrorism (AML/CFT) laws remains in effect. Changes to operational requirements to incorporate the recent amendments to FICA are in the process of being formulated and implemented. The AML/CFT environment is dynamic and the Bank's compliance and risk management programme is under constant review to remain relevant and in touch with industry norms and best practices.

The Bank utilises automated systems and manual processes as part of its programme to combat money laundering and terrorist financing. Systems provide transaction activity monitoring to detect possible money laundering, client name screening to detect possible high-risk clients, transaction screening to detect terrorist financing, and online training to create awareness in respect of the Bank's AML/CFT obligations.

Transaction activity monitoring is based on a predetermined set of parameters as designed by the Compliance function and aims to highlight suspicious and/or unusual transactions. Name screening is performed on all clients and associated persons on a daily basis with the objective of identifying prominent influential persons or public officials. Transaction screening of cross-border remittances occurs in real time and sender and beneficiary details are filtered against sanction lists, including the United Nations Security Council's lists. Potential matches are addressed within the Compliance function, which also reports relevant transactions to the Financial Intelligence Centre (FIC) as required by legislation.

Processes to ensure adequacy of client identification and verification documentation and information are followed by a centralised support function that is subject to ongoing reviews by the Compliance function.

Training is offered to all staff by way of an online training system. Focused training to relevant business functions is performed in person by members of the Compliance function.

Consumer protection regulation continued to be a key focus in 2017. The Compliance function carried out extensive monitoring reviews throughout the year and the Group remains in material compliance with the Consumer Protection Act (CPA).

The NCA has imposed strict requirements on credit and service providers, including standardised affordability assessments, stringent credit bureau enquiry time frames, disclosures to consumers, advertising and marketing practices, complaints handling, pricing, and reporting to the respective regulators. Training on these areas has continued to be a key focus for 2017. New amendments to the NCA were published in the latter part of 2017. Business processes will be reformulated and will be enhanced where necessary to ensure compliance with these amendments. The Compliance function carried out extensive training and monitoring reviews throughout the year.

During the course of December 2017, the new FAIS Fit and Proper requirements were released. These new requirements are designed to meet the consumer protection objective of the FAIS Act and provide further clarity as to the definitions and requirements. The implementation of the new FAIS Fit and Proper requirements is a major focus area for the Compliance function for the coming 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. This Code remains a focus area in the coming year.

The Group's business is built on trust and integrity as perceived by our stakeholders, especially our clients, the Board, CGD and the regulators. An important element of trust and integrity is ensuring that the Group conducts its business in accordance with the values and the Code of Conduct that it has adopted, and 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 Group. This policy forms part of the Group'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 their Compliance function in fulfilling its obligations. The Compliance Officers provide regular training to ensure that all employees are familiar with their regulatory obligations and provide advice on regulatory issues. The Compliance staff independently monitors the business units to ensure adherence to policies and procedures and other technical requirements.

The Group places paramount importance on the health and safety of its employees and constantly strives to improve their safety standards. The Group's aim is to eliminate all work-related injuries and illnesses. All our operations are guided by the Occupational Health and Safety Policy, which is based on leading safety practices at the workplace. This policy was formulated with the co-operation and participation of management. In our efforts to continually improve our safety performance, each operation is monitored monthly through a formal review system. Safety is a key performance indicator and a key element of performance reward for the vast majority of the Group's employees.

H Stoffberg
Head: Compliance

28 February 2018

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 risk-based audits.

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 the Companies Act and 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 consistently applied, appropriate accounting policies, 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, it continues to adopt the going concern basis in preparing the annual financial statements.

These annual financial statements, set out on pages 43 to 97, have been approved by the Board of Mercantile Bank Holdings Limited and are signed on its behalf by:

GP de Kock
Acting Chairman

KR Kumbier
CEO

28 February 2018

MEL TEIXEIRA
CFO

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 (Chartered Accountant) South Africa.

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

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 2017, 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

28 February 2018

Independent Auditor's report

To the shareholder of Mercantile Bank Holdings Limited

Report on the audit of the financial statements

Opinion

We have audited the consolidated and separate financial statements of Mercantile Bank Holdings Limited and its subsidiaries (the Group) set out on pages 44 to 96, which comprise the consolidated and separate statements of financial position as at 31 December 2017, and the consolidated and separate statements of comprehensive income, statements of changes in equity and the consolidated and separate statements of cash flows for the year then ended, and the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the Group as at 31 December 2017, and its consolidated and separate financial performance and consolidated and separate cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs) and the requirements of the Companies Act of South Africa.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the consolidated and separate financial statements section of our report. We are independent of the Group in accordance with the Independent Regulatory Board for Auditors Code of Professional Conduct for Registered Auditors (IRBA Code) and other independence requirements applicable to performing audits of financial statements in South Africa. We have fulfilled our other ethical responsibilities in accordance with the IRBA Code and in accordance with other ethical requirements applicable to performing audits in South Africa. The IRBA Code is consistent with the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (Parts A and B). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other information

The Directors are responsible for the other information. The other information comprises the Directors' report, as required by the Companies Act of South Africa, Certificate from the Company Secretary, Audit Committee report and supplementary information as disclosed on page 97. The other information does not include the consolidated and separate financial statements and our auditor's report thereon.

Our opinion on the consolidated and separate financial statements does not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.

In connection with our audit of the consolidated and separate financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

If, based on the work we have performed on the other information that we obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of the Directors for the consolidated and separate financial statements

The Directors are responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with International Financial Reporting Standards 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.

In preparing the consolidated and separate financial statements, the Directors are responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Group or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the consolidated and separate financial statements

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

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

- identify and assess the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are

Independent Auditor's report continued

appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors;
- conclude on the appropriateness of the Directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated and separate financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation; and
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated and separate financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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

Report on other legal and regulatory requirements

In terms of the Independent Regulatory Board for Auditors (IRBA) Rule published in Government Gazette Number 39475 dated 4 December 2015, we report that Deloitte & Touche has been the auditor of Mercantile Bank Holdings for 16 years.

Deloitte & Touche
Registered Auditor
Per: Diana Jorge
Partner

28 February 2018

National Executive: *LL Bam Chief Executive Officer, *TMM Jordan Deputy Chief Executive Officer; Clients and Industries, *MJ Jarvis Chief Operating Officer, *AF Mackie Audit and Issurance, *N Singh Risk Advisory, *NB Kader Tax and Legal, TP Pillay Consulting, S Gwala BPS, *JK Mazzocco Talent and Transformation, MG Dicks Risk Independence and Legal, *TJ Brown Chairman of the Board.

**Partner and Registered Auditor*

A full list of partners and directors is available on request

B-BBEE rating: Level 1 contributor in terms of the DTI Generic Scorecard as per the amended Codes of Good Practice

Associate of Deloitte Africa, a Member of Deloitte Tohmatsu Limited

Audit Committee report

for the year ended 31 December 2017

The GAC is pleased to present its report for the 2017 financial year. This report has been prepared based on the requirements of the Companies Act, the King Codes of Governance for South Africa and other applicable regulatory requirements.

The GAC's duties include its statutory duties in terms of section 94(7) 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, with the exception of the securitisation vehicle, Compass Securitisation (RF) Limited, which has a separate audit committee. The GAC's main objective is to assist the Board in fulfilling its oversight responsibilities, in particular with regard to evaluation of the adequacy and efficiency of accounting policies, internal controls and financial and corporate reporting processes. In addition, the GAC assesses the effectiveness of the internal auditors and the independence and effectiveness of the external auditors.

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 2017, the members were:

- TH Njikizana (Chairman) Chartered Accountant (South Africa)
- L Hyne Chartered Accountant (South Africa)
- GP de Kock
- DR Motsepe

The CEO, Deputy CEO, CFO, heads of Risk, Internal Audit, Compliance Management and Treasury and representatives from the External Auditors are permanent attendees to the Committee meetings. The External and Internal Auditors have unrestricted access to the GAC Chairman, or any other member of the Committee, including closed sessions without management, on any matter that they regard as relevant to the fulfilment of the Committee's responsibilities. The GAC chair meets with the External and Internal Auditors separately between Audit Committee meetings. During 2017, the GAC's charter was amended to include, as permanent attendees, the CGD group heads of internal audit and compliance.

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 activity;
- 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;
- reviewed policies and procedures for preventing and detecting fraud; and
- undertaken a deep dive on the requirements of IFRS 9: Financial instruments and reviewed a detailed project plan, including principles, major risks, timelines and resources, in advance of the implementation in 2018.

The head of Internal Audit reported functionally 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 followed and assurances obtained, the GAC believes that significant internal financial controls are effective.

Regulatory compliance

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

- reviewed and recommended the Compliance Charter for approval; and
- evaluated the effectiveness and performance of the Compliance function.

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

Audit Committee report continued

for the year ended 31 December 2017

External audit

Based on processes followed and assurances received, the GAC is satisfied that both Deloitte & Touche and the audit partner, D Jorge, are independent of the Group. The GAC confirms 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 2018. The reappointment of the external auditor is subject to approval by the shareholder at the upcoming AGM.

Combined assurance

The GAC is of the view that the arrangements in place for the combined assurance model are working toward achieving the objective of a more effective, integrated approach across the disciplines of risk management, compliance and audit (and other assurance providers, as applicable). The journey of combined assurance will continuously evolve as the process matures within the organisation.

Finance function

The GAC received regular reports from the CFO regarding the financial performance of the Group, the tracking and monitoring of key performance indicators, details of budgets, forecasts, long-term plans and capital expenditures, financial reporting controls and processes, and the adequacy and reliability of management information used during the financial reporting process. The GAC believes that the CFO, 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 followed and assurances obtained, we believe that the accounting practices are effective.

Annual financial statements and integrated reporting process

The GAC reviewed and discussed the Integrated Annual Report, reporting process and governance and financial information included in the Integrated Annual Report after considering recommendations from the Social, Ethics and Transformation Committee, the Remuneration Committee, the Group RMC and the DAC.

The GAC remains satisfied with the overall control environment, including those supporting the financial statements for 2017, as confirmed by Internal Audit.

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

On behalf of the GAC

TH Njikizana
Chairman of the GAC

28 February 2018

Directors' report

for the year ended 31 December 2017

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 2017.

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.

Holding company

The 100% shareholder of the Company is CGD.

Financial results

An overview of the financial results is set out in the Group Review, commencing on page 8 of the Integrated Annual Report. Details of the Company and Group financial results are set out on pages 44 to 97 and, in the opinion of the Directors, require no further comment.

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 20 to the annual financial statements.

Directors, Company Secretary and registered addresses

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

GP de Kock°	*(Acting Chairman)*
KR Kumbier#	*(CEO)*
RS Caliço*#	*(Deputy CEO)*
L Hyne°	
AT Ikalafeng°	
TH Njikizana^°	
DR Motsepe°	

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

The Directors of the Company, as at 28 February 2018, and details of their backgrounds, are shown on pages 6 and 7.

T Singh is the Company Secretary.

The registered addresses of the Company are:

Postal
PO Box 782699, Sandton 2146

Physical
1st Floor, Mercantile Bank, 142 West Street, Sandown 2196

Dividends

A dividend of R42,458 million was declared on 28 February 2018 in respect of the year ended 31 December 2017 (2016: R35,226 million and paid in 2017).

Special resolutions

Two special resolutions were adopted during 2017. The first was at the AGM held on 31 May 2017: to approve the fees and remuneration respectively payable to Non-Executive Directors and Executive Directors. The second was on 2 June 2017: to approve the conversion to equity of the shareholder loan in the wholly owned subsidiary, Mercantile Rental Finance Proprietary Limited.

Change in accounting policy

The Company has changed its accounting policy with regards to the measurement of investments in subsidiaries which were previously held as available-for-sale financial assets measured at fair value, with any changes in the fair value recognised in other comprehensive income, to available-for-sale financial assets held at cost.

Events after the reporting period

Apart from the dividends declared and the sale of Mercantile (refer to note 33 on page 85), no other 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 2017

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

1. Basis of presentation

The Company financial statements as well as the consolidated financial statements for the Group are prepared in accordance with IFRS adopted by the International Accounting Standards Board; the South African Institute of Chartered Accountants' Financial Reporting Guides as issued by the Accounting Practices Committee; Financial Reporting Pronouncements as issued by the Financial Reporting Standards Council; and the Companies Act.

In the current year the Group has applied the below mandatory amendments to IFRSs issued by the International Accounting Standards Board and that are effective for an accounting period that begins on or after 1 January 2017.

Amendments to IAS 7 Disclosure initiative

The Group has applied these amendments for the first time in the current year. The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The Group's liabilities arising from financing activities consist of long-term funding (note 19). Consistent with the transition provisions of the amendments, the Group has not disclosed comparative information for the prior period. Apart from the additional disclosure in note 19, the application of these amendments had no material impact on the Group's consolidated financial statements.

All other IFRSs that became effective in the current reporting period have had no impact on the Group.

2. Basis of consolidation

Subsidiaries are entities over which the Group has exposure to variable returns and the power to direct relevant activities that affect those returns. 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. Recognition of assets and liabilities

3.1 Assets

The Group recognises an asset 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.

3.2 Liabilities

The Group recognises a liability 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.

3.3 Provisions

A provision is 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 can be made.

3.4 Contingent liabilities

A contingent liability is disclosed where the Group 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 an obligation in terms of which it is merely possible that an outflow of resources will be required to settle the obligation, or the amount of an obligation cannot be measured with sufficient reliability.

4. Financial instruments

A financial asset or financial liability is recognised in the Group's statement of financial position when the Group has become a party to the contractual provisions of that financial instrument. Regular way purchases or sales of financial assets are recognised using settlement date accounting. On initial recognition, financial instruments are recognised at fair value and, in the case of a financial instrument not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial instruments are included.

The Group derecognises a financial asset when:

- the contractual rights to the cash flows arising from the financial asset 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 the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit or loss.

4.1 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 instruments.

Derivative financial instruments (derivatives) are not entered into for trading or speculative purposes. All derivatives are recognised in the statement of financial position. Derivatives 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 or loss.

Derivatives related to unlisted equity instruments where fair value cannot be reliably determined are measured at cost less impairment.

A derivative's notional principal amount 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.

4.2 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 or loss

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

Available-for-sale financial assets

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

Negotiable securities

Negotiable securities consist of government stock and treasury bills.

Government stock acquired prior to 31 December 2014 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 sold or otherwise disposed of. At that time, the cumulative gains or losses previously recognised in other comprehensive income are included in profit or loss.

Government stock acquired from 1 January 2015 has been designated as held-to-maturity and is carried at amortised cost.

All other negotiable securities are classified as loans and receivables and 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 or loss with resultant gains and losses being included in profit or 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 or loss, rather it is suspended. In certain instances, interest is also suspended where portfolio impairments are recognised.

Other accounts receivable

Other accounts receivable comprises items in transit, properties in possession, structured loans, accrued income, prepayments and deposits that meet the definition of financial assets, and other receivables. These assets have been designated as loans and receivables and are measured at amortised cost.

4.3 Financial liabilities

The Group's financial liabilities include deposits, long-term funding and debt securities and other accounts payable, consisting of accruals, product-related credits, and sundry creditors. These financial liabilities are measured at amortised cost. Derivative instruments are measured at fair value through profit or loss; the resultant gains and losses are included in profit or loss.

4.4 Fair value estimation

The fair value of publicly traded derivatives, securities and investments is based on the quoted market prices 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.

Accounting policies continued

for the year ended 31 December 2017

In assessing the fair value of non-publicly traded financial instruments, the Group uses a variety of valuation methods that take into consideration input assumptions, which are based, as far as possible, on objective market information 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 valuation techniques, such as earnings multiples, option pricing models, discounted cash flows, replacement cost, and net asset values of underlying investee entities are used to determine fair values.

4.5 Amortised cost

Amortised cost is determined 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.

4.6 Impairment

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 or 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's 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 recognising a specific impairment expense. Where the impairment 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 in prior years. The reversal of an impairment is recognised through profit or loss, except for the reversal of an impairment of equity instruments designated as available-for-sale, which reversal is recognised in other comprehensive income.

5. Foreign currency transactions

Transactions in foreign currencies are converted to the functional currency at the prevailing exchange rate on the transaction date. Monetary assets, liabilities and commitments in foreign currencies are translated to the functional currency using the rate of exchange at reporting date. Gains and losses on foreign exchange are recognised in profit or loss.

6. Subsidiaries

Investments in subsidiaries are measured at cost. The accounting policy was changed from available-for-sale financial assets measured at fair value during the year (refer to note 29 for additional disclosure). Investments in subsidiaries are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

7. 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.

8. Property and equipment

Owner-occupied properties are held for use in the supply of services or for administrative purposes and are reflected in the statement of financial position at fair value, less any subsequent accumulated depreciation and/or impairment. The fair value is based on capitalisation rates for net rentals for each property. Revaluations are performed annually by independent registered professional valuators.

Any revaluation increase is recognised in other comprehensive income, except to the extent that it reverses a revaluation decrease for the same asset previously recognised in profit or loss, in which case it is recognised in profit or loss to the same extent with the excess recognised in other comprehensive income. A decrease in the carrying amount arising from a valuation is recognised in other comprehensive income, except to the extent that it exceeds the related non-distributable reserve of that asset recognised in equity, in which case the excess is recognised in profit or loss. On the subsequent sale or retirement of a revalued property, the revaluation surplus relating to that property is transferred to distributable reserves.

All equipment is stated at historical cost, less accumulated depreciation and subsequent accumulated impairment. 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 or loss as incurred.

Depreciation on equipment is calculated using the straight-line method. Leasehold improvements are depreciated over the period of the lease, or over such lesser period as is considered appropriate.

The residual values and useful lives of property and equipment are reviewed and adjusted, if appropriate, at each reporting date.

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 derecognised. 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 the disposal of property and equipment are recognised in profit or loss and are determined by deducting from the proceeds the net carrying amounts.

Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount is written down 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.

9. Intangible assets

9.1 Computer software

Direct costs associated with purchasing, developing and enhancing computer software programs, 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 financial period.

Computer software and licences that are recognised as intangible assets are amortised on a straight-line basis over a period of three to five years but, where appropriate, to a maximum of 10 years. These intangible assets are carried at historical cost less accumulated amortisation and/or impairment.

9.2 Derecognition of intangible assets

An intangible asset is derecognised on disposal or when future economic benefits are no longer expected from its use or disposal. Gains and losses on the disposal of intangible assets are determined by deducting the net carrying amounts from the proceeds and are recognised in profit or loss.

9.3 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 of impairment. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment.

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount is written down 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.

10. Tax

Income tax expense represents the sum of current and deferred tax.

10.1 Current tax

Current tax is determined based on taxable profits for the period. Taxable profit may differ from accounting profit as it may exclude, or include, items of income or expense that are taxable or deductible in other periods, and it would further exclude 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.

10.2 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 of such items, and is determined 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 sufficient taxable temporary differences or taxable profits will be available against which those deductible temporary differences may be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from initial recognition of goodwill, or from 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 timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

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

The carrying amount of deferred tax assets is reviewed at each reporting date and is reduced to the extent that it is no longer probable that it will be used.

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 is 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,

Accounting policies continued

for the year ended 31 December 2017

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.

10.3 Current and deferred tax

Current and deferred tax are recognised in profit or loss, except when they relate to items recognised in other comprehensive income or directly in equity, in which case the tax is recognised in the same statement as the related item.

11. Instalment sales and leases

11.1 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 recognised in profit or loss on a straight-line basis over the term 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.

11.2 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.

12. Interest income and interest expense

Except where interest income is suspended, interest income and expense are recognised in profit or loss for all interest-bearing instruments measured at amortised cost, using the effective interest rate method.

13. 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.

14. Retirement funds

The Group operates a defined contribution fund that 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 or loss as accrued.

15. 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 costs of the defined benefit plan are assessed using the projected unit credit method. Under this method, the current service cost of providing post-retirement medical benefits is recognised in profit or loss. The interest cost and expected return on plan assets, as well as the effect of settlements on the liability and plan assets, are recognised in profit or loss and any remeasurement of the defined benefit liability and assets (which include actuarial gains and losses) is recognised in other comprehensive income. The net post-retirement asset or liability recognised in the consolidated statement of financial position reflects the full value of the plan deficit or surplus.

16. 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.

16.1 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 recognised, the Group makes judgements as to whether there is any observable data indicating a measurable decrease in the estimated future cash flows from a portfolio of loans, before the decrease can be attributed to 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 forecasting 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.

16.2 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, management is required to make estimates in areas such as credit risk, volatilities and correlations. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

16.3 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.

17. Recent accounting developments

There are a number of new and revised standards in issue that are not yet effective and that the Group has no plans to early adopt. These include the following standards that could be applicable to the business of the Group and that may have an impact on future financial statements. Except for IFRS 9 (refer below), the impact of initial application of the following standards and interpretations is not expected to be significant to the Group:

Standard	Standard name and detail	Effective date
IFRS 1 IFRS 12 IAS 28	Amendments resulting from annual improvements 2014 – 2016 cycle	Annual periods beginning on or after 1 January 2018
IFRS 3 IFRS 11 IAS 12 IAS 23	Amendments resulting from annual improvements 2015 – 2017 cycle	Annual periods beginning on or after 1 January 2019
IFRS 2	**Share-based payment:** Amendments to clarify the classification and measurement of share-based payment transactions	Annual periods beginning on or after 1 January 2018
IFRS 4	**Insurance contracts:** Amendments regarding the interaction of IFRS 4 and IFRS 9	Annual periods beginning on or after 1 January 2018
IFRS 7	**Financial instruments:** Additional hedge accounting disclosures	Annual periods beginning on or after 1 January 2018
IFRS 9	**Financial instruments** In July 2014, the International Accounting Standards Board issued IFRS 9 Financial instruments, which replaces IAS 39 Financial instruments: Recognition and measurement. IFRS 9, which is effective for the Group for the financial year commencing 1 January 2018, introduces: • a principles-based approach to the classification of financial assets according to an entity's business model and the nature of the cash flows of the asset; • an expected credit loss impairment model for all financial assets not measured at fair value through profit and loss; and • a new hedge accounting model. The Group has assessed all its assets and liabilities against the classification and measurement criteria and, although certain classifications will change, the impact of these changes is not significant. The change from an IAS 39 'incurred loss' model to an IFRS 9 'expected loss' model has resulted in the Group having to build a new model to cater for this. The IFRS 9 model, built during 2017, is still being refined and going through internal governance processes, and has not yet been audited. While we expect a transitional increase in balance sheet provisions in line with the requirements of the standard, management does not anticipate this having a significant impact on the Group's capital adequacy levels. The Group does not apply hedge accounting and hence there is no impact on the Group.	Annual periods beginning on or after 1 January 2018
IFRS 9	**Financial instruments:** Amendments regarding prepayment features with negative compensation and modifications of financial liabilities	Annual periods beginning on or after 1 January 2019
IFRS 10	**Consolidated financial statements:** Amendments regarding the sale or contribution of assets between an investor and its associate or joint venture	Deferred indefinitely
IFRS 15	**Revenue from contracts with customers**	Annual periods beginning on or after 1 January 2018
IFRS16	**Leases**	Annual periods beginning on or after 1 January 2019
IFRS 17	**Insurance contracts**	Annual periods beginning on or after 1 January 2021
IAS 28	**Investments in associates and joint ventures:** Amendments regarding long-term interests in associates and joint ventures	Annual periods beginning on or after 1 January 2019
IAS 40	**Investment property:** Amendments to clarify transfers of property to, or from, investment property	Annual periods beginning on or after 1 January 2018
IFRIC 22	**Foreign currency transactions and advance consideration**	Annual periods beginning on or after 1 January 2018
IFRIC 23	**Uncertainty over income tax treatments**	Annual periods beginning on or after 1 January 2019

Statements of financial position

at 31 December 2017

		GROUP		COMPANY		
	Note	**2017 R'000**	2016 R'000	**2017 R'000**	Restated 2016 R'000	Restated 2015 R'000
Assets						
Cash and cash equivalents	2	**1 750 165**	2 247 070	**4 159**	4 134	4 120
Derivative financial instruments	3	**104 016**	29 442	**–**	–	–
Negotiable securities	4	**904 166**	509 874	**–**	–	–
Loans and advances	5	**9 459 819**	8 661 812	**–**	–	–
Other investments	6	**6 985**	6 712	**62**	62	62
Interest in subsidiaries	7	**–**	–	**746 217**	746 270	746 415
Other accounts receivable	8	**689 688**	327 001	**–**	–	–
Non-current assets held for sale	9	**22 500**	–	**–**	–	–
Current tax receivable	10	**32**	681	**–**	–	–
Property and equipment	11	**244 176**	254 604	**–**	–	–
Intangible assets	12	**153 533**	178 813	**–**	–	–
Deferred tax assets	13	**15 090**	–	**–**	–	–
Total assets		**13 350 170**	12 216 009	**750 438**	750 466	750 597
Equity and liabilities						
Liabilities		**11 014 144**	10 060 131	**3 643**	3 560	3 584
Other accounts payable	14	**511 712**	308 567	**3 643**	3 560	3 584
Derivative financial instruments	3	**128 044**	43 733	**–**	–	–
Current tax payable	10	**6 280**	7 324	**–**	–	–
Provisions and other liabilities	15	**119 723**	94 072	**–**	–	–
Deposits	17	**9 337 177**	8 473 034	**–**	–	–
Debt securities	18	**241 594**	241 009	**–**	–	–
Long-term funding	19	**609 395**	837 699	**–**	–	–
Deferred tax liabilities	13	**60 219**	54 693	**–**	–	–
Total equity attributable to equity holder of the parent		**2 336 026**	2 155 878	**746 795**	746 906	747 013
Share capital and share premium	20	**1 207 270**	1 207 270	**1 207 270**	1 207 270	1 207 270
Employee benefits reserve		**(6 218)**	(7 319)	**–**	–	–
Property revaluation reserve		**129 301**	128 229	**–**	–	–
Available-for-sale reserve		**5 186**	4 727	**33**	33	33
Retained earnings/(Accumulated loss)		**1 000 487**	822 971	**(460 508)**	(460 397)	(460 290)
Non-controlling interests		**–**	–	**–**	–	–
Total equity		**2 336 026**	2 155 878	**746 795**	746 906	747 013
Total equity and liabilities		**13 350 170**	12 216 009	**750 438**	750 466	750 597

Statements of comprehensive income

for the year ended 31 December 2017

		GROUP		COMPANY	
	Note	**2017 R'000**	2016 R'000	**2017 R'000**	Restated 2016 R'000
Interest income	22	1 139 093	1 003 841	39	39
Interest expense	23	(607 300)	(513 699)	–	–
Net interest income		531 793	490 142	39	39
Net charge for credit losses	5.4	(40 134)	(40 254)	–	–
Net interest income after credit losses		491 659	449 888	39	39
Net non-interest income		335 602	291 181	35 226	29 197
Non-interest income	24	634 614	516 781	35 226	29 197
Fee and commission expenditure	25	(299 012)	(225 600)	–	–
Net interest and non-interest income		827 261	741 069	35 265	29 236
Operating expenditure	26	(534 176)	(493 885)	(150)	(146)
Profit before tax		293 085	247 184	35 115	29 090
Tax	27	(80 343)	(70 166)	–	–
Profit after tax		212 742	177 018	35 115	29 090
Other comprehensive income					
Items that will not be reclassified to profit or loss:		2 173	16 784	–	–
Revaluation of owner-occupied properties	11	1 489	21 874	–	–
Remeasurement of defined benefit obligation	16	1 530	1 438	–	–
Deferred tax thereon	13	(846)	(6 528)	–	–
Items that may subsequently be reclassified to profit or loss:		459	2 044	–	–
Gains on remeasurement to fair value on financial assets designated as available-for-sale		616	3 077	–	–
Deferred tax thereon	13	(157)	(1 033)	–	–
Other comprehensive income net of tax		2 632	18 828	–	–
Total comprehensive income		215 374	195 846	35 115	29 090
Profit after tax attributable to:					
Equity holder of the parent		212 742	176 132	35 115	29 090
Non-controlling interests		–	886	–	–
		212 742	177 018	35 115	29 090
Total comprehensive income attributable to:					
Equity holder of the parent		215 374	194 960	35 115	29 090
Non-controlling interests		–	886	–	–
		215 374	195 846	35 115	29 090

Statements of changes in equity

for the year ended 31 December 2017

	Share capital and share premium R'000	Employee benefits reserve R'000	Property revaluation reserve R'000	Available-for-sale reserve R'000	Retained earnings R'000	Attributable to equity holder of the parent R'000	Non-controlling interests R'000	Total R'000
Group								
Balance at 31 December 2015	1 207 270	(8 354)	112 480	2 683	707 698	2 021 777	(1 165)	2 020 612
Net movement for the year	–	1 035	15 749	2 044	115 273	134 101	1 165	135 266
Total comprehensive income for the year	–	1 035	15 749	2 044	144 470	163 298	1 165	164 463
Profit after tax	–	–	–	–	176 132	176 132	886	177 018
Increase in shareholding of Mercantile Rental Finance from 74,9% to 100%	–	–	–	–	(31 662)	(31 662)	279	(31 383)
Other comprehensive income	–	1 438	21 874	3 077	–	26 389	–	26 389
Tax relating to other comprehensive income	–	(403)	(6 125)	(1 033)	–	(7 561)	–	(7 561)
Dividend paid	–	–	–	–	(29 197)	(29 197)	–	(29 197)
Balance at 31 December 2016	1 207 270	(7 319)	128 229	4 727	822 971	2 155 878	–	2 155 878
Net movement for the year	–	1 101	1 072	459	177 516	180 148	–	180 148
Total comprehensive income for the year	–	1 101	1 072	459	212 742	215 374	–	215 374
Profit after tax	–	–	–	–	212 742	212 742	–	212 742
Other comprehensive income	–	1 530	1 489	616	–	3 635	–	3 635
Tax relating to other comprehensive income	–	(429)	(417)	(157)	–	(1 003)	–	(1 003)
Dividend paid	–	–	–	–	(35 226)	(35 226)	–	(35 226)
Balance at 31 December 2017	1 207 270	(6 218)	129 301	5 186	1 000 487	2 336 026	–	2 336 026

	Share capital and share premium R'000	Available-for-sale reserve R'000	Accumulated loss R'000	Total R'000
Company				
Balance at 1 January 2016 (as previously reported)	1 207 270	1 292 702	(460 290)	2 039 682
Adjustments due to a change in accounting policy (refer to note 29)	–	(1 292 669)	–	(1 292 669)
Balance at 1 January 2016 (restated)	1 207 270	33	(460 290)	747 013
Net movement for the year	–	–	(107)	(107)
Total comprehensive income for the year	–	–	29 090	29 090
Profit after tax	–	–	29 090	29 090
Other comprehensive income	–	–	–	–
Dividend paid	–	–	(29 197)	(29 197)
Balance at 31 December 2016	1 207 270	33	(460 397)	746 906
Net movement for the year	–	–	(111)	(111)
Total comprehensive income for the year	–	–	35 115	35 115
Profit after tax	–	–	35 115	35 115
Other comprehensive income	–	–	–	–
Dividend paid	–	–	(35 226)	(35 226)
Balance at 31 December 2017	1 207 270	33	(460 508)	746 795

Statements of cash flows

for the year ended 31 December 2017

	Note	GROUP 2017 R'000	GROUP 2016 R'000	COMPANY 2017 R'000	COMPANY 2016 R'000
Cash flows from operating activities					
Cash receipts from clients	28.1	1 787 210	1 531 861	39	39
Cash paid to clients, suppliers and employees	28.2	(1 342 446)	(1 161 131)	(150)	(146)
Cash generated from/(utilised in) operations	28.3	444 764	370 730	(111)	(107)
Dividends received		–	–	35 226	29 197
Tax (paid)	28.4	(91 305)	(79 953)	–	–
Net (increase) in income-earning assets	28.5	(1 240 356)	(1 411 557)	–	–
Net increase in deposits and other accounts	28.6	687 845	1 634 132	136	121
Net cash (outflow)/inflow from operating activities		(199 052)	513 352	35 251	29 211
Cash flows from investing activities					
Purchase of intangible assets	12	(23 282)	(27 117)	–	–
Purchase of property and equipment	11	(11 870)	(32 120)	–	–
Proceeds on disposal of property and equipment		244	5 671	–	–
Net cash (outflow) from investing activities		(34 908)	(53 566)	–	–
Cash flows from financing activities					
Dividends paid		(35 226)	(29 197)	(35 226)	(29 197)
Net (decrease)/increase in long-term funding	19	(228 304)	191 484	–	–
Proceeds from long-term borrowings		132 862	316 829	–	–
Repayments of long-term borrowings		326 979	125 345	–	–
(Gains) on exchange rate movements*		(34 188)	–	–	–
Proceeds from debt securities	18	241 585	38 199	–	–
Repayment of debt securities	18	241 000	–	–	–
Net cash (outflow)/inflow from financing activities		(262 945)	200 486	(35 226)	(29 197)
Net cash (outflow)/inflow for the year		(496 905)	660 272	25	14
Cash and cash equivalents at the beginning of the year		2 247 070	1 586 798	4 134	4 120
Cash and cash equivalents at the end of the year	2	1 750 165	2 247 070	4 159	4 134

* *IAS 7 does not require disclosure on effects of foreign exchange rate changes relating to prior years.*

Notes to the annual financial statements

for the year ended 31 December 2017

1. Categories and fair values of financial instruments

1.1 Category analysis of financial instruments

	GROUP			
	2017		2016	
	Fair value R'000	**Carrying amount R'000**	Fair value R'000	Carrying amount R'000
Assets				
Available-for-sale	6 985	6 985	58 109	58 109
Other investments	6 985	6 985	6 712	6 712
Negotiable securities – Government stock	–	–	51 397	51 397
Held-to-maturity				
Negotiable securities – Government stock	51 093	50 997	204 549	206 314
Amortised cost	12 753 555	12 752 841	11 487 178	11 487 316
Loans and advances				
Current accounts	1 825 612	1 825 612	1 745 478	1 745 478
Credit cards	36 414	36 414	30 945	30 945
Mortgage loans	4 787 057	4 787 057	4 266 096	4 266 096
Instalment sales and leases	1 488 907	1 488 907	1 135 894	1 135 894
Structured loans	193 684	193 684	210 584	210 584
Medium-term loans	1 128 145	1 128 145	1 272 085	1 272 085
Negotiable securities				
Treasury bills	853 883	853 169	252 025	252 163
Cash and cash equivalents	1 750 165	1 750 165	2 247 070	2 247 070
Other accounts receivable	689 688	689 688	327 001	327 001
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	–	730	730
Held-for-trading				
Derivative financial instruments	104 016	104 016	29 442	29 442
	12 915 649	12 914 839	11 780 008	11 781 911
Liabilities				
Held-for-trading				
Derivative financial instruments	128 044	128 044	43 733	43 733
Amortised cost	10 699 870	10 699 870	9 860 309	9 860 309
Long-term funding	609 395	609 395	837 699	837 699
Deposits	9 337 177	9 337 177	8 473 034	8 473 034
Debt securities*	241 594	241 594	241 009	241 009
Other accounts payable	511 712	511 712	308 567	308 567
	10 827 922	10 827 922	9 904 042	9 904 042

** Additional disclosure relating to financial instruments in respect of the prior year has been included.*

Notes to the annual financial statements continued

for the year ended 31 December 2017

1. Categories and fair values of financial instruments continued

1.1 Category analysis of financial instruments continued

	COMPANY			
	2017		2016	
	Fair value R'000	Carrying amount R'000	Fair value R'000	Carrying amount R'000
Assets				
Available-for-sale				
Other investments	62	62	62	62
Loans and receivables				
Cash and cash equivalents	4 159	4 159	4 134	4 134
	4 221	4 221	4 196	4 196
Liabilities				
Amortised cost				
Other accounts payable	3 643	3 643	3 560	3 560
	3 643	3 643	3 560	3 560

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 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 and securities 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.
- The fair value of other investments that are unlisted is determined by reference to the net asset value of the entity and/or the underlying net asset value of its investment holdings.
- The fair value of loans and advances, designated at fair value through profit and loss, is calculated using the credit spread observed at origination. The fair value is adjusted for deterioration of credit quality through the application of the credit impairment models.

1.3 Fair value measurements as required by IFRS 13

Financial instruments that are measured at fair value 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).

1. Categories and fair values of financial instruments continued

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

	GROUP			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2017				
Assets				
Available-for-sale				
Other investments	–	–	6 985	6 985
Negotiable securities – Government stock	–	–	–	–
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	–	–	–
Held-for-trading				
Derivative financial instruments	–	104 016	–	104 016
	–	104 016	6 985	111 001
Liabilities				
Held-for-trading				
Derivative financial instruments	–	128 044	–	128 044
	–	128 044	–	128 044
2016				
Assets				
Available-for-sale				
Other investments	–	–	6 712	6 712
Negotiable securities – Government stock	51 397	–	–	51 397
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	–	730	730
Held-for-trading				
Derivative financial instruments	–	29 442	–	29 442
	51 397	29 442	7 442	88 281
Liabilities				
Held-for-trading				
Derivative financial instruments	–	43 733	–	43 733
	–	43 733	–	43 733

	COMPANY			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2017				
Assets				
Available-for-sale				
Other investments	–	–	62	62
2016				
Assets				
Available-for-sale				
Other investments	–	–	62	62

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

Notes to the annual financial statements continued

for the year ended 31 December 2017

1. Categories and fair values of financial instruments continued

1.4 Reconciliation of Level 3 fair value measurements of financial assets

	GROUP	
	2017 R'000	2016 R'000
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning of the year	6 712	5 958
Gains on remeasurement to fair value in other comprehensive income	273	754
Balance at the end of the year	6 985	6 712

	COMPANY	
	2017 R'000	2016 R'000
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning and end of the year	62	62

	GROUP	
	2017 R'000	2016 R'000
Fair value through profit and loss		
Loans and advances – mortgage loans		
Balance at the beginning of the year	730	5 210
Repayment of loans and advances	(730)	(4 732)
Gains on remeasurement to fair value in comprehensive income	–	252
Balance at the end of the year	–	730

2. Cash and cash equivalents

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
Cash on hand	37 637	37 287	–	–
Central Bank balances	328 239	500 587	–	–
Money market funds	426 674	1 022 498	–	–
Rand-denominated bank balances	196 329	86 726	4 159	4 134
Foreign currency-denominated bank balances	761 286	599 972	–	–
	1 750 165	2 247 070	4 159	4 134

3. Derivative financial instruments

	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**
2017				
Held-for-trading				
Foreign exchange contracts	1 085 190	104 016	1 353 728	128 044
Interest rate swaps	–	–	–	–
	1 085 190	104 016	1 353 728	128 044
2016				
Held-for-trading				
Foreign exchange contracts	809 652	29 442	1 156 396	43 731
Interest rate swaps	175	–	240 175	2
	809 827	29 442	1 396 571	43 733

4. Negotiable securities

	GROUP	
	2017 R'000	2016 R'000
Loans and receivables		
Treasury bills	853 169	252 163
Available-for-sale		
Government stock	–	51 397
Held-to-maturity		
Government stock	50 997	206 314
	904 166	509 874
Maturity analysis		
Maturing within one month	29 901	–
Maturing after one month but within six months	556 796	252 163
Maturing after six months but within 12 months	291 707	206 583
Maturing after one year but within five years	25 762	51 128
	904 166	509 874

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

Notes to the annual financial statements continued

for the year ended 31 December 2017

5. Loans and advances

5.1 Product analysis

	GROUP	
	2017 R'000	2016 R'000
Amortised cost	**9 580 785**	8 750 547
Current accounts	**1 858 855**	1 765 592
Credit cards	**39 505**	33 971
Mortgage loans	**4 819 294**	4 303 121
Instalment sales and leases	**1 500 587**	1 144 073
Structured loans	**193 874**	211 189
Medium-term loans	**1 168 670**	1 292 601
Designated at fair value through profit and loss		
Mortgage loans	**–**	730
Gross loans and advances	**9 580 785**	8 751 277
Less: Portfolio impairments for credit losses	**(24 439)**	(26 583)
Specific impairments for credit losses	**(96 527)**	(62 882)
	9 459 819	8 661 812

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

5.2 Maturity analysis

	GROUP	
	2017 R'000	2016 R'000
Repayable on demand and maturing within one month	**1 963 232**	1 844 298
Maturing after one month but within six months	**138 890**	233 249
Maturing after six months but within 12 months	**155 084**	74 691
Maturing after 12 months	**7 323 579**	6 599 039
	9 580 785	8 751 277

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

5. Loans and advances continued

5.3 Detailed product analysis of loans and advances

	Gross amount R'000	Portfolio impairments R'000	Specific impairments R'000	Net balance R'000
Group				
2017				
Current accounts	1 858 855	(10 182)	(23 061)	1 825 612
Credit cards	39 505	(549)	(2 542)	36 414
Mortgage loans	4 819 294	(4 752)	(27 485)	4 787 057
Instalment sales and leases	1 500 587	(4 633)	(7 047)	1 488 907
Structured loans	193 874	(190)	–	193 684
Medium-term loans	1 168 670	(4 133)	(36 392)	1 128 145
	9 580 785	(24 439)	(96 527)	9 459 819
2016				
Current accounts	1 765 592	(7 861)	(12 253)	1 745 478
Credit cards	33 971	(842)	(2 184)	30 945
Mortgage loans	4 303 851	(4 965)	(32 060)	4 266 826
Instalment sales and leases	1 144 073	(3 145)	(5 034)	1 135 894
Structured loans	211 189	(605)	–	210 584
Medium-term loans	1 292 601	(9 165)	(11 351)	1 272 085
	8 751 277	(26 583)	(62 882)	8 661 812

5.4 Impairments for credit losses

	Total R'000	Current accounts R'000	Credit cards R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Medium-term loans R'000
Group							
2017							
Balance at the beginning of the year	(89 465)	(20 114)	(3 026)	(37 025)	(8 179)	(605)	(20 516)
Movements for the year							
Credit losses written off	3 742	525	114	2 339	165	–	599
Net impairments (raised)/released	(35 243)	(13 654)	(179)	2 449	(3 665)	414	(20 608)
Balance at the end of the year	(120 966)	(33 243)	(3 091)	(32 237)	(11 679)	(191)	(40 525)
2016							
Balance at the beginning of the year	(59 654)	(16 961)	(2 381)	(7 177)	(5 040)	(342)	(27 753)
Movements for the year							
Credit losses written off	3 303	1 183	143	547	495	–	935
Net impairments (raised)/released	(33 114)	(4 336)	(788)	(30 395)	(3 634)	(263)	6 302
Balance at the end of the year	(89 465)	(20 114)	(3 026)	(37 025)	(8 179)	(605)	(20 516)

Notes to the annual financial statements continued

for the year ended 31 December 2017

5. Loans and advances continued

5.4 Impairments for credit losses continued

	GROUP 2017 R'000	GROUP 2016 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	(35 243)	(33 114)
Amounts written off directly to comprehensive income	(13 155)	(10 288)
Reversal of impairments for properties in possession previously impaired	4 500	–
Recoveries in respect of amounts previously written off	3 764	3 148
	(40 134)	(40 254)

5.5 Product analysis of performing loans and advances

	Gross amount R'000	Portfolio impairment R'000	Net balance R'000
Group			
2017			
Current accounts	1 798 543	(10 182)	1 788 361
Credit cards	36 963	(549)	36 414
Mortgage loans	4 675 384	(4 752)	4 670 632
Instalment sales and leases	1 492 242	(4 633)	1 487 609
Structured loans	193 874	(190)	193 684
Medium-term loans	1 061 908	(4 133)	1 057 775
	9 258 914	(24 439)	9 234 475
2016			
Current accounts	1 741 703	(7 861)	1 733 842
Credit cards	31 787	(842)	30 945
Mortgage loans	4 180 982	(4 965)	4 176 017
Instalment sales and leases	1 136 050	(3 145)	1 132 905
Structured loans	211 189	(605)	210 584
Medium-term loans	1 268 132	(9 165)	1 258 967
	8 569 843	(26 583)	8 543 260

5.6 Product analysis of performing loans and advances excluding loans and advances with renegotiated terms

	GROUP 2017 R'000	GROUP 2016 R'000
Current accounts	1 778 698	1 689 251
Credit cards	36 963	31 787
Mortgage loans	4 439 397	4 156 121
Instalment sales and leases	1 492 165	1 135 763
Structured loans	193 874	211 189
Medium-term loans	1 025 149	1 173 963
	8 966 246	8 398 074

5. Loans and advances continued

5.7 Product analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired

	GROUP	
	2017 R'000	2016 R'000
Current accounts	19 845	52 452
Credit cards	–	–
Mortgage loans	235 987	24 862
Instalment sales and leases	77	287
Structured loans	–	–
Medium-term loans	36 759	94 169
	292 668	171 770

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

	Past due for				
	1 – 30 days R'000	**31 – 60 days R'000**	**61 – 90 days R'000**	**Total gross amount R'000**	**Fair value of collateral and other credit enhance-ments R'000**
Group					
2017					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	12 429	49 833	2 097	64 359	43 576
Instalment sales and leases	–	3 018	16	3 034	1 853
Structured loans	–	–	–	–	–
Medium-term loans	–	4 575	–	4 575	–
	12 429	57 426	2 113	71 968	45 429
2016					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	21 531	15 546	9 557	46 634	38 263
Instalment sales and leases	138	404	–	542	466
Structured loans	–	–	–	–	–
Medium-term loans	3 555	–	38 062	41 617	35 280
	25 224	15 950	47 619	88 793	74 009

Notes to the annual financial statements continued

for the year ended 31 December 2017

5. Loans and advances continued

5.9 Product analysis of loans and advances that are individually impaired

	Gross amount R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhancements R'000
Group				
2017				
Current accounts	60 312	(23 061)	37 251	48 519
Credit cards	2 542	(2 542)	–	–
Mortgage loans	143 910	(27 485)	116 425	165 811
Instalment sales and leases	8 345	(7 047)	1 298	1 530
Structured loans	–	–	–	–
Medium-term loans	106 762	(36 392)	70 370	94 674
	321 871	(96 527)	225 344	310 534
2016				
Current accounts	23 889	(12 253)	11 636	15 120
Credit cards	2 184	(2 184)	–	–
Mortgage loans	122 869	(32 060)	90 809	114 889
Instalment sales and leases	8 023	(5 034)	2 989	3 076
Structured loans	–	–	–	–
Medium-term loans	24 469	(11 351)	13 118	15 508
	181 434	(62 882)	118 552	148 593

5.10 Collateral held as security and other credit enhancements

Fair value of collateral and other credit enhancements is determined by referencing the realisable value of security held.

All clients of the Bank are accorded a risk grading. The risk grading is dependent upon the client'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 professional valuation (certain segments up to 100%)
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

5. Loans and advances continued

5.10 Collateral held as security and other credit enhancements continued

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 and in compliance with the applicable Court rules and directives.

A client 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.

6. Other investments

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
Available-for-sale				
Unlisted equities	6 985	6 712	62	62
	6 985	6 712	62	62

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

7. Interest in subsidiaries

	COMPANY	
	2017 R'000	Rstated 2016 R'000
Unlisted		
Shares at cost	746 217	746 217
Mercantile Bank Limited	745 967	745 967
Mercantile Insurance Brokers Proprietary Limited	250	250
Loan to Mercantile Bank Limited	–	53
	746 217	746 270

A list of principal subsidiary companies is contained in note 31.

During 2017, the Company changed its accounting policy in regard to the measurement of interest in subsidiaries (refer to note 29).

Notes to the annual financial statements continued

for the year ended 31 December 2017

8. Other accounts receivable

	GROUP	
	2017 R'000	2016 R'000
Items in transit	**269 262**	164 437
Properties in possession	**–**	18 550
Prepayments and deposits	**35 513**	33 824
Structured loans accrued income	**11 076**	9 996
Other receivables	**373 837**	100 194
	689 688	327 001

The Directors consider that the carrying amount of other accounts receivable approximates fair value.

The other accounts receivable are all current and not past due; therefore, no age analysis has been prepared for past due but not impaired receivables.

Structured loans accrued income relates to the present value of future cash flows. Properties in possession has been reclassified to non-current assets held for sale (refer to note 9).

9. Non-current assets held for sale

	GROUP	
	2017 R'000	2016 R'000
Properties in possession	**22 500**	–
	22 500	–

The Bank purchased this property out of a loan default during 2012. An offer to purchase was received during 2017 and, although certain suspensive conditions remain to be met, the property has been accounted for at the offer to purchase value. The property was previously disclosed under other accounts receivable (refer to note 8).

10. Current tax receivable/payable

	GROUP	
	2017 R'000	2016 R'000
South African Revenue Service		
Current tax receivable	**32**	681
Current tax payable	**6 280**	7 324

11. Property and equipment

	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
Group							
2017							
Open market value/cost at the beginning of the year	205 990	13 280	53 536	12 839	31 865	1 049	318 559
Revaluation	1 489	–	–	–	–	–	1 489
Additions	642	2 729	6 811	799	889	–	11 870
Transfer*	–	928	(70)	(681)	(177)	–	–
Disposals	–	(2 925)	(599)	(669)	(3 030)	(173)	(7 396)
Open market value/cost at the end of the year	208 121	14 012	59 678	12 288	29 547	876	324 522
Accumulated depreciation and impairment losses at the beginning of the year	(6 090)	(4 550)	(29 494)	(3 490)	(19 657)	(674)	(63 955)
Depreciation – disclosed in operating expenditure	(8 731)	(1 768)	(3 857)	(1 245)	(4 164)	(172)	(19 937)
Depreciation – disclosed in fee and commission expenditure	–	–	(3 606)	–	–	–	(3 606)
Revaluation		–	–	–	–	–	–
Transfer*	–	(275)	38	150	87	–	–
Disposals	–	2 876	549	617	2 937	173	7 152
Accumulated depreciation and impairment losses at the end of the year	(14 821)	(3 717)	(36 370)	(3 968)	(20 797)	(673)	(80 346)
Net carrying amount at the end of the year	193 300	10 295	23 308	8 320	8 750	203	244 176

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

Notes to the annual financial statements continued

for the year ended 31 December 2017

11. Property and equipment continued

	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
Group							
2016							
Open market value/cost at the beginning of the year	186 332	11 464	36 068	12 118	31 505	1 071	278 558
Revaluations	18 425	–	–	–	–	–	18 425
Additions	1 233	3 759	22 763	1 448	2 659	258	32 120
Write-off of obsolete assets	–	(1 943)	(5 295)	(511)	(939)	–	(8 688)
Disposals	–	–	–	(216)	(1 360)	(280)	(1 856)
Open market value/cost at the end of the year	205 990	13 280	53 536	12 839	31 865	1 049	318 559
Accumulated depreciation and impairment losses at the beginning of the year	(3 232)	(4 709)	(26 219)	(2 927)	(17 530)	(537)	(55 154)
Depreciation – disclosed in operating expenditure	(6 308)	(1 263)	(3 717)	(1 192)	(4 314)	(196)	(16 990)
Depreciation – disclosed in fee and commission expenditure	–	–	(986)	–	–	–	(986)
Revaluation	3 450	–		–	–	–	3 450
Write-off of obsolete assets	–	1 422	1 428	497	832	–	4 179
Disposals	–	–	–	132	1 355	59	1 546
Accumulated depreciation and impairment losses at the end of the year	(6 090)	(4 550)	(29 494)	(3 490)	(19 657)	(674)	(63 955)
Net carrying amount at the end of the year	199 900	8 730	24 042	9 349	12 208	375	254 604

The cumulative historical cost of owner-occupied properties that have been revalued is R60,194 million (2016: R59,552 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 2016 and 31 December 2017.

A mortgage bond in the amount of R150 million (2016: R150 million) has been registered over a property included in owner-occupied properties (refer to note 19).

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

12. Intangible assets

	GROUP	
	2017 R'000	2016 R'000
Computer software		
Cost at the beginning of the year	382 233	355 128
Additions	23 282	27 117
Write-off of obsolete computer software	(215)	(12)
Cost at the end of the year	405 300	382 233
Accumulated amortisation and impairment losses at the beginning of the year	(203 420)	(163 064)
Amortisation	(48 562)	(40 368)
Write-off of obsolete computer software	215	12
Accumulated amortisation and impairment losses at the end of the year	(251 767)	(203 420)
Net carrying amount at the end of the year	153 533	178 813

During 2016 and 2017, the Group identified no events or circumstances that would indicate that the Group's intangible assets may need to be impaired.

13. Deferred tax assets and (liabilities)

	GROUP	
	2017 R'000	2016 R'000
Balance at the beginning of the year	(54 693)	(51 889)
Current year charge		
Per the statement of comprehensive income	10 567	4 757
Per the statement of changes in equity/other comprehensive income	(1 003)	(7 561)
	(45 129)	(54 693)
Tax effects of temporary differences between tax and book value for:		
Intangible assets	(23 232)	(31 281)
Property and equipment	(1 319)	(893)
Provisions and other liabilities	20 509	18 246
Impairments on loans and advances	5 953	7 004
Current assets	10 578	5 595
Revaluations	(52 398)	(64 309)
Leased assets	2 785	2 587
Other	(8 005)	8 358
	(45 129)	(54 693)
Deferred tax assets	15 090	–
Deferred tax liabilities	(60 219)	(54 693)
	(45 129)	(54 693)

Notes to the annual financial statements continued

for the year ended 31 December 2017

14. Other accounts payable

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
Accruals	40 597	27 600	–	–
Product-related credits	319 902	182 837	–	–
Sundry creditors	147 667	94 570	97	–
Previous minority shareholders (share buy-back during 2012)	3 546	3 560	3 546	3 560
	511 712	308 567	3 643	3 560

15. Provisions and other liabilities

	Deferred bonus scheme R'000	**Staff incentives R'000**	**Audit fees R'000**	**Post-retirement medical benefits R'000**	**Leave pay R'000**	**Other risks R'000**	**Total R'000**
Group							
At 1 January 2016	8 378	23 766	4 967	22 080	12 811	22 734	94 736
Provision raised	19 202	30 737	8 431	1 875	4 174	1 536	65 955
Reversal of provision	–	–	–	–	–	(1 944)	(1 944)
Charged to provision	(3 453)	(23 209)	(8 908)	(3 331)	(3 633)	(22 141)	(64 675)
At 31 December 2016	24 127	31 294	4 490	20 624	13 352	185	94 072
Provision raised	29 787	38 094	8 680	1 980	8 767	1 363	88 671
Reversal of provision	–	–	–	–	–	(1 236)	(1 236)
Charged to provision	(12 998)	(30 029)	(8 413)	(3 570)	(6 766)	(8)	(61 784)
At 31 December 2017	40 916	39 359	4 757	19 034	15 353	304	119 723

Post-retirement medical benefits

Refer to note 16 for detailed disclosure of this provision.

Leave pay

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

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.

16. Post-retirement medical benefits

The Bank operates a post-retirement medical scheme. Independent actuaries value this scheme annually (the last valuation was carried out at 31 December 2017). It is the actuary's opinion that the plan is in a sound financial position.

	GROUP	
	2017 R'000	2016 R'000
The amounts recognised in the statement of financial position are as follows (refer to note 15):		
Present value of total service liabilities	19 034	20 624
Liability in the statement of financial position	19 034	20 624
The amounts recognised in the statement of comprehensive income are as follows:		
Net interest cost (refer to note 23)	1 805	1 853
Staff cost (refer to note 26)	(1 865)	(1 871)
Current service cost	7	22
Employer benefit payments	(1 872)	(1 893)
Total included in comprehensive income	(60)	(18)
The amounts recognised in the statement of comprehensive income are as follows:		
Remeasurement of defined benefit obligation	(1 530)	(1 438)
Total included in other comprehensive income	(1 530)	(1 438)
Reconciliation of the movement in the present value of total service liabilities:		
At the beginning of the year	20 624	22 080
Current service cost	7	22
Interest costs	1 805	1 853
Remeasurement of defined benefit obligation	(1 530)	(1 438)
Employer benefit payments	(1 872)	(1 893)
At the end of the year	19 034	20 624
The principal actuarial assumptions used were as follows:		
Discount rate	9,6%	9,2%
Rate of medical inflation	8,5%	8,6%
Salary inflation	8,0%	8,1%

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 R1,880 million (2016: R1,967 million) and a decrease of R1,615 million (2016: R1,677 million), respectively.

Notes to the annual financial statements continued

for the year ended 31 December 2017

17. Deposits

	GROUP	
	2017 R'000	2016 R'000
Call deposits and current accounts	**5 116 915**	4 596 068
Savings accounts	**187 990**	179 471
Term and notice deposits	**3 419 416**	3 072 586
Negotiable certificates of deposit	**23 423**	22 246
Foreign currency deposits	**589 433**	602 663
	9 337 177	8 473 034
Maturity analysis		
Repayable on demand and maturing within one month	**6 526 357**	5 795 769
Maturing after one month but within six months	**1 228 886**	1 287 633
Maturing after six months but within 12 months	**259 686**	314 387
Maturing after 12 months but within five years	**1 322 248**	1 075 245
	9 337 177	8 473 034

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

18. Debt securities

	GROUP	
	2017 R'000	2016 R'000
Unrated class A notes	**241 594**	241 009
	241 594	241 009

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

The notes issued in 2014 (R202 million) and 2016 (an additional R38 million) were linked to JIBAR with interest repayable quarterly and matured on 6 June 2017. In replacement, AAA rated notes to the value of R240 million were issued on 6 June 2017. These replacement notes are linked to JIBAR with interest repayable quarterly and mature on 6 June 2020.

19. Long-term funding

	GROUP	
	2017 R'000	2016 R'000
International Finance Corporation (IFC)	90 945	207 017
Short-term portion payable in the next 12 months	90 945	117 053
Portion payable after 12 months but within five years	–	89 964
Standard Bank of South Africa Limited (Standard Bank)	146 342	150 078
Short-term portion payable in the next 12 months	5 331	3 770
Portion payable after 12 months but within five years	141 011	146 308
Banco Nacional Ultramarino S.A. (BNU Macau)	247 737	480 604
Short-term portion payable in the next 12 months	247 737	–
Portion payable after 12 months but within five years	–	480 604
Bank One Limited		
Short-term portion payable in the next 12 months	124 371	–
	609 395	837 699
Long-term funding before non-cash movements	643 583	837 699
Exchange rate (gains)	(34 188)	*
	609 395	837 699

** Disclosure on effects of foreign exchange rate changes relating to the prior year are not required in terms of IFRS 7.*

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

The original loan obtained from Standard Bank in 2012 was renegotiated and extended in 2016. The loan, with interest linked to JIBAR and repayable monthly, is repayable from 29 December 2017 to 29 December 2021. The loan is secured by a mortgage over the Group's owner-occupied property (refer to note 11).

The three-year foreign currency loan of USD15 milllion obtained from BNU Macau in 2015 was settled in 2017 as there was an option of early settlement. The Group obtained an additional loan of USD20 million in 2016, with interest linked to LIBOR and payable quarterly, which will be early-settled in March 2018.

The one-year foreign currency loan of USD10 million obtained from Bank One Limited, with interest linked to LIBOR and payable quarterly, matures on 13 October 2018.

In December 2017, a committed R740 million seven-year term loan facility was concluded with the IFC. At year-end, Mercantile had not yet drawn down against this facility.

20. Share capital and share premium

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
20.1 Issued – Group and Company				
At 31 December 2016 and 31 December 2017	3 614 018 195	36 140	1 171 130	1 207 270

20.2 Authorised

The total authorised number of ordinary shares is 4 465 955 440 shares (2016: 4 465 955 440 shares) with a par value of 1 cent each.

Notes to the annual financial statements continued

for the year ended 31 December 2017

20. Share capital and share premium continued

20.3 Unissued

The unissued ordinary and preference shares are under the control of the Directors until the next Annual General Meeting.

20.4 Rights, preferences and restrictions of shares

Unless stated otherwise in the memorandum of incorporation of the Company, a share affords every holder of such share the right to certain dividends when declared, the return of capital on the winding up of the Company and the right to attend and vote at meetings of shareholders.

21. Contingent liabilities and commitments

21.1 Guarantees, letters of credit and committed undrawn facilities

	GROUP	
	2017 R'000	2016 R'000
Guarantees	583 249	457 473
Lending-related	745	1 631
Mortgage	122 206	85 017
Performance	460 298	370 825
Letters of credit	10 144	20 979
Committed undrawn facilities	142 185	302 372
	735 578	780 824

21.2 Commitments under operating leases

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

	GROUP	
	2017 R'000	2016 R'000
Property rentals		
Due within one year	7 948	5 625
Due between one and five years	13 914	15 731
	21 862	21 356
After-tax effect on operating leases	15 741	15 376

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.

22. Interest income

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
Loans and receivables at amortised cost	1 125 838	977 432	39	39
Cash and cash equivalents	100 516	86 372	39	39
Negotiable securities	27 660	8 157	–	–
Loans and advances	997 662	882 903	–	–
Loans and receivables designated as available-for-sale				
Negotiable securities	2 430	10 568	–	–
Loans and receivables designated as held-to-maturity				
Negotiable securities	10 825	15 561	–	–
Loans and receivables designated at fair value through profit and loss				–
Loans and advances	–	280	–	–
	1 139 093	1 003 841	39	39

23. Interest expense

	GROUP	
	2017 R'000	2016 R'000
Deposits	494 697	427 204
Debt securities	23 335	22 059
Long-term funding	86 164	58 986
Held-for-trading – Interest rate swaps	–	232
Net interest on defined benefit obligation	1 805	1 853
Other	1 299	3 365
	607 300	513 699

24. Non-interest income

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
Fee and commission income	412 078	335 874	–	–
Loans and receivables	412 078	335 659	–	–
Insurance-related products	–	215	–	–
Trading income	222 536	180 907	–	–
Held-for-trading	222 536	180 935	–	–
Foreign currency	222 536	180 577	–	–
Derivative assets and liabilities	–	358	–	–
Designated at fair value through profit and loss	–	(28)	–	–
Loans and advances	–	(28)	–	–
Investment income	–	–	35 226	29 197
Dividends	–	–	35 226	29 197
	634 614	516 781	35 226	29 197

25. Fee and commission expenditure

	GROUP	
	2017 R'000	2016 R'000
Relating to non-interest income earned from:		
Foreign currency	142 169	113 614
Fees and commissions	156 843	111 986
	299 012	225 600

Notes to the annual financial statements continued

for the year ended 31 December 2017

26. Operating expenditure

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
Amortisation (refer to note 12)	**48 562**	40 368	**–**	–
Auditors' remuneration				
Audit fees – Current year	**8 680**	8 236	**–**	–
– Prior year underprovision	**–**	150	**–**	–
Fees for other services – Tax advisory fees	**324**	239	**–**	–
– Regulatory reviews	**75**	–	**–**	–
– Securitisation vehicle reviews	**195**	204	**–**	–
– *Less:* Securitisation vehicle reviews expenditure capitalised	**(195)**	–	**–**	–
– Other	**–**	35	**–**	–
	9 079	8 864	**–**	–
Depreciation (refer to note 11)	**19 937**	16 990	**–**	–
Directors' remuneration (refer to note 30.3)				
Executive Directors	**17 947**	17 037	**–**	–
Non-Executive Directors' fees	**4 484**	4 231	**–**	–
	22 431	21 268	**–**	–
Indirect tax				
Non-claimable value added tax	**16 627**	15 244	**–**	–
Skills development levy	**2 448**	2 193	**–**	–
	19 075	17 437	**–**	–
Loss/(Profit) on sale and write-off of intangible assets and property and equipment	**42**	(852)	**–**	–
Marketing	**9 090**	8 002	**150**	146
Operating leases for premises and other related costs	**16 035**	15 278	**–**	–
Other operating costs	**48 521**	58 720	**–**	–
Professional fees				
Consulting	**2 733**	1 443	**–**	–
Legal and collection	**4 492**	5 378	**–**	–
Computer consulting and services	**51 495**	50 062	**–**	–
	58 720	56 883	**–**	–
Staff costs				
Salaries, allowances and incentives	**249 256**	227 733	**–**	–
Post-retirement medical benefits (refer to notes 15 and 16)	**(1 865)**	(1 871)	**–**	–
Deferred bonus scheme	**29 786**	19 201	**–**	–
Other	**5 507**	5 864	**–**	–
	282 684	250 927	**–**	–
Total operating expenditure	**534 176**	493 885	**150**	146
Number of persons employed by the Group at year-end	**502**	510		

27. Tax

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
South African normal tax	90 910	74 923	–	–
Current year	90 910	74 206	–	–
Prior year	–	717	–	–
Deferred tax	(10 567)	(4 757)	–	–
Current year	(11 064)	(5 185)	–	–
Prior year	497	428	–	–
	80 343	70 166	–	–
Direct tax				
South African normal tax	90 910	74 923	–	–
South African tax rate reconciliation				
South African standard tax rate (%)	28,00	28,00	28,00	28,00
Exempt income (%)	–	–	(28,09)	(28,10)
Expenses not deductible for tax purposes (%)	0,04	0,03	–	–
Additional allowances for tax purposes (%)	–	4,12	–	–
Capital gain inclusion on unrealised portion not taxable (%)	0,41	(4,15)	–	–
(Over)/Underprovision prior years (%)	(0,17)	0,13	–	–
Tax losses (%)	(0,87)	0,26	0,09	0,10
Effective tax rate (%)	27,41	28,39	0,00	(0,00)
Estimated tax losses available for offset against future taxable income	6 987	34 256	6 987	6 879

Notes to the annual financial statements continued

for the year ended 31 December 2017

28. Notes to statements of cash flows

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
28.1 Cash receipts from clients				
Interest income	1 139 093	1 003 841	39	39
Non-interest income	634 614	516 781	35 226	29 197
Adjusted for: Dividends received	–	–	(35 226)	(29 197)
Revaluation of fair value financial instruments	9 739	8 091	–	–
Recoveries in respect of amounts previously written off	3 764	3 148	–	–
	1 787 210	1 531 861	39	39
28.2 Cash paid to clients, suppliers and employees				
Interest expense	(607 300)	(513 699)	–	–
Operating expenditure and fee and commission expenditure	(833 188)	(719 485)	(150)	(146)
Adjusted for: Amortisation	48 562	40 368	–	–
Depreciation	23 543	17 976	–	–
Write-off of obsolete property and equipment	244	4 819	–	–
Loss/(Profit) on sale and write-off of obsolete intangible assets and property and equipment	42	(852)	–	–
Deferred bonus scheme expense	29 786	19 201	–	–
(Decrease) in provisions and other liabilities	(4 135)	(9 459)	–	–
	(1 342 446)	(1 161 131)	(150)	(146)
28.3 Reconciliation of profit before tax to cash generated from operations				
Profit before tax	293 085	247 184	35 115	29 090
Profit before tax adjusted for:				
Dividends received	–	–	(35 226)	(29 197)
Revaluation of fair value financial instruments	9 739	8 091	–	–
Net impairments raised	43 898	43 402	–	–
Amortisation	48 562	40 368	–	–
Depreciation	23 543	17 976	–	–
Write-off of obsolete property and equipment	244	4 819	–	–
Loss/(Profit) on sale and write-off of obsolete intangible assets and property and equipment	42	(852)	–	–
Deferred bonus scheme expense	29 786	19 201	–	–
(Decrease) in provisions and other liabilities	(4 135)	(9 459)	–	–
Cash generated from/(utilised in) operations	444 764	370 730	(111)	(107)
28.4 Tax				
Amounts paid at the beginning of the year	(6 643)	(11 673)	–	–
Statement of comprehensive income (charge)	(90 910)	(74 923)	–	–
Less: Amounts owing at the end of the year	6 248	6 643	–	–
Total tax (paid)	(91 305)	(79 953)	–	–

28. Notes to statements of cash flows continued

	GROUP		COMPANY	
	2017 R'000	2016 R'000	**2017 R'000**	2016 R'000
28.5 Net movement in income-earning assets				
(Increase)/Decrease in negotiable securities	(393 949)	43 944	–	–
(Increase) in loans and advances	(846 407)	(1 455 501)	–	–
Net (increase) in income-earning assets	(1 240 356)	(1 411 557)	–	–
28.6 Net movement in deposits and other accounts				
Increase in deposits	864 143	1 711 181	–	–
Decrease in subsidiary loans	–	–	53	145
(Increase) in other accounts receivable	(380 687)	(156 270)	–	–
Increase in other accounts payable	204 389	79 221	83	(24)
Net increase in deposits and other accounts	687 845	1 634 132	136	121

29. Change in accounting policy

The Company has changed its accounting policy with regards to the measurement of Investments in subsidiaries which were previously held as available-for-sale financial assets measured at fair value, with any changes in the fair value recognised in other comprehensive income, to available-for-sale financial assets held at cost. The reason for this change is to disclose a more reliable and relevant value of the investments and to align with industry practice.

The effect of this voluntary change in accounting policy on the Company's financial statements is a reduction in the value of interests in subsidiaries, and other comprehensive income recognised in available-for-sale reserves on these financial assets. The change in accounting policy was applied retrospectively and the corresponding comparative figures were restated.

The effect on the individual line items on the Company's financial statements is disclosed below:

	COMPANY	
	2017 R'000	2016 R'000
Effect on the statement of other comprehensive income		
Gains on remeasurement to fair value on financial assets designated as available-for-sale	–	(152 649)
Tax relating to other comprehensive income	–	–
Net decrease in other comprehensive income	–	(152 649)

	COMPANY		
	2017 R'000	2016 R'000	2015 R'000
Effect on the statement of financial position			
Assets			
Decrease in Interest in subsidiaries	–	(1 445 318)	(1 292 669)
Reconciled as follows:			
Opening balance of interest in subsidiaries as previously reported	–	2 191 588	2 039 084
Adjustment as a result of the change in accounting policy	–	(1 445 318)	(1 292 669)
Closing balance of interest in subsidiaries as a result of the effect of the change in accounting policy	–	746 270	746 415
Equity			
Decrease in available-for-sale reserves	–	(1 445 318)	(1 292 669)

Notes to the annual financial statements continued

for the year ended 31 December 2017

30. Related party information

30.1 Identity of related parties with whom transactions have occurred

The parent company and material subsidiaries of the Group are identified on pages 1 and 84. All of these entities and the Directors are related parties. Other than as listed below, there are no other related parties with whom transactions have taken place.

30.2 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.

		GROUP	
		2017 R'000	2016 R'000
Balances between the parent company (CGD) and the Bank:			
Legal entity	**Nature of account**		
CGD – Lisbon (Branch of CGD)	Nostro accounts	25 120	7 642
Banco Comercial e de Investimentos – Mozambique (BCI) (Subsidiary of CGD)	Local currency placements	–	44 020
Total Assets		25 120	51 662
CGD – Lisbon (Branch of CGD)	Vostro accounts	(1 575)	(1 864)
CGD – Paris (Branch of CGD)	Vostro accounts	(2)	(10)
CGD – London (Branch of CGD)	Vostro accounts	–	(8)
Banco Comercial e de Investimentos – Mozambique (BCI) (Subsidiary of CGD)		(95 302)	(65 710)
	Fixed deposits	(40 000)	(64 250)
	Call and notice deposits	(55 302)	(1 460)
Banco Caixa Geral Angola SA (BCGA) (Subsidiary of CGD)	Call deposit	(1 737)	(8 436)
Banco Nacional Ultramarino SA (BNU Macau) (Subsidiary of CGD)	Long-term funding	(247 737)	(480 604)
Total liabilities		(346 353)	(556 632)
Net (liabilities) – CGD		(321 233)	(504 970)
Transactions between the parent company (CGD) and the Bank:			
Interest paid by the Bank to CGD – Lisbon		1 912	–
Interest paid by the Bank to BCI		4 646	1 418
Interest paid by the Bank to BCGA		123	247
Interest paid by the Bank to BNU		14 357	11 204
Interest received by the Bank from CGD – Lisbon		144	103
Interest received by the Bank from CGD – New York		–	307
Interest received by the Bank from BCI		–	6 329
Fees received by the Bank from BCGA		97	–

30. Related party information continued

30.2 Related party balances and transactions continued

		GROUP	
		2017 R'000	2016 R'000
Balances with the Company, its subsidiaries and joint venture:			
Loan to:	Loan from:		
Mercantile Bank Limited	Mercantile Bank Holdings Limited	–	53
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown Proprietary Limited	66 952	64 140
Mercantile Insurance Brokers Proprietary Limited	Mercantile Bank Limited	111	41
Mercantile Rental Finance Proprietary Limited	Mercantile Bank Limited	483 230	479 250
Mercantile Payment Solutions Proprietary Limited	Mercantile Bank Limited	2 971	2 292
Compass Securitisation (RF) Limited	Mercantile Rental Finance Proprietary Limited	574	568
Mercantile Payment Solutions Proprietary Limited*	Grant Electronics Close Corporation	1 867	1 426
Other accounts receivable:	**Other accounts payable:**		
Portion 2 of Lot 8 Sandown Proprietary Limited*	Mercantile Rental Finance Proprietary Limited	25	22
Debt securities issued by:	**Invested in debt securities by:**		
Compass Securitisation (RF) Limited	Mercantile Rental Finance Proprietary Limited	–	112 101
Compass Securitisation (RF) Limited	Mercantile Bank Limited	104 220	–
Deposit with:	**Deposit by:**		
Mercantile Bank Limited	Mercantile Insurance Brokers Proprietary Limited	485	463
Mercantile Bank Limited	Mercantile Bank Holdings Limited	4 159	4 134
Mercantile Bank Limited	Mercantile Payment Solutions Proprietary Limited	140	96
Mercantile Bank Limited	The Mercantile Bank Foundation (NPC)	41	39
Transactions with the Company, its subsidiaries and joint venture:			
Interest received by:	**Interest paid by:**		
Portion 2 of Lot 8 Sandown Proprietary Limited	Mercantile Bank Limited	2 618	209
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown Proprietary Limited	–	245
Mercantile Insurance Brokers Proprietary Limited	Mercantile Bank Limited	–	11
Mercantile Bank Limited	Mercantile Rental Finance Proprietary Limited	43 265	42 056
Mercantile Rental Finance Proprietary Limited	Compass Securitisation (RF) Limited	7 465	16 357
Mercantile Bank Limited	Compass Securitisation (RF) Limited	9 838	–

Notes to the annual financial statements continued

for the year ended 31 December 2017

30. Related party information continued

30.2 Related party balances and transactions continued

		GROUP 2017 R'000	GROUP 2016 R'000
Non-interest income earned by:	**Operating expenditure paid by:**		
Portion 2 of Lot 8 Sandown Proprietary Limited	Mercantile Bank Limited	23 311	21 860
Mercantile Bank Limited	Mercantile Rental Finance Proprietary Limited	736	314
Mercantile Bank Limited	Mercantile Payment Solutions Proprietary Limited	67 328	55 769
Grant Electronics Close Corporation*	Mercantile Payment Solutions Proprietary Limited	15 935	13 878
Mercantile Rental Finance Proprietary Limited*	Compass Securitisation (RF) Limited	6 831	6 473
Portion 2 of Lot 8 Sandown Proprietary Limited	Mercantile Rental Finance Proprietary Limited	263	228
Donations received by:	**Donations paid by:**		
The Mercantile Bank Foundation (NPC)	Mercantile Bank Limited	915	1 161
Dividends earned by:	**Dividends paid by:**		
Mercantile Bank Holdings Limited	Mercantile Bank Limited	35 226	29 197
Sale of rental finance assets by:	**Purchase of rental finance assets by:**		
Mercantile Rental Finance Proprietary Limited*	Compass Securitisation (RF) Limited	148 867	195 348

** Additional disclosure relating to related parties in respect of the prior year has been included.*

Guarantees

Mercantile Bank Limited acted as guarantor over the mortgage bond between Portion 2 of Lot 8 Sandown Proprietary Limited and Standard Bank Limited for a maximum amount of R90 million in respect of the property as per note 11.

Other

Post-retirement medical plan

Details of the post-retirement medical plan are disclosed in note 16.

30.3 Director and Director-related activities

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

	Directors' fees R'000	Salary R'000	Role-based allowance* R'000	Fringe benefits R'000	Retirement funds and medical aid contri-butions R'000	Perfor-mance bonus^ R'000	Total R'000
Group							
2017							
Non-Executive Directors							
GP de Kock	1 219	–	–	–	–	–	1 219
L Hyne	836	–	–	–	–	–	836
AT Ikalafeng	708	–	–	–	–	–	708
DR Motsepe	796	–	–	–	–	–	796
TH Njikizana	925	–	–	–	–	–	925
Executive Directors							
RS Caliço	–	3 290	–	646	–	2 000	5 936
KR Kumbier	–	3 881	2 862	–	661	4 607	12 011
	4 484	7 171	2 862	646	661	6 607	22 431

	Directors' fees R'000	Salary R'000	Role-based allowance* R'000	Fringe benefits R'000	Retirement funds and medical aid contri-butions R'000	Perfor-mance bonus^ R'000	Total R'000
Group							
2016							
Non-Executive Directors							
GP de Kock	1 150	–	–	–	–	–	1 150
L Hyne	789	–	–	–	–	–	789
AT Ikalafeng	668	–	–	–	–	–	668
DR Motsepe	751	–	–	–	–	–	751
TH Njikizana	873	–	–	–	–	–	873
Executive Directors							
RS Caliço	–	3 015	–	578	85	1 800	5 478
KR Kumbier	–	3 887	2 700	–	622	4 350	11 559
	4 231	6 902	2 700	578	707	6 150	21 268

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

^ This is the performance bonus earned for the financial year but paid in the following year/s.

Notes to the annual financial statements continued

for the year ended 31 December 2017

30. Related party information continued

30.3 Director and Director-related activities continued

	GROUP	
	2017 R'000	2016 R'000
Balances with/(from) key management personnel (Board of Directors)		
Loans and advances	34	232
Committed undrawn facilities	5 431	–
Deposits*	(10 870)	(4 680)
Amounts paid by CGD to Executive Directors	1 055	1 470

** Additional disclosure relating to related parties in respect of the prior year has been included.*

Service agreements

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, particularly in building and embedding a strong leadership team.

RS Caliço, Deputy CEO

Mr Caliço has been seconded to Mercantile by CGD and took up office at Mercantile on 1 July 2014 as Executive Director. In July 2015, Mr Caliço was appointed the Deputy CEO of the Group. In terms of his service agreement, Mr Caliço 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/Deputy CEO.

31. 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.

The principal consolidated companies are as follows:

Company name	Effective holding %	Nature of business
Compass Securitisation (RF) Limited	100	Securitisation special purpose vehicle
Mercantile Bank Limited	100	Banking
Mercantile Rental Finance Proprietary Limited	100	Rental finance
Portion 2 of Lot 8 Sandown Proprietary Limited	100	Property holding
Mercantile Insurance Brokers Proprietary Limited	100	Currently under voluntary liquidation

The Bank owns 50% of Mercantile Payment Solutions Proprietary Limited (MPS) with a third party owning the other 50%. Due to the shareholder requirement to have unanimous consent by both parties to make decisions around the relevant activities of the entity, this entity is considered a joint arrangement. MPS is a separate legal entity and both parties have rights to the net assets of the business and, as such, this entity is considered a joint venture. The earnings related to this joint venture have been accounted for in profit and loss under non-interest income while the investment in the joint venture has not been accounted for as it is considered immaterial.

32. Going concern

The Directors have reviewed the Group's and Company's budgets and cashflow forecasts and have considered the Group's and Company's ability to continue as a going concern in light of current and anticipated economic conditions. On the basis of this review, and in the light of the current financial position, the Directors are satisfied that the Group and Company have adequate resources to continue in business for the foreseeable future. The going concern basis therefore continues to apply and has been adopted in the preparation of the annual financial statements.

33. Events after the reporting period

Subsequent to year-end the Company declared a dividend of R42,458 million which was approved by the Board on 28 February 2018.

During March 2017, CGD announced its intention to sell Mercantile. As at 31 December 2017, the sale of Mercantile was still in progress after the decree for the sale was signed and issued by the Portuguese government in December 2017.

No other 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.

Risk management and control

Group risk management philosophy

The Group recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks that became 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 related policies and procedures are reviewed and stress tested to adapt to changing circumstances. Risks inherent to existing activities are maintained within the approved risk tolerance levels, thereby optimising the risk return parameters for the creation of sustainable growth and value for all stakeholders.

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 for concentration risk and 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 and 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, *inter alia:*

- enhancements/additions to the Risk Tolerance Framework as approved by the Board and incorporated into the Group's ICAAP. Further enhancements are planned for 2018;
- significant progress was made with the alignment of processes to the requirements set out in the Principles for Effective Risk Data Aggregation and Risk Reporting (RDARR) as published by the Bank for International Settlements (publication BCBS239);
- completion of a comprehensive new impairment model aligned to the requirements stipulated in IFRS 9, which is effective from 1 January 2018;
- business continuity management continues to be an area of focus;
- completion of a comprehensive material risk assessment and related action plans to mitigate these identified risks;
- progress toward the establishment of a combined assurance approach;
- enhancements to various risk reporting (including the calculation of a daily liquidity coverage ratio), automation of selected regulatory reporting, and the introduction of additional stress testing;
- further improvements to various risk and control self-assessment templates;
- additions to the prudential management schedule, including various realignments to new regulatory requirements and international best practice, wherein risk-related ratios are monitored and reported to the ALCO and Board on a monthly basis;
- increased interaction with the Group's holding company's risk departments in Portugal and alignment of some risk management processes;
- review of the application of the Principles for Sound Liquidity Risk Management and Supervision and applying more conservative liquidity buffers;
- review of the application of the Principles for the Sound Management of Operational Risk;
- further enhancement of the Group's ICAAP and related documentation;
- various projects were undertaken during the current year by the Operational Risk team to improve efficiencies and mitigate risk; and
- continuous improvement with regard to cyber security following the assessment by a specialist provider. Completion of associated action plans is underway to mitigate identified gaps. Progress is monitored by the Information Security Steering Committee.

Enterprise-wide Risk Management Framework

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, business line management, Finance and Control, Legal/Compliance, Treasury, and Operations with support from IT. 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 procedure manuals are subject to ongoing review and are signed off at least annually 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 and 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 levels 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 applicable 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	Reputational 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 (including cyber) risk	Compliance risk
Investment risk	Market conduct 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 and within laid-down parameters, delegated to line heads and line managers 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 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.

Risk management and control continued

The top 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 ALCO (which incorporates capital management), under the auspices of the RMC, proactively evaluates and manages the capital requirements of the Group as determined by internal assessments and regulatory requirements. A comprehensive re-evaluation of the capital requirements under the ICAAP 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

The Group offers a spread of banking products common to the banking industry. Although there is a focus on small and medium-sized businesses across a wide variety of industries, the client target market selection includes Corporate/Commercial/Private Banking and the more recently launched Private Practice.

The Bank's Credit Risk Strategy, which is contained within our Group Risk and Credit Risk policy manuals, is approved by the Group CREDCOM and ratified by the RMC. Mercantile Rental Finance has a similar credit risk assessment and mandate process, which is adopted in the credit risk area managing this subsidiary's loan book. Although no specific targeting of the broader personal retail-based market is done, Private Banking was launched at the end of 2014 and Private Practice during 2017 – both specifically target entrepreneurs with the view to ultimately acquiring their business accounts and associated funding requirements. To manage the related credit risk, a dedicated Credit Manager is responsible for these portfolios.

Dependent on the risk profile of the client across all portfolios/market segments, the risk inherent in the product offering and the track record/payment history of the client, varying types and levels of security are taken to mitigate credit-related risks. Unsecured lending is only considered for financially strong borrowers or for some facilities, such as overdrafts and credit cards within the Private Bank and Private Practice portfolios.

The Group does, however, have a small structured loan portfolio that includes an element of unsecured lending and the Group is financially rewarded for the additional risk taken. This portfolio is carefully managed within agreed RMC limits/parameters.

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

Monthly reporting to ALCO includes reporting on large exposures. A portfolio analysis report is prepared and presented to the RMC analysing the performance and make-up of the book including client, geographic, segment and product concentration.

The Group continues to adopt 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). This meeting covers a wide variety of topics that includes reporting on excess reports, arrear reports, security-related matters, possible changes in risk grades, and any other relevant credit-related matters requiring a specific mention or discussion. 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. Identified accounts with continued behavioural concerns and/or financial underperformance are monitored by way of 'Watch List' reporting.

In addition, new deals and/or products, as well as requests for substantial increases in credit facilities, are considered at a daily credit consideration meeting. A formal and detailed application will then be submitted through the normal credit process if the Credit Consideration Committee considers the proposal to be desirable.

All Credit matters are subject to continuous review, amendment and/or enhancements. The following can be highlighted:

- 2017 saw the recruitment of skilled staff and focused development on existing staff to build a culture of learning and development;
- It also brought about enhanced focus and continuous improvement of the OnBase workflow system that was previously deployed within the Credit Origination and Assessment areas and which is expected to be further enhanced moving forward;
- The Credit Department was also split into a segmented structure during this period, based on the market segments served, which brought about an improved ability to drive "volume" within the Business Banking segment and "complexity" within the Corporate/Commercial segment;
- 2017 also saw a dedicated legal resource being employed specifically to review security profiles and identify risk;
- The previously sestablished Credit Legal and Compliance area continues to enhance supervision and monitoring of covenants within the area, particularly in respect of larger exposures;
- During the latter part of the year, credit mandates were increased along with various other initiatives to build capacity and drive efficiencies as well as to drive an improved client experience. These increases were considered in line with staff competence and tenure within the role. RMC approval mandates were also increased during this time;
- CGD previously amended the Group's Limits of Authority for approval, which resulted in Risk Group Exposures between R93 million and R163 million requiring approval from that company's risk department. This approval is in addition to approval by the RMC. Approvals in excess of R163 million require approval from the CGD credit committee;
- The IFRS 9 project is on track to meet the effective date of 1 January 2018. Specific credit-related requirements have been identified and are being addressed by direct involvement and participation on the IFRS 9 Steering Committee; and
- The new head of Credit appointed to the role during the latter part of 2016 has acclimatised well and continues to build on the foundation previously established.

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
2017				
Current accounts	1 858 855	–	–	1 858 855
Credit cards	39 505	84 164	–	123 669
Mortgage loans	4 819 294	58 021	–	4 877 315
Instalment sales and leases	1 500 587	–	–	1 500 587
Structured loans	193 874	–	–	193 874
Medium-term loans	1 168 670	–	–	1 168 670
Negotiable securities	–	–	904 166	904 166
Cash and cash equivalents	–	–	1 750 165	1 750 165
Guarantees	–	–	583 249	583 249
Letters of credit	–	–	10 144	10 144
	9 580 785	142 185	3 247 724	12 970 694
2016				
Current accounts	1 765 592	196 236	–	1 961 828
Credit cards	33 971	78 888	–	112 859
Mortgage loans	4 303 851	27 248	–	4 331 099
Instalment sales and leases	1 144 073	–	–	1 144 073
Structured loans	211 189	–	–	211 189
Medium-term loans	1 292 601	–	–	1 292 601
Negotiable securities	–	–	509 874	509 874
Cash and cash equivalents	–	–	2 247 070	2 247 070
Guarantees	–	–	457 473	457 473
Letters of credit	–	–	20 979	20 979
	8 751 277	302 372	3 235 396	12 289 045

Risk management and control continued

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, among others, 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 reputation risk, as well as the risk of financial loss.

The aim of operational risk management is to enhance the level of risk maturity across the Group by implementing and embedding risk-based control identification and assessments, challenging the current status quo with regard to operational controls, 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 operational environments;
- conducting monitoring and reviews by both the Compliance and Internal Audit functions, in line with annual plans approved by the Board;
- comprehensive data security and protection;
- ongoing review of the Group-wide risk and 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;
- the Group has embarked on a programme to comply with the requirements of BCBS 239 to ensure accurate, complete, consistent and timely risk information. The Board is fully supportive of this project and has committed human and financial resources;
- 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 (BASA) operational risk forum as well as of industry working groups tasked with investigating and making recommendations to BASA on topical issues.

The Group subscribes to the Principles for the Sound Management of Operational Risk.

Technology risk

IT Governance, Risk, Compliance (ITGRC) and Information Security Management (ISM) are committed to managing risk appropriately within the technology environment to maximise potential opportunities and minimise the adverse effects of technology risk within the Group.

IT is a key functional enabler in assisting the Group to achieve its strategic and operating objectives and is dependent on the availability of adequately skilled resources. ITGRC and ISM are, therefore, key components in technology-related projects and in business-as-usual activities. An ITGRC risk framework was integrated into the Enterprise-wide Risk Management Framework thereby ensuring an integrated risk model whereby risk assessment, management and reporting are consistent across all operations. This enables quick and transparent reporting to all stakeholders and the Board.

The following key milestones were achieved during the year:

- Successful submission in respect of the SWIFT customer security program;
- Successful improvement in security alert management, using cases built in the security information and event management (SIEM);
- Implementation of USB flash drive lockdowns and processes for the issuing of protected Mercantile USB flash drives;
- Successful incident response management to industry threats such as WannaCry;
- More reporting of incidents via the centralised cyber security inbox;
- Approval of a defence-in-depth security strategy;
- Completion of the governance framework relating to cyber security;
- Comprehensive penetration testing based on a threat-centric approach for third party risk;
- Automation of vulnerability scanning on the Group's test environments;
- Implementation of targeted threat protection for email; and
- Increased training via e-learning and cyber master classes.

In terms of the ITGRC and ISM, the following future steps, among others, have been planned for 2018 to reduce and understand technology-related risks:

- Re-establishment of the Information Security Steering Committee;
- Implementation of end-to-end third-party management for IT;
- Improved IT asset management;

- Re-establishing the Group's security centre capabilities for threat intelligence and threat analysis, i.e. Trustwave and Snode;
- Rolling out two-factor authentications; and
- Further improvements in logical access and change management utilising a workflow system.

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 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 such action. 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 this 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 client 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 92 to 96).

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 Bank's Treasury system. 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 R14,0 million (2016: R14,4 million). An adverse movement in the exchange rate of 10% would reduce the Group's income by R1,4 million (2016: R1,4 million).

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

	US Dollar R'000	Euro R'000	Pound sterling R'000	Other R'000	Total R'000
2017					
Total foreign exchange assets	593 835	98 612	33 270	41 059	766 776
Total foreign exchange liabilities	(843 272)	(78 921)	(32 396)	(8 861)	(963 450)
Commitments to purchase foreign currency	1 002 639	254 785	41 075	23 631	1 322 130
Commitments to sell foreign currency	(750 004)	(271 860)	(42 183)	(54 679)	(1 118 726)
Year-end effective net open foreign currency positions	3 198	2 616	(234)	1 150	6 730
2016					
Total foreign exchange assets	469 139	95 369	28 377	20 722	613 607
Total foreign exchange liabilities	(928 381)	(67 225)	(23 380)	(11 949)	(1 030 935)
Commitments to purchase foreign currency	1 067 769	125 184	30 721	21 083	1 244 757
Commitments to sell foreign currency	(601 866)	(149 119)	(36 531)	(29 455)	(816 971)
Year-end effective net open foreign currency positions	6 661	4 209	(813)	401	10 458

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 clients. Interest margins may increase as a result of such changes, but may reduce or create losses in the event that unexpected adverse movements occur. The ALM forum monitors interest rate repricing on a daily basis, and reports back to the ALCO, RMC and the Board.

The Group is exposed to interest rate risk as it takes deposits from clients at both fixed and variable 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 the 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 intentional proprietary interest rate positions. Under interest rate swap contracts, the Group agrees to exchange the difference between fixed and variable 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 repricing 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 repricing 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.

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 or 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 regularly to the ALCO and Board.

At the reporting date, a 50 basis-point change in prevailing interest rates was applied as a sensitivity analysis to determine the impact on earnings as a result of a change in interest rates. If interest rates increased/decreased by 50 basis points, and all other variables remained constant, the Group's net profit and equity at year-end would increase by R8,8 million or decrease by R15,5 million, respectively (2016: increase/decrease by R10,4 million/R16,9 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 below summarises the Group's exposure to interest rate risk. Assets and liabilities are included at carrying amounts, categorised by the earlier of contractual repricing or maturity dates, and also indicate their effective interest rates at year-end. The repricing profile indicates that the Group remains asset-sensitive, although to a lesser extent than previously, as interest-earning assets reprice sooner than interest-paying liabilities, before and after derivative hedging activities. Thus, future net interest income remains vulnerable to a decrease in market interest rates.

	Up to 1 month R'000	1 to 3 months R'000	4 to 12 months R'000	1 to 5 years R'000	Non-interest-sensitive R'000	Total R'000	Effective interest rate %
2017							
Assets							
Cash and cash equivalents	718 116	–	–	–	1 032 049	1 750 165	5,7
Derivative financial instruments	–	–	–	–	104 016	104 016	–
Negotiable securities	29 901	197 674	650 829	25 762	–	904 166	8,9
Loans and advances	9 671 996	–	–	–	(212 177)	9 459 819	10,9
Other investments	–	–	–	–	6 985	6 985	–
Other accounts receivable	–	–	–	–	689 688	689 688	–
Non-current assets held for sale	–	–	–	–	22 500	22 500	–
Current tax receivable	–	–	–	–	32	32	–
Property and equipment	–	–	–	–	244 176	244 176	–
Intangible assets	–	–	–	–	153 533	153 533	–
Deferred tax assets	–	–	–	–	15 090	15 090	
Total assets	10 420 013	197 674	650 829	25 762	2 055 892	13 350 170	
Equity and liabilities							
Other accounts payable	–	–	–	–	511 712	511 712	–
Derivative financial instruments	–	–	–	–	128 044	128 044	–
Current tax payable	–	–	–	–	6 280	6 280	–
Provisions and other liabilities	–	–	–	–	119 723	119 723	–
Deposits	6 595 142	317 916	455 727	144 971	1 823 421	9 337 177	5,7
Debt securities	–	241 594	–	–	–	241 594	9,7
Long-term funding	518 450	87 485	–	–	3 460	609 395	10,2
Deferred tax liabilities	–	–	–	–	60 219	60 219	–
Total equity	–	–	–	–	2 336 026	2 336 026	–
Total equity and liabilities	7 113 592	646 995	455 727	144 971	4 988 885	13 350 170	–
Financial position interest sensitivity gap	3 306 421	(449 321)	195 102	(119 209)		2 932 993	
Derivative financial instruments	–	–	–	–		–	
Total net interest sensitivity gap	3 306 421	(449 321)	195 102	(119 209)		2 932 993	

Risk management and control continued

	Up to 1 month R'000	1 to 3 months R'000	4 to 12 months R'000	1 to 5 years R'000	Non–interest-sensitive R'000	Total R'000	Effective interest rate %
2016							
Assets							
Cash and cash equivalents	1 403 859	–	–	–	843 211	2 247 070	6,0
Derivative financial instruments	–	–	–	–	29 442	29 442	–
Negotiable securities	–	140 407	318 339	51 128	–	509 874	6,8
Loans and advances	8 813 547	–	731	–	(152 466)	8 661 812	11,0
Other investments	–	–	–	–	6 712	6 712	–
Other accounts receivable	–	–	–	–	327 001	327 001	–
Current tax receivable	–	–	–	–	681	681	–
Property and equipment	–	–	–	–	254 604	254 604	–
Intangible assets	–	–	–	–	178 813	178 813	–
Total assets	10 217 406	140 407	319 070	51 128	1 487 998	12 216 009	
Equity and liabilities							
Other accounts payable	–	–	–	–	308 567	308 567	–
Derivative financial instruments	–	–	–	–	43 733	43 733	–
Current tax payable	–	–	–	–	7 324	7 324	–
Provisions and other liabilities	–	–	–	–	94 072	94 072	–
Deposits	5 787 308	346 950	487 908	44 854	1 806 014	8 473 034	5,7
Debt securities	–	241 009	–	–	–	241 009	9,6
Long-term funding	630 682	204 153	–	–	2 864	837 699	9,7
Deferred tax liabilities	–	–	–	–	54 693	54 693	–
Total equity	–	–	–	–	2 155 878	2 155 878	–
Total equity and liabilities	6 417 990	792 112	487 908	44 854	4 473 145	12 216 009	
Financial position interest sensitivity gap	3 799 416	(651 705)	(168 838)	6 274		2 985 147	
Derivative financial instruments	201 381	(196 817)	(5 183)	619		–	
Total net interest sensitivity gap	4 000 797	(848 522)	(174 021)	6 893		2 985 147	

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 on a regular basis. 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:

- Contractual maturity mismatches analysis;
- Monitoring of daily cash flow movements and requirements, including daily settlements and collateral management processes;
- Maintenance of increased levels of readily available, high-quality liquid assets (in excess of the statutory requirements), as well as strong financial position liquidity ratios;
- An assumptions-based sensitivity analysis to assess potential cash flows at risk;
- Graphical analysis of client deposits trend line;

- Deposit campaign management throughout the year to achieve deposit objectives;
- Management of concentration risk (undue reliance on any single counterparty or counterparty group, sector, market, product, instrument, currency and tenor);
- Maintenance of sources of funding for contingency funding needs;
- Monitoring of daily cash flow movements and requirements, including daily settlements and collateral management processes;
- Targeting of a diversified funding base to avoid undue concentrations by investor, market source and maturity;
- Creation and monitoring of prudential liquidity risk limits;
- Maintenance of an appropriate mix of term-funding; and
- Redefinition of stress testing in line with prudential ratios and possible regulatory requirements in respect of 10-day liquid asset holdings (stressed to 30 days).

Overall, the Group's key liquidity risk metrics, which have been formulated to achieve a prudent liquidity profile, were maintained at acceptable levels. Through 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 continue 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 was successful in raising commercial, retail and wholesale funding, while ensuring compliance with the Basel III liquidity requirements.

The Group increased prudential liquidity buffers during the year, but essentially 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.

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

	Assets R'000	Liabilities R'000	Total mismatch R'000
2017			
Maturing up to one month	4 469 066	7 201 566	(2 732 500)
Maturing between one and three months	248 974	1 343 498	(1 094 524)
Maturing between three and six months	508 170	216 382	291 788
Maturing between six months and one year	452 690	480 344	(27 654)
Maturing after one year	7 349 341	1 708 589	5 640 752
Non-contractual	321 929	63 765	258 164
	13 350 170	11 014 144	2 336 026
2016			
Maturing up to one month	4 408 624	6 212 890	(1 804 266)
Maturing between one and three months	369 494	1 255 196	(885 702)
Maturing between three and six months	135 664	786 558	(650 894)
Maturing between six months and one year	282 368	314 893	(32 525)
Maturing after one year	6 650 213	1 432 341	5 217 872
Non-contractual	369 646	58 253	311 393
	12 216 009	10 060 131	2 155 878

Risk management and control continued

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

	Up to 1 month R'000	1 to 3 months R'000	4 to 6 months R'000	7 to 12 months R'000	Over 1 year R'000
2017					
Deposits	6 527 243	1 037 140	206 937	275 153	1 451 228
Long-term funding	–	249 595	–	222 067	206 671
Debt securities	–	–	–	–	294 448
Derivative financial instruments	39 445	67 357	15 564	5 678	–
Other accounts payable	508 167	–	–	–	3 546
Guarantees, letters of credit and committed undrawn facilities	735 578	–	–	–	–
Operating lease commitments	650	1 308	1 993	3 997	13 914
	7 811 083	1 355 400	224 494	506 895	1 969 807
2016					
Deposits	5 796 523	1 007 419	298 859	333 041	1 179 592
Long-term funding	–	–	500 515	–	452 016
Debt securities	–	245 830	–	–	–
Derivative financial instruments	9 710	17 670	15 846	507	–
Other accounts payable	305 007	–	–	–	3 560
Guarantees, letters of credit and committed undrawn facilities	780 824	–	–	–	–
Operating lease commitments	467	937	1 391	2 830	15 731
	6 892 531	1 271 856	816 611	336 378	1 650 899

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 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.

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 Group consists almost entirely of Tier 1 capital. The Group remains well capitalised 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 surplus capital held. The dividend policy remains insignificant in relation to earnings and capital.

The Group complies with the provisions of section 46 of the Companies Act, whereby all dividends and distributions are authorised by the Board. The Board authorises a distribution after 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:

	Unaudited 2017 R'000	Audited 2016 R'000
Risk-weighted assets – banking book		
Credit risk	9 036 287	8 890 645
Operational risk	1 455 297	1 283 143
Market risk	55 863	36 288
Equity	6 923	6 651
Other assets	1 106 649	662 354
	11 661 019	10 879 081
Net qualifying capital and reserves		
Tier 1 capital	2 099 366	1 950 911
Share capital and share premium	1 483 300	1 483 300
Retained earnings	747 079	545 034
Other reserves	(982)	69 742
Less: Deductions	(130 031)	(147 165)
Tier 2 capital	24 946	26 214
General allowance for credit impairment	24 946	26 214
	2 124 312	1 977 125
Capital adequacy ratio (%)	18,2	18,2
Tier 1 capital (%)	18,0	18,0
Tier 2 capital (%)	0,2	0,2

Glossary of terms

Abbreviation	Definition/Description
AGM	Annual General Meeting
ALCO	Asset and Liability Committee
ALM	Asset and Liability Management
AML	Anti-money laundering
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
CFT	Combating financing of terrorism
CGD	Caixa Geral de Depósitos S.A., a company registered in Portugal and parent company of Mercantile Bank Holdings Limited
Companies Act	Companies Act, No. 71 of 2008
CPSP	Conditional Phantom Share Plan
CREDCOM	Credit Committee
CRS	The OECD's Common Reporting Standard
CSR	Corporate social responsibility
DAC	Directors' Affairs Committee
FAIS	The Financial Advisory and Intermediary Services Act, No. 37 of 2002
FATCA	Foreign Accounts Tax Compliance Act
FICA	The Financial Intelligence Centre Act, No. 38 of 2001
FSC	Financial Services Sector Code
GAC	Group Audit Committee
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards and Interpretations
IT	Information technology
King III	King Report on Corporate Governance for South Africa 2009
King IV	King Report on Corporate Governance for South Africa 2016

Abbreviation	Definition/Description
Mercantile	Mercantile Bank Holdings Limited and its subsidiaries
Mercantile Rental Finance	Mercantile Rental Finance Proprietary Limited
OECD	Organisation for Economic Co-operation and Development
RMC	Risk and Capital Management Committee
SARB	South African Reserve Bank
SME	Small and medium enterprise
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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PO Box 31558, Braamfontein 2017
Tel: +27 11 624 1450
Fax: +27 11 614 9611

Boksburg business centre

Atlas Lifestyle Centre, cnr Atlas and
North Rand Roads, Boksburg 1459
PO Box 31558, Braamfontein 2017
Tel: +27 11 918 5276
Fax: +27 11 918 4159

Cape Town City business centre

1 Ground Floor, Roggebaai Place
Jetty Street, Foreshore
Cape Town 2001
PO Box 51, Cape Town 8000
Tel: +27 21 419 9402
Fax: +27 21 419 5929

Cape Town Tygerberg business centre

Ground Floor, The Edge
3 Howick Close, Tyger Waterfront
Bellville 7530
PO Box 5436, Tygervalley 7536
Tel: +27 21 910 0161
Fax: +27 21 910 0163

Comaro Crossing business centre

Shop FF9, Comaro Crossing Shopping
Centre, Orpen and Comaro Roads
Oakdene 2190
PO Box 31558, Braamfontein 2017
Tel: +27 11 435 0640
Fax: +27 11 435 1586

Durban business centre

Shop 25A, The Atrium
430 Peter Mokaba Road
Berea, Durban 2001
PO Box 519, Durban 4000
Tel: +27 31 209 9048
Fax: +27 31 209 9446

Horizon business centre

Shop 56, The Village @ Horizon
Shopping Centre, cnr Sonop Street and
Ontdekkers Road, Horizon 1724
PO Box 31558, Braamfontein 2017
Tel: +27 11 763 6000
Fax: +27 11 763 8742

Pretoria Menlyn business centre

Unit C-G01, Menlyn Square Office Park
cnr Lois and Aramist Streets
Menlyn 0181
PO Box 31558, Braamfontein 2017
Tel: +27 12 342 1151
Fax: +27 12 342 1191

Sandton business centre

Ground Floor, 142 West Street
Sandown 2196
PO Box 31558
Braamfontein 2017
Tel: +27 11 302 0775
Fax: +27 11 884 1821

Strijdom Park business centre

Shop 2, Homeworld Centre
cnr Malibongwe Drive and CR Swart
Road, Strijdom Park, Randburg 2194
PO Box 31558, Braamfontein 2017
Tel: +27 11 791 0854
Fax: +27 11 791 2387

Vanderbijlpark business centre

Office 3, The Palms
274 Louis Trichardt Boulevard
Vanderbijlpark 1911
PO Box 31558
Braamfontein 2017
Tel: +27 16 981 4132/9
Fax: +27 16 981 0767

Welkom business centre

Shop 1 and 1C
Welkom Shopping Centre
Bounded by Bok
Toronto and Arrarat Street
Welkom 9459
PO Box 2207, Welkom 9460
Tel: +27 57 357 3143
Fax: +27 57 352 7879

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