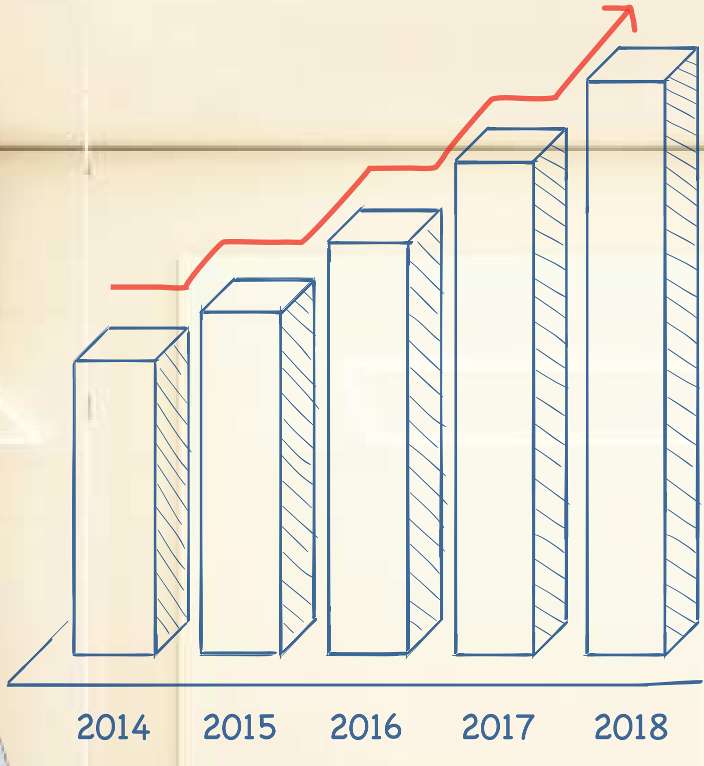
Mercantile Bank
Holdings Limited
The Business Bank inspired by entrepreneurs



2018 INTEGRATED ANNUAL REPORT

for the year ended 31 December

CONTENTS

Bank Regulations public disclosure
The December 2018 disclosure, required in terms of Regulation 43 of the Banks Act Regulations, is published on the Group's website.

Registration number: 1989/000164/06
Member of the CGD Group
Web: **www.mercantile.co.za**
Email: **info@mercantile.co.za**

OUR APPROACH TO INTEGRATED REPORTING

SCOPE OF THE REPORT

Our 2018 integrated annual report provides a comprehensive overview of the Group's activities and its financial and non-financial performance. The report also gives a detailed synopsis of the Group's value-creating operating model and strategy, and all financial and non-financial matters that are considered 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 positively or negatively 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 and relationship capital as imperative to 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 specifically structured according to capitals but the capitals are embedded and discussed within the relevant sections of the integrated annual report.

REPORTING FRAMEWORK

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

- International Integrated Reporting Council's Integrated Reporting Framework;
- King IV Report on Corporate Governance for South Africa 2016;
- Companies Act, No. 71 of 2008;
- International Financial Reporting Standards; and
- Banks Act, No. 94 of 1990.

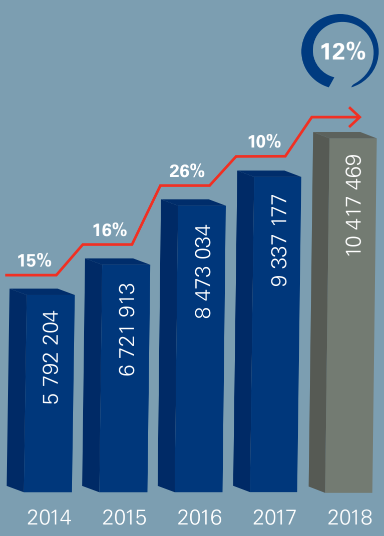
The Board acknowledges its responsibility to ensure the integrity of this integrated annual report. In the Board's opinion, this integrated annual report addresses all the issues that are material to the Group's ability to create value and fairly presents the integrated performance of the Group. This report was approved by the Board of Directors of the Mercantile Group on 27 February 2019.

FIVE-YEAR GROUP SALIENT FEATURES

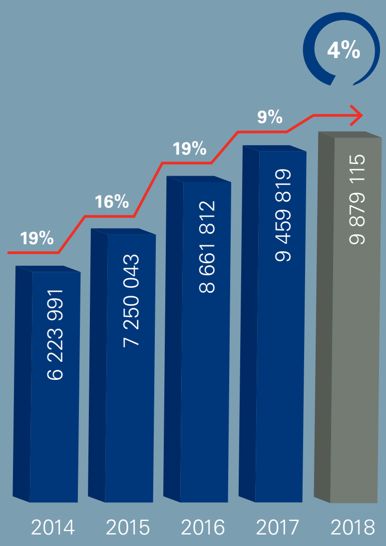
years ended 31 December

	2018 R'000	2017 R'000	2016 R'000	2015 R'000	2014 R'000
Statement of financial position					
Total assets	**14 847 967**	13 350 170	12 216 009	10 034 386	8 767 662
Loans and advances	**9 879 115**	9 459 819	8 661 812	7 250 043	6 223 991
Cash and cash equivalents	**3 178 571**	1 750 165	2 247 070	1 586 798	1 518 444
Total equity	**2 524 584**	2 336 026	2 155 878	2 020 612	1 899 911
Long-term funding	**883 927**	609 395	837 699	646 215	527 559
Debt securities	**352 076**	241 594	241 009	202 810	202 764
Deposits	**10 417 469**	9 337 177	8 473 034	6 721 913	5 792 204
Statement of comprehensive income					
Profit before tax	**345 579**	293 085	247 184	205 227	180 675
Profit after tax	**249 429**	212 742	177 018	146 889	127 653
Financial performance ratios (%)					
Return on average equity (ROE)	**10.3**	9.5	8.4	7.4	6.9
Return on average assets (ROA)	**1.8**	1.7	1.6	1.6	1.5
Cost-to-income	**59.5**	61.6	63.2	63.6	63.2
Share statistics (cents)					
Net asset value per share	**69.9**	64.6	59.7	55.9	52.6
Tangible net asset value per share	**66.3**	60.4	54.7	50.6	47.4

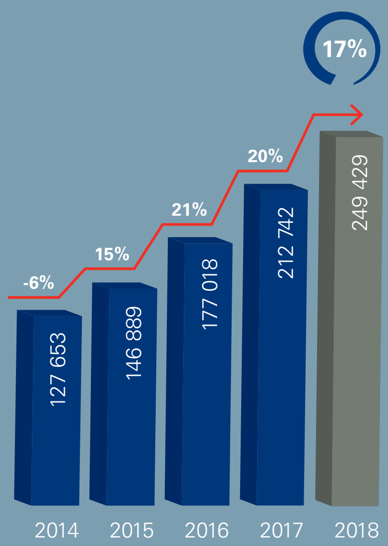
DEPOSITS
R'000



LOANS AND ADVANCES
R'000



PROFIT AFTER TAX
R'000

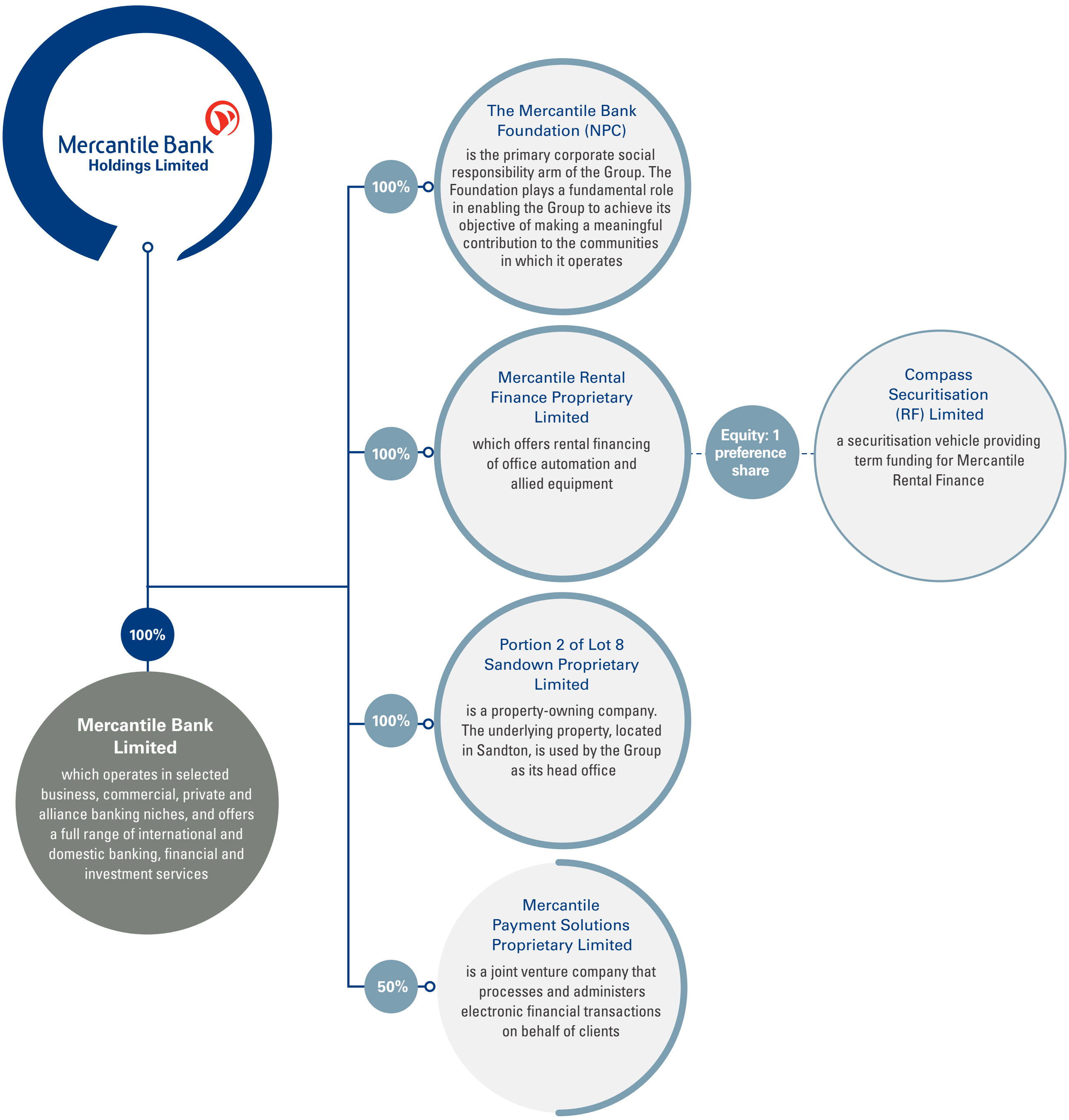


ABOUT US AND OUR VALUE-CREATING BUSINESS MODEL

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. Whilst it operates exclusively within South Africa, Mercantile has reach into other key African markets through its parent company's subsidiaries in Angola and Mozambique.

CGD announced in 2017 that it intended to sell its entire stake in the Mercantile Group. During 2018, the sale process proceeded and Capitec Bank Limited was selected by CGD (supported by the Portuguese state) as the successful bidder in November 2018. The sale process is expected to be finalised in 2019 following regulatory approvals. Please refer to Group Review | Sale of Mercantile on pages 10 and 11 for more information.

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 capitals, along with an explanation of what each represents to us:

INPUTS	OUTCOMES AT THE END OF 2018
FINANCIAL CAPITAL Our shareholder's equity and funding from investors and clients that is used to support our business and operational activities, including credit extension (advances)	• Profits are shared between ordinary shareholders [R50 million (2017: R42 million) in dividends] and retained earnings, to be applied for future value creation [R199 million (2017: R170 million)] • Contributed to societal growth through goods and services bought [R1.5 billion (2017: R1.3 billion)], taxes paid [R110 million (2017: R91 million)] and employee compensation [R324 million (2017: R289 million)] • Sound credit rating
MANUFACTURED CAPITAL Our business structure and operational processes, including our physical and digital infrastructure, our products and our IT estate, that provide the framework and mechanics of how we do business and make money	• Operate 12 business centres nationally • Property and equipment of R256 million (2017: R244 million) • Enhanced digital portfolio with new online platforms, mobile and other banking applications, along with transactional and trading platforms • Call centres, data centres and premises for support functions
HUMAN CAPITAL Our people, investing in their development and our collective knowledge, skills and experience to enable innovative and competitive solutions for our clients	• 510 (2017: 502) skilled and experienced employees with improved transformation. The percentage of black employees increased from 71% in 2017 to 74% in 2018. In respect of the senior management team, 40% (2017: 43%) are women and 50% (2017: 48%) are black • An experienced leadership team • R2.6 million (2017: R1.9 million) in direct training spend on ongoing skills development • 48% (2017: 37%) of vacancies filled internally • Employee engagement at 76% (2017: 74%) and attrition at only 10% (2017: 10%) • Corporate culture based on clear ethics and values
NATURAL CAPITAL Our positive or negative impact on natural resources through our operations and business activity	• Only small bank to have implemented the International Finance Corporation's Environmental and Social Risk Management performance standards and exclusion list
INTELLECTUAL CAPITAL Our brand and franchise value, research and development, innovation capacity, reputation and strategic partnerships	• Enterprise risk management framework • IT capabilities, including innovation of new technologies. Invested R95 million (2017: R76 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
SOCIAL AND RELATIONSHIP CAPITAL Our citizenship and strong stakeholder relationships, including the communities we serve, as we recognise that banks play an important role in building an economically thriving society	• 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 82.1% in 2017 to 83.5% in 2018. The achievement exceeds the satisfaction levels of our major competitors • R1 million spent on education and skills development in society

STRATEGY

WHY DO WE EXIST?

INTEGRATION 2019

WE **GROW** ENTREPRENEURS IN

ESTABLISHED BUSINESSES

MARKET FOCUS

OUR VISION

We grow entrepreneurs through successful partnerships.

TO DELIVER

KEY PRODUCTS

- Transactional banking
- Lending
- Foreign exchange
- Deposits
- Payment services

ACHIEVING

GOAL

GROWTH in PROFIT

DRIVEN BY

CULTURE

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

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 individuals and the community we serve, and strive to deliver excellence in everything we do.

THROUGH

GREAT RELATIONSHIPS

BASED ON

FANTASTIC SERVICE

SERVICE STANDARDS

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

OUR MISSION

We financially partner with entrepreneurs on their journey towards creating successful businesses.

THROUGH

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

FOCUSED ON

STRATEGIC DELIVERABLES

RESULTING IN

GREAT VALUE ...

STAKEHOLDERS

Clients
Community
Employees
Regulators
Shareholders
Suppliers

APPROACH

WE DO OUR TALKING ON THE FIELD

BOARD OF DIRECTORS

GP DE KOCK (64)
CHAIRMAN, INDEPENDENT NON-EXECUTIVE DIRECTOR

Deon attended executive programmes at the Business Schools of the University of Cape Town and Stanford University, California. He retired in 2004 as CEO 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. Deon had been the Acting Chairman of the Group since May 2016 and was appointed as Chairman of the Board of the Mercantile Group with effect from 24 April 2018.

KR KUMBIER (47)
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.

MEL TEIXEIRA (51)
FD

Emilia holds a BCom (Hons) degree from the University of Pretoria and is a Chartered Accountant (South Africa). Emilia joined Mercantile as the Head of Finance in January 2006 and was promoted to Chief Financial Officer in April 2013. In June 2018, Emilia was appointed as the Group's FD. She has over 21 years' experience in the financial services sector, having also previously served as the General Manager: Group Finance and Administration at Sasfin Bank Limited, as the Head of Accounting and Risk Control at Commerzbank AG, and as a Senior Bank Supervision Analyst at the SARB. Emilia is accountable for Mercantile's Finance, Human Resources, Electronic Services, Treasury and ALM functions.

AT IKALAFENG (52)
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, including as an executive director and Chief Marketing Officer for Nike Africa. He is the founder of the Brand Leadership Group, Brand Africa, and Public Sector Excellence. Thebe is a non-executive director of SA Tourism, World-Wide Fund for Nature in SA and Car Track Holdings Limited and the founder of Brand Africa 100: Africa's Best Brands, the premier research and ranking of brands in Africa. Thebe has been named one of the 100 most influential Africans by New Africa magazine. An Afro optimist passionate about promoting African tourism, trade and business, he has been to 52 countries in Africa. He writes, speaks and consults on Africa-focused branding, leadership and related matters.

ADMINISTRATION

GROUP SECRETARY: **T SINGH**

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

Postal address: PO Box 782699, Sandton 2146

DAPHNE

DR MOTSEPE (61)

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 Bank Limited 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), Zenzar South Africa, the Lewis Group and Edcon Limited. Daphne is a member of the executive committee of the Consultative Group to Assist the Poor, an international organisation headquartered in Washington DC, which promotes responsible and inclusive financial markets. She is also a trustee of the Alexander Forbes Community Trust.

RICARDO

RS CALIÇO (46)

NON-EXECUTIVE DIRECTOR, 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' 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, a year later, was appointed Deputy CEO of the Mercantile Group. Ricardo stepped down as the Deputy CEO on 16 June 2018 to take up another executive role within the CGD Group i.e. as the Deputy CEO of CGD France, but has continued his involvement with the Mercantile Group in the role of a Non-Executive Director, with effect from 18 June 2018.

TAPIWA

TH NJIKIZANA (43)

INDEPENDENT NON-EXECUTIVE DIRECTOR, ZIMBABWEAN

Tapiwa is a Chartered Accountant (South Africa), has attended executive education programmes at Harvard Business School 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 23 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.

LOUIS

L HYNE (75)

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 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.

GROUP REVIEW

GP DE KOCK / CHAIRMAN

KR KUMBIER / CEO

HOLDING COMPANY

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

CGD is the largest bank in Portugal, with 3.8 million clients in that country, a presence in 20 other countries spanning four continents, a global network of 1 068 branches and consolidated assets of €89 billion (as at December 2018).

TRADING CONDITIONS

While 2018 began on a reasonably positive note for the economy, a number of factors, including the ongoing investigations into state capture and the re-emergence of discussions around expropriation of land without compensation, saw the South African economy struggle due to the lack of internal and foreign investment.

The currency spiked to R15.7 to the US Dollar from highs of R11.6 to the US Dollar early in 2018 but, at year-end, was trading at slightly below R14 to the US Dollar which is a more realistic level. Added to this, fuel prices jumped to an all-time high on the back of a weak currency and rampant oil prices. Inflation remained within the SARB's band (3% – 6%) at 5.2%.

At the same time, the USA pushed its rate agenda with four hikes in 2018 resulting in the SARB raising local rates. Further, international concerns such as Brexit, the trade war between the USA and China and ongoing troubles in the Middle East and Turkey, placed enormous pressure on emerging market currencies such as the Rand.

FINANCIAL OVERVIEW

For the four years to 2018, and under difficult economic conditions, the Group has continued its trend of double-digit growth in net profit after tax (i.e. 2018: 17%, 2017: 20%, 2016: 21% and 2015: 15%). Growth in net profit after tax of 17% for the 2018 financial year is a remarkable achievement, coming as it did after a year in which the Group was both deeply involved in the sale process and focused on trying to grow the business in a very challenging economic environment.

As a smaller bank, the Group ordinarily must maintain high liquidity levels but this requirement was compounded by the sale process. To this end, the deposit base grew by a high 12% to R10.4 billion and the Bank used the full R740 million International Finance Corporation facility in 2018. In addition, the Group's securitisation vehicle issued additional Global Credit Ratings Company Proprietary Limited 'AAA'-rated notes to a new investor to bring the total of unrated A notes in issue to R350 million.

The modest growth by 4% in loans and advances was largely due to higher than normal attrition resulting from repayments of circa R600 million on certain large commercial property loans. The decrease in the repo rate resulted in a negative endowment effect for the year. Against all these factors, Mercantile grew its net interest income by 10% in 2018.

Despite a difficult economic climate and tough trading conditions (which led to high lending defaults throughout the industry), a technical recession in 2018 and the implementation of the IFRS 9 accounting standard on 1 January 2018, the charge for credit losses is a low 0.5% as a percentage of average lending (2017: 0.4%). Non-performing loans as a percentage of total loans and advances increased from 3.4% in 2017 to 3.8% for 2018. If it were not for the implementation of IFRS 9 in 2018, the Group would have reported a decrease of around 1% in non-performing loans as a percentage of total loans and advances as lending pre-2018 was reported net of interest in suspense balances. The pre-tax transitional adjustment for IFRS 9 on 1 January 2018, which was debited directly against total equity, amounted to R47 million for the Group.

Growing net non-interest income continued to be a key focus for the Group and we have again achieved significant growth in this line i.e. 14% in 2018 (2017: 15%) with the various business units contributing as follows:

- Card grew non-interest income by 36% and is now managing 55 000 merchants (66% increase);
- Mercantile Payment Solutions grew non-interest income by 36% and processed transaction values of R100 billion in 2018;
- Despite the foreign exchange market taking strain and the average value of deals decreasing across the industry, Treasury managed to grow its non-interest income by 6%; and
- Mercantile Rental Finance grew non-interest income by 13%.

For the second year in a row, through strict cost control by each business unit, Mercantile was able to contain its annual cost growth to 8%. In 2018, this contributed to bringing the cost-to-income ratio below 60% for the first time.

Profit after tax

R249 million

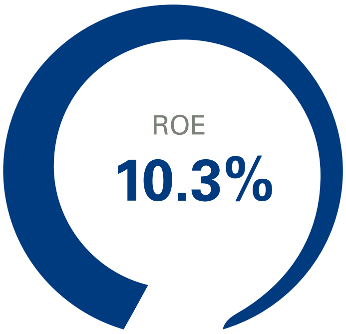
Growth in non-interest income

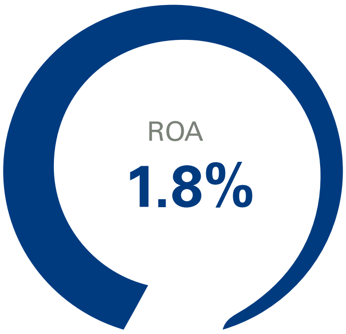
↑14%

STRATEGIC INITIATIVES AND ACHIEVEMENTS

Given the sale process of Mercantile, the Group did not engage in new business partnership activities or launching of new products for the 2018 year, but rather focused on consolidating and increasing the efficiencies of existing products and services. Emphasis was placed on business performance through capitalising on investments and improvements that have been made over time from a systems, process and efficiency perspective. This was augmented by further streamlining and improving current methodologies, culminating in improved client experience and ease of doing business. Regulatory requirements were also met. Some specific initiatives and projects undertaken included:

- Mercantile Rental Finance successfully implemented major operational and client interface efficiencies, including implementing workflow methodologies, automated credit scoring and improved processes. The most noticeable effect is the reduced client application turnaround time from minimum 36 hours (industry norm) to less than half an hour. These improvements have had a very positive effect on growing the business;
- Mercantile implemented IFRS 9 in 2018 and Deloitte & Touche submitted the required audit reports to the SARB's Prudential Authority. Further system developments will be dealt with on an ongoing basis;
- Mercantile again participated in the annual Consulta business bank client service measurement survey to gain insight into the level of service delivered by the Bank and the level of our clients' satisfaction. The outcome was very rewarding as the Bank's overall satisfaction score again exceeded those of our major competitors;
- The Credit Division focused on the improvement of overall efficiency and scalability of credit practices through enhanced controls, improved risk management and improved client service with specific focus on credit scoring models, covenants management, collections management processes and the automation of management information systems and credit portfolio maintenance;
- The objective of the digital on-boarding project was to create a portal and web service where clients and non-clients could open an account (end-to-end) with minimal intervention from a Mercantile staff member. The capability was created for Treasury intermediaries to digitally open a trading account for a client within minutes rather than the 24 hours or more that it previously took. This unique development enables intermediaries to open the account and start trading within seconds. Many intermediaries are using this capability and more will be brought on board in 2019;





- The Group establishes alliance partner relationships whereby the partner uses the Group's technology solution for issuing card programmes to its client base. During the year under review, a significant card programme project was set up, tested and launched through a credit solutions provider, which company is actively contacting its existing base to offer this new credit card product; and
- Much attention has been given to initiatives focused on operational efficiency enhancements. The very successful secure, electronic document signing service was extended to most products and services and, where permitted, documents are now signed in this manner. The automation of most of the back-office activities related to this service contributed further to client convenience, a significant decrease in processing time and cost savings. The provision of accurate, timely and real-time management information system reports was also a focus and added greatly to the improvement of Mercantile's client information management, enhanced sales, revenue management and client relations. Significant enhancements were also achieved through, among others, journal process automation, electronic BOP signatures and the automation of bond registrations and cancellations.

DIRECTORATE AND COMPANY SECRETARY

GP de Kock, who served as the acting Chairman from 1 June 2016, was appointed as Chairman of the Boards of Mercantile and the Group, effective 24 April 2018.

RS Caliço's tenure as Deputy CEO of the Group ended on 16 June 2018, however, he remains on the Board as a Non-Executive Director. We would like to thank Ricardo for his contribution to the Group as an Executive Director and we wish him all the best in his role at CGD France.

MEL Teixeira, who served as the Chief Financial Officer of the Group, was appointed FD of the Group, effective 15 June 2018.

There were no other 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 5 October 2018:

Short-term:	P-2.za (2017: P-2.za)
Long-term:	Baa1.za (2017: Baa1.za)
Outlook:	Stable (2017: 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.

SALE OF MERCANTILE

In March 2017, CGD announced its intention to dispose of its entire shareholding in Mercantile. As CGD is a Portuguese state-owned entity, the sale of Mercantile constituted 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 commenced the formal and transparent process, which would incorporate at least two phases, to sell Mercantile in January 2018. In the first phase, interested parties, having signed a non-disclosure agreement, were given access to information in relation to Mercantile on which to base a non-binding offer. An impressive total of 18 non-binding offers were received and, on 15 June 2018, the Portuguese government published a shortlist of four potential buyers it had approved to participate in the second phase of the sale of Mercantile, viz. the South African banks Nedbank Group and Capitec Bank; the consortium made up of Arise BV (established in 2017 by Norfund, FMO and Rabobank) and the South African company Grindrod Limited; and the Riqueza Consortium, comprising the Public Investment Corporation (on behalf of the Government Employees Pension Fund) and Bayport Financial Services.

These short-listed contenders conducted their own due diligence of Mercantile and were invited to submit binding offers which were reviewed by CGD. On 22 November 2018, the Portuguese government approved the resolution selecting the proposal of Capitec Bank Limited as the successful bidder to acquire 100% of the share capital of Mercantile Bank Holdings Limited, for R3.2 billion (subject to adjustment in terms of the net asset value as at date of change of control). The Shares Sale and Purchase Agreement was signed by CGD and Capitec on 23 January 2019. Submission of the requisite applications to the local regulators (SARB, Competition Commission, etc.) is underway and it is expected that the transaction should be concluded during 2019.

As CGD is the seller and this is a CGD-run process, the detailed terms of the non-binding offers, the ultimate determination of the successful bidder and the detailed terms of the Shares Sale and Purchase Agreement were determined by CGD. The Board's role in this process was to review the short-listed bidders and to confirm whether it had objections to any of these. In determining whether it had any such objections, the Board considered the interests of all stakeholders, the most important of whom were Mercantile's clients and staff.

Non-performing loans as a percentage of loans and advances

3.8%

Credit loss ratio

0.5%

OUTLOOK

The economy is likely to continue to struggle for a while longer as insufficient electricity supply remains a concern, the debate about expropriation of land without compensation continues and uncertainty remains around the results of the upcoming general elections in South Africa. However, on the positive side, President Ramaphosa has attracted impressive foreign and domestic investment promises, action is being seen to be taken on corruption and state capture-related matters and important posts (such as the National Director of Public Prosecutions) have been filled. The ship that is South Africa is in a good position to right itself although it will require government, business and labour to work very closely together.

At a micro level, the outlook for the Group is very positive. The imminent purchase of Mercantile by Capitec is expected to be finalised with approval by the various regulators and, thereafter, the opportunity exists to truly disrupt the business banking market and change the way that businesses are banked in South Africa. We are looking forward to the challenges and opportunities this will bring.

APPRECIATION

At the core of the Mercantile culture is our belief in building and maintaining strong and enduring relationships with all our stakeholders. It is because of these relationships that Mercantile has achieved outstanding business growth and has been able to deliver a very good set of results for the 2018 year.

We would like to express our sincere thanks to all our external stakeholders for continuing to partner with and support us in achieving our goals. We would like to thank the Prudential Authority within the SARB for its oversight and guidance. Also, as 2018 is likely to be the last full year with CGD as the majority shareholder, we would especially like to thank CGD for their counsel, guidance and support over the past years.

We would also like to thank our internal stakeholders – our excellent staff. We are very proud of the Mercantile team's wonderful service ethos and commitment to quality, which exemplify the culture we have strived to build and have helped us achieve and exceed our goals for 2018.

GP de Kock	KR Kumbier
Chairman	*CEO*

27 February 2019

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 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:

1/ Responsible business
2/ Community
3/ Environment

Areas of action | Indicators

RESPONSIBLE BUSINESS

Areas of action:

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

Indicators:

- Practices against corruption and money laundering
- Code of Conduct

1 ETHICS AND COMPLIANCE

WHAT WE DID IN 2018

As emphasised in King IV, an organisation must fundamentally add value to stakeholders, which includes doing business responsibly and ethically. The Group is committed to high moral, ethical and legal standards. A further ethics imperative of King IV is that the board should position corporate governance as being concerned not only with structure and process, but also with ethical consciousness and conduct. Group leadership and guidance are provided within a framework of ethical and prudent controls, which support the establishment of an ethical culture.

The Group 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: our shareholder, clients, employees, alliance partners, service providers, joint venture partners, the community, government and society at large.

King IV now also refers to ethics in remuneration, recognition and performance management, which means that these functions should be viewed through an ethics lens. In 2018, the Group enhanced its focus on applying ethical principles to the strategy and implementation of these strategies, monitoring and auditing according to ethical principles and reporting on outcomes in a transparent and integrated manner.

The Group's Code of Conduct 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.

As part of its ongoing efforts to raise awareness of the importance of – and need for – ethical behaviour, the Ethics Office provided awareness training at every induction session in 2018 as well as to employees across the Group. The trends of unethical behaviour identified during the past four years are included as case studies in the awareness training. In addition, 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. During 2018, 91% of the Board and staff reaffirmed their commitment.

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 the 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, conformity with the values and principles adopted, as well as the development of best corporate governance principles and ethical conduct.

The Group is a Tier 3 Sponsor of The Ethics Institute and its Head of Internal Audit and Company Secretary 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 Group uses a variety of indicators, surveys and tools to ensure that ethical conduct across our Group and its subsidiaries remains at the highest possible standard.

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 Group is an issuer and acquirer of MasterCard and VISA payment cards and has, in line with the card associations' regulations, adopted proactive measures to prevent fraudulent use of these products. The Group makes use of 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 potential fraudulent behaviour. Clients are contacted to confirm the validity of transactions whenever an alert is raised.

In addition to standard monitoring measures, the Group 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 the 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 SABRIC, which determines common trends and alerts the industry accordingly. The Fraud Department is actively involved in industry fraud prevention collaborations and makes use of knowledge acquired from the rest of the banking industry to assist with fraud prevention and detection within the Group.

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

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

FRAUD OTHER THAN ON PAYMENT CARDS

The Group has adopted a zero-tolerance approach towards all types of fraud and theft. The Group's Forensic Investigators investigate all incidents relating to external fraud, while internal fraud is investigated by Internal Audit.

If an incident of fraud is brought to the Group'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 Group 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 Group's point-of-sale devices. Merchants are trained on the card association requirements concerning payment card acceptance and use of the point-of-sale terminals. Real-time monitoring of merchant activity is performed seven days a week and action is taken to protect the merchant and the Group 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.

Losses resulting from fraud in the aforementioned areas were well contained and are indicative of the Group's fraud prevention efforts and the dedication of its fraud prevention team.

FRAUD AWARENESS

Fraud awareness material on prevalent modus operandi is made available to clients and staff members on the Group's website in the Fraud Prevention webpage. A fraud awareness communication was disseminated to all Internet Banking clients focusing on Internet banking security.

Fraud alerts containing warnings of prevalent fraud trends, as well as relevant fraud prevention and awareness material, are disseminated to all staff. The aim of the fraud alerts is to cover specific and current fraud trends as and when they are identified as well as to create awareness of the most prevalent fraud incidents.

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

WHISTLE-BLOWING

The Group has a comprehensive Protected Disclosures Policy based on the Protected Disclosures Act, No. 26 of 2000, as amended. The policy addresses the reporting of actual or attempted fraud, corruption and/or any other improper or unethical conduct. Employees are encouraged to blow the whistle and make disclosures in good faith and on reasonable grounds. To this end, an internally-administered enhanced anonymous web-based reporting system is in place to enable employees to make untraceable reports directly to Compliance Management and Internal Audit.

An electronic step-by-step guide on when and how to blow the whistle is always available to all employees and contracted staff through a dedicated link on the Intranet. Further, the Group is a supporter of International Fraud Awareness Week. During this week in 2018, from 11 to 17 November, the Group focused on whistle-blowing under the tagline: 'See Something? Say Something!'. Each employee received a desk drop parcel containing a whistle and a card reflecting the Intranet URL to access the whistle-blowing reporting system and related information and were required to view a video presentation that covered the regulatory and business rights and obligations related to whistle-blowing. This initiative was well-received and raised awareness across the Group.

Areas of action Indicators

RESPONSIBLE BUSINESS continued

2 CLIENT RELATIONSHIP MANAGEMENT

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

- 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 2018

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 by giving them access to dedicated, skilled bankers who are supported by a team of finance and business specialists. The introduction of a specialised unit during 2018, dedicated to the growth of women- and black-owned businesses, is a testimony of our commitment to these markets.

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 again participated in the annual Consulta client service measurement survey together with the 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. In the Business Banking category, the Bank managed to further increase its already very high overall levels of service.

3 RISK MANAGEMENT

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

- 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 2018

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. Even though the Group has experienced no significant loss to date, the Group placed significant focus on cyber security in 2018 to offer protection against cyber risk, which continues to increase due to ongoing sophistication of threat actors.

The Group's cyber security capabilities are enhanced continually, and the consideration of cyber risk is an integral part of all new developments on the digital strategy journey, while maintaining and enhancing current defences.

RESPONSIBLE BUSINESS
continued

- 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
- Safety and health

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

4 HUMAN CAPITAL DEVELOPMENT

WHAT WE DID IN 2018

An annual talent review is conducted to identify development 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/or BANKSETA, thereby focusing on developing, motivating and retaining key individuals.

In terms of leadership development, the Company continued with its customised, accredited Leadership Development Programme for First Line Managers – 'Leading the Mercantile Way'. A total of 25 junior and middle managers completed the programme and their graduation is planned for 2019.

In an effort to enhance the managerial talent pool, two 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 local and international companies, supplemented by formal learning through business schools operating locally and in the host countries. Both participants successfully completed the programme.

Mercantile implemented a second Banking Sales Learnership to create a pipeline of talent. A group of 15 internal employees and unemployed graduates participated in the programme, which will conclude in early 2019. We continued with the learnership programme in the Internal Audit Department with two internal employees, who successfully completed the coursework component of the programme and are expected to complete their competency assessment in early 2019. Mercantile provided training and workplace experience to 20 BANKSETA graduate learners, including Kuyasa learners and Business Analyst learners, who will complete their learnerships in January 2019.

The employee engagement score for 2018 is 76% (against 74% in 2017). These high levels of engagement contributed to 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 behavioural standards:

- 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 with 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, well-being 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 by email. Health and Wellness days were held during 2018 to give employees the opportunity to benefit from services

Areas of action Indicators

RESPONSIBLE BUSINESS continued

4 HUMAN CAPITAL DEVELOPMENT continued

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 monthly 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 towards creating a wellness culture. The absenteeism rate was 1.05% in December 2018 compared to 1.7% in December 2017.

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 within the Group. The Committee's charter stipulates how transformation will be implemented, monitored and integrated across the Group.

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.

Adherence to the Employment Equity Act, No. 55 of 1998, and associated skills development, basic conditions of employment and labour relations legislation is regarded as essential. The desired results of the implementation of the Employment Equity plan are to improve 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 Employment Equity plan of the Group.

Employment Equity is regarded as a key business imperative, targets set for 2015 to 2018 have been 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 71% in 2017 to 74% in 2018 (please refer to the tables on page 33). New targets have been set for the period 2018 to 2021.

The Group continues to strive to improve its facilities to ensure the safety and well-being 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.

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

5 RESPONSIBLE SUPPLIER MANAGEMENT

WHAT WE DID IN 2018

A targeted procurement strategy to minimise exposure to environmental and social risks and to enhance B-BBEE has been adopted, with its principles detailed in the Group's Procurement Charter and Procurement Policy. The Group is cognisant of its social and environment criteria when deliberating the on-boarding of new suppliers.

The objective in relation to B-BBEE is to actively promote the effective support of suppliers and contractors from B-BBEE-accredited enterprises as set out in the FSC and the Department of Trade and Industry's B-BBEE Codes of Good Practice. The Group will also, where appropriate, focus on enterprise development as a means of increasing its empowerment supplier base.

Areas of action Indicators

COMMUNITY

- 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

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

6 SOCIAL AND FINANCIAL INCLUSION

WHAT WE DID IN 2018

The Group's projected share of the industry target growth was confirmed by the Banking Association of South Africa during 2014: B-BBEE SME Financing to be R198 million and B-BBEE Transaction Financing to be R132 million (to be achieved by the end of 2017). In anticipation of new targets to be set by the Banking Association (still awaiting) our performance during 2018 remained strong.

The Group achieved R310 million (2017: R299 million) and R507 million (2017: R396 million), respectively, which remains significantly higher than the 2017 targets and year-on-year growth is evident in both categories.

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 R791 million (2017: R904 million) in Transformational Infrastructure through its investments in government bonds and treasury bills.

The Group has a 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 engaged in various initiatives that support, train and develop entrepreneurs.

Areas of action Indicators

COMMUNITY
continued

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

- Social-oriented activities for the benefit of the community

7 SUPPORT TO THE SOCIAL ECONOMY

WHAT WE DID IN 2018

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

Our employees' time is precious as it represents a sacrifice for both the employees and the Bank: employees must often 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.

Socio-economic development: employee initiatives

Mercantile participated in many 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:

- Sparrow Schools, which caters for children from disadvantaged backgrounds with learning disabilities;
- Action for the Blind, a school that provides computer-related training to people with disabilities;
- Afrika Tikkun, an organisation that provides holistic development of the youth in the areas of education, health and social services;
- 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 that disadvantaged youth with potential can receive the education they cannot afford;
- Quali-Books, a reading intervention strategy focused on providing library book resources to create reading corners in schools that do not have these resources. The organisation also provides training intervention programmes for teachers to create an enthused reading culture that will enhance readership capabilities and improve the levels of literacy found in schools; and

Areas of action Indicators

COMMUNITY
continued

7 SUPPORT TO THE SOCIAL ECONOMY continued

- Nelson Mandela Library, based in Protea Glen Secondary School, which provides library and laboratory facilities to learners at the school and to surrounding communities to enable quality teaching and learning in science and technology. The library assists learners in grades 8 to 12.

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.

Chartered Accountant Graduate Programme

Mercantile launched its graduate programme in 2015 and currently has two students enrolled in the programme. The students are, respectively, completing their second and third years at the Universities of Pretoria and the Witwatersrand. These students complete vacation work at the Company. Once they achieve their degrees and postgraduate diplomas in accounting, they will start three-year trainee accountant contracts at Deloitte & Touche and, thereafter, will join Mercantile on a two-year working contract.

8 FINANCIAL EDUCATION AND LITERACY

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

- Financial literacy practices

WHAT WE DID IN 2018

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

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 2018. The Hope Factory's goal and purpose is to see real economic transformation through advancing the growth of entrepreneurial black businesses. Thirty entrepreneurs were on-boarded to the impactful Flagship Enterprise Development Programme. It is individually designed for SMMEs to address their business growth needs while focusing on development of their business skills, leadership mastery, financial acumen and preparation for the Supplier Development Programme.

While mentorship remains the key and compulsory element of every programme, additional services are included to facilitate growth during the organisation's four-year journey:

1. *Business skill mastery*
   - Business diagnostic assessment
   - Business development plan and goal setting
   - Business development workshops
   - Business-specific clinics
   - Entrepreneur Advisory Board
   - Exposure to market through corporate videos
   - Business growth investment to the value of R20 000 per entrepreneur
2. *Leadership development and self-mastery*
   - Personal preference
   - Assessment
   - Leadership coaching
   - Personal development plans and goal setting
   - Personal development workshops
3. *Financial excellence*
   - Financial skills excellence boot camps
   - Financial coaching

Areas of action Indicators

ENVIRONMENT

Areas of action:

- 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

Indicators:

- Environmental management system
- Eco-efficiency socially-oriented activities for the benefit of the community

9 ECO-EFFICIENCY

WHAT WE DID IN 2018

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.

Areas of action:

- 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 and integrating environmental criteria

Indicators:

- Environmental management system
- Eco-efficiency socially-oriented activities for the benefit of the community

10 ADAPTING TO CLIMATE CHANGE

WHAT WE DID IN 2018

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

Areas of action Indicators

ENVIRONMENT
continued

11 SUSTAINABILITY MANAGEMENT

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 2018

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 King IV, and take into account the size of our business and the communities and industries in which the Group operates.

The Board is accountable 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 2018

12 COMMUNICATION AND TRAINING

Areas of action:

- Internal and external communication on sustainability
- Training on sustainability
- Development of an integrated annual 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 2018

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.

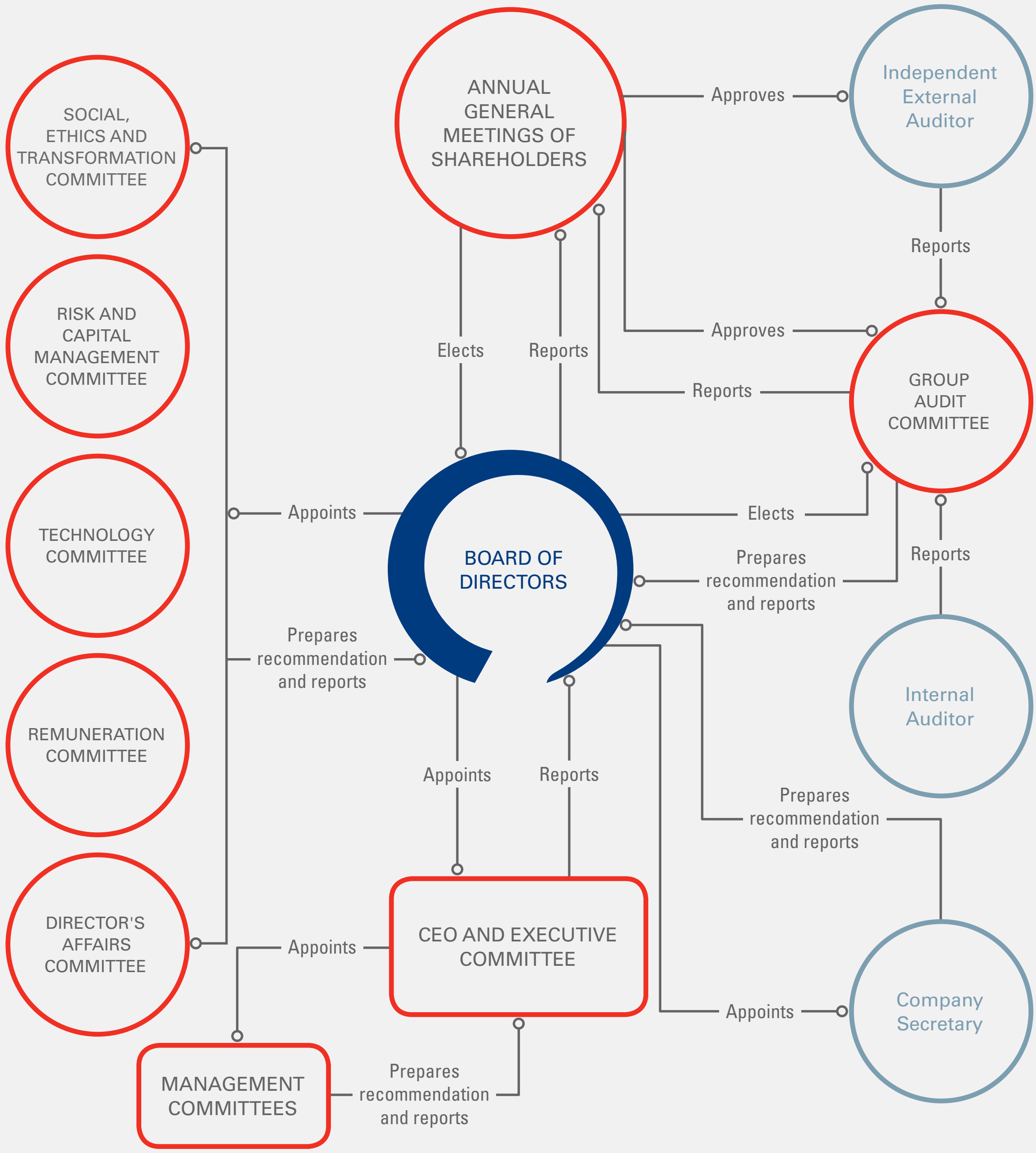
Environmental training and awareness for employees, community and clients continued in 2018. An internal recycling campaign was launched in 2018.

CORPORATE GOVERNANCE

The Board subscribes, and is committed, to ensuring that the Group complies with the corporate governance principles of fairness, accountability, responsibility and transparency as set out in King IV.

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 continued 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 2018 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 and operational controls, compliance with legislation 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 annual 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 *(Chairman) (appointed 24 April 2018 as Chairman, formerly appointed as Acting Chairman)*	23 November 2000	4/4
KR Kumbier *(CEO)*	1 June 2010	4/4
RS Caliço *(resigned as Deputy CEO on 16 June 2018 and appointed as Non-Executive Director, effective 18 June 2018)*	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
MEL Teixeira	15 June 2018	2/2

RESPONSIBILITY

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

- Approve the Group's strategy, vision and objectives and monitor and 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 annual 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.

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. As at 31 December 2018, the Board, which has a unitary board structure, comprised eight Directors, two of whom were executive.

INDEPENDENCE

A robust annual evaluation of director independence is undertaken in accordance with the criteria set out in King IV 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. Except for Mr R Caliço, who is an employee of CGD, all of the Non-Executive Directors are classified as independent. The Board is satisfied that its composition currently reflects an appropriate balance.

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 COMPANY SECRETARY

The appointment and removal of the Group Company Secretary is a matter for consideration by the Board as a whole. The Group Company Secretary ensures that statutory and regulatory procedures are complied with and acts as custodian of good governance. The Group Company Secretary attends all Board and Board Committee meetings and has unrestricted access to the Chairman. The Group Company 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 Company 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 Company 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 Company 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 2018

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 2018, along with an overview of its performance against these, follow.

What we did in 2018 | Rating

	What we did in 2018	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**	
	The Board engaged with management in strategy sessions throughout 2018 and updates on the execution of the strategy agreed upon 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. The 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. Progress against the implementation of the ethics management framework was reviewed at every Board meeting.	Substantially 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 2018 top ten risks included: funding and liquidity risk; credit risk; cybercrime and information security risks; regulatory and legal risk; human capital risk; operational risk; IT risk; strategic risk; business resilience risk; and capital risk. Major project progress monitored included implementation of IFRS 9 and the Basel Committee on Banking Supervision's Principles for Effective Risk Data Aggregation and Risk Reporting (RDARR) (BCBS239). The Board reviewed and approved the ICAAP. During 2018, 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 had oversight of the execution of the Bank's IT strategy, and continued to focus on reviewing and endorsing plans to maintain and enhance the Bank's cyber and information security framework and to monitor developments around cybercrime and information security.	Substantially 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 2018, 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; the increase in regulatory costs (emanating from the payments systems, for example 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 Mercantile. 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 CGD and the lead regulator (SARB) regarding the sale process. In all matters pertaining to the sale process, the Mercantile Board continued to prioritise the best interests of all stakeholders, the most important of whom are Mercantile's clients and staff.	Fully achieved

THE BOARD HAS SET THE FOLLOWING OBJECTIVES FOR 2019:

- Oversee management's delivery of the approved Group strategy within the framework of a sound control and risk management environment, with a focus on the achievement of the four corporate governance outcomes, namely, ethical culture, good performance, effective control and legitimacy;
- 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 information technology strategy, with a focus on the deliberate separation of technology and information;
- 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 needs, expectations and interests of stakeholders are met; and
- The focus of the Board's role in the sale of Mercantile for 2019 is expected to shift to oversight of the execution of the sale transaction, while continuing to ensure that the impact on the normal operations of the Bank is minimised and that the legitimate interests of depositors and staff are adequately protected.

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 Group Audit Committee (GAC); the Risk and Capital Management Committee (RMC); the Directors' Affairs Committee (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
DR Motsepe	5/5
GP de Kock *(resigned 6 June 2018)*	3/3

As at 31 December 2018, the GAC comprises three Independent Non-Executive Directors, one of whom acts as Chairman. The Chairman of the Board is not a member of the GAC. The CEO, FD, heads of Internal Audit, Risk, Compliance Management, and Treasury, the External Auditor and the heads of CGD Group Compliance and Internal Audit 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 FD, the heads of Internal Audit, Risk, and Compliance Management, the CEO and the External Auditor have unrestricted access to the Chairman of the GAC. 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, the Internal and External Auditor's 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 Auditor's appointment is recommended by the GAC and approved at the AGM. The GAC reviews the External Auditor's terms of engagement and fees and also pre-approves an engagement letter on the principles of what non-audit services the External Auditor may provide. The GAC meets with the External Auditor, 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 2018 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 to 43) 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 2019, to review and consider management's plans in respect of future changes to IFRS and other regulations, as well as focus on ensuring that the Group's financial systems, processes and internal controls are operating effectively and are consistent with the Group's complexity and 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
MEL Teixeira *(appointed 15 June 2018)*	2/2

As at 31 December 2018, the RMC comprises six members i.e. four Non-Executive Directors (one of whom acts as Chairman), the CEO and the FD.

RMC meetings are held at least four times per annum. The RMC meetings are attended by the heads of Risk, Credit, Treasury, Internal Audit 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, the Internal Auditor, 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 2018 were potential risks emanating from the sale process, credit risk, and operations and technology, specifically cyber and information security risks. 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 2018 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 2019, 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 90 to 104.

DAC

COMPOSITION AND ATTENDANCE

Name	Meeting attendance
GP de Kock *(Chair)*	4/4
L Hyne	4/4
TH Njikizana	4/4
AT Ikalafeng	4/4
DR Motsepe	4/4
RS Caliço	1/2

As at 31 December 2018, the DAC comprises all the Non-Executive Directors. The Chairman of the Board chairs the DAC and the CEO and FD attend 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 or 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 2018. 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.

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 2018 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
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 Chairman, CEO and FD attend 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, our shareholder's interests and commercial well-being;
- 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 FD 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 2018 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 *(resigned 16 June 2018)*	2/2
MEL Teixeira *(appointed 15 June 2018)*	2/2

As at 31 December 2018, this committee comprises three Non-Executive Directors, one of whom acts as Chairman, the CEO and FD. 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 regarding:

- Social and economic development, including the goals and purposes of:
  - The United Nations Global Compact principles;
  - The Organisation for Economic Co-operation and Development recommendations regarding corruption;
  - The Employment Equity Act; and
  - The Broad-Based Black Economic Empowerment Act, No. 53 of 2003;
- 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 *(resigned 16 June 2018)*	2/2
MEL Teixeira *(appointed 15 June 2018)*	2/2

This committee is mandated to assist the Board in its duties regarding the governance of IT in accordance with the provisions of King IV. As at 31 December 2018, the Technology Committee comprises two Independent Non-Executive Directors, the CEO and the FD. An Independent Non-Executive Director chairs this committee. The heads of IT, Risk, 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 regarding 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 and FD participate in all Board meetings. Since 2014, the Board started a practice of providing a senior employee with the opportunity to gain experience at board level and for the 2018 financial year, the Head of Business Banking and Centralised Operations was invited to attend Board meetings as an observer. Other members of management are invited to present on relevant topics or about their businesses.
- The Board interrogates and approves the business strategy, multi-year 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 and the Board meets at least annually with the lead regulator i.e. the Prudential Authority of the SARB).

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 Steering Committee.

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

REMUNERATION PHILOSOPHY AND GOVERNANCE PRINCIPLES

The remuneration philosophy is designed to enable the attraction, motivation and retention of suitably qualified employees 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
  - 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:
  - Alignment of remuneration and performance; and
  - Alignment of remuneration and long-term corporate interest; and
- Disclosure of Remuneration Policy and specific objectives, complying with transparency as required by relevant competent authorities.

Factors influencing the structural design of the best practice remuneration processes are:

- Attraction, motivation and retention of key talent;
- Reward policies and practices that support the achievement of the Group's strategic objectives;
- Strong link between Group performance and pay;
- Strong link between individual performance and pay;
- Sound governance policies and compliance with all statutory and other relevant regulations;
- Remuneration decisions are defensible;
- Maintain competitive rates of pay and benefits; and
- Remuneration costs are managed.

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 Company is committed to providing managers with the tools, training and information necessary to make sound remuneration decisions. Each Manager is responsible for ensuring that performance management processes are completed bi-annually for employees and that remuneration increases are based on performance and within policy guidelines, to ensure equity and consistency throughout the Group. The Performance Management process is aligned to the Balanced Scorecard through key result areas (KRAs), which include financial and non-financial measurement criteria.

The four main components of compensation 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 choose to participate in a tax saving benefit to pay for school or tertiary institution fees (in accordance with income tax regulations). It also includes medical aid and retirement contributions.

SHORT-TERM INCENTIVES

Short-term incentives form an important component of variable pay. The objectives of the short-term incentive scheme are to reward outstanding performance and 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 and 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 employees whose contribution within the next three to five years is viewed as critical, and whose retention is regarded as a priority.

Mercantile has 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 'clawback' mechanism is built into the features of the deferred bonus scheme in that the award can be cancelled at the discretion of the Board.

The value of a phantom share is a function of the net asset value of the Group 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. Reduction ('malus') is the risk adjustment arrangement through which the Group may totally or partially reduce the amount of the variable remuneration that has been subject to deferral. The Board uses audited information to verify and assess the extent to which performance conditions of the CPSPs have been fulfilled to determine the number of phantom shares that will vest or not. Performance conditions are based on the achievement of specified targets for growth in Group earnings and return on equity, which may be impacted if there is a material downturn in the financial performance of the Group or the Group suffers a material failure of risk management.

The long-term incentive scheme is reviewed periodically within the context of best practices and corporate governance considerations, and 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 or rewards geared to the Group's share price or performance do not form part of the remuneration of Non-Executive Directors. The shareholder annually approves all Directors' fees.

For 2018, the compensation for senior Managers and material risk-takers, including the CEO, Deputy CEO (became a Non-Executive Director in June 2018) and FD is:

Remuneration amount (R'000)	Senior management	Other material risk-takers
Fixed remuneration		
Number of employees	25	2
Total fixed cash-based remuneration: (none of which is deferred or linked to shares or other share-linked instruments)	44 723	2 424
Variable remuneration		
Number of employees	22	1
Total variable cash-based remuneration (short-term incentive)	17 736	33
Number of employees	16	–
Share-linked instruments granted in 2015 and paid in the 2018 financial year	22 966	–
Total remuneration (fixed and variable)	85 425	2 457

20 employees were granted 22 million share-linked instruments in 2018 vesting in 2021.

No special payments were made during the financial year.

	Amounts deferred in prior years paid in 2018		Deferred amounts		
Deferred and retained remuneration	**Total amount deferred from prior years paid in 2018**	**Amendment paid during the year due to *ex* post implicit adjustments**	**Amount of outstanding deferred remuneration payable for 2018**	**Deferred remuneration brought forward from prior years to be paid post 2018**	**Deferred remuneration for 2018 and deferred remuneration brought forward from prior years to be paid post 2018**
Senior management (number)	1	1	1	1	1
Cash (R'000)	1 992	250	2 396	4 437	6 833

The material-risk takers and senior Managers are employees whose professional activities have a material impact on risk-taking decisions, as well as the senior responsible employees in all of the control functions and responsible for the following areas: Treasury, Electronic Services, Commercial Banking, Business Banking, Rental Finance, Card, Marketing, Credit, Risk, Compliance, Internal Audit, Legal, Secretariat, Centralised Operations, Information Technology, Finance, and Human Resources.

The Chairman of the Remuneration Committee's fee for 2018 was R178 080 and the fee for each of the other three members was R94 382.

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.

The Company consults with independent external consultants on market data and practices relating to remuneration and advice on governance. External labour specialists were consulted to review the remuneration philosophy of the Company in relation to compliance with various labour laws and a few aesthetic cosmetic changes were approved. An external market survey was used in the benchmarking of remuneration packages against the financial industry.

Risk measures are part of determining the bonus pool value and also of individual KRA 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.

EMPLOYMENT EQUITY

The table below illustrates the number of employees per occupational level as at 31 December 2018:

	Male				Female				Foreign nationals		
Occupational levels	A	C	I	W	A	C	I	W	Male	Female	Total
Top management	0	0	0	1	0	0	0	1	0	0	2
Senior management	1	2	1	8	2	1	3	2	0	0	20
Middle management	18	6	15	28	12	9	10	31	0	0	129
Junior management	55	20	12	11	127	38	25	46	0	0	334
Semi-skilled	3	0	0	0	7	4	1	5	0	0	20
Unskilled	3	0	0	0	1	0	0	0	0	0	4
Total permanent	**80**	**28**	**28**	**48**	**149**	**52**	**39**	**85**	**0**	**0**	**509**
Temporary employees	0	0	0	0	0	0	0	1	0	0	1
Grand total	**80**	**28**	**28**	**48**	**149**	**52**	**39**	**86**	**0**	**0**	**510**

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

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

SKILLS DEVELOPMENT

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

Training category	Number of Employment Equity employees trained	Number of employees trained
Changing client expectations development	73	92
Management, leadership and change management	43	54
Risk management with a key focus on cyber security	42	42
Regulatory compliance	304	380
Bursaries	27	28
In-house	352	472
Fraud Awareness Training	255	319

During 2018, employees participated in the following initiatives:

BANKSETA initiative	Number of learners enrolled
BANKSETA Kuyasa Learnership	16
BANKSETA Business Analyst Learnership	4
International Executive Development Programme	2
Mercantile initiative	
Internal Audit Technician Learnership	2 (employed)
Sales Learnership	15 (10 employed and 5 unemployed)
Leadership and Management	25 (employed)

Mercantile launched its second Banking Sales Learnership in December 2017 in partnership with Milpark Education and, on completion, the learners will receive an Advanced Certificate in Banking, NQF level 6. The purpose of the Learnership is to create a talent pipeline in the Business and Commercial banking environment. We continued with the Internal Audit Department Learnership programme in cooperation 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 continued for employees in 2018, including ethics, anti-money laundering, cyber security and fraud awareness.

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 and reports any significant or material control weaknesses to management, the GAC and/or the RMC for consideration and remedial action, as appropriate.

The activity also works closely with the Risk and Compliance Management functions to ensure, among other tasks, that an appropriate combined assurance programme is followed. The Risk and Compliance Management processes are also reviewed by the Internal Audit activity in accordance with approved internal audit planning.

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, the 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.

ANNUAL FINANCIAL STATEMENTS

Accounting policies and the basis of preparation for the annual financial statements are set out on pages 45 to 51 of this report.

REGULATION

The Prudential Authority (formerly the Bank Supervision Department) of the SARB is the lead regulator of the Group. The Financial Surveillance Department of the SARB, the Financial Services Conduct Authority (formerly 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 engage with media. Communication with the SARB and the Registrar of Companies is done in compliance with the respective laws and 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 Compliance Charter is reviewed and approved annually by the Board to assess the extent to which the Group is effectively managing its regulatory risks.

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.

The head of Compliance reports to the CEO and has unrestricted and unfettered access to the Chairman of the Board, the GAC and the RMC. The head of Compliance is supported by two Compliance Officers, a Treasury Compliance Officer, a Money Laundering Control Officer, three Compliance Monitoring Specialists, a Money Laundering Reporting Officer and two New Client Registration Officers. The Compliance function at Mercantile follows a centralised structure that coordinates activities across 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 their peers and to 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 performed by the Compliance function:

- Creating awareness by training employees in respect of the impact of, and their responsibilities relating to, legislative requirements;
- Independent 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 and existing business ventures and processes.

A compliance tool was developed to assist management in reporting compliance breaches electronically and thereby supporting the Compliance function in fulfilling its obligations.

Other 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 Committees.

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

- Banks Act, No. 94 of 1990;
- Companies Act, No. 71 of 2008;
- National Payment Systems Act, No. 78 of 1998 (NPS);
- National Credit Act, No. 34 of 2005 (NCA);
- Financial Intelligence Centre Act, No. 38 of 2001 (FICA);
- Financial Advisory and Intermediary Services Act, No. 37 of 2002 (FAIS);
- Occupational Health and Safety Act, No. 85 of 1993 (OHS);
- Financial Sector Regulation Act, No. 9 of 2017;
- Protection of Personal Information Act, No. 4 of 2013 (POPIA);
- Foreign Account Tax Compliance Act (FATCA) and The Common Reporting Standard; and
- Financial Services Sector Code.

The most notable development and focus areas in respect of regulatory reforms are the implementation of the FICA Amendment Act, POPIA, FATCA and CRS and the Twin Peaks regulatory reform model.

POPIA, in short, is a privacy law aimed at safeguarding personal information and striking a balance between the right to privacy, the need to share information and regulating how personal information is processed. The Regulator was appointed and assumed office from 1 December 2016. The Regulations were published in December 2018 and are currently under review by the Compliance function. POPIA becomes effective and enforceable at a date yet to be gazetted.

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

CRS focuses on tax residency as opposed to US citizenship. The main purposes of CRS are to obtain financial account information of member countries' citizens who hold bank accounts in foreign financial institutions and to annually exchange that information automatically with the revenue office of the account holder's country of citizenship.

A high level of priority was placed on the FATCA and CRS remediation project in order for the Group to meet its 2018 reporting requirements.

The Financial Sector Regulation Act was signed into law during the course of August 2017 and envisaged the Twin Peaks model of regulation. This resulted in the creation of a prudential regulator – the Prudential Authority – housed in the SARB, while the Financial Services Board was transformed into a dedicated market conduct regulator – the Financial Sector Conduct Authority (FSCA).

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 is to promote and enhance the safety and soundness of regulated financial institutions, while the FSCA is 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.

The Twin Peaks approach required the drafting of various pieces of legislation to achieve its objective of regulatory reform and strengthening consumer protection. Accordingly, the Conduct of Financial Institutions Bill (COFI) was drafted and released for comment in December 2018. COFI serves to give legislative effect to the market conduct policy approach and promote an enhanced TCF culture within financial institutions.

Compliance with AML/CFT laws remains in effect. The Group strengthened its anti-money laundering controls through changes it made to, *inter alia*, its transaction monitoring rules, its scope of compliance audits, and its client due diligence processes as part of its Risk Management and Compliance Programme that must be implemented in line with the FICA Amendment Act. The Group is in the final stages of implementing both the changes brought about the FICA Amendment Act and the new international funds transfer reporting requirements. The AML/CFT environment is dynamic and the Group continuously reviews its controls to ensure they remain relevant and effective.

The regulatory review of the Group's level of FICA compliance conducted during 2017 was closed by the regulator with no intention to issue sanctions.

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 continued to be a key focus for 2018.

The implementation of the new FAIS Fit and Proper requirements is a major focus area for the Compliance function. The Group's FAIS representatives, key individuals and compliance officers all received training on the new applicable requirements. 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 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 and is pleased to report that no severe incidents occurred during 2018. All 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.

The Group's business is built on trust and integrity as perceived by its stakeholders, especially its 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, regulations, rules and standards. The Group's Market Conduct Policy is designed to facilitate compliance with applicable statutory and regulatory obligations across the Group and forms part of its Enterprise-wide Risk Management Framework.

E Agrella
Acting Head: Compliance

27 February 2019

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, though 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 Auditor is responsible for reporting on the fair presentation of the consolidated and separate annual financial statements.

The consolidated and separate 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 consolidated and separate 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 44 to 104, have been approved by the Board of Mercantile Bank Holdings Limited and are signed on its behalf by:

GP de Kock
Chairman

KR Kumbier
CEO

27 February 2019

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 FD, 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.

COMPANY SECRETARY'S CERTIFICATE

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 2018, all such returns as are required of a public company in terms of the Companies Act, and that all such returns are true, correct and up-to-date.

T Singh
Company Secretary

27 February 2019

INDEPENDENT AUDITOR'S REPORT

To the shareholder of Mercantile Bank Holdings Limited

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS

OPINION

We have audited the consolidated and separate annual financial statements of Mercantile Bank Holdings Limited and its subsidiaries (the Group) set out on pages 45 to 103, which comprise the consolidated and separate statement of financial position as at 31 December 2018, and the consolidated and separate statement of comprehensive income, the consolidated and separate statement of changes in equity and the consolidated and separate statement of cash flows for the year then ended, and the notes to the consolidated and separate annual financial statements, including a summary of significant accounting policies.

In our opinion, the consolidated and separate annual financial statements present fairly, in all material respects, the consolidated and separate financial position of the Group as at 31 December 2018, and its consolidated and separate financial performance and consolidated 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 Annual 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 Company Secretary's Certificate, the Audit Committee Report and the Directors' Report as required by the Companies Act of South Africa, and the supplementary information as disclosed on page 104. The other information does not include the consolidated and separate annual financial statements and our auditor's report thereon.

Our opinion on the consolidated and separate annual 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 annual 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 annual 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 ANNUAL FINANCIAL STATEMENTS

The Directors are responsible for the preparation and fair presentation of the consolidated and separate annual 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 annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated and separate annual 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 ANNUAL FINANCIAL STATEMENTS

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

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the 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 annual 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 annual financial statements, including the disclosures, and whether the consolidated and separate annual 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 annual 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 Limited for 17 years.

Deloitte & Touche

Deloitte & Touche
Registered Auditor
Per: Diana Jorge
Partner

28 February 2019

National Executive: *LL Bam Chief Executive Officer, *TMM Jordan Deputy Chief Executive Officer; Clients & Industries, *MJ Jarvis Chief Operating Officer, *AF Mackie Audit & Assurance, *N Singh Risk Advisory, DP Ndlovu Tax & Legal, TP Pillay Consulting, *JK Mazzocco Talent & Transformation, MG Dicks Risk Independence & Legal, KL Hodson Corporate Finance *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 Touche Tohmatsu Limited

AUDIT COMMITTEE REPORT

for the year ended 31 December 2018

The GAC is pleased to present its report for the 2018 financial year. This report has been prepared based on the requirements of the Companies Act, the Bank's Act, King IV 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 role of the Audit Committee has never been more fundamental in ensuring that trust and integrity are maintained over corporate reporting, entrenched by the efficiency of internal controls, the effectiveness of the Internal Audit function, the independence of the External Auditor and optimised through a combined assurance model. The GAC's main objective is to assist the Board in fulfilling its oversight responsibilities, in particular regarding 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 audit activity and the independence and effectiveness of the External Auditor.

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 three Independent Non-Executive Directors. As at 31 December 2018, the members were:

- TH Njikizana *(Chair)* Chartered Accountant (South Africa);
- L Hyne Chartered Accountant (South Africa); and
- DR Motsepe.

The CEO, FD, heads of Risk, Internal Audit and Compliance Management, as well as the heads of CGD Group Compliance and Internal Audit, and representatives from the External Auditor 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 Chairman meets with the External and Internal Auditors separately between Audit Committee meetings.

The GAC's responsibility to oversee integrated reporting, requires that all members have an understanding of financial statements and IFRS; an ability to assess the general application of IFRS in connection with the accounting for estimates, accruals, and reserves; experience preparing, auditing, analysing, or evaluating financial statements that present a breadth and level of complexity of account issues generally comparable to what can reasonably be expected to arise in the financial statements, or experience actively supervising those engaged in such activities; an understanding of internal control over financial reporting and an understanding of the Audit Committee's function. At least one-third of the members of the GAC, at any time, shall have academic qualifications, or experience, in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resources management. In addition, all GAC members should meet predetermined skills, competency and experience requirements. The GAC is free to consult with specialists or consultants to assist it with the performance of its functions, subject to a Board-approved process, and all GAC members must keep current with developments affecting the required skill set.

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 and the auditor's scope and terms of engagement, ensuring the fees agreed do not impinge on the auditor's ability to perform adequate procedures as disclosed in note 27 to the annual financial statements;
- Believes the appointment of Deloitte & Touche complies with the relevant provisions of the Banks Act, the Companies Act, and King IV;
- 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 annual 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 annual 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 and the implementation thereof in 2018. Refer to pages 93 to 97 for the detail.

For the sake of completeness, it is noted that Internal Audit provided a written assessment of the effectiveness of the system of internal controls and risk management to the GAC, who reported on these matters to the Board. It was, however, the duty of the GAC to agree a risk-based audit programme with Internal Audit.

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 and annual plan for approval; and
- Evaluated the effectiveness and performance of the Compliance function.

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

EXTERNAL AUDIT

The lead regulator, the Prudential Authority, designated 'auditor independence and audit quality measures' to be the flavour-of-the-year topic for 2018 and requested the GAC Chairman to present to that regulator on how the GAC ensures that it is able to attest on an annual basis to auditor independence as stipulated in the various legislative requirements and Basel papers. The GAC Chairman accordingly presented the practical steps followed by the GAC to enable it to come to the conclusion that all the various requirements pertaining to auditor independence are satisfactorily met, and that the integrity of its audits was preserved to ensure a high-quality audit.

The presentation made specific reference to the policies and processes followed to determine ongoing independence and audit quality, which included annual reviews of the performance of the External Auditor against the scope and accepted timelines through formal surveys of Executive Managers, Internal Audit, discussions with auditors and based on its own interactions with the auditor. In addition, the GAC considered the quality control standards applicable to the External Auditor and, in May 2018, adopted a practice to request the External Auditor to report on its audit quality controls and independence. The External Auditor covered the following aspects in their presentation – ethical requirements and independence, client and engagement acceptance continuance, engagement performance and monitoring.

During the period under reporting, the GAC has posed questions directly to the External Auditor on how the high-profile audit failures and scandals in the local environment have caused them to modify their own practices to avoid similar failures and received feedback in this regard. The GAC without fail considers for discussion with the External Auditor if and when they arise, any banking regulatory actions that have a bearing on the conduct of the audit. Going forward, the GAC will investigate the availability of the external audit firm's annual transparency report and any inspection reports on the audit firm issued by the relevant audit oversight body for due consideration.

Deloitte & Touche was appointed as the Group's External Auditor in 1998 and the Group has embedded the policy of rotating the audit partner every five years, which is aligned to the Companies Act. The current audit partner was appointed in 2014. There have been significant changes in the management of the Group during the External Auditor's tenure, which has mitigated the attendant risk of familiarity between the External Auditor and management. The adoption of the mandatory audit firm rotation will be considered as required by regulations.

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 Auditor (in terms of the Auditing Profession 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 2019. The reappointment of the External Auditor is subject to approval by the shareholder at the upcoming AGM.

EXTERNAL AUDITOR'S SERVICES: NON-AUDIT SERVICES

The Group will not contract its External Auditor 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 Auditor:

- 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 the External Auditor to provide non-audit services.

Mercantile will not contract its auditor on services prohibited in terms of section 90(2) of the Companies Act, and under the Code of Professional Conduct mentioned in the Auditing Profession Act, as amended from time to time. To ensure that such is complied with:

- The External Auditor confirms 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 exceeding 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 Auditor 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.

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 FD 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 FD, 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 SETCOM; the Remuneration Committee; the Group RMC and the DAC.

The GAC remains satisfied with the overall control environment, including those supporting the annual financial statements for 2018, 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

27 February 2019

DIRECTORS' REPORT

for the year ended 31 December 2018

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 2018.

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 page 45 to 104 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 21 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°	*(Chairman)*
KR Kumbier#	*(CEO)*
MEL Teixeira#	*(FD, effective 15 June 2018)*
RS Caliço*	*(Deputy CEO up to 16 June 2018)*
L Hyne°	
AT Ikalafeng°	
TH Njikizana^°	
DR Motsepe°	

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

The Directors of the Company, as at 27 February 2019, 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 R49.886 million was declared on 27 February 2019 in respect of the year ended 31 December 2018 (2017: R42.458 million and paid in 2018).

SPECIAL RESOLUTIONS

Two special resolutions were adopted during 2018 at the AGM held on 6 June 2018. The first was to approve the fees and remuneration respectively payable to Non-Executive Directors and Executive Directors. The second was in terms of section 45 of the Companies Act to approve financial assistance to intra-group companies.

EVENTS AFTER THE REPORTING PERIOD

Apart from the dividends declared and the ongoing sale of Mercantile (refer to note 33 on page 89), 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 2018

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

1. BASIS OF PRESENTATION

The separate annual financial statements of the Company as well as the consolidated annual 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 2018.

With the exception of IFRS 9, all other IFRSs that became effective in the current reporting period have had no material 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, 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.

4.1 DERIVATIVE FINANCIAL INSTRUMENTS

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 and are held only to cover economic exposures. 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

Business model assessment

We determine our business models at the level that best reflects how we manage portfolios of financial assets to achieve our business objectives. Judgement is used in determining our business models, which is supported by relevant, objective evidence including:

- How the economic activities of our businesses generate benefits, for example through trading revenue, enhancing yields or hedging funding or other costs and how such economic activities are evaluated and reported to key management personnel; and

- The significant risks affecting the performance of our businesses, for example, market risk, credit risk, or other risks as described in the Risk Management section, and the activities undertaken to manage those risks.

Our business models fall into two categories, which are indicative of the key strategies used to generate returns:

- Held-to-collect contractual cash flows (HTC): the objective of this business model is to hold loans and securities to collect contractual principal and interest cash flows. Sales are incidental to this objective and are expected to be insignificant or infrequent.
- Other fair value business models: these business models are not held-to-collect contractual cash flows, and primarily represent business models where assets are held-for-trading or managed on a fair value basis.

Solely payments of principal and interest assessment

Instruments held within a held-to-collect contractual cash flows business model are assessed to evaluate if their contractual cash flows are comprised of solely payments of principal and interest. Solely payments of principal and interest assessment payments are those which would typically be expected from basic lending arrangements. Principal amounts include par repayments from lending and financing arrangements, and interest primarily relates to basic lending returns, including compensation for credit risk and the time value of money associated with the principal amount outstanding over a period of time. Interest can also include other basic lending risks and costs (for example, liquidity risk, servicing or administrative costs) associated with holding the financial asset for a period of time and a profit margin.

Where the contractual terms introduce exposure to risk or variability of cash flows that are inconsistent with a basic lending arrangement, the related financial asset is classified and measured at fair value through profit or loss.

Financial assets at amortised cost

The Group has classified loans, trade receivables, negotiable securities and cash at banks as financial assets at amortised cost. Amortised cost is determined using the effective interest rate method. The effective interest rate is the rate that discounts expected 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.

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.

Financial assets at fair value through other comprehensive income

Financial assets that are held for collection of contractual cash flows, where the assets' cash flows solely represent payments of principal and interest, and that are not designated at amortised cost or at fair value through profit or loss, are measured at fair value through other comprehensive income. Movements in the carrying amount are taken through other comprehensive income, except for impairment gains or losses, interest revenue, foreign exchange gains and losses on the instruments, which are recognised in profit or loss.

When the financial asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income, may subsequently be reclassified within equity. Interest income on these financial assets is measured using the effective interest rate method. The Group has classified other investments as financial assets at fair value through other comprehensive income.

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.

Negotiable securities

Negotiable securities consist of government stock and treasury bills. These financial assets have been designated as loans and receivables and are measured at amortised cost subject to impairment.

Loans and advances

Loans and advances principally comprise amounts advanced to third parties in terms of certain products namely, current accounts, mortgage loans, credit card facilities, instalment sales and leases, structured loans and term loans. These financial assets are measured at amortised cost subject to impairment.

Other accounts receivable

Other accounts receivable comprises items in transit, 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, 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.

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, less ECL. 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

Having adopted IFRS 9, the Group's accounting policy for impairment of financial assets has changed significantly and the ECL model is now applied instead of the incurred loss methodology model under IAS 39.

Key principles of the accounting policy for impairment of financial assets are listed below:

- The Group assesses whether a financial asset has significantly increased credit risk since initial recognition to determine whether to use a 12-month expected loss approach or a lifetime expected loss approach to calculate its impairment provision.
- At each reporting date, the Group assesses whether there has been a SICR for financial assets since initial recognition, by comparing the credit risk of default occurring over the expected life between the reporting date and the date of initial recognition. In determining whether credit risk has increased significantly since initial recognition, the Group uses its internal credit risk grading system, external risk ratings and expert judgement forecast information to assess deterioration in the credit quality of a financial asset.
- The Group assesses whether the credit risk on a financial asset has increased significantly on an individual or collective basis. For the purposes of a collective evaluation of impairment, financial assets are grouped based on shared credit risk characteristics, taking into account instrument type, credit risk ratings, date of initial recognition, remaining term to maturity, industry, geographical location of the borrower and other relevant factors. Assets migrate through the following three credit stages based on the change in credit quality since initial recognition:
  - Stage 1: 12 – month ECL

    Includes financial assets that have not had a SICR since initial recognition, or that have low credit risk at the reporting date. ECL are calculated and recognised based on their PD over 12 months. Interest is recognised on the full amount due.
  - Stage 2: Lifetime ECL – not credit impaired

    Includes financial assets that have had a SICR since initial recognition, unless they have low credit risk at the reporting date, but that do not have objective evidence of impairment. ECL are calculated and recognised based on their lifetime PD. Interest is recognised on the full amount due.
  - Stage 3: Lifetime ECL – credit impaired

    Includes financial assets that have objective evidence of impairment at the reporting date. ECL are calculated and recognised based on their lifetime PD. Interest is only recognised insofar as it is expected to be recovered i.e. on the net carrying value (value of the exposure less calculated ECL).
- The amount of ECL is measured as the probability-weighted present value of all cash shortfalls over the expected life of the financial asset discounted at its original effective interest rate. The Group considers its historical loss experience and adjusts this for current observable data. In addition, the Group uses reasonable and supportable expert judgement on future economic conditions, including estimating the amount of an ECL.

4.7 MODIFICATION

The Group sometimes renegotiates or otherwise modifies the contractual cash flows of loans to clients. When this happens, the Group assesses whether or not the new terms are substantially different to the original terms. If the terms are substantially different, the Group derecognises the original financial asset and recognises a 'new' asset at fair value and recalculates the effective interest rate for the asset. The date of renegotiation is consequently considered to be the date of initial recognition for impairment calculation purposes, including for the purpose of determining whether a SICR has occurred. However, the Group also assesses whether the new financial asset recognised is deemed to be credit-impaired at initial recognition, especially in circumstances where the renegotiation was driven by the debtor being unable to make the originally agreed payments. Differences in the carrying amount are also recognised in profit or loss as a gain or loss on derecognition.

If the terms are not substantially different, the renegotiation or modification does not result in derecognition, and the Group recalculates the gross carrying amount based on the revised cash flows of the financial asset, and recognises a modification gain or loss in profit or loss. The new gross carrying amount is recalculated by discounting the modified cash flows at the original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets).

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and recognition of a new liability. The difference between the carrying value of the original financial liability and the consideration paid is recognised in profit or loss.

4.8 DERECOGNITION

A financial instrument or a portion of a financial instrument will be derecognised and a gain or loss recognised when the Group's contractual rights expire, financial assets are transferred or financial liabilities are extinguished. On derecognition of a financial asset or liability, the difference between the consideration and the carrying amount on the settlement date is included in finance charges and fair value movements for the year. On derecognition of equity instruments designated at fair value through other comprehensive income, the cumulative fair value gains/losses recognised in other comprehensive income is not subsequently recycled to profit or loss.

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. 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

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

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.

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 annual 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, 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, 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

Interest income and expense for all financial instruments, except those measured or designated at fair value through profit or loss, are recognised as 'interest income' and 'interest expense' in profit or loss using the effective interest method. Interest on financial instruments measured at fair value through profit or loss is included within the fair value movement during the period.

The effective interest rate is the rate that exactly discounts estimated future cash flows of the financial instrument through the expected life of the financial instrument or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. The future cash flows are estimated taking into account all the contractual terms of the instrument.

The calculation of the effective interest rate includes all fees and points paid or received between parties to the contract that are incremental and directly attributable to the specific lending arrangement, transaction costs and all other premiums or discounts. For financial assets at fair value through profit or loss, transaction costs are recognised in profit or loss at initial recognition.

The interest income or interest expense is calculated by applying the effective interest rate to the gross carrying amount of non-credit impaired financial assets (i.e. at the amortised cost of the financial asset before adjusting for any ECL allowance), or to the amortised cost of financial liabilities. For credit-impaired financial assets, the interest income is calculated by applying the effective interest rate to the amortised cost of the credit-impaired financial assets (i.e. the gross carrying amount less the allowance for ECL). For financial assets originated or purchased credit-impaired, the effective interest rate reflects the ECL in determining the future cash flows expected to be received from the financial asset.

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 co-funded by payments from employees and 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, 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 ECL ON LOANS AND ADVANCES

The extent of the ECL allowance for financial assets measured at amortised cost is calculated using complex models and significant assumptions about future economic conditions and credit behaviour.

Further significant judgements are necessary in applying the accounting requirements for measuring ECL, such as:

- Determining criteria for SICR:

  ECL is measured as an allowance equal to a 12-month ECL for stage 1 assets, or a lifetime ECL for stage 2 or stage 3 assets. An asset moves to stage 2 when its credit risk has increased significantly since initial recognition and to stage 3 when it becomes non-performing, which includes accounts in business rescue, debt review, liquidation and sequestration;
- Choosing appropriate models and assumptions for the measurement of ECL:

  Judgement is applied in identifying the most appropriate model for each type of asset, as well as for determining the assumptions used in these models, including assumptions that relate to key drivers of credit risk; and
- Establishing the number and relative weightings of forward-looking scenarios.

Currently the Group does not make use of specific macro-economic forward-looking scenarios due to the lack of adequate correlation in the performance of its loans and advances relative to macro-economic indicators or an index of these indicators. A management overlay is applied for specific types of exposures based on expert collaborative opinions and assessments.

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 annual financial statements. The impact of initial application of the following standards and interpretations is not expected to be significant to the Group:

Standard	Standard title and detail	Effective date
IFRS 3	**Business combinations:** Amendments to clarify the definition of a business	Business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020
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
IFRS16	**Leases** In January 2016, the International Accounting Standards Board issued IFRS 16 Leases, which replaces IAS 17 Leases. The scope of IFRS 16 is generally similar to IAS 17, however the new standard requires lessees to recognise nearly all leases on the balance sheet which will reflect their right to use an asset for a period of time and the associated liability for payments. The definition of a lease is different from the current IFRIC 4 guidance and might result in some contracts being treated differently in the future. IFRS 16 includes detailed guidance to help companies assess whether a contract contains a lease or a service, or both. The Group has assessed its assets, liabilities and contractual lease obligations against the classification and measurement criteria of IFRS 16. The transitional impact will result in the recognition of right of use assets and associated liabilities. Management does however not anticipate this having a significant impact on the Group's capital adequacy levels.	Annual periods beginning on or after 1 January 2019
IAS 1	**Presentation of financial statements:** Amendments regarding the definition of material	Annual periods beginning on or after 1 January 2020
IAS 8	**Accounting policies, changes in accounting estimates and errors**: Amendments regarding the definition of material	Annual periods beginning on or after 1 January 2020
IAS 19	**Employee benefits:** Amendments regarding plan amendments, curtailments and settlements	Annual periods beginning on or after 1 January 2019
IAS 28	**Investments in associates and joint ventures:** Amendments regarding the sale of contribution of assets between an investor and its associate or joint venture	Deferred indefinitely
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
IFRIC 23	Uncertainty over income tax treatments	Annual periods beginning on or after 1 January 2019

STATEMENTS OF FINANCIAL POSITION

as at 31 December 2018

	Note	GROUP 2018 R'000	GROUP 2017 R'000	COMPANY 2018 R'000	COMPANY 2017 R'000
ASSETS					
Cash and cash equivalents	3	**3 178 571**	1 750 165	**3 821**	4 159
Derivative financial instruments	4	**17 903**	104 016	**–**	–
Negotiable securities	5	**790 810**	904 166	**–**	–
Loans and advances	6	**9 879 115**	9 459 819	**–**	–
Other investments	7	**8 078**	6 985	**62**	62
Interest in subsidiaries	8	**–**	–	**746 217**	746 217
Other accounts receivable	9	**523 413**	689 688	**–**	–
Non-current assets held-for-sale	10	**22 500**	22 500	**–**	–
Current tax receivable	11	**–**	32	**–**	–
Property and equipment	12	**256 226**	244 176	**–**	–
Intangible assets	13	**128 917**	153 533	**–**	–
Deferred tax assets	14	**42 434**	15 090	**–**	–
Total assets		**14 847 967**	13 350 170	**750 100**	750 438
EQUITY AND LIABILITIES					
Liabilities		**12 323 383**	11 014 144	**3 526**	3 643
Other accounts payable	15	**440 847**	511 712	**3 526**	3 643
Derivative financial instruments	4	**15 437**	128 044	**–**	–
Current tax payable	11	**5 716**	6 280	**–**	–
Provisions and other liabilities	16	**139 639**	119 723	**–**	–
Deposits	18	**10 417 469**	9 337 177	**–**	–
Debt securities	19	**352 076**	241 594	**–**	–
Long-term funding	20	**883 927**	609 395	**–**	–
Deferred tax liabilities	14	**68 272**	60 219	**–**	–
Total equity attributable to equity holder of the parent		**2 524 584**	2 336 026	**746 574**	746 795
Share capital and share premium	21	**1 207 270**	1 207 270	**1 207 270**	1 207 270
Employee benefits reserve		**(5 631)**	(6 218)	**–**	–
Property revaluation reserve		**145 367**	129 301	**–**	–
Other reserves		**5 707**	5 186	**33**	33
Retained earnings/(Accumulated loss)		**1 171 871**	1 000 487	**(460 729)**	(460 508)
Total equity and liabilities		**14 847 967**	13 350 170	**750 100**	750 438

STATEMENTS OF COMPREHENSIVE INCOME

for the year ended 31 December 2018

	Note	GROUP 2018 R'000	GROUP 2017 R'000	COMPANY 2018 R'000	COMPANY 2017 R'000
Interest income	23	**1 237 441**	1 139 093	**32**	39
Interest expense	24	**(650 496)**	(607 300)	**–**	–
Net interest income		**586 945**	531 793	**32**	39
Net charge for credit losses	6.4	**(47 602)**	(40 134)	**–**	–
Net interest income after credit losses		**539 343**	491 659	**32**	39
Net non-interest income		**383 261**	335 602	**42 458**	35 226
Non-interest income	25	**797 570**	634 614	**42 458**	35 226
Fee and commission expenditure	26	**(414 309)**	(299 012)	**–**	–
Net interest and non-interest income		**922 604**	827 261	**42 490**	35 265
Operating expenditure	27	**(577 025)**	(534 176)	**(253)**	(150)
Profit before tax		**345 579**	293 085	**42 237**	35 115
Tax	28	**(96 150)**	(80 343)	**–**	–
Profit after tax		**249 429**	212 742	**42 237**	35 115
Other comprehensive income					
Items that will not be reclassified to profit or loss:		**17 174**	2 632	**–**	–
Revaluation of owner-occupied properties	12	**22 314**	1 489	**–**	–
Remeasurement of defined benefit obligation	17	**815**	1 530	**–**	–
Gains on remeasurement to fair value on financial assets designated as fair value through other comprehensive income		**672**	616	**–**	–
Deferred tax thereon	14	**(6 627)**	(1 003)	**–**	–
Other comprehensive income net of tax		**17 174**	2 632	**–**	–
Total comprehensive income		**266 603**	215 374	**42 237**	35 115
Profit after tax attributable to equity holder of the parent		**249 429**	212 742	**42 237**	35 115
Total comprehensive income attributable to equity holder of the parent		**266 603**	215 374	**42 237**	35 115

STATEMENTS OF CHANGES IN EQUITY

for the year ended 31 December 2018

	GROUP					
	Share capital and share premium R'000	Employee benefits reserve R'000	Property revalu-ation reserve R'000	Other reserves R'000	Retained earnings R'000	Total R'000
Balance as at 1 January 2017	1 207 270	(7 319)	128 229	4 727	822 971	2 155 878
Net movement for the year	–	1 101	1 072	459	177 516	180 148
Total comprehensive income for the year	–	1 101	1 072	459	212 742	215 374
Profit after tax	–	–	–	–	212 742	212 742
Other comprehensive income	–	1 530	1 489	616	–	3 635
Tax relating to other comprehensive income	–	(429)	(417)	(157)	–	(1 003)
Dividend paid	–	–	–	–	(35 226)	(35 226)
Balance as at 31 December 2017	**1 207 270**	**(6 218)**	**129 301**	**5 186**	**1 000 487**	**2 336 026**
Changes on initial application of IFRS 9 (refer to note 1)	**–**	**–**	**–**	**–**	**(35 587)**	**(35 587)**
Restated balance as at 1 January 2018	**1 207 270**	**(6 218)**	**129 301**	**5 186**	**964 900**	**2 300 439**
Net movement for the year	**–**	**587**	**16 066**	**521**	**206 971**	**224 145**
Total comprehensive income for the year	**–**	**587**	**16 066**	**521**	**249 429**	**266 603**
Profit after tax	**–**	**–**	**–**	**–**	**249 429**	**249 429**
Other comprehensive income	**–**	**815**	**22 314**	**672**	**–**	**23 801**
Tax relating to other comprehensive income	**–**	**(228)**	**(6 248)**	**(151)**	**–**	**(6 627)**
Dividend paid	**–**	**–**	**–**	**–**	**(42 458)**	**(42 458)**
Balance as at 31 December 2018	**1 207 270**	**(5 631)**	**145 367**	**5 707**	**1 171 871**	**2 524 584**

	COMPANY			
	Share capital and share premium R'000	Other reserve R'000	Accumulated loss R'000	Total R'000
Balance as at 1 January 2017	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 as at 31 December 2017	**1 207 270**	**33**	**(460 508)**	**746 795**
Net movement for the year	**–**	**–**	**(221)**	**(221)**
Total comprehensive income for the year	**–**	**–**	**42 237**	**42 237**
Profit after tax	**–**	**–**	**42 237**	**42 237**
Other comprehensive income	**–**	**–**	**–**	**–**
Dividend paid	**–**	**–**	**(42 458)**	**(42 458)**
Balance as at 31 December 2018	**1 207 270**	**33**	**(460 729)**	**746 574**

STATEMENTS OF CASH FLOWS

for the year ended 31 December 2018

	Note	GROUP 2018 R'000	GROUP 2017 R'000	COMPANY 2018 R'000	COMPANY 2017 R'000
Cash flows from operating activities					
Cash receipts from clients	29.1	**2 011 122**	1 787 210	**32**	39
Cash paid to clients, suppliers and employees	29.2	**(1 542 773)**	(1 342 446)	**(253)**	(150)
Cash generated from/(utilised in) operations	29.3	**468 349**	444 764	**(221)**	(111)
Dividends received		**–**	–	**42 458**	35 226
Tax (paid)	29.4	**(110 864)**	(91 305)	**–**	–
Net (increase) in income-earning assets	29.5	**(403 417)**	(1 240 356)	**–**	–
Net increase/(decrease) in deposits, other accounts receivable and payable	29.6	**1 176 043**	687 845	**(117)**	136
Net cash inflow/(outflow) from operating activities		**1 130 111**	(199 052)	**42 120**	35 251
Cash flows from investing activities					
Purchase of intangible assets	13	**(28 965)**	(23 282)	**–**	–
Purchase of property and equipment	12	**(15 305)**	(11 870)	**–**	–
Proceeds on disposal of property and equipment		**9**	244	**–**	–
Net cash (outflow) from investing activities		**(44 261)**	(34 908)	**–**	–
Cash flows from financing activities					
Dividends paid		**(42 458)**	(35 226)	**(42 458)**	(35 226)
Net increase/(decrease) in long-term funding	20	**274 532**	(228 304)	**–**	–
Proceeds from long-term borrowings		**740 010**	132 862	**–**	–
Repayments of long-term borrowings		**(464 772)**	(326 978)	**–**	–
(Gain) on exchange rate movements		**(706)**	(34 188)	**–**	–
Proceeds from debt securities	19	**110 482**	241 585	**–**	–
Repayment of debt securities	19	**–**	(241 000)	**–**	–
Net cash inflow/(outflow) from financing activities		**342 556**	(262 945)	**(42 458)**	(35 226)
Net cash inflow/(outflow) for the year		**1 428 406**	(496 905)	**(338)**	25
Cash and cash equivalents at the beginning of the year		**1 750 165**	2 247 070	**4 159**	4 134
Cash and cash equivalents at the end of the year	3	**3 178 571**	1 750 165	**3 821**	4 159

NOTES TO THE ANNUAL FINANCIAL STATEMENTS
for the year ended 31 December 2018

1. CHANGE IN ACCOUNTING POLICY

The Group has adopted IFRS 9, as issued by the International Accounting Standards Board in July 2014 and with a transition date of 1 January 2018, which resulted in changes in accounting policies and adjustments to the amounts previously recognised in the annual financial statements. The Group did not early adopt any parts of IFRS 9 in previous years.

As permitted by the transitional provisions of IFRS 9, the Group elected not to restate comparative figures. Any adjustments to the carrying values of financial assets and liabilities at the date of transition were recognised in the opening retained earnings and other reserves of the current year.

As a result, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also only been applied in the current year. The comparative period notes disclosures are consistent with that of the prior year.

The adoption of IFRS 9 has resulted in changes in accounting policies for recognition, classification and measurement of financial assets and financial liabilities, as well as for impairment of financial assets. IFRS 9 also significantly amends other standards dealing with financial instruments, such as IFRS 7 Financial Instruments: Disclosures.

Set out below are disclosures relating to the impact of the adoption of IFRS 9 on the Group.

Effect on the statement of financial position	R'000
ASSETS	
Decrease in net loans and advances	(47 254)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	9 459 819
Adjustment due to change in classification of interest in suspense in terms of IFRS 9	91 241
Adjustment as a result of IFRS 9 ECL (refer to note 6.4)	(138 494)
Restated opening balance in terms of IFRS 9 on 1 January 2018	9 412 566
Decrease in cash and cash equivalents	(54)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	1 710 285
Adjustment as a result of IFRS 9 ECL	(54)
Restated opening balance in terms of IFRS 9 on 1 January 2018	1 710 231
Decrease in negotiable securities	(16)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	904 166
Adjustment as a result of IFRS 9 ECL	(16)
Restated opening balance in terms of IFRS 9 on 1 January 2018	904 150
Increase in deferred tax assets	11 736
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	(45 130)
Adjustment as a result of IFRS 9 ECL	11 736
Restated opening balance in terms of IFRS 9 on 1 January 2018	(33 394)
EQUITY	
Decrease in retained earnings	(35 587)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	1 000 487
Adjustment on initial application of IFRS 9	(35 587)
Restated opening balance in terms of IFRS 9 on 1 January 2018	964 900

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS

2.1 CATEGORY ANALYSIS OF FINANCIAL INSTRUMENTS

	GROUP			
	2018		2017	
	Fair value R'000	Carrying amount R'000	Fair value R'000	Carrying amount R'000
ASSETS				
Amortised cost	**14 370 502**	**14 371 909**	12 753 555	12 752 841
Loans and advances				
Current accounts	**1 824 828**	**1 824 828**	1 825 612	1 825 612
Credit cards	**41 790**	**41 790**	36 414	36 414
Mortgage loans	**4 952 970**	**4 952 970**	4 787 057	4 787 057
Instalment sales and leases	**1 821 359**	**1 821 359**	1 488 907	1 488 907
Structured loans	**134 126**	**134 126**	193 684	193 684
Medium-term loans	**1 104 042**	**1 104 042**	1 128 145	1 128 145
Negotiable securities				
Government stock	**25 292**	**25 800**	*	*
Treasury bills	**764 111**	**765 010**	853 883	853 169
Cash and cash equivalents	**3 178 571**	**3 178 571**	1 750 165	1 750 165
Other accounts receivable	**523 413**	**523 413**	689 688	689 688
Fair value through profit or loss				
Derivative financial instruments	**17 903**	**17 903**	*	*
Fair value through other comprehensive income				
Other investments	**8 078**	**8 078**	*	*
Available-for-sale				
Other investments	*	*	6 985	6 985
Held-to-maturity				
Negotiable securities – Government stock	*	*	51 093	50 997
Held-for-trading				
Derivative financial instruments	*	*	104 016	104 016
	14 396 483	**14 397 890**	12 915 649	12 914 839
LIABILITIES				
Fair value through profit or loss				
Derivative financial instruments	**15 437**	**15 437**	*	*
Held-for-trading				
Derivative financial instruments	*	*	128 044	128 044
Amortised cost	**12 094 319**	**12 094 319**	10 699 878	10 699 878
Long-term funding	**883 927**	**883 927**	609 395	609 395
Deposits	**10 417 469**	**10 417 469**	9 337 177	9 337 177
Debt securities	**352 076**	**352 076**	241 594	241 594
Other accounts payable	**440 847**	**440 847**	511 712	511 712
	12 109 756	**12 109 756**	10 827 922	10 827 922

** Change in classification as a result of IFRS 9 implementation.*

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.1 CATEGORY ANALYSIS OF FINANCIAL INSTRUMENTS continued

	COMPANY			
	2018		2017	
	Fair value R'000	Carrying amount R'000	Fair value R'000	Carrying amount R'000
ASSETS				
Fair value through other comprehensive income				
Other investments	**62**	**62**	*	*
Available-for-sale				
Other investments	*	*	62	62
Amortised cost				
Cash and cash equivalents	**3 821**	**3 821**	4 159	4 159
	3 883	**3 883**	4 221	4 221
LIABILITIES				
Amortised cost				
Other accounts payable	**3 526**	**3 526**	3 643	3 643
	3 526	**3 526**	3 643	3 643

** Change in classification as a result of IFRS 9 implementation.*

2.2 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.

2.3 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).

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.3 FAIR VALUE MEASUREMENTS AS REQUIRED BY IFRS 13 continued

	GROUP			
	2018			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
ASSETS				
Fair value through other comprehensive income				
Other investments	–	–	8 078	8 078
Fair value through profit or loss				
Derivative financial instruments	–	17 903	–	17 903
Amortised cost				
Loans and advances				
Current accounts	–	–	1 824 828	1 824 828
Credit cards	–	–	41 790	41 790
Mortgage loans	–	–	4 952 970	4 952 970
Instalment sales and leases	–	–	1 821 359	1 821 359
Structured loans	–	–	134 126	134 126
Medium-term loans	–	–	1 104 042	1 104 042
Negotiable securities				
Government stock	–	–	25 292	25 292
Treasury bills	–	–	764 111	764 111
Cash and cash equivalents	–	–	#	–
Other accounts receivable	–	–	523 413	523 413
	–	17 903	11 200 009	11 217 912
LIABILITIES				
Fair value through profit or loss				
Derivative financial instruments	–	15 437	–	15 437
Amortised cost				
Long-term funding	–	–	883 927	883 927
Deposits	–	–	10 417 469	10 417 469
Debt securities	–	–	352 076	352 076
Other accounts payable	–	–	440 847	440 847
	–	15 437	12 094 319	12 109 756

 # The fair value of these assets closely approximates their carrying amount due to the short-term or on-demand repayment terms.

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.3 FAIR VALUE MEASUREMENTS AS REQUIRED BY IFRS 13 continued

	GROUP			
	2017			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
ASSETS				
Available-for-sale				
Other investments	–	–	6 985	6 985
Held-for-trading				
Derivative financial instruments	–	104 016	–	104 016
Amortised cost^				
Loans and advances				
Current accounts	–	–	1 825 612	1 825 612
Credit cards	–	–	36 414	36 414
Mortgage loans	–	–	4 787 057	4 787 057
Instalment sales and leases	–	–	1 488 907	1 488 907
Structured loans	–	–	193 684	193 684
Medium-term loans	–	–	1 128 145	1 128 145
Negotiable securities				
Treasury bills	–	–	853 883	853 883
Cash and cash equivalents	–	–	#	–
Other accounts receivable	–	–	689 688	689 688
Held-to-maturity				
Negotiable securities – Government stock	–	–	51 093	51 093
	–	104 016	11 061 468	11 165 484
LIABILITIES				
Held-for-trading				
Derivative financial instruments	–	128 044	–	128 044
Amortised cost^				
Long-term funding	–	–	609 395	609 395
Deposits	–	–	9 337 177	9 337 177
Debt securities	–	–	241 594	241 594
Other accounts payable	–	–	511 712	511 712
	–	128 044	10 699 878	10 827 922

 # The fair value of these assets closely approximates their carrying amount due to the short-term or on-demand repayment terms.
^ Additional disclosure relating to fair value measurements in respect of the prior year has been included.

	COMPANY			
	Level 1 R'000	**Level 2 R'000**	**Level 3 R'000**	**Total R'000**
2018				
ASSETS				
Fair value through other comprehensive income				
Other investments	**–**	**–**	**62**	**62**
2017				
ASSETS				
Available-for-sale				
Other investments	–	–	62	62

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

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.4 RECONCILIATION OF LEVEL 3 FAIR VALUE MEASUREMENTS OF FINANCIAL ASSETS

	GROUP	
	2018 R'000	2017 R'000
Fair value through other comprehensive income (2017: Available-for-sale*)		
Other investments – unlisted equities		
Balance at the beginning of the year	**6 985**	6 712
Additions	**421**	–
Gains on remeasurement to fair value in other comprehensive income	**672**	273
Balance at the end of the year	**8 078**	6 985

	COMPANY	
	2018 R'000	2017 R'000
Fair value through other comprehensive income (2017: Available-for-sale*)		
Other investments – unlisted equities		
Balance at the beginning and end of the year	**62**	62

** Change in classification as a result of IFRS 9 implementation.*

	GROUP	
	2018 R'000	2017 R'000
Fair value through profit or loss		
Loans and advances – mortgage loans		
Balance at the beginning of the year	**–**	730
Repayment of loans and advances	**–**	(730)
Balance at the end of the year	**–**	–

3. CASH AND CASH EQUIVALENTS

	GROUP		COMPANY	
	2018 R'000	2017 R'000	**2018 R'000**	2017 R'000
Cash on hand	**29 983**	37 637	**–**	–
Central Bank balances	**309 252**	328 239	**–**	–
Money market funds	**1 565 038**	426 674	**–**	–
Rand-denominated bank balances	**469 012**	196 329	**3 821**	4 159
Foreign currency-denominated bank balances	**805 411**	761 286	**–**	–
Less: ECL on performing cash and cash equivalents (stage 1)	**(125)**	–	**–**	–
	3 178 571	1 750 165	**3 821**	4 159

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4. 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
2018				
Fair value through profit or loss*				
Foreign exchange contracts	**772 101**	**17 903**	**683 744**	**15 437**
	772 101	**17 903**	**683 744**	**15 437**
2017				
Held-for-trading*				
Foreign exchange contracts	1 085 190	104 016	1 353 728	128 044
	1 085 190	104 016	1 353 728	128 044

** Change in classification as a result of IFRS 9 implementation.*

5. NEGOTIABLE SECURITIES

	GROUP	
	2018 R'000	2017 R'000
Amortised cost		
Treasury bills	**765 022**	853 169
Government stock	**25 800**	*
Less: ECL on performing negotiable securities (stage 1)	**(12)**	–
Held-to-maturity		
Government stock	*	50 997
	790 810	904 166
Maturity analysis		
Maturing within one month	**149 668**	29 901
Maturing after one month but within six months	**587 053**	556 796
Maturing after six months but within 12 months	**28 300**	291 707
Maturing after one year but within five years	**25 789**	25 762
	790 810	904 166

** Change in classification as a result of IFRS 9 implementation.*

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

6. LOANS AND ADVANCES

6.1 PRODUCT ANALYSIS

	GROUP	
	2018 R'000	2017 R'000
Amortised cost		
Current accounts	**1 871 827**	1 858 855
Credit cards	**44 012**	39 505
Mortgage loans	**4 991 393**	4 819 294
Instalment sales and leases	**1 863 086**	1 500 587
Structured loans	**134 126**	193 874
Medium-term loans	**1 179 997**	1 168 670
Gross loans and advances	**10 084 441**	9 580 785
Less: ECL on performing loans and advances (stage 1)	**(78 291)**	*
ECL on underperforming loans and advances (stage 2)	**(21 230)**	*
ECL on non-performing loans and advances (stage 3)	**(105 805)**	*
Portfolio impairments for credit losses	*	(24 439)
Specific impairments for credit losses	*	(96 527)
Net loans and advances	**9 879 115**	9 459 819

** Change in classification as a result of IFRS 9 implementation.*

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

6.2 MATURITY ANALYSIS

	2018 R'000	2017 R'000
Repayable on demand and maturing within one month	**1 932 112**	1 963 232
Maturing after one month but within six months	**154 728**	138 890
Maturing after six months but within 12 months	**99 615**	155 084
Maturing after 12 months	**7 897 986**	7 323 579
	10 084 441	9 580 785

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

6. LOANS AND ADVANCES continued

6.3 DETAILED PRODUCT ANALYSIS OF LOANS AND ADVANCES

	GROUP				
		ECL			
	Gross amount R'000	Stage 1 R'000	Stage 2 R'000	Stage 3 R'000	Net balance R'000
2018					
Current accounts	**1 871 827**	**(27 384)**	**(2 567)**	**(17 048)**	**1 824 828**
Credit cards	**44 012**	**(391)**	**(56)**	**(1 775)**	**41 790**
Mortgage loans	**4 991 393**	**(6 198)**	**(5 788)**	**(26 437)**	**4 952 970**
Instalment sales and leases	**1 863 086**	**(15 892)**	**(3 624)**	**(22 211)**	**1 821 359**
Structured loans	**134 126**	**–**	**–**	**–**	**134 126**
Medium-term loans	**1 179 997**	**(28 426)**	**(9 195)**	**(38 334)**	**1 104 042**
	10 084 441	**(78 291)**	**(21 230)**	**(105 805)**	**9 879 115**

	Gross amount R'000	Portfolio impairments R'000	Specific impairments R'000	Net balance R'000
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

6.3.1 Off-balance sheet ECL included in product analysis

	GROUP			
	ECL			
	Stage 1 R'000	Stage 2 R'000	Stage 3 R'000	Total R'000
2018				
Current accounts	**9 656**	**117**	**189**	**9 962**
Credit cards	**94**	**1**	**120**	**215**
Mortgage loans	**2 021**	**–**	**36**	**2 057**
Instalment sales and leases	**67**	**–**	**–**	**67**
Structured loans	**–**	**–**	**–**	**–**
Medium-term loans	**1 784**	**65**	**12**	**1 861**
	13 622	**183**	**357**	**14 162**

Refer to note 22.1 for gross contingent liabilities and commitments to which these ECL relate to.

2017

No comparative information is available for the prior year as the ECL model did not apply under IAS 39.

6. LOANS AND ADVANCES continued

6.3 DETAILED PRODUCT ANALYSIS OF LOANS AND ADVANCES continued

6.3.2 Detailed analysis of leases (rental assets) included in instalment sales and leases

	GROUP	
	2018 R'000	2017 R'000
Gross investment in lease receivables^		
Less than one year	**442 169**	348 522
One to five years	**977 104**	779 960
More than five years	**–**	–
Gross investment in lease receivables	**1 419 273**	1 128 482
Unearned finance income	**(305 927)**	(246 018)
Net investment in lease receivables	**1 113 346**	882 464
Net lease receivable		
Less than one year	**361 586**	280 084
One to five years	**751 760**	602 380
More than five years	**–**	–
Net investment in lease receivables	**1 113 346**	882 464
Less: ECL	**(34 778)**	*
Portfolio and specific impairments for credit losses	*****	(3 337)
Net lease receivable	**1 078 568**	879 127

** Change in classification as a result of IFRS 9 implementation.*
^ Additional disclosure relating to lease receivables in respect of the prior year has been included.

6.4 CREDIT IMPAIRMENTS BY PRODUCT

	GROUP						
	Total R'000	Current accounts R'000	Credit cards R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Medium-term loans R'000
2018							
Balance at the beginning of the year	**(120 966)**	**(33 243)**	**(3 091)**	**(32 237)**	**(11 679)**	**(191)**	**(40 525)**
Transitional adjustments in terms of IFRS 9	**(138 494)**	**(46 587)**	**1 046**	**(35 637)**	**(7 537)**	**191**	**(49 970)**
Restated balance at the beginning of the year	**(259 460)**	**(79 830)**	**(2 045)**	**(67 874)**	**(19 216)**	**–**	**(90 495)**
Movements for the year							
Credit losses written-off*	**113 272**	**27 784**	**950**	**51 734**	**10 347**	**–**	**22 457**
Net impairments (raised)/released	**(59 138)**	**5 047**	**(1 127)**	**(22 283)**	**(32 858)**	**–**	**(7 917)**
Balance at the end of the year	**(205 326)**	**(46 999)**	**(2 222)**	**(38 423)**	**(41 727)**	**–**	**(75 955)**
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)

** Loans written-off are generally subject to continued collection efforts for a period of time following write-off. The contractual amount outstanding on loans written-off during the year ended 31 December 2018 that are subject to enforcement activity is R6.5 million.*

6. LOANS AND ADVANCES continued

6.4 CREDIT IMPAIRMENTS BY PRODUCT continued

	GROUP	
	2018 R'000	2017 R'000
Net charge for credit losses in the statements of comprehensive income		
Net impairments raised	**(59 138)**	(35 243)
Interest adjustment on impaired advances	**8 931**	–
Amounts written off directly to comprehensive income	**–**	(13 155)
Reversal of impairments for properties in possession previously impaired	**–**	4 500
Recoveries in respect of amounts previously written off	**2 605**	3 764
	(47 602)	(40 134)

6.5 ECL BY STAGE

	GROUP			
	ECL			
	Stage 1 R'000	**Stage 2 R'000**	**Stage 3 R'000**	**Total R'000**
2018				
Balance at the beginning of the year	**(24 440)**	**–**	**(96 526)**	**(120 966)**
Transitional adjustments in terms of IFRS 9	**(61 864)**	**(14 333)**	**(62 297)**	**(138 494)**
Restated balance at the beginning of the year	**(86 304)**	**(14 333)**	**(158 823)**	**(259 460)**
Transfers*				
Transfer to stage 1	**(4 788)**	**4 574**	**214**	**–**
Transfer to stage 2	**246**	**(246)**	**–**	**–**
Transfer to stage 3	**566**	**202**	**(768)**	**–**
Movements for the year	**21 496**	**(15 026)**	**(95 467)**	**(88 997)**
New financial assets originated or purchased	**(15 265)**	**(3 861)**	**(3 328)**	**(22 454)**
Financial assets that have been derecognised	**5 758**	**7 460**	**39 095**	**52 313**
Credit losses written-off	**–**	**–**	**113 272**	**113 272**
Balance at the end of the year	**(78 291)**	**(21 230)**	**(105 805)**	**(205 326)**

* *Transfers of ECL occur when the credit stage of an account at the end of the financial year differs from that at the beginning of the year. In this case, the opening balance of that account's ECL is disclosed as a reduction of ECL in its original credit stage and a corresponding increase (of the same magnitude) of ECL in its new credit stage. Any movements in the amount of ECL which arise as a direct result of the change in credit stage fall within the "movements for the year" line.*

Disclosure relating to the qualitative drivers of changes in ECL have been included under the risk management and control section.

2017

No comparative information is available for the prior year as the ECL model did not apply under IAS 39.

6. LOANS AND ADVANCES continued

6.6 PRODUCT ANALYSIS OF PERFORMING LOANS AND ADVANCES

	GROUP			
		ECL		
	Gross amount R'000	Stage 1 R'000	Stage 2 R'000	Net balance R'000
2018				
Current accounts	**1 838 407**	**(27 384)**	**(2 567)**	**1 808 456**
Credit cards	**41 001**	**(391)**	**(56)**	**40 554**
Mortgage loans	**4 786 074**	**(6 198)**	**(5 788)**	**4 774 088**
Instalment sales and leases	**1 831 512**	**(15 892)**	**(3 624)**	**1 811 996**
Structured loans	**134 126**	**–**	**–**	**134 126**
Medium-term loans	**1 071 213**	**(28 426)**	**(9 195)**	**1 033 592**
	9 702 333	**(78 291)**	**(21 230)**	**9 602 812**

	GROUP		
	Gross amount R'000	Portfolio impairment R'000	Net balance R'000
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

6.7 PRODUCT ANALYSIS OF PERFORMING LOANS AND ADVANCES (EXCLUDING LOANS AND ADVANCES WITH RENEGOTIATED TERMS)

	GROUP	
	2018 R'000	2017 R'000
Current accounts	**1 838 407**	1 778 698
Credit cards	**41 001**	36 963
Mortgage loans	**4 651 706**	4 439 398
Instalment sales and leases	**1 821 414**	1 492 165
Structured loans	**134 126**	193 874
Medium-term loans	**1 033 807**	1 025 149
	9 520 461	8 966 247

6. LOANS AND ADVANCES continued

6.8 PRODUCT ANALYSIS OF LOANS AND ADVANCES WITH RENEGOTIATED TERMS THAT WOULD OTHERWISE BE PAST DUE OR IMPAIRED

	GROUP	
	2018 R'000	2017 R'000
Current accounts	**–**	19 845
Credit cards	**–**	–
Mortgage loans	**134 368**	235 987
Instalment sales and leases	**10 098**	77
Structured loans	**–**	–
Medium-term loans	**37 406**	36 759
	181 872	292 668

6.9 PRODUCT AGE ANALYSIS OF LOANS AND ADVANCES THAT ARE PAST DUE BUT NOT INDIVIDUALLY IMPAIRED

	GROUP				
	Past due for				
	1 – 30 days R'000	31 – 60 days R'000	61 – 90 days R'000	Total gross amount R'000	Fair value of collateral and other credit enhance-ments R'000
2018					
Current accounts	**–**	**–**	**–**	**–**	**–**
Credit cards	**–**	**–**	**–**	**–**	**–**
Mortgage loans	**88 453**	**22 955**	**16 658**	**128 066**	**183 972**
Instalment sales and leases	**2 853**	**389**	**–**	**3 242**	**4 328**
Structured loans	**–**	**–**	**–**	**–**	**–**
Medium-term loans	**3 601**	**738**	**748**	**5 087**	**2 114**
	94 907	**24 082**	**17 406**	**136 395**	**190 414**
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

6. LOANS AND ADVANCES continued

6.10 PRODUCT ANALYSIS OF LOANS AND ADVANCES THAT ARE INDIVIDUALLY IMPAIRED

	GROUP			
	Gross amount R'000	ECL Stage 3 R'000	Net balance R'000	Fair value of collateral and other credit enhance-ments R'000
2018				
Current accounts	**33 420**	**(17 048)**	**16 372**	**53 951**
Credit cards	**3 011**	**(1 775)**	**1 236**	**–**
Mortgage loans	**205 319**	**(26 437)**	**178 882**	**254 392**
Instalment sales and leases	**31 574**	**(22 211)**	**9 363**	**39 983**
Structured loans	**–**	**–**	**–**	**–**
Medium-term loans	**108 784**	**(38 334)**	**70 450**	**53 858**
	382 108	**(105 805)**	**276 303**	**402 184**
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

6.11 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 Bank clients 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 the client's financial standing and the acceptability of their dealings with the Bank, including adherence to repayment terms and compliance with other set conditions.

Description of collateral held as security and other credit enhancements	Method of valuation
Cession of debtors	15% – 75% of debtors due and payable under 90 days and depending on debtor credit quality
Pledge of shares	50% of listed shares value; nil for unlisted shares
Pledge and cession 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

6. LOANS AND ADVANCES continued

6.11 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 or trustee will dispose of all assets.

7. OTHER INVESTMENTS

	GROUP		COMPANY	
	2018 R'000	2017 R'000	**2018 R'000**	2017 R'000
Fair value through other comprehensive income (2017: Available-for-sale*)				
Unlisted equities	**8 078**	6 985	**62**	62
	8 078	6 985	**62**	62

** Change in classification as a result of IFRS 9 implementation.*

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

8. INTEREST IN SUBSIDIARIES

	COMPANY	
	2018 R'000	2017 R'000
Unlisted		
Shares at cost		
Mercantile Bank Limited	**745 967**	745 967
Mercantile Insurance Brokers Proprietary Limited	**250**	250
	746 217	746 217

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

9. OTHER ACCOUNTS RECEIVABLE

	GROUP	
	2018 R'000	2017 R'000
Items in transit	**406 906**	269 262
Prepayments and deposits	**30 474**	35 513
Structured loans accrued income	**–**	11 076
Other receivables	**86 033**	373 837
	523 413	689 688

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.

10. NON-CURRENT ASSETS HELD-FOR-SALE

	GROUP	
	2018 R'000	2017 R'000
Properties in possession	**22 500**	22 500
	22 500	22 500

The Bank purchased this property out of a loan default during 2012. An offer to purchase, received in 2017, was subsequently cancelled in 2018 as certain suspensive conditions were not met. The property has been accounted for at the lower of the carrying amount and fair value, less costs to sell. Management remains committed to disposing of the property within 12 months.

11. CURRENT TAX RECEIVABLE AND PAYABLE

	GROUP	
	2018 R'000	2017 R'000
South African Revenue Service		
Current tax receivable	**–**	32
Current tax payable	**5 716**	6 280

12. PROPERTY AND EQUIPMENT

	GROUP						
	Owner-occupied properties R'000	**Leasehold improvements R'000**	**Computer equipment R'000**	**Furniture and fittings R'000**	**Office equipment R'000**	**Motor vehicles R'000**	**Total R'000**
2018							
Open market value or cost at the beginning of the year	**208 121**	**14 012**	**59 678**	**12 288**	**29 547**	**876**	**324 522**
Revaluation	**16 449**	**–**	**–**	**–**	**–**	**–**	**16 449**
Additions	**164**	**271**	**13 574**	**598**	**698**	**–**	**15 305**
Write-off of obsolete assets	**–**	**(44)**	**(63)**	**–**	**(24)**	**–**	**(131)**
Disposal	**–**	**–**	**–**	**–**	**–**	**(95)**	**(95)**
Open market value or cost at the end of the year	**224 734**	**14 239**	**73 189**	**12 886**	**30 221**	**781**	**356 050**
Accumulated depreciation and impairment losses at the beginning of the year	**(14 821)**	**(3 717)**	**(36 370)**	**(3 968)**	**(20 797)**	**(673)**	**(80 346)**
Depreciation – disclosed in operating expenditure	**(8 778)**	**(1 964)**	**(3 032)**	**(1 279)**	**(3 819)**	**(116)**	**(18 988)**
Depreciation – disclosed in fee and commission expenditure	**–**	**–**	**(6 540)**	**–**	**–**	**–**	**(6 540)**
Revaluation	**5 865**	**–**	**–**	**–**	**–**	**–**	**5 865**
Disposal	**–**	**–**	**–**	**–**	**–**	**95**	**95**
Write-off of obsolete assets	**–**	**41**	**28**	**–**	**21**	**–**	**90**
Accumulated depreciation and impairment losses at the end of the year	**(17 734)**	**(5 640)**	**(45 914)**	**(5 247)**	**(24 595)**	**(694)**	**(99 824)**
Net carrying amount at the end of the year	**207 000**	**8 599**	**27 275**	**7 639**	**5 626**	**87**	**256 226**

12. PROPERTY AND EQUIPMENT continued

	GROUP						
	Owner-occupied properties R'000	Leasehold improve-ments R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
2017							
Open market value or cost at the beginning of the year	205 990	13 280	53 536	12 839	31 865	1 049	318 559
Revaluations	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 or 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)
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

The cumulative historical cost of owner-occupied properties that have been revalued is R60.358 million (2017: R60.194 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 2017 and 31 December 2018.

A mortgage bond in the amount of R150 million (2017: R150 million) has been registered over a property included in owner-occupied properties (refer to note 20).

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

13. INTANGIBLE ASSETS

	GROUP	
	2018 R'000	2017 R'000
Computer software		
Cost at the beginning of the year	**405 300**	382 233
Additions	**28 965**	23 282
Transfer	**(22)**	–
Write-off of obsolete computer software	**–**	(215)
Cost at the end of the year	**434 243**	405 300
Accumulated amortisation and impairment losses at the beginning of the year	**(251 767)**	(203 420)
Amortisation	**(53 581)**	(48 562)
Transfer	**22**	–
Write-off of obsolete computer software	**–**	215
Accumulated amortisation and impairment losses at the end of the year	**(305 326)**	(251 767)
Net carrying amount at the end of the year	**128 917**	153 533

During 2018 and 2017, the Group identified no events or circumstances that would indicate that the Group's intangible assets may need to be impaired.

14. DEFERRED TAX ASSETS AND LIABILITIES

	GROUP	
	2018 R'000	2017 R'000
Balance as at the beginning of the year	**(45 129)**	(54 693)
Current year charge		
Per the statement of comprehensive income	**14 182**	10 567
IFRS 9 transitional adjustment (refer to note 1)	**11 736**	–
Other comprehensive income	**(6 627)**	(1 003)
Balance as at the end of the year	**(25 838)**	(45 129)
Tax effects of temporary differences between tax and book value for:		
Intangible assets	**(15 673)**	(23 232)
Property and equipment	**(1 737)**	(1 319)
Provisions and other liabilities	**25 799**	20 509
Impairments on loans and advances	**21 839**	5 953
Current assets	**11 569**	10 578
Revaluations	**(58 350)**	(52 398)
Leased assets	**769**	2 785
Other	**(10 054)**	(8 005)
	(25 838)	(45 129)
Deferred tax assets	**42 434**	15 090
Deferred tax liabilities	**68 272**	60 219

15. OTHER ACCOUNTS PAYABLE

	GROUP		COMPANY	
	2018 R'000	2017 R'000	2018 R'000	2017 R'000
Accruals	**37 820**	40 597	**–**	–
Product-related credits	**282 959**	319 902	**–**	–
Sundry creditors	**116 542**	147 667	**–**	97
Previous minority shareholders (2012 share buy-back)	**3 526**	3 546	**3 526**	3 546
	440 847	511 712	**3 526**	3 643

16. PROVISIONS AND OTHER LIABILITIES

	GROUP						
	Deferred bonus scheme R'000	Staff incentives R'000	Audit fees R'000	Post-retirement medical benefits R'000	Leave pay R'000	Other risks R'000	Total R'000
As at 1 January 2017	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)
As at 31 December 2017	**40 916**	**39 359**	**4 757**	**19 034**	**15 353**	**304**	**119 723**
Provision raised	**41 007**	**44 335**	**11 243**	**2 220**	**14 757**	**2 069**	**115 631**
Reversal of provision	**–**	**(2 578)**	**–**	**–**	**–**	**(505)**	**(3 083)**
Charged to provision	**(25 984)**	**(36 082)**	**(11 166)**	**(3 162)**	**(14 963)**	**(1 275)**	**(92 632)**
As at 31 December 2018	**55 939**	**45 034**	**4 834**	**18 092**	**15 147**	**593**	**139 639**

POST-RETIREMENT MEDICAL BENEFITS

Refer to note 17 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.

17. 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 2018). It is the actuary's opinion that the plan is in a sound financial position.

	GROUP	
	2018 R'000	2017 R'000
The amounts recognised in the statement of financial position are as follows (refer to note 16):		
Present value of total service liabilities	**18 092**	19 034
Liability in the statement of financial position	**18 092**	19 034
The amounts recognised in the statements of comprehensive income are as follows:		
Net interest cost (refer to note 24):	**1 731**	1 805
Staff cost (refer to note 27):	**(1 858)**	(1 865)
Current service cost	**7**	7
Employer benefit payments	**(1 865)**	(1 872)
Total included in comprehensive income	**(127)**	(60)
The amounts recognised in the statements of comprehensive income are as follows:		
Remeasurement of defined benefit obligation	**(815)**	(1 530)
Total included in other comprehensive income	**(815)**	(1 530)
Reconciliation of the movement in the present value of total service liabilities:		
Balance as at the beginning of the year	**19 034**	20 624
Current service cost	**7**	7
Interest costs	**1 731**	1 805
Remeasurement of defined benefit obligation	**(815)**	(1 530)
Employer benefit payments	**(1 865)**	(1 872)
Balance as at the end of the year	**18 092**	19 034
The principal actuarial assumptions used were as follows:		
Discount rate (%)	**9.4**	9.6
Rate of medical inflation (%)	**7.7**	8.5
Salary inflation (%)	**7.2**	8.0

The effect of a 1% increase/decrease on the assumed rate of medical inflation would be an increase in the liability in the amount of R1.736 million (2017: R1.880 million) or a decrease of R1.502 million (2017: R1.615 million), respectively.

18. DEPOSITS

	GROUP	
	2018 R'000	2017 R'000
Call deposits and current accounts	**5 952 493**	5 116 915
Savings accounts	**186 515**	187 990
Term and notice deposits	**3 628 602**	3 419 416
Negotiable certificates of deposit	**–**	23 423
Foreign currency deposits	**649 859**	589 433
	10 417 469	9 337 177
Maturity analysis		
Repayable on demand and maturing within one month	**7 399 109**	6 526 357
Maturing after one month but within six months	**1 386 436**	1 228 886
Maturing after six months but within 12 months	**328 392**	259 686
Maturing after 12 months but within five years	**1 303 532**	1 322 248
	10 417 469	9 337 177

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

19. DEBT SECURITIES

	GROUP	
	2018 R'000	2017 R'000
Unrated class A notes	**352 076**	241 594
	352 076	241 594

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

The notes issued in 2014 of R240 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 maturing on 6 June 2020. In December 2018, an additional R110 million in notes were issued. These notes are also linked to JIBAR with interest repayable quarterly and maturing on 6 December 2021.

20. LONG-TERM FUNDING

	GROUP 2018 R'000	GROUP 2017 R'000
International Finance Corporation (IFC)	**742 880**	90 945
Short-term portion payable in the next 12 months	**–**	90 945
Portion payable after 12 months but within five years	**742 880**	–
Standard Bank of South Africa Limited (Standard Bank)	**141 047**	146 342
Short-term portion payable in the next 12 months	**6 905**	5 331
Portion payable after 12 months but within five years	**134 142**	141 011
Banco Nacional Ultramarino S.A. (BNU Macau)		
Short-term portion payable in the next 12 months	**–**	247 737
Bank One Limited		
Short-term portion payable in the next 12 months	**–**	124 371
	883 927	609 395
Long-term funding before non-cash movements	**884 633**	643 583
(Gain) on exchange rate movement	**(706)**	(34 188)
	883 927	609 395

The loan obtained from the IFC in 2011, with interest linked to JIBAR and repayable quarterly, was repaid between 15 September 2014 and 15 September 2018. In 2018, a R740 million facility from the IFC was utilised, with quarterly interest repayments linked to JIBAR and semi-annual capital repayments due from 15 March 2020 to 15 March 2025.

The loan obtained from Standard Bank, 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 12).

The three-year foreign currency loan of USD20 million obtained from BNU Macau in 2016 was settled in 2018 as there was an option of early settlement.

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

21. SHARE CAPITAL AND SHARE PREMIUM

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
21.1 ISSUED – GROUP AND COMPANY				
As at 31 December 2017 and 31 December 2018	**3 614 018 195**	**36 140**	**1 171 130**	**1 207 270**

21.2 AUTHORISED

The total authorised number of ordinary shares is 4 465 955 440 shares (2017: 4 465 955 440 shares) with a par value of 1 cent.

21.3 UNISSUED

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

21.4 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.

22. CONTINGENT LIABILITIES AND COMMITMENTS

22.1 GUARANTEES, LETTERS OF CREDIT AND COMMITTED UNDRAWN FACILITIES

	GROUP	
	2018 R'000	2017 R'000
Guarantees	**913 723**	583 249
Lending-related	**692**	745
Mortgage	**123 611**	122 206
Performance	**789 420**	460 298
Letters of credit	**8 213**	10 144
Committed undrawn facilities	**279 882**	142 185
	1 201 818	735 578

22.2 COMMITMENTS IN TERMS OF OPERATING LEASES

	GROUP	
	2018 R'000	2017 R'000
The total minimum future lease payments in terms of operating leases are as follows:		
Property rentals		
Due within one year	**6 981**	7 948
Due between one and five years	**6 933**	13 914
	13 914	21 862
After-tax effect on operating leases	**10 018**	15 741

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.

23. INTEREST INCOME

	GROUP		COMPANY	
	2018 R'000	2017 R'000	2018 R'000	2017 R'000
Amortised cost	**1 237 441**	1 125 838	**32**	39
Cash and cash equivalents	**103 850**	100 516	**32**	39
Negotiable securities	**67 036**	27 660	**–**	–
Loans and advances	**1 066 555**	997 662	**–**	–
Loans and receivables designated as available-for-sale				
Negotiable securities	*	2 430	**–**	–
Loans and receivables designated as held-to-maturity				
Negotiable securities	*	10 825	**–**	–
	1 237 441	1 139 093	**32**	39

** Change in classification as a result of IFRS 9 implementation.*

24. INTEREST EXPENSE

	GROUP	
	2018 R'000	2017 R'000
Deposits	**536 933**	494 697
Debt securities	**22 710**	23 335
Long-term funding	**87 946**	86 164
Net interest on defined benefit obligation	**1 731**	1 805
Other	**1 176**	1 299
	650 496	607 300

25. NON-INTEREST INCOME

	GROUP		COMPANY	
	2018 R'000	2017 R'000	**2018 R'000**	2017 R'000
Fee and commission income				
Loans and receivables	**534 369**	412 078	**–**	–
Trading income				
Fair value through profit or loss				
Foreign currency	**263 201**	*	**–**	–
Held-for-trading				
Foreign currency	*****	222 536	**–**	–
Investment income				
Dividends	**–**	–	**42 458**	35 226
	797 570	634 614	**42 458**	35 226

** Change in classification as a result of IFRS 9 implementation.*

26. FEE AND COMMISSION EXPENDITURE

	GROUP	
	2018 R'000	2017 R'000
Relating to non-interest income earned from:		
Foreign currency	**181 021**	142 169
Fees and commissions	**233 288**	156 843
	414 309	299 012

27. OPERATING EXPENDITURE

	GROUP		COMPANY	
	2018 R'000	2017 R'000	**2018 R'000**	2017 R'000
Amortisation (refer to note 13)	**53 581**	48 562	**–**	–
Auditor's remuneration				
Audit fees – Current year	**11 193**	8 680	**–**	–
Fees for other services – Tax advisory fees	**210**	324	**–**	–
– Regulatory reviews	**(5)**	75	**–**	–
– Securitisation vehicle reviews	**45**	195	**–**	–
– *Less:* Securitisation vehicle reviews expenditure capitalised	**(45)**	(195)	**–**	–
	11 398	9 079	**–**	–
Depreciation (refer to note 12)	**18 988**	19 937	**–**	–
Directors' remuneration (refer to note 30.3)				
Executive Directors	**17 031**	17 947	**–**	–
Non-Executive Directors' fees	**4 718**	4 484	**–**	–
	21 749	22 431	**–**	–
Indirect tax				
Non-claimable value added tax	**15 184**	16 627	**–**	–
Skills development levy	**2 718**	2 448	**–**	–
	17 902	19 075	**–**	–
(Profit)/Loss on sale of intangible assets and property and equipment	**(9)**	42	**–**	–
Marketing	**10 270**	9 090	**253**	150
Operating leases for premises and other related costs	**16 470**	16 035	**–**	–
Other operating costs	**55 439**	48 521	**–**	–
Professional fees				
Consulting	**2 001**	2 733	**–**	–
Legal and collection	**5 069**	4 492	**–**	–
Computer consulting and services	**57 270**	51 495	**–**	–
	64 340	58 720	**–**	–
Staff costs				
Salaries, allowances and incentives	**260 621**	249 256	**–**	–
Post-retirement medical benefits (refer to notes 16 and 17)	**(1 858)**	(1 865)	**–**	–
Deferred bonus scheme	**41 007**	29 786	**–**	–
Other	**7 127**	5 507	**–**	–
	306 897	282 684	**–**	–
Total operating expenditure	**577 025**	534 176	**253**	150
Number of persons employed by the Group at year-end	**510**	502	**–**	–

28. TAX

	GROUP 2018 R'000	GROUP 2017 R'000	COMPANY 2018 R'000	COMPANY 2017 R'000
South African normal tax	**110 332**	90 910	**–**	–
Current year	**109 749**	90 910	**–**	–
Prior year	**583**	–	**–**	–
Deferred tax	**(14 182)**	(10 567)	**–**	–
Current year	**(12 981)**	(11 064)	**–**	–
Prior year	**(1 201)**	497	**–**	–
	96 150	80 343	**–**	–
Direct tax				
South African normal tax	**110 332**	90 910	**–**	–
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 (%)	**0.02**	0.04	**–**	–
Capital gain inclusion on unrealised portion not taxable (%)	**0.63**	0.41	**–**	–
Overprovision prior years (%)	**(0.06)**	(0.17)	**–**	–
Tax losses (%)	**(0.77)**	(0.87)	**0.09**	0.10
Effective tax rate (%)	**27.82**	27.41	**–**	–
Estimated tax losses available for offset against future taxable income	**7 319**	6 987	**7 319**	6 987

29. NOTES TO STATEMENTS OF CASH FLOWS

	GROUP 2018 R'000	GROUP 2017 R'000	COMPANY 2018 R'000	COMPANY 2017 R'000
29.1 CASH RECEIPTS FROM CLIENTS				
Interest income	**1 237 441**	1 139 093	**32**	39
Non-interest income	**797 570**	634 614	**42 458**	35 226
Adjusted for: Dividends received	**–**	–	**(42 458)**	(35 226)
Revaluation of fair value financial instruments	**(26 494)**	9 739	**–**	–
Recoveries in respect of amounts previously written off	**2 605**	3 764	**–**	–
	2 011 122	1 787 210	**32**	39
29.2 CASH PAID TO CLIENTS, SUPPLIERS AND EMPLOYEES				
Interest expense	**(650 496)**	(607 300)	**–**	–
Operating expenditure and fee and commission expenditure	**(991 334)**	(833 188)	**(253)**	(150)
Adjusted for: Amortisation	**53 581**	48 562	**–**	–
Depreciation	**25 528**	23 543	**–**	–
Write-off of obsolete intangible asset and property and equipment	**41**	244	**–**	–
(Profit)/Loss on sale of intangible assets and property and equipment	**(9)**	42	**–**	–
Deferred bonus scheme expense	**41 007**	29 786	**–**	–
(Decrease) in provisions and other liabilities	**(21 091)**	(4 135)	**–**	–
	(1 542 773)	(1 342 446)	**(253)**	(150)

29. NOTES TO STATEMENTS OF CASH FLOWS continued

	GROUP		COMPANY	
	2018 R'000	2017 R'000	**2018 R'000**	2017 R'000
29.3 RECONCILIATION OF PROFIT BEFORE TAX TO CASH GENERATED FROM OPERATIONS				
Profit before tax	**345 579**	293 085	**42 237**	35 115
Profit before tax adjusted for:				
Dividends received	**–**	–	**(42 458)**	(35 226)
Revaluation of fair value financial instruments	**(26 494)**	9 739	**–**	–
Net impairments raised	**50 207**	43 898	**–**	–
Amortisation	**53 581**	48 562	**–**	–
Depreciation	**25 528**	23 543	**–**	–
Write-off of obsolete intangible asset and property and equipment	**41**	244	**–**	–
(Profit)/Loss on sale of intangible assets and property and equipment	**(9)**	42	**–**	–
Deferred bonus scheme expense	**41 007**	29 786	**–**	–
(Decrease) in provisions and other liabilities	**(21 091)**	(4 135)	**–**	–
Cash generated from operations	**468 349**	444 764	**(221)**	(111)
29.4 TAX				
Amounts paid at the beginning of the year	**(6 248)**	(6 643)	**–**	–
Statement of comprehensive income (charge)	**(110 332)**	(90 910)	**–**	–
Less: Amounts owing at the end of the year	**5 716**	6 248	**–**	–
Total tax (paid)	**(110 864)**	(91 305)	**–**	–
29.5 NET MOVEMENT IN INCOME-EARNING ASSETS				
Decrease/(Increase) in negotiable securities	**113 340**	(393 949)	**–**	–
(Increase) in loans and advances	**(516 757)**	(846 407)	**–**	–
Net (increase) in income-earning assets	**(403 417)**	(1 240 356)	**–**	–
29.6 NET MOVEMENT IN DEPOSITS, OTHER ACCOUNTS RECEIVABLE AND PAYABLE				
Increase in deposits	**1 080 292**	864 143	**–**	–
Decrease in subsidiary loans	**–**	–	**–**	53
Decrease/(Increase) in other accounts receivable	**166 275**	(380 687)	**–**	–
(Decrease)/Increase in other accounts payable	**(70 524)**	204 389	**(117)**	83
Net increase in deposits and other accounts	**1 176 043**	687 845	**(117)**	136

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 2 and 89. 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 been entered into.

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	
		2018 R'000	2017 R'000
Balances between CGD and the Bank:			
Legal entity	**Nature of account**		
CGD – Lisbon (Branch of CGD)	Nostro accounts	**173 509**	25 120
Total assets		**173 509**	25 120
CGD – Lisbon (Branch of CGD)	Vostro accounts	**(6 498)**	(1 575)
CGD – Paris (Branch of CGD)	Vostro accounts	**–**	(2)
Banco Comercial e de Investimentos – Mozambique (BCI) (Subsidiary of CGD)		**(820)**	(95 302)
	Fixed deposits	**–**	(40 000)
	Call and notice deposits	**(820)**	(55 302)
Banco Caixa Geral Angola SA (BCGA) (Subsidiary of CGD)	Call deposit	**(10 144)**	(1 737)
Banco Nacional Ultramarino S.A. (BNU Macau) (Subsidiary of CGD)	Long-term funding	**–**	(247 737)
Total liabilities		**(17 462)**	(346 353)
Net assets/(liabilities) – CGD		**156 047**	(321 233)
Transactions between CGD and the Bank:			
Interest paid by the Bank to CGD – Lisbon		**–**	1 912
Interest paid by the Bank to BCI		**13 674**	4 646
Interest paid by the Bank to BCGA		**85**	123
Interest paid by the Bank to BNU Macau		**5 448**	14 357
Interest received by the Bank from CGD – Lisbon		**219**	144
Dividends paid by Mercantile Bank Holdings Limited to CGD – Lisbon		**42 458**	35 226
Fees received by the Bank from BCGA		**99**	97

30. RELATED PARTY INFORMATION continued

30.2 RELATED PARTY BALANCES AND TRANSACTIONS continued

		GROUP 2018 R'000	GROUP 2017 R'000
Balances with the Company, its subsidiaries and joint venture:			
Loan to:	**Loan from:**		
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown Proprietary Limited	**–**	66 952
Mercantile Insurance Brokers Proprietary Limited	Mercantile Bank Limited	**111**	111
Mercantile Rental Finance Proprietary Limited	Mercantile Bank Limited	**364 967**	483 230
Mercantile Payment Solutions Proprietary Limited	Mercantile Bank Limited	**3 377**	2 971
Compass Securitisation (RF) Limited	Mercantile Rental Finance Proprietary Limited	**839**	574
Grant Electronics Close Corporation	Mercantile Bank Limited	**2 076**	–
Mercantile Payment Solutions Proprietary Limited	Grant Electronics Close Corporation	**436**	1 867
Other accounts receivable:	**Other accounts payable:**		
Portion 2 of Lot 8 Sandown Proprietary Limited	Mercantile Rental Finance Proprietary Limited	**27**	25
Mercantile Bank Limited	Mercantile Rental Finance Proprietary Limited	**7 869**	–
Debt securities issued by:	**Invested in debt securities by:**		
Compass Securitisation (RF) Limited	Mercantile Bank Limited	**151 629**	104 220
Deposit with:	**Deposit by:**		
Mercantile Bank Limited	Mercantile Insurance Brokers Proprietary Limited	**485**	485
Mercantile Bank Limited	Mercantile Bank Holdings Limited	**3 821**	4 159
Mercantile Bank Limited	Mercantile Payment Solutions Proprietary Limited	**–**	140
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown Proprietary Limited	**69 462**	–
Mercantile Bank Limited	The Mercantile Bank Foundation (NPC)	**41**	41

30. RELATED PARTY INFORMATION continued

30.2 RELATED PARTY BALANCES AND TRANSACTIONS continued

		GROUP	
		2018 R'000	2017 R'000
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	**2 540**	2 618
Mercantile Bank Limited	Mercantile Rental Finance Proprietary Limited	**37 317**	43 265
Mercantile Rental Finance Proprietary Limited	Compass Securitisation (RF) Limited	**–**	7 465
Mercantile Bank Limited	Compass Securitisation (RF) Limited	**17 447**	9 838
Non-interest income earned by:	**Operating expenditure paid by:**		
Portion 2 of Lot 8 Sandown Proprietary Limited	Mercantile Bank Limited	**25 056**	23 311
Mercantile Bank Limited	Mercantile Rental Finance Proprietary Limited	**484**	736
Mercantile Bank Limited	Mercantile Payment Solutions Proprietary Limited	**98 213**	67 328
Grant Electronics Close Corporation	Mercantile Payment Solutions Proprietary Limited	**20 068**	15 935
Mercantile Rental Finance Proprietary Limited	Compass Securitisation (RF) Limited	**7 161**	6 831
Portion 2 of Lot 8 Sandown Proprietary Limited	Mercantile Rental Finance Proprietary Limited	**283**	263
Donations received by:	**Donations paid by:**		
The Mercantile Bank Foundation (NPC)	Mercantile Bank Limited	**1 158**	915
Dividends earned by:	**Dividends paid by:**		
Mercantile Bank Holdings Limited	Mercantile Bank Limited	**42 458**	35 226
Sale of rental finance assets by:	**Purchase of rental finance assets by:**		
Mercantile Rental Finance Proprietary Limited	Compass Securitisation (RF) Limited	**304 677**	148 867
Mercantile Rental Finance Proprietary Limited	Mercantile Bank Limited	**199 915**	–

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 12).

Other

Post-retirement medical plan

Details of the post-retirement medical plan are disclosed in note 17.

30. RELATED PARTY INFORMATION continued

30.3 DIRECTOR AND DIRECTOR-RELATED ACTIVITIES

There were no material transactions with the Directors, other than the following:

	GROUP						
	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
2018							
Non-Executive Directors							
RS Caliço *(appointed 18 June 2018)*^	–	–	–	–	–	–	–
GP de Kock	**1 282**	–	–	–	–	–	**1 282**
L Hyne	**880**	–	–	–	–	–	**880**
AT Ikalafeng	**745**	–	–	–	–	–	**745**
DR Motsepe	**838**	–	–	–	–	–	**838**
TH Njikizana	**973**	–	–	–	–	–	**973**
Executive Directors							
RS Caliço *(resigned 16 June 2018)*	–	**1 570**	–	**296**	–	–	**1 866**
KR Kumbier	–	**4 052**	**3 034**	–	**693**	**4 791**	**12 570**
MEL Teixeira *(appointed 15 June 2018)*	–	**1 402**	–	–	**197**	**996**	**2 595**
	4 718	**7 024**	**3 034**	**296**	**890**	**5 787**	**21 749**
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

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

^ *In line with CGD policy, an employee of CGD will not be paid a fee for holding a directorship on the board of a subsidiary of CGD. Accordingly, Mr Caliço did not receive a fee for his role as Non-Executive Director of the Mercantile Board.*

30. RELATED PARTY INFORMATION continued

30.3 DIRECTOR AND DIRECTOR-RELATED ACTIVITIES continued

	GROUP	
	2018 R'000	**2017 R'000**
Balances with/(from) key management personnel (Board of Directors)		
Loans and advances	**25**	34
Committed undrawn facilities	**5 402**	5 431
Deposits	**(8 093)**	(10 870)
Amounts paid by CGD to Executive Directors	**439**	1 055

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 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 was seconded to Mercantile by CGD in July 2014 as Executive Director and Mr Caliço was appointed Deputy CEO of the Group from July 2015. Mr Caliço stepped down as Deputy CEO on 16 June 2018. He remains in service to CGD and continues to serve Mercantile as a Non-Executive Director, effective 18 June 2018.

MEL Teixeira, FD

Ms Teixeira joined Mercantile in January 2006 and was promoted to Chief Financial Officer in April 2013. On 15 June 2018, Ms Teixeira was appointed FD of the Group. In terms of her service agreement, Ms Teixeira has agreed to perform such duties, functions and services as are assigned to her from time to time by the Board of Directors and which are consistent and commensurate with her position as FD.

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

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 the statement of comprehensive income 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 cash flow 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 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 R49.886 million, which was approved by the Board on 27 February 2019. During March 2017, CGD announced its intention to sell Mercantile. On 22 November 2018, the Portuguese government approved the resolution selecting the proposal of Capitec Bank Limited, to acquire 100% of the share capital of Mercantile. As at 31 December 2018, the sale of Mercantile was still in progress pending regulatory approvals. The Shares Purchase and Sale Agreement was signed on 23 January 2019. No other material events 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. Risk management is a key focus of the Group and addresses a wide spectrum of risks that are continually evaluated. 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; 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 to the Risk Tolerance Framework as approved by the Board and incorporated into the Group's ICAAP;
- Further 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 comprehensive new impairment models, which are aligned to the requirements stipulated in IFRS 9 (effective 1 January 2018). Further enhancements to these models are planned for 2019;
- Business continuity management continues to be an area of focus;
- Enhancements to risk reporting, automation of selected regulatory reporting, and the introduction of additional stress testing;
- Continual enhancement and expansion of the prudential management schedule, wherein risk-related ratios are monitored and reported monthly to the ALCO and Board;
- Review of the application of the Principles for Sound Liquidity Risk Management and Supervision and applying conservative liquidity buffers;
- Enhanced liquidity evaluation, monitoring and management – specifically during the Group's sale process;
- Review of the application of the Principles for the Sound Management of Operational Risk;
- Various projects were undertaken during the current year by the Operational Risk team to improve efficiencies and mitigate risk; and
- Continuous improvement regarding cyber security and the implementation of artificial intelligence/machine learning technologies in the threat intelligence space. Completion of associated action plans is monitored by the Information Security Steering Committee.

ENTERPRISE-WIDE RISK MANAGEMENT

An Enterprise-wide Risk Management Framework is adopted to ensure appropriate and focused management of all risks. Risk assessment is a dynamic process and is reviewed regularly in line with changing circumstances. Risk dimensions vary in importance, depending upon the business activities of the organisation and related risks. The overall objective of enterprise-wide risk management is to ensure an integrated and effective risk management framework, wherein 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, Senior Management, Risk, 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 AND 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 pre-defined 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. 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 and will remain a focus area during 2019.

CREDIT RISK

Credit risk is the risk of suffering a financial loss, should any of the Group's clients or market counterparties fail to fulfil their contractual obligations to the Group. Credit risk is a significant risk for the Group and management carefully manages its exposure to credit risk. Credit risk management and control are centralised in a credit risk management team, which reports regularly to the Board of Directors.

The Group offers a spread of banking products common to the banking industry. The core market focus is established small to medium-sized businesses and commercial companies across a wide variety of industries, as well as private banking to the respective entrepreneurs. A Group subsidiary, Mercantile Rental Finance, provides rental finance solutions with its core focus being the office automation, telecommunications and information technology sectors.

The Group's Credit Risk Strategy, which is contained within our Group Risk and Credit Risk policy manuals, is approved by the Group's CREDCOM and ratified by RMC. Credit parameters and risk appetite levels are clearly defined and reflected in governing procedures and policies, which are reassessed from time to time to ensure relevance and competitiveness. 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.

Dependent on the risk profile of the client across all portfolios or market segments, the risk inherent in the product offering and the track record and 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 certain segments and 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 and 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 Group does not lend to foreign-registered companies but does provide banking to several locally-registered companies that have foreign shareholding.

Monthly reporting to ALCO includes reporting on large exposures. A portfolio analysis report is also prepared monthly and quarterly and presented to the RMC analysing the performance and composure of the portfolio 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 automated on the Bank's workflow system. Levels of credit approval mandates are determined by the experience of the mandated individual, with dual or multiple sign-off on all material values. Mandates have also been accorded to frontline management within predetermined rules and parameters as approved by RMC, which approvals are evaluated and monitored by Credit on an ongoing basis.

An ongoing weekly review is 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, including reporting on excess and arrear positions, security-related matters, possible changes in risk grades, the Bank's advances portfolio composure and performance, and any other relevant credit-related matters requiring specific mention or discussion. Adverse behavioural patterns, such as continual excesses above approved limits and arrears on loan facilities, are monitored closely by the Credit Department and are 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 monthly 'Watch List' reporting. Fortnightly collection meetings are held and non-performing exposures are interrogated and monitored. To protect the Group, prompt action is taken by senior internal stakeholders, including the CEO, on large defaults. This action has seen a good measure of historical success given our flat structure that drives agility.

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 desirable.

The following is highlighted for the year under review:

- 2018 saw the ongoing recruitment of skilled staff and focused development of existing staff to continue a culture of learning and development;
- The benefits stemming from the prior year's departmental restructure, based on the market segments served, proved beneficial with efforts ongoing to further identify risk and enhance client service;
- Enhanced focus and continuous improvement of the Group's workflow system deployed within the Credit Origination and Assessment areas (with continued enhancements anticipated);
- Continued inroads have been made regarding the review of large exposure or high risk security profiles and related risks;
- The previously-established Credit Legal and Compliance area continues to enhance supervision and monitoring of covenants within the area, particularly in respect of larger exposures;
- Credit mandates were amended along with various other initiatives to build capacity and drive efficiencies, as well as to drive an improved client experience. These amendments were considered in line with staff competence and tenure within the role;
- The year under review has seen the start of a project aimed at automating credit decision-making in the lower end of the business banking segment, where the deal values are low and the volumes are high. We will continue driving this journey and will ensure comprehensive analysis and testing before eventual adoption and roll-out;
- A decision-support model was introduced to Mercantile Rental Finance with full implementation anticipated in 2019, subject to project objectives and testing being achieved; and
- The newly-established IFRS 9 impairment model was implemented with ongoing refinement undertaken as the year progressed.

CREDIT RISK MEASUREMENT

LOANS AND ADVANCES (INCLUDING LOAN COMMITMENTS AND GUARANTEES)

The estimation of credit exposure for risk management purposes is complex and requires the use of models, as the exposure varies with changes in market conditions, expected cash flows and time value of money. The assessment of credit risk of a portfolio of assets entails further estimations regarding the likelihood of defaults occurring in the associated loss ratios and of default correlations between counterparties. The Group measures credit risk using PD, EAD and LGD.

CREDIT RISK GRADING

The Group uses internal credit risk grading's that reflect its assessment of the PD of individual counterparties. The Group's rating method comprises of two main rating levels for instruments not in default (1 and 2) and three main default classes (3 to 5). The credit grades are calibrated such that the risk of default increases exponentially at each higher risk grade.

The following data is typically used to monitor the Group's exposures:

- Payment record, including payment ratios and ageing analysis;
- Extent of utilisation of granted limit;
- Forbearances (both requested and granted);
- Changes in business, financial and economic conditions;
- Credit rating information supplied by external rating agencies (limited use hereof); and
- Information obtained by periodic review of client files, including audited annual financial statements review and market data, such as changes in the financial sector the client operates, etc.

The table below provides a mapping of the Group's internal credit risk grades to external ratings.

Group's credit risk grade	Description
1	Low to fair risk
2	Increased credit risk
3	Monitoring
4	Doubtful
5	Impaired

SICR

The Group monitors all financial assets, issued loan commitments and financial guarantee contracts that are subject to impairment requirements to assess whether there has been a SICR since initial recognition. If there has been a SICR the Group will measure the loss allowance based on lifetime rather than 12-month ECL.

The Group considers a financial instrument to have experienced a SICR if the borrower is on the watch list and/or meets at least one of the following criteria:

- Significant adverse changes in business, financial and/or economic conditions in which the borrower operates;
- Actual or expected forbearance or restructuring;
- Actual or expected significant adverse change in operating results of the borrower;
- Significant change in collateral value which is expected to increase the risk of default; or
- Early signs of cash flow or liquidity problems such as delay in servicing of trade creditors and loans.

A backstop is applied and the financial instrument is considered to have experienced a SICR if the borrower is more than 30 days past due on contractual payments.

The Group has not applied the low credit risk exemption for any financial instruments in the year ended 31 December 2018.

DEFINITION OF DEFAULT AND CREDIT-IMPAIRMENT ASSETS

Critical to the determination of ECL is the definition of default. The definition of default is used in measuring the amount of ECL and in the determination of whether the loss allowance is based on 12-month or lifetime ECL, as default is a component of the PD which affects the measurement of ECL.

The Group defines a financial instrument as being in default, which is fully aligned with the definition of credit impaired, when it meets at least one of the following criteria:

QUANTITATIVE CRITERIA

The borrower is more than 90 days past due on its contractual payments.

QUALITATIVE CRITERIA

The borrower meets unlikeliness to pay criteria, which indicates the borrower is in significant financial difficulty. These are instances where, *inter alia:*

- The borrower is in long-term forbearance;
- The borrower is deceased and collectability is questionable or unknown;
- The borrower is insolvent;
- The borrower remains in unauthorised breach of financial covenant(s) that might have a negative impact on recoverability;
- An active market for the financial assets has disappeared because of financial difficulties;
- Concessions have been made by the lender relating to the borrower's financial difficulty or inability to meet contractual obligations (distressed restructure) and the borrower remains in breach of conceded terms; or
- It is becoming probable that the borrower may enter bankruptcy.

The criteria above have been applied to all financial instruments held by the Group and are consistent with the definition of default used for internal credit risk management purposes. The default definition has been applied consistently to the PD, EAD, and LGD throughout the Group's expected loss calculations.

An instrument is considered to no longer be in default (i.e. to have cured) when it no longer meets any of the default criteria for a period of six consecutive months. This period of six months has been determined based on an analysis that considers the likelihood of a financial instrument returning to default status after cure using different possible cure definitions and it is aligned with regulatory requirements.

ECL STAGE DETERMINATION

IFRS 9 outlines a 'three-stage' model for impairment based on changes in credit quality since initial recognition as summarised below:

- A financial instrument that is not credit-impaired on initial recognition is classified as 'Stage 1' and has its credit risk continuously measured by the Group. Financial instruments in Stage 1 have their ECL measured at an amount equal to the portion of lifetime ECL that result from default events possible within the next 12 months.
- If a SICR since initial recognition is identified, the financial instrument is moved to 'Stage 2' but is not yet deemed to be credit-impaired.
- If the financial instrument is credit-impaired, the financial instrument is then moved to 'Stage 3'.
- Instruments in Stage 2 or 3 have their ECL measured based on ECL on a lifetime basis.

MEASURING ECL – EXPLANATION OF INPUTS, ASSUMPTIONS AND ESTIMATION TECHNIQUES

The ECL is measured on either a 12-month (12M) or lifetime basis depending on whether a SICR has occurred since initial recognition or whether an asset is considered to be credit-impaired. A pervasive concept in measuring ECL in accordance with IFRS 9 is that the measurement should consider forward-looking information. ECL are the discounted product of the PD, EAD, and LGD, defined as follows:

- The PD represents the likelihood of a borrower defaulting on its financial obligation (as per 'Definition of default and credit-impaired' above), either over the next 12 months (12M PD), or over the remaining lifetime (lifetime PD) of the obligation. The calculation is based on a hybrid Markov chain model.
- EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities over the next 12 months (12M EAD) or over the remaining lifetime (lifetime EAD). The Group's modelling approach for EAD reflects expected changes in the balance outstanding over the lifetime of the loan exposure that are permitted by the current contractual terms, such as amortisation profiles, changes in utilisation of undrawn commitments and credit mitigation actions taken before default.
- LGD is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the Group expects to receive, taking into account cash flows from any collateral. The LGD models for secured assets consider forecasts of future collateral valuation taking into account sale discounts, time to realisation of collateral, cross-collateralisation, seniority of claim, cost of realisation of collateral and cure rates (i.e. exit from non-performing status). LGD models for unsecured assets consider time of recovery, recovery rates and seniority of claims. The calculation is on a discounted cash flow basis, where the cash flows are discounted by the original effective interest rate of the loan.

The ECL is determined by projecting the PD, LGD and EAD for each future month and for each individual exposure. These three components are multiplied and adjusted for the likelihood of survival (i.e. the exposure has not prepaid or defaulted in an earlier month). This effectively calculates an ECL for each future month, which is then discounted to the reporting date. The discount rate used in the ECL calculation is the original effective interest rate or an approximation thereof.

The lifetime PD is developed by applying a maturity profile to the current 12-month PD. The maturity profile looks at how defaults develop on a portfolio from the point of initial recognition throughout the lifetime of the loans. The maturity profile is based on historical observed data and is assumed to be the same across all assets within a portfolio and credit grade band. This is supported by historical analysis.

The 12-month and lifetime EADs are determined based on the expected payment profile, which varies by product type.

- For amortising products and bullet repayment loans, this is based on the contractual repayments owed by the borrower over a 12 month or lifetime basis; and
- For revolving products, the EAD is predicted by adding a 'credit conversion factor' to the current drawn balance, which allows for the expected drawdown of the remaining limit by the time of default.

The 12-month and lifetime LGDs are determined based on the factors that impact the recoveries made post-default.

- For secured products, this is primarily based on collateral type, projected collateral values and time to recovery.
- For unsecured products, LGD's are typically set at product level due to the limited differentiation in recoveries achieved across different borrowers.

The assumptions underlying the ECL calculation such as how the maturity profile of the PDs change, etc. are monitored and reviewed periodically. There have been no significant changes in estimation techniques or significant assumptions made during the reporting period.

FORWARD-LOOKING INFORMATION INCORPORATED INTO THE ECL MODELS

The Group performed a statistical analysis of the correlation between the default rates and various macro-economic factors and indices thereof. A full statistical model concluded that it would not be appropriate to incorporate macro-economic forecasts into the determination of the ECL without incurring significant expenses due to the lack of adequate correlation in the performance of the Group's loans and advances relative to macro-economic indicators or an index of these indicators. The Group will continue to monitor these correlations and will incorporate forward-looking information into the ECL model once more information is included in the observation period to take cognisance of economic cycles and the relative impact they have on the performance of the Group's loans and advances.

The current risk assessment framework includes stringent credit risk assessments that are performed during the lifetime of the exposures and it is believed that these will incorporate enough forward-looking assessment. Additional ECL are recognised by way of a management overlay after significant expert consultation with executive management and seasoned credit professionals.

CREDIT RISK EXPOSURE

MAXIMUM EXPOSURE TO CREDIT RISK – FINANCIAL INSTRUMENTS SUBJECT TO IMPAIRMENT

The following table contains an analysis of the credit risk exposure of financial instruments for which an ECL allowance is recognised. The gross carrying amount of financial assets below also represents the Group's maximum exposure to credit risk on these assets.

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2018				
Current accounts	**1 871 827**	**–**	**–**	**1 871 827**
Credit cards	**44 012**	**94 475**	**–**	**138 487**
Mortgage loans	**4 991 393**	**185 407**	**–**	**5 176 800**
Instalment sales and leases	**1 863 086**	**–**	**–**	**1 863 086**
Structured loans	**134 126**	**–**	**–**	**134 126**
Medium-term loans	**1 179 997**	**–**	**–**	**1 179 997**
Negotiable securities	**–**	**–**	**790 810**	**790 810**
Cash and cash equivalents	**–**	**–**	**3 178 571**	**3 178 571**
Guarantees	**–**	**–**	**913 723**	**913 723**
Letters of credit	**–**	**–**	**8 213**	**8 213**
	10 084 441	**279 882**	**4 891 317**	**15 255 640**
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

COLLATERAL AND OTHER CREDIT ENHANCEMENTS

The Group employs a range of policies and practices to mitigate credit risk. The most common of these is accepting collateral for funds advanced. The Group has internal policies on the acceptability of specific classes of collateral or credit risk mitigation. The Group prepares a valuation of the collateral obtained as part of the loan origination process and this assessment is reviewed periodically. The principal collateral types for loans and advances are:

- Mortgages over residential properties;
- Charges over business assets, such as premises, inventory and accounts receivable; and
- Charges over financial instruments, such as debt securities.

Longer-term finance and lending to corporate entities are generally secured; while credit card facilities are generally unsecured. The Group's policies regarding obtaining collateral have not significantly changed during the reporting period and there has been no significant change in the overall quality of the collateral held by the Group since the prior period.

A portion of the Group's financial assets originated by the mortgage business has sufficiently low loan-to-value ratios, which results in no loss allowance being recognised in accordance with the Group's ECL model.

The Group closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Group will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held to mitigate potential losses are detailed in note 6.11 of the notes to the annual financial statements.

LOSS ALLOWANCE

The loss allowance recognised in the period could be impacted by a variety of factors, as described below:

- Transfers between Stage 1 and Stages 2 or 3 due to financial instruments experiencing significant increases (or decreases) of credit risk or becoming credit-impaired in the period, and the consequent step up (or step down) between 12-month and Lifetime ECL;
- Additional allowances for new financial instruments recognised during the period, releases for financial instruments derecognised in the period and write-offs of allowances related to assets that were written off during the period;
- Impact on the measurement of ECL due to changes in PDs, EADs and LGDs in the period, arising from regular refreshing of inputs to models;
- Impacts on the measurement of ECL due to changes made to models and assumptions (not applicable during 2018); and
- Discount unwind within ECL due to the passage of time, as ECL is measured on a present value basis.

The changes in the loss allowance between the beginning and the end of the financial period due to these factors are detailed in note 6.5 of the notes to the annual financial statements.

MODIFICATION OF FINANCIAL ASSETS

The Group sometimes modifies the terms of loans provided to clients due to commercial renegotiations or for distressed loans to ensure maximum recovery.

Such restructuring activities include extended payment term arrangements and payment holidays. Restructuring policies and practices are based on indicators or criteria which, in the judgement of management, indicate that payment will most likely continue. These policies are kept under continuous review. Restructuring is most commonly applied to term loans.

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset. The Group may determine that the credit risk has significantly improved after restructuring, so that the assets are moved from Stage 3 or Stage 2 (Lifetime ECL) to Stage 1 (12-month ECL). This is only the case for assets that have performed in accordance with the new terms for six consecutive months or more.

WRITE-OFF POLICY

Loans and debt securities are written off when the Group has no reasonable expectations of recovering the financial asset (either in its entirety or a portion of it). This is the case when the Group determines that the borrower does not have assets or sources of income that could generate enough cash flows to repay the amounts subject to the write-off. A write-off constitutes a derecognition event. The Group may apply enforcement activities to financial assets written off. Recoveries resulting from the Group's enforcement activities will result in impairment gains.

PRESENTATION OF ALLOWANCE FOR ECL IN THE STATEMENT OF FINANCIAL POSITION

Loss allowances for ECL are presented in the statement of financial position as follows:

- For financial assets measured at amortised cost: as a deduction from the gross carrying amount of the assets; and
- The Group presents a combined loss allowance for both components where a financial instrument includes both a drawn and an undrawn component and the Group cannot identify the ECL on the loan commitment component separately from those on the drawn component. The combined amount is presented as a deduction from the gross carrying amount of the drawn component.

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 status quo regarding 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 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;
- Review and amendment of appropriate risk mitigation actions in line with the Group's risk appetite and tolerances 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 programme;

- 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;
- Embarking 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
- Managing 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 regarding 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 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 Information Security Management 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 client security programme;
- Relocation of the Group's data centre;
- Improvement in security alert management, using cases built in the security information and event management (SIEM) system;
- Increased reporting of incidents via the centralised cyber security inbox;
- Comprehensive insider threat assessment;
- Reimplementation of vulnerability scanning tools and broadened scope to include all technology assets;
- Implementation of SNODE technologies as a threat intelligence and analysis tool. Exceptions are monitored by SNODE's Security Operations Centre;
- Deployed two-factor authentication for user workstation access;
- Implemented a workflow system for Change Management, on-boarding and off-boarding of staff and procurement of IT assets;
- Segmented Information Technology work area into an isolated secure network;
- Redefined Group Policy Objects against Centre for Internet Security benchmarks and controls; and
- Successfully completed multiple disaster recovery and business continuity tests.

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 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.

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 99 to 103).

There has been no significant change to the Group's exposure to market risks or the way it manages and measures these risks. 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 the 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 R18.2 million (2017: R14.0 million). An adverse movement in the exchange rate of 10% would reduce the Group's income by R1.8 million (2017: 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
2018					
Total foreign exchange assets	**606 246**	**110 126**	**69 526**	**26 055**	**811 953**
Total foreign exchange liabilities	**(483 600)**	**(91 035)**	**(51 018)**	**(24 983)**	**(650 636)**
Commitments to purchase foreign currency	**582 286**	**156 522**	**29 283**	**28 987**	**797 078**
Commitments to sell foreign currency	**(696 194)**	**(173 122)**	**(46 328)**	**(28 417)**	**(944 061)**
Year-end effective net open foreign currency positions	**8 738**	**2 491**	**1 463**	**1 642**	**14 334**
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

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 or 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 R11.5 million or decrease by R18.5 million, respectively (2017: increase/decrease by R8.8 million/R15.5 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 %
2018							
ASSETS							
Cash and cash equivalents	2 084 470	–	–	–	1 094 101	3 178 571	5.6
Derivative financial instruments	–	–	–	–	17 903	17 903	–
Negotiable securities	149 668	341 074	274 279	25 801	(12)	790 810	9.4
Loans and advances	10 084 413	–	–	–	(205 298)	9 879 115	11.0
Other investments	–	–	–	–	8 078	8 078	–
Other accounts receivable	–	–	–	–	523 413	523 413	–
Non-current assets held-for-sale	–	–	–	–	22 500	22 500	–
Current tax receivable	–	–	–	–	–	–	–
Property and equipment	–	–	–	–	256 226	256 226	–
Intangible assets	–	–	–	–	128 917	128 917	–
Deferred tax assets	–	–	–	–	42 434	42 434	–
Total assets	12 318 551	341 074	274 279	25 801	1 888 262	14 847 967	
EQUITY AND LIABILITIES							
Other accounts payable	–	–	–	–	440 847	440 847	–
Derivative financial instruments	–	–	–	–	15 437	15 437	–
Current tax payable	–	–	–	–	5 716	5 716	–
Provisions and other liabilities	–	–	–	–	139 639	139 639	–
Deposits	7 592 524	237 036	519 699	62 268	2 005 942	10 417 469	5.7
Debt securities	–	352 076	–	–	–	352 076	8.9
Long-term funding	141 047	742 880	–	–	–	883 927	10.6
Deferred tax liabilities	–	–	–	–	68 272	68 272	–
Total equity	–	–	–	–	2 524 584	2 524 584	–
Total equity and liabilities	7 733 571	1 331 992	519 699	62 268	5 200 437	14 847 967	–
Financial position interest sensitivity gap	4 584 980	(990 918)	(245 420)	(36 467)		3 312 175	
Derivative financial instruments	–	–	–	–		–	
Total net interest sensitivity gap	4 584 980	(990 918)	(245 420)	(36 467)		3 312 175	

	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	

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 for 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.

There were no significant changes in the way in which the Group manages and measures liquidity 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	Mismatch R'000
2018			
Maturing up to one month	**5 784 556**	**7 990 736**	**(2 206 180)**
Maturing between one and three months	**370 514**	**1 192 461**	**(821 947)**
Maturing between three and six months	**381 069**	**202 477**	**178 592**
Maturing between six months and one year	**127 927**	**328 467**	**(200 540)**
Maturing after one year	**7 931 206**	**2 537 444**	**5 393 762**
Non-contractual	**252 695**	**71 798**	**180 897**
	14 847 967	**12 323 383**	**2 524 584**
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

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
2018					
Deposits	**7 399 887**	**1 196 056**	**206 128**	**348 715**	**1 419 241**
Long-term funding	**–**	**–**	**–**	**–**	**1 209 351**
Debt securities	**–**	**–**	**–**	**–**	**398 716**
Derivative financial instruments	**6 860**	**6 265**	**2 236**	**76**	**–**
Other accounts payable	**437 322**	**–**	**–**	**–**	**3 525**
Guarantees, letters of credit and committed undrawn facilities	**1 201 818**	**–**	**–**	**–**	**–**
Operating lease commitments	**652**	**1 265**	**1 804**	**3 260**	**6 933**
	9 046 539	**1 203 586**	**210 168**	**352 051**	**3 037 766**
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

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. In terms of some term debt structures the funders may require certain covenants to be met. These specific covenants are monitored during the year as part of the Group's capital management processes and are reported to the RMC on a regular basis. 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 2018 R'000	Audited 2017 R'000
Risk-weighted assets – banking book		
Credit risk	**9 917 993**	9 036 287
Operational risk	**1 648 930**	1 455 297
Market risk	**14 338**	55 863
Equity	**8 016**	6 923
Other assets	**1 024 274**	1 106 649
	12 613 551	11 661 019
Net qualifying capital and reserves		
Tier 1 capital	**2 254 121**	2 099 366
Share capital and share premium	**1 483 300**	1 483 300
Retained earnings	**883 415**	747 079
Other reserves	**127**	(982)
Less: Deductions	**(112 721)**	(130 031)
Tier 2 capital	**87 499**	24 946
General allowance for ECL	**87 499**	24 946
	2 341 620	2 124 312
Capital adequacy ratio (%)	**18.6**	18.2
Tier 1 capital (%)	**17.9**	18.0
Tier 2 capital (%)	**0.7**	0.2

GLOSSARY OF TERMS

ABBREVIATION	DEFINITION OR DESCRIPTION
AGM	Annual General Meeting
ALCO	Asset and Liability Committee (a Management Committee accountable to the RMC)
ALM	Asset and Liability Management
Bank Regulations	Regulations relating to banks issued under section 90 of the Banks Act, No. 94 of 1990, as amended
Banks Act	Banks Act, No. 94 of 1990, as amended
BANKSETA	The Banking Sector Education and Training Authority
B-BBEE	Broad-Based Black Economic Empowerment
CEO	Chief Executive Officer
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	Common Reporting Standard
CSR	Corporate Social Responsibility
DAC	Directors' Affairs Committee
EAD	Exposure at Default
ECL	Expected Credit Loss/Losses
FD	Financial Director
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
ITGRC	IT Governance, Risk, Compliance
King IV	King IV Report on Corporate Governance for South Africa 2016
LGD	Loss Given Default
Mercantile	Mercantile Bank Holdings Limited and its subsidiaries
Mercantile Rental Finance	Mercantile Rental Finance Proprietary Limited
PD	Probability of Default
RMC	Risk and Capital Management Committee
SABRIC	South African Banking Risk Information Centre
SARB	South African Reserve Bank
SETCOM	Social, Ethics and Transformation Committee
SICR	Significant Increase in Credit Risk
SME	Small or Medium-sized 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

GROUP ADDRESSES

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MERCANTILE BANK BUSINESS CENTRES

BEDFORD BUSINESS CENTRE

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WELKOM BUSINESS CENTRE

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