Mercantile Bank
Member of CGD Group

2008 Annual Financial Statements

your bank, your partner, our focus

Mercantile Bank Limited

Member of CGD Group
Reg No. 1965/006706/06
An Authorised Financial Services Provider and Credit Provider NCRCP19

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Glossary of terms

Abbreviation:	Definition/Description:
ALCO	Asset and Liability Committee
ALM	Asset and Liability Management
Banks Act	Banks Act, No. 94 of 1990, as amended
Bank Regulations	Regulations relating to Banks issued under Section 90 of the Banks Act, 1990, as amended
BCM	Business Continuity Management
BEE	Black Economic Empowerment
CGD	Caixa Geral de Depósitos S.A., a company registered in Portugal
Companies Act	Companies Act, No. 61 of 1973, as amended
CREDCOM	Credit Committee
MBHL	Mercantile Bank Holdings Limited
IFRS	International Financial Reporting Standards and Interpretations
JSE	JSE Limited
Mercantile	Mercantile Bank Limited
RMC	Risk and Capital Management Committee
SARB	South African Reserve Bank
the Bank	Mercantile Bank Limited
the Board	The Board of Directors
the Company	Mercantile Bank Limited
the Code	Code of Banking Practice

Directors' responsibility

In terms of the Companies Act, the Directors are required to maintain adequate accounting records and to prepare annual financial statements that fairly present the financial position at year-end and the results and cash flows for the year ended 31 December 2008 of the Company.

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 Audit Committee and other risk monitoring committees and functions.

The internal controls include risk-based systems of accounting and administrative controls designed to provide reasonable, but not absolute, assurance that assets are safeguarded and that transactions are executed and recorded in accordance with sound business practices and the Company'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 Company's internal audit function conducts inspections, financial and specific audits and co-ordinates audit coverage with the external auditors.

The external auditors are responsible for reporting on the Company's annual financial statements.

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

These annual financial statements, set out on pages 5 to 57, have been approved by the Board and are signed on their behalf by:

J A S de Andrade Campos
Chairman

23 April 2009

D J Brown
Chief Executive Officer

23 April 2009

Certificate from the Company Secretary

In terms of section 268G (d) 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 2008 all such returns as are required of a public company in terms of the Act, and that all such returns are true, correct and up-to-date.

R van Rensburg
Company Secretary
23 April 2009

Independent auditor's report

to the member of Mercantile Bank Limited

Report on the financial statements

We have audited the annual financial statements of Mercantile Bank Limited, which comprise the Directors' report, balance sheet as at 31 December 2008, the income statement, the statement of changes in equity and cash flow statement for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages 5 to 57.

Directors' responsibility for the financial statements

The Company's Directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act of South Africa. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

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

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

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as at 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards, and in the manner required by the Companies Act of South Africa.

Deloitte & Touche.

Per **Riaan Eksteen**
Partner

23 April 2009

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

Directors' report

for the year ended 31 December 2008

The Directors have pleasure in presenting their report, which forms part of the audited annual financial statements of the Company for the year ended 31 December 2008.

1. Nature of business

The Company is a registered bank, incorporated in the Republic of South Africa, and provides its clients with a full range of domestic and international banking services. In addition, it provides a full range of specialised financing, savings and investment facilities to the retail, commercial, corporate and alliance banking niche markets.

2. Holding company

MBHL, a company incorporated in the Republic of South Africa, wholly owns the Company. The ultimate holding company is CGD, a company registered in Portugal.

3. Financial results

Details of the financial results are set out on pages 6 to 57 and in the opinion of the Directors require no further comment.

4. Share capital

There were no changes to the authorised and issued share capital of the Company during the year (2007: nil). The authorised and issued share capital of the Company is detailed in note 14 to the annual financial statements.

5. Dividends

No dividend was declared during the year under review (2007: nil).

6. Directors, Company Secretary and registered addresses

The Directors of the Company during the year and at the date of this report were as follows:

J A S de Andrade Campos *† *(Chairman)*
D J Brown # *(Chief Executive Officer)*
G P de Kock †
L Hyne †
A T Ikalafeng †
J P M Lopes *#
T H Njikizana ^† (appointed 6 November 2008)
S Rapeti †

The Company Secretary is Ms R van Rensburg and the registered addresses of the Company are:

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

* Portuguese ^Zimbabwean # Executive
† Independent Non-Executive

7. Consolidated annual financial statements

In terms of Section 288 of the Companies Act, consolidated annual financial statements have not been presented as the Company is wholly owned by MBHL, which is a company incorporated in the Republic of South Africa.

8. Going concern

The Company's annual financial statements have been prepared on the going concern basis.

9. Special resolutions

Subsequent to the financial year-end, a special resolution to change the Articles of Association of the Company was registered on 10 February 2009.

The resolution was required in order to align the provisions of the Articles of Association to that of the Banks Act in respect of the composition of the Board.

10. Post balance sheet events

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

Accounting policies

for the year ended 31 December 2008

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

1. Basis of presentation

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

In the current year, the Company has adopted IFRIC 11 – IFRS 2 Group and Treasury Transactions, which is effective for annual reporting periods beginning on or after 1 March 2007. The impact of this adoption has been disclosed in note 30 of the annual financial statements.

2. Recognition of assets and liabilities

2.1 Assets

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

2.2 Liabilities

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

2.3 Provisions

Provisions are recognised when the Company 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 of the obligation can be made.

2.4 Contingent liabilities

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

3. Financial instruments

Financial assets and financial liabilities are recognised on the Company's balance sheet when the Company has become a party to the contractual provisions of that instrument. Regular way purchases or sales of financial assets are recognised using settlement date accounting. On initial recognition, financial instruments are recognised at their fair value and in the case of a financial instrument not at fair value through profit and loss, transaction costs that are directly attributable to the acquisition or issue of the financial instrument are included.

The Company derecognises a financial asset when:

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

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

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

3.1 Derivative financial instruments

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

The Company uses the following derivative financial instruments to reduce its underlying financial risks and/or to enhance yields:

- forward exchange contracts;
- foreign currency swaps;
- interest rate swaps; and
- unlisted equity options.

Derivative financial instruments ("derivatives") are not entered into for trading or speculative purposes. All derivatives are recognised on the balance sheet. Derivative financial instruments are initially recorded at cost and are remeasured to fair value at each subsequent reporting date. Changes in the fair value of derivatives are recognised in income.

Accounting policies

for the year ended 31 December 2008 (continued)

3. **Financial instruments** (continued)

3.1 Derivative financial instruments (continued)

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

Embedded derivatives are separated from the host contract and accounted for as a separate derivative when:

- the embedded derivative's economic characteristics and risks are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the combined instrument is not measured at fair value with changes in fair value reported in income.

A derivative's notional principal reflects the value of the Company'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.

3.2 Financial assets

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

Financial assets at fair value through profit and loss

Loans and receivables with fixed interest rates and corporate bonds are classified at fair value through profit and loss. Financial assets are designated at fair value through profit and loss, primarily to eliminate or significantly reduce the accounting mismatch. The Company seeks to demonstrate that by applying the fair value option, it significantly reduces measurement inconsistency that would otherwise arise from measuring derivatives at fair value with gains and losses in profit and loss, and the loans and receivables and corporate bonds at amortised cost.

Available-for-sale

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

Cash and cash equivalents

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

Bank term deposits

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

Other investments

Investments consist of listed and unlisted equity investments. Other investments have been designated as available-for-sale. These assets are measured at fair value, at each reporting date, with the resultant gains or losses being recognised in equity until the financial asset is sold, or otherwise disposed of, or found to be impaired. At that time the cumulative gains or losses previously recognised in equity are included in income.

Negotiable securities

Negotiable securities consist of government stock, Treasury bills, corporate bonds and debentures.

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

Corporate bonds are designated at fair value through profit and loss.

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

Accounting policies

for the year ended 31 December 2008 (continued)

3. **Financial instruments** (continued)

3.2 Financial assets (continued)

Loans and advances

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

Other accounts receivable

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

3.3 Financial liabilities

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

3.4 Fair value estimation

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

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

3.5 Amortised cost

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

3.6 Impairments

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

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

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

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

If the recoverable amount of the advance is estimated to be less than the carrying amount, the carrying amount of the advance is reduced to its recoverable amount by raising a specific impairment, which is recognised as an expense.

Accounting policies

for the year ended 31 December 2008 (continued)

3. Financial instruments (continued)

3.6 Impairments (continued)

Where the impairment loss subsequently reverses, the carrying amount of the advance is increased to the revised estimate of its recoverable amount, subject to the increased carrying amount not exceeding the carrying amount that would have been determined had no impairment loss been recognised for the advance in prior years. A reversal of an impairment loss is recognised as income immediately.

4. Foreign currency transactions

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

5. Subsidiaries

Investments in subsidiaries in the Company's annual financial statements are designated as available-for-sale assets and are recognised at fair value. Fair value is estimated as the net asset value of the investee entities. All gains and losses on the sale of subsidiaries are recognised in income.

6. Associated companies

Associated companies are those companies in which the Company exercises significant influence, but not control or joint control, over their financial and operating policies and holds between 20% and 50% interest therein. These investments are designated as available-for-sale assets and are recognised at fair value. This method is applied from the effective date on which the enterprise became an associated company, up to the date on which it ceases to be an associated company.

The results and assets and liabilities of associated companies are incorporated in the financial statements as available-for-sale assets and are recognised at fair value, except when the investment is classified as held for sale, in which case it is accounted for in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

7. Property and equipment

7.1 Owner-occupied properties

Owner-occupied properties are held for use in the supply of services or for administrative purposes and are stated in the balance sheet at open-market fair value on the basis of their existing use at the date of revaluation, less any subsequent accumulated depreciation calculated using the straight-line method and subsequent accumulated impairment losses.

The open-market fair value is based on capitalisation rates for open market net rentals for each property. Revaluations are performed annually by independent registered professional valuators.

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

7.2 Equipment

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

Depreciation on equipment is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives. Leasehold improvements are depreciated over the period of the lease or over such lesser period as is considered appropriate. The equipment's residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Accounting policies

for the year ended 31 December 2008 (continued)

7. Property and equipment (continued)

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

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

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

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

8. Intangible assets

Computer software

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

Computer software and licences that are recognised as intangible assets are amortised on the straight-line basis at rates appropriate to the expected useful lives of the assets, which is usually between three and five years, but where appropriate over a maximum of ten years and are carried at cost less any accumulated amortisation and any accumulated impairment losses. The carrying amount of capitalised computer software and licences is reviewed annually for indication of impairment and is written down when the carrying amount exceeds the recoverable amount.

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

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

9. 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 and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

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

10. Taxation

Income taxation expense represents the sum of the taxation currently payable and deferred taxation.

10.1 Current taxation

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

10.2 Deferred taxation

Deferred taxation is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred taxation liabilities are generally recognised for all taxable temporary differences, and deferred taxation assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised.

Accounting policies

for the year ended 31 December 2008 (continued)

10. **Taxation** (continued)

10.2 **Deferred taxation** (continued)

Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

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

Deferred taxation 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 they are expected to reverse in the foreseeable future.

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

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

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

10.3 **Current and deferred taxation for the period**

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

11. **Sale and repurchase agreements and lending of securities**

Securities sold subject to linked repurchase agreements ("repos") are reflected in the annual financial statements as investments with the proceeds recognised in cash and cash equivalents and the counterparty liability is included in amounts due to other banks, deposits from banks, other deposits, or deposits due to customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of repo agreements using the effective interest method.

Securities purchased under agreements to resell ("reverse repos") are recorded as cash and cash equivalents. Securities lent to counterparties are also retained in the annual financial statements.

Securities borrowed are not recognised in the annual financial statements, unless these are sold to third parties, in which case the purchase and sale are recorded with the gain or loss being included in income. The obligation to return them is recorded at fair value in other accounts payable.

12. **Instalment sales and leases**

12.1 **The Company as the lessee**

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

12.2 **The Company 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.

Accounting policies

for the year ended 31 December 2008 (continued)

13. Interest income and interest expense

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

14. 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 rights to receive payment have been established.

15. Retirement funds

The Company operates defined contribution funds, the assets of which are held in separate trustee-administered funds. The retirement funds are funded by payments from employees and by the Company. The Company contributions to the retirement funds are based on a percentage of the payroll and are charged to income as accrued.

16. Post-retirement medical benefits

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

Actuarial gains and losses, the effect of settlements on the liability and plan assets and the curtailment gain due to the change in the post-retirement subsidy of in-service members are recognised in income immediately.

17. Equity compensation plans

Share options and/or conditional awards in MBHL are awarded to employees of the Company at the discretion of the Remuneration Committee and are approved by the Board. The Company has applied the requirements of IFRS 2 to share-based payments.

These share-based payments are equity-settled are measured at fair value at the grant date and expensed on a straight-line basis over the vesting period, based on the Company's estimate of shares that will eventually vest.

Fair value of share options is measured by use of a Black-Scholes model. The fair value has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Accounting policies

for the year ended 31 December 2008 (continued)

18. General credit-risk reserve

Banks Act circular 21/2004 requires that a general credit-risk reserve be recognised within Shareholders' equity for any shortfall between total impairments raised in terms of IAS 39 and the provisions required in terms of Regulation 28 of the Regulations relating to Banks. Such reserve was maintained through an appropriation of distributable reserves to a general credit-risk reserve. The new Bank Regulations, which were effective 1 January 2008, no longer require general credit-risk reserves, which resulted in the balance of this reserve being transferred to distributable reserves.

19. Critical accounting estimates and judgements

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

19.1 Impairment losses on loans and advances

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

19.2 Fair value of instruments

The fair value of financial instruments that are not quoted in active markets are 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. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however areas such as credit risk, volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments.

19.3 Impairment of available-for-sale equity investments

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

Accounting policies
for the year ended 31 December 2008 (continued)

19. Critical accounting estimates and judgements (continued)

19.4 Income taxes

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

20. Recent accounting developments

There are standards and interpretations in issue that are not yet effective and will not be early adopted. These include the following standards and interpretations that could be applicable to the business of the Company and may have an impact on future financial statements. The impact of initial application has not been assessed as at the date of authorisation of the annual financial statements.

IFRS 2 (Share Based Payments) was issued during 2008 but is only effective for annual periods beginning on or after 1 January 2009. The Company will comply with the applicable standard from the year ending 31 December 2009.

IFRS 3 (Business Combinations) was issued during 2008 but is only effective for business combinations concluded on or after 1 July 2009. The Company will comply with the applicable standard from the year ending 31 December 2010.

IFRS 8 (Operating Segments) was issued during 2006 but is only effective for annual periods beginning on or after 1 January 2009. The Company will comply with the applicable standard from the year ending 31 December 2009.

IFRIC 13 (Customer Loyalty Programmes) was issued during 2007 but is only effective for annual periods beginning on or after 1 July 2008. The Company will apply IFRIC 13 from the year ending 31 December 2009.

IFRIC 15 (Agreements for the Construction of Real Estate) was issued during 2008 but is only effective for annual periods beginning on or after 1 January 2009. The Company will comply with the applicable standard from the year ending 31 December 2009.

IFRIC 17 (Distributions of Non-cash Assets to Owners) was issued during 2008 but is only effective for annual periods beginning on or after 1 July 2009. The Company will comply with the applicable standard from the year ending 31 December 2010.

IAS 1 (Presentation of Financial Statements) was issued during 2008 but is only effective for annual periods beginning on or after 1 January 2009. The Company will comply with the applicable standard from the year ending 31 December 2009.

IAS 23 (Borrowing Costs) was issued during 2008 but is only effective for annual periods beginning on or after 1 January 2009. The Company will comply with the applicable standard from the year ending 31 December 2009.

IAS 27 (Consolidated and Separate Financial Statements) was issued during 2008 but is only effective for annual periods beginning on or after 1 July 2009. The Company will comply with the applicable standard from the year ending 31 December 2010.

IAS 28 (Investments in Associates) was issued during 2008 but is only effective for annual periods beginning on or after 1 July 2009. The Company will comply with the applicable standard from the year ending 31 December 2010.

IAS 31 (Interest in Joint Ventures) was issued during 2008 but is only effective for annual periods beginning on or after 1 July 2009. The Company will comply with the applicable standard from the year ending 31 December 2010.

IAS 39 (Financial Instruments: Recognition and Measurement) was issued during 2008 but is only effective for annual periods beginning on or after 1 July 2009. The Company will comply with the applicable standard from the year ending 31 December 2010.

Accounting policies

for the year ended 31 December 2008 (continued)

20. Recent accounting developments (continued)

On 22 May 2008, the International Accounting Standards Board issued its latest standard, titled Improvements to International Financial Reporting Standards 2008. The Standard included 35 amendments to various current Standards. The following amendments have not been applied in the 2008 financial year as they are not yet effective.

Standard	Annual periods beginning on or after
IFRS 1 (AC 138) – First-time Adoption of International Financial Reporting Standards	1 January 2009
IFRS 5 (AC 142) – Non-current Assets Held for Sale and Discontinued Operations	1 July 2009
IAS 1 (AC 101) – Presentation of Financial Statements	1 January 2009
IAS 16 (AC 123) – Property, Plant and Equipment	1 January 2009
IAS 19 (AC 116) – Employee Benefits	1 January 2009
IAS 20 (AC 134) – Accounting for Government Grants and Disclosure of Government Assistance	1 January 2009
IAS 27 (AC 132) – Consolidated and Separate Financial Statements	1 January 2009
IAS 28 (AC 110) – Investments in Associates	1 January 2009
IAS 29 (AC 124) – Financial Reporting in Hyperinflationary Economies	1 January 2009
IAS 31 (AC 119) – Interests in Joint Ventures	1 January 2009
IAS 32 (AC 125) – Financial Instruments: Presentation	1 January 2009
IAS 36 (AC 128) – Impairment of Assets	1 January 2009
IAS 38 (AC 129) – Intangible Assets	1 January 2009
IAS 39 (AC 133) – Financial Instruments: Recognition and Measurement	1 January 2009
IAS 40 (AC 135) – Investment Property	1 January 2009
IAS 41 (AC 137) – Agriculture	1 January 2009

Balance sheet

at 31 December 2008

	Note	2008 R'000	2007 R'000
ASSETS			
Intangible assets	2	76 894	23 568
Property and equipment	3	35 995	16 655
Other accounts receivable	4	50 501	33 593
Interest in subsidiaries	5	91 033	80 116
Other investments	6	20 070	8 917
Deferred taxation assets	7	153 531	–
Non-current assets held for sale	8	5 289	–
Loans and advances	9	3 403 789	2 814 743
Derivative financial instruments	10	56 873	43 814
Negotiable securities	11	247 141	275 577
Bank term deposits	12	324 295	170 618
Cash and cash equivalents	13	1 464 959	1 252 376
Total assets		5 930 370	4 719 977
EQUITY AND LIABILITIES			
Shareholders' equity		1 296 760	853 379
Share capital and share premium	14	1 483 300	1 483 300
Share-based payments reserve		4 650	–
General reserve		12 231	12 231
Property revaluation reserve		69	69
Available-for-sale reserve		52 436	35 531
General credit-risk reserve		–	19 403
Accumulated loss		(255 926)	(697 155)
Liabilities		4 633 610	3 866 598
Deposits	15	4 391 543	3 770 800
Derivative financial instruments	10	95 091	15 356
Provisions	16	48 560	42 407
Other accounts payable	18	98 110	38 035
Taxation	19	306	–
Total equity and liabilities		5 930 370	4 719 977

Income statement

for the year ended 31 December 2008

	Note	2008 R'000	2007 R'000
Interest income	21	**669 221**	473 870
Interest expenditure	22	**(337 913)**	(250 092)
Net interest income		**331 308**	223 778
Net charge for credit losses	9	**(6 618)**	(5 358)
Net interest income after credit losses		**324 690**	218 420
Net gains on disposal and revaluation of available-for-sale investments		**9 839**	5 594
Non-interest income	23	**259 955**	190 904
Recurring		**259 955**	175 829
Non-recurring		**–**	15 075
Fee and commission expenditure	24	**(76 119)**	(28 841)
Net interest and non-interest income		**518 365**	386 077
Operating expenditure	25	**(259 166)**	(221 132)
Profit before taxation		**259 199**	164 945
Taxation	26	**159 028**	–
Profit after taxation		**418 227**	164 945

Statement of changes in equity

for the year ended 31 December 2008

	Share capital R'000	Share premium R'000	Share-based payments reserve R'000	General reserve R'000	Property revaluation reserve R'000	Available for-sale reserve R'000	General credit-risk reserve R'000	Accu-mulated loss R'000	Total R'000
Shareholders' equity at 31 December 2006	124 969	1 358 331	–	12 231	69	29 869	13 954	(856 651)	682 772
Net movement for the year	–	–	–	–	–	5 662	5 449	159 496	170 607
Gains and losses on remeasurement to fair value	–	–	–	–	–	11 262	–	–	11 262
Release to income on disposal of available-for-sale financial assets	–	–	–	–	–	(5 600)	–	–	(5 600)
Increase in general credit-risk reserve	–	–	–	–	–	–	5 449	(5 449)	–
Profit after taxation	–	–	–	–	–	–	–	164 945	164 945
Shareholders' equity at 31 December 2007	124 969	1 358 331	–	12 231	69	35 531	19 403	(697 155)	853 379
Net movement for the year	–	–	4 650	–	–	16 905	(19 403)	441 229	443 381
Gains and losses on remeasurement to fair value	–	–	–	–	–	32 241	–	–	32 241
Release to income on disposal of available-for-sale financial assets	–	–	–	–	–	(9 839)	–	–	(9 839)
Share-based payments expense	–	–	4 650	–	–		–	3 599	8 249
Transfer to deferred taxation liability	–	–	–	–	–	(5 497)	–	–	(5 497)
Decrease in general credit-risk reserve	–	–	–	–	–	–	(19 403)	19 403	–
Profit after taxation	–	–	–	–	–	–	–	418 227	418 227
Shareholders' equity at 31 December 2008	124 969	1 358 331	4 650	12 231	69	52 436	–	(255 926)	1 296 760

Cash flow statement

for the year ended 31 December 2008

	Note	2008 R'000	2007 R'000
Operating activities			
Cash receipts from customers	27.1	**999 621**	631 290
Cash paid to suppliers and employees	27.2	**(644 968)**	(479 973)
Cash generated from operations	27.3	**354 653**	151 317
Dividends received		**2 614**	2 167
Taxation received	27.4	**306**	–
Net (increase) in income earning assets	27.5	**(725 743)**	(376 789)
Net increase in deposits and other accounts	27.6	**659 058**	218 496
Net cash inflow/(outflow) from operating activities		**290 888**	(4 809)
Investing activities			
Purchase of property, equipment and intangible assets		**(86 536)**	(19 859)
Acquisition of investments		**(470)**	–
Proceeds on sale of property, equipment and intangible assets		**43**	108
Proceeds on disposal of other investments		**9 839**	5 594
(Increase)/Decrease in interest in subsidiaries		**(1 181)**	623
Net cash (outflow) from investing activities		**(78 305)**	(13 534)
Net cash inflow/(outflow) for year		**212 583**	(18 343)
Cash and cash equivalents at beginning of year		**1 252 376**	1 270 719
Cash and cash equivalents at end of year	13	**1 464 959**	1 252 376

Notes to the annual financial statements
for the year ended 31 December 2008

	2008 Fair value R'000	2008 Carrying amount R'000	2007 Fair value R'000	2007 Carrying amount R'000
1. Categories and fair values of financial instruments				
Assets				
Available-for-sale	131 641	131 641	95 607	95 607
Other investments	20 070	20 070	8 917	8 917
Interest in subsidiaries	91 033	91 033	80 116	80 116
Negotiable securities – Government stock	20 538	20 538	6 574	6 574
Loans and receivables	5 315 783	5 316 236	4 347 053	4 355 376
Current accounts	503 622	503 622	655 384	655 384
Credit card	14 920	14 920	15 184	15 184
Mortgage loans	1 560 921	1 560 921	1 196 363	1 196 363
Instalment sales and leases	349 480	349 480	276 720	276 720
Structured loans	254 795	254 795	83 878	83 878
Other advances	566 140	566 140	433 057	433 057
Negotiable securities – Treasury bills	226 150	226 603	203 880	204 010
Negotiable securities – Debentures	–	–	26 000	34 193
Bank term deposits	324 295	324 295	170 618	170 618
Cash and cash equivalents	1 464 959	1 464 959	1 252 376	1 252 376
Other accounts receivable	50 501	50 501	33 593	33 593
Loans and receivables designated at fair value through profit and loss	153 911	153 911	185 017	185 017
Mortgage loans	53 946	53 946	40 962	40 962
Instalment sales and leases	21 300	21 300	26 997	26 997
Other advances	78 665	78 665	86 258	86 258
Corporate bonds	–	–	30 800	30 800
Held-for-trading	56 873	56 873	43 814	43 814
Derivative financial instruments	56 873	56 873	43 814	43 814
	5 658 208	5 658 661	4 671 492	4 679 815
Liabilities				
Held-for-trading	95 091	95 091	15 356	15 356
Derivative financial instruments	95 091	95 091	15 356	15 356
Other financial liabilities	4 489 959	4 489 959	3 808 835	3 808 835
Deposits	4 391 543	4 391 543	3 770 800	3 770 800
Taxation	306	306	–	–
Other accounts payable	98 110	98 110	38 035	38 035
	4 585 050	4 585 050	3 824 191	3 824 191

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

1. Categories and fair values of financial instruments (continued)

Cash and cash equivalents have short terms to maturity. For this reason, the carrying amounts at the reporting date approximate the fair values.

Treasury and debentures have short terms to maturity and are carried at amortised cost. Fair value is based on quoted market values at balance sheet date.

The fair values of loans and advances that are carried at amortised cost approximate the fair values reported as they bear variable rates of interest. In addition, fair value is approximated through the credit impairment models.

Deposits generally have short terms to maturity, thus the values reported approximate the fair value.

The fair value of public traded derivatives, securities and investments is based on quoted market values at balance sheet 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 and interest in subsidiaries which are unlisted, is determined by reference to the net asset value of the entity.

The fair value of loans and advances designated at fair value through profit and loss is calculated using the credit spread observed at origination. The fair values are adjusted for deterioration of credit quality through the application of the credit impairment models.

	2008 R'000	2007 R'000
Loans and receivables designated at fair value through profit and loss		
Cumulative changes in fair value attributable to credit risk	–	–
Changes in fair value attributable to changes in credit risk recognised during the period	–	–

At reporting date there are no significant concentrations of credit risk.

To confirm the amount of the fair value attributable to changes in credit risk, a review of those loans or receivables designated at fair value through profit and loss was conducted. The Company has no credit derivatives over loans and receivables designated at fair value through profit and loss.

2. Intangible assets

	2008 R'000	2007 R'000
Computer software		
Cost at beginning of year	61 291	51 671
Additions	59 412	15 850
Net transfer from property and equipment	282	424
Write-off of obsolete stock	–	(6 654)
Cost at end of year	120 985	61 291
Accumulated amortisation and impairment losses at beginning of year	(37 723)	(40 122)
Amortisation	(6 086)	(3 715)
Net transfer from property and equipment	(282)	(424)
Write-off of obsolete stock	–	6 538
Accumulated amortisation and impairment losses at end of year	(44 091)	(37 723)
Net carrying amount at end of year	76 894	23 568

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	Owner-occupied property R'000	Leasehold improve-ments R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
3. Property and equipment							
2008							
Open market value/cost at beginning of year	164	18 325	70 493	8 499	22 185	415	120 081
Additions	–	699	24 900	439	1 086	–	27 124
Transfer*	–	–	(203)	348	(427)	–	(282)
Write-off of obsolete assets	–	–	(29)	(13)	(12)	–	(54)
Disposals	–	(107)	(1 265)	–	(403)	–	(1 775)
Open market value/cost at end of year	164	18 917	93 896	9 273	22 429	415	145 094
Accumulated depreciation and impairment losses at beginning of year	–	(13 908)	(64 808)	(7 723)	(16 671)	(316)	(103 426)
Depreciation	–	(819)	(5 211)	(330)	(1 382)	(28)	(7 770)
Transfer*	–	–	203	(314)	393	–	282
Write-off of obsolete assets	–	–	28	13	11	–	52
Disposals	–	106	1 265	–	392	–	1 763
Accumulated depreciation and impairment losses at end of year	–	(14 621)	(68 523)	(8 354)	(17 257)	(344)	(109 099)
Net carrying amount at end of year	164	4 296	25 373	919	5 172	71	35 995
2007							
Open market value/cost at beginning of year	164	18 129	68 468	8 368	21 124	339	116 592
Additions	–	213	2 918	14	752	112	4 009
Transfer *	–	(17)	(893)	117	369	–	(424)
Disposals	–	–	–	–	(60)	(36)	(96)
Open market value/cost at end of year	164	18 325	70 493	8 499	22 185	415	120 081
Accumulated depreciation and impairment losses at beginning of year	–	(12 825)	(60 125)	(7 129)	(14 695)	(287)	(95 061)
Depreciation	–	(1 092)	(5 617)	(479)	(1 627)	(65)	(8 880)
Transfer*	–	9	934	(115)	(404)	–	424
Disposals	–	–	–	–	55	36	91
Accumulated depreciation and impairment losses at end of year	–	(13 908)	(64 808)	(7 723)	(16 671)	(316)	(103 426)
Net carrying amount at end of year	164	4 417	5 685	776	5 514	99	16 655

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

Note:
The owner-occupied property comprises stand 624 Malvern, Johannesburg, with a building thereon. The property is valued at the offer to purchase amount received.

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
4. Other accounts receivable		
Items in transit	2 626	3 913
Loans to fellow subsidiaries and holding company (refer to note 28.2)	11 260	9 987
Prepayments and deposits	6 179	4 917
Other receivables	30 436	14 776
	50 501	33 593
5. Interest in subsidiaries		
Unlisted		
Shares at fair value		
Portion 2 of Lot 8 Sandown (Pty) Limited	41 621	32 220
Loans to subsidiaries	49 412	47 896
Portion 2 of Lot 8 Sandown (Pty) Limited	44 832	43 987
LSM (Troyeville) Properties (Pty) Limited	6 265	5 931
Less: Provisions held against loan accounts	(1 685)	(2 022)
	91 033	80 116

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

The loans bear interest at the prevailing prime rate and have no fixed terms of maturity.

	2008 R'000	2007 R'000
6. Other investments		
Available-for-sale		
Unlisted equities	5 571	4 460
Interest in associated company*	3 234	4 251
Other	2 337	209
Listed equities	19 788	4 457
Mercantile Bank Holdings Limited (shares held by the Bank for the employee share option scheme)	7 785	4 457
African Bank Investment Limited	648	–
Kap International Limited	11	–
Visa Inc.	11 344	–
	25 359	8 917
Reclassification of investments as non-currents asset held for sale (see note 8)	(5 289)	–
Total	20 070	8 917
Directors' valuation of unlisted investments	5 571	4 460

*The percentage shareholding of the Bank in this entity is 21.4%. The financial year-end is February.

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

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
7. Deferred taxation		
Reconciliation		
Balance at the beginning of the year		
Current year charge		
– per the income statement	159 028	–
– per the statement of changes in equity	(5 497)	–
Balance at the end of the year	153 531	–
Deferred taxation is attributable to the following temporary differences		
Assets		
Property and equipment	(9 619)	–
Intangibles	3	–
Short and long-term provisions	2 550	–
Calculated tax losses	157 739	–
Revaluations	(5 497)	–
Leases	1 376	–
Interest rate swaps	2 497	–
Other	4 482	–
	153 531	–

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

	2008 R'000	2007 R'000
8. Non-current assets held for sale		
Unlisted investment – Bond Exchange of South Africa Limited	2 055	–
Interest in associated company	3 234	–
	5 289	–

Unlisted investment

The Company intends to dispose of the investment in the Bond Exchange of South Africa Limited and anticipates that the disposal will be concluded by June 2009.

The investment has been valued at the offer price less costs to sell in terms of the scheme arrangement proposed by the purchaser.

No impairment loss was recognised on reclassification of the investment as a non-current asset held for sale at 31 December 2008.

Interest in associated company

The Company intends to dispose of Statman Investments (Pty) Limited and anticipates that the disposal will be concluded by June 2009.

The investment has been valued at the carrying amount as the offer price by the purchaser has not yet been concluded.

No impairment loss was recognised on reclassification of the interest in the associated company as a non-current asset held for sale at 31 December 2008.

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
9. Loans and advances		
Category analysis		
Amortised cost	3 329 515	2 755 878
Current accounts	506 103	657 886
Credit card	22 420	21 555
Mortgage loans	1 568 744	1 200 419
Instalment sales and leases	352 406	277 562
Structured loans	285 225	131 191
Other advances	594 617	467 265
Fair value through profit and loss	154 106	154 528
Mortgage loans	53 960	40 980
Instalment sales and leases	21 338	27 026
Other advances	78 808	86 522
	3 483 621	2 910 406
Less: Impairments for credit losses	(58 849)	(57 187)
Less: Interest in suspense	(20 983)	(38 476)
	3 403 789	2 814 743

All loans and advances are denominated in South African Rand.

	2008 R'000	2007 R'000
Maturity analysis		
Repayable on demand	757 379	900 360
Maturing within six months	11 319	136 671
Maturing after six months but within 12 months	36 288	158 547
Maturing after 12 months	2 678 635	1 714 828
	3 483 621	2 910 406

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

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

9. Loans and advances (continued)

Detailed category analysis of loans and advances

	Gross amount R'000	Interest in suspense R'000	Total impairments R'000	Net balance R'000
2008				
Current accounts	**506 103**	**409**	**2 072**	**503 622**
Credit card	**22 420**	**2 254**	**5 246**	**14 920**
Mortgage loans	**1 622 704**	**3 694**	**4 143**	**1 614 867**
Instalment sales and leases	**373 744**	**654**	**2 310**	**370 780**
Structured loans	**285 225**	**–**	**30 430**	**254 795**
Other advances	**673 425**	**13 972**	**14 648**	**644 805**
	3 483 621	**20 983**	**58 849**	**3 403 789**
2007				
Current accounts	657 886	210	2 292	655 384
Credit card	21 555	1 568	4 803	15 184
Mortgage loans	1 241 399	1 768	2 366	1 237 265
Instalment sales and leases	304 588	256	615	303 717
Structured loans	131 191	19 918	27 395	83 878
Other advances	553 787	14 756	19 716	519 315
	2 910 406	38 476	57 187	2 814 743

	Total R'000	Current accounts R'000	Credit card R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Other advances R'000
Impairments for credit losses							
2008							
Balance at the beginning of the year	**57 187**	**2 292**	**4 803**	**2 366**	**615**	**27 395**	**19 716**
Movements for the year:							
Credit losses written off	**(5 858)**	**(1 288)**	**(666)**	**–**	**(640)**	**–**	**(3 264)**
Net impairments raised/(released)	**7 520**	**1 068**	**1 109**	**1 777**	**2 335**	**3 035**	**(1 804)**
	58 849	**2 072**	**5 246**	**4 143**	**2 310**	**30 430**	**14 648**
2007							
Balance at the beginning of the year	64 394	7 672	8 641	1 447	5 904	25 395	15 335
Movements for the year:							
Credit losses written-off	(14 414)	(240)	(3 483)	(683)	(5 646)	–	(4 362)
Net impairments raised/(released)	7 207	(5 140)	(355)	1 602	357	2 000	8 743
	57 187	2 292	4 803	2 366	615	27 395	19 716

	2008 R'000	2007 R'000
Impairments for credit losses consist of:		
Portfolio impairments	**19 768**	32 663
Specific impairments	**39 081**	24 524
Balance at end of year	**58 849**	57 187
Net charge for credit losses		
Net impairments raised	**(7 520)**	(7 207)
Recoveries in respect of amounts previously written off	**902**	1 849
	(6 618)	(5 358)

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

9. Loans and advances (continued)

	Gross amount R'000	Interest in suspense R'000	Portfolio impairment R'000	Net balance R'000
Category analysis of performing loans and advances				
2008				
Current accounts	**502 086**	**–**	**966**	**501 120**
Credit card	**15 988**	**–**	**1 068**	**14 920**
Mortgage loans	**1 591 909**	**–**	**415**	**1 591 494**
Instalment sales and leases	**367 848**	**–**	**671**	**367 177**
Structured loans	**232 213**	**–**	**15 430**	**216 783**
Other advances	**640 457**	**–**	**1 218**	**639 239**
	3 350 501	**–**	**19 768**	**3 330 733**
2007				
Current accounts	656 479	–	1 867	654 612
Credit cards	15 317	–	826	14 491
Mortgage loans	1 220 604	–	554	1 220 050
Instalment sales and leases	301 319	–	332	300 987
Structured loans	131 191	19 918	27 395	83 878
Other advances	513 104	–	1 689	511 415
	2 838 014	19 918	32 663	2 785 433

	2008 R'000	2007 R'000
Category analysis of performing loans and advances excluding loans and advances with renegotiated terms		
Current accounts	**502 086**	656 479
Credit card	**15 988**	15 317
Mortgage loans	**1 591 067**	1 220 604
Instalment sales and leases	**367 848**	301 319
Structured loans	**232 213**	131 191
Other advances	**637 500**	512 349
	3 346 702	2 837 259
Category analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired		
Current accounts	**–**	–
Credit card	**–**	–
Mortgage loans	**842**	–
Instalment sales and leases	**–**	–
Structured loans	**–**	–
Other advances	**2 957**	755
	3 799	755

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	0 – 30 days R'000	Past due for: 31 – 60 days R'000	61 – 90 days R'000	Total gross amount R'000	Fair value of collateral and other credit enhancements R'000
9. Loans and advances (continued)					
Category age analysis of loans that are past due but not individually impaired					
2008					
Current accounts	**703**	**–**	**–**	**703**	**–**
Credit card	**336**	**254**	**342**	**932**	**–**
Mortgage loans	**17 740**	**7 198**	**–**	**24 938**	**20 142**
Instalment sales and leases	**731**	**559**	**–**	**1 290**	**971**
Structured loans	**–**	**–**	**–**	**–**	**–**
Other advances	**268**	**1 133**	**–**	**1 401**	**1 199**
	19 778	**9 144**	**342**	**29 264**	**22 312**
2007					
Current accounts	–	–	–	–	–
Credit cards	119	201	215	535	–
Mortgage loans	2 413	6 689	–	9 102	7 203
Instalment sales and leases	191	283	–	474	474
Structured loans	–	–	–	–	–
Other advances	1 284	245	–	1 529	1 279
	4 007	7 418	215	11 640	8 956

	Gross amount R'000	Interest in suspense R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhancements R'000
Category analysis of loans and advances that are individually impaired					
2008					
Current accounts	**4 017**	**409**	**1 106**	**2 502**	**2 173**
Credit card	**6 432**	**2 254**	**4 178**	**–**	**–**
Mortgage loans	**30 795**	**3 694**	**3 728**	**23 373**	**26 127**
Instalment sales and leases	**5 896**	**654**	**1 639**	**3 603**	**3 706**
Structured loans	**53 012**	**–**	**15 000**	**38 012**	**28 462**
Other advances	**32 968**	**13 972**	**13 430**	**5 566**	**6 510**
	133 120	**20 983**	**39 081**	**73 056**	**66 978**
2007					
Current accounts	1 407	210	425	772	219
Credit cards	6 238	1 568	3 977	693	–
Mortgage loans	20 795	1 768	1 812	17 215	18 338
Instalment sales and leases	3 269	256	283	2 730	2 705
Structured loans	–	–	–	–	–
Other advances	40 683	14 756	18 027	7 900	9 016
	72 392	18 558	24 524	29 310	30 278

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

9. Loans and advances (continued)

Collateral held as security and other credit enhancements

Fair value of collateral and other credit enhancements is determined with reference to the realisable value of security under forced-sale conditions.

All customers of the Bank are accorded a client risk grading. The risk grading of a client reflects, in broad terms, the client's creditworthiness and standing with the Bank. Specific criteria are applicable to the different risk grades. The risk grading of clients calls for judgement and continuing critical appraisal of the client's financial standing and forms an integral part of the Bank's assessment of the risk concerned. Changes in the risk grades are automated based on arrears on an instalment debt account.

Description of collateral held as security and other credit enhancements	Method of valuation
Cession of debtors	15% – 60% of debtors repayable under 90 days and depending on debtor credit quality
Pledge of shares	variable dependent on liquidity and credit quality of the shares pledged
Limited pledge and cession	variable depending on asset type and value
Cession of life and endowment policies	100% of surrender value
Pledge of call and savings accounts, fixed and notice deposits	90% – 100%
Vacant land	50% of professional valuation
Residential properties	75% of professional valuation
Commercial and industrial properties	70% of professional valuation
Catering, industrial and office equipment	variable depending on asset type and depreciated value
Trucks	variable depending on asset type and depreciated value
Earth moving equipment	variable depending on asset type and depreciated value
Motor vehicles	variable depending on asset type and depreciated value
General notarial bond	variable depending on asset type and depreciated value
Special notarial bond	variable depending on asset type and depreciated value

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

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

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
10. Derivative financial instruments				
2008				
Held-for-trading				
Foreign exchange contracts	**1 015 487**	**56 689**	**1 067 003**	**86 094**
Interest rate swaps	**16 816**	**184**	**130 639**	**8 997**
	1 032 303	**56 873**	**1 197 642**	**95 091**
2007				
Held-for-trading				
Foreign exchange contracts	924 445	39 566	486 032	7 481
Interest rate swaps	103 251	4 248	80 907	7 875
	1 027 696	43 814	566 939	15 356

	2008 R'000	2007 R'000
11. Negotiable securities		
Loans and receivables		
Treasury bills	**226 603**	204 010
Debentures	**–**	34 193
Available-for-sale		
Government stock	**20 538**	6 574
Held at fair value through profit and loss		
Corporate bonds	**–**	30 800
	247 141	275 577
Maturity analysis		
Repayable within one month	**24 823**	102 752
Maturing within six months	**178 258**	145 769
Maturing after six months but within 12 months	**23 522**	20 482
Maturing after 12 months but within five years	**–**	–
Maturing after five years	**20 538**	6 574
	247 141	275 577

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

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
12. Bank term deposits		
Foreign bank balances	**324 295**	170 618
	324 295	170 618
Maturity analysis		
Maturing within three to six months	**211 379**	170 618
Maturing after six months but within 12 months	**112 916**	–
	324 295	170 618
13. Cash and cash equivalents		
Cash and bank notes	**26 764**	35 910
Central Bank balances	**79 388**	60 889
Domestic bank balances	**257 251**	315 080
Foreign bank balances	**1 101 556**	840 497
	1 464 959	1 252 376

14. Share capital and share premium

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
Opening and closing balance	62 484 353	124 969	1 358 331	1 483 300

The total authorised number of ordinary shares is 62 630 000 shares (2007: 62 630 000 shares) with a par value of R2.00 per share.

No shares were issued during the financial years ended 31 December 2007 and 31 December 2008.

The unissued shares are under the control of the shareholders until the next Annual General Meeting.

	2008 R'000	2007 R'000
15. Deposits		
Call deposits and current accounts	**1 709 895**	1 389 568
Savings accounts	**166 422**	174 714
Term and notice deposits	**2 326 438**	2 066 671
Negotiable certificates of deposit	**32 361**	39 695
Foreign deposits	**156 427**	100 152
	4 391 543	3 770 800
Maturity analysis		
Repayable on demand and within one month	**2 818 034**	2 072 342
Maturing after one month but within six months	**1 060 030**	1 267 181
Maturing after six months but within 12 months	**505 318**	284 187
Maturing after 12 months	**8 161**	147 090
	4 391 543	3 770 800

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

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	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
16. Provisions						
At 31 December 2006	10 382	2 100	12 853	8 299	5 330	38 964
Additional provision raised	14 976	4 880	1 490	3 075	2 100	26 521
Charged to provision	(12 356)	(3 790)	–	(2 738)	(4 194)	(23 078)
At 31 December 2007	**13 002**	**3 190**	**14 343**	**8 636**	**3 236**	**42 407**
Additional provision raised	**20 788**	**5 810**	**188**	**3 411**	**308**	**30 505**
Charged to provision	**(13 190)**	**(5 370)**	–	**(2 958)**	**(2 834)**	**(24 352)**
At 31 December 2008	**20 600**	**3 630**	**14 531**	**9 089**	**710**	**48 560**

Post-retirement medical benefits

Refer to note 17 for detailed disclosure of this provision.

Leave pay

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

Other risks

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

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

17. Post-retirement medical benefits

The Company operates a partly funded post-retirement medical scheme. The assets of the funded plans are held independently of the Company's assets in a separate trustee-administered fund. Independent actuaries value this scheme at least every three years. The last actuarial valuations were carried out at 31 December 2008. The actuary's opinion is that the plan is in a sound financial position.

	2008 R'000	2007 R'000	2006 R'000	2005 R'000
The amounts recognised in the balance sheet are as follows (refer to note 16):				
Present value of total service liabilities	**19 664**	20 223	18 989	16 651
Fair value of plan assets	**(5 133)**	(5 880)	(6 136)	(6 237)
– Provident fund	**(922)**	(838)	(1 457)	(1 624)
– Endowment bond	**(3 118)**	(3 446)	(3 729)	(4 104)
– Annuities	**(1 093)**	(1 596)	(950)	(509)
Liability in the balance sheet	**14 531**	14 343	12 853	10 414
The amounts recognised in the income statement are as follows (refer to note 24):				
Current service cost	**89**	116	115	414
Interest costs	**1 568**	1 539	1 365	1 659
Expected return on plan assets	**(529)**	(549)	(396)	(575)
Actuarial loss	**368**	936	1 957	1 736
Employer benefit payments	**(1 308)**	(1 202)	(1 168)	(1 085)
Payments from plan assets	**–**	650	846	540
Effect on curtailment	**–**	–	(280)	(455)
Total included in staff costs	**188**	1 490	2 439	2 234
Reconciliation of the movement in the present value of total service liabilities:				
At the beginning of year	**20 223**	18 989	16 651	22 277
Current service cost	**89**	116	115	414
Interest costs	**1 568**	1 539	1 365	1 659
Actuarial loss	**(908)**	781	2 306	1 610
Employer benefit payments	**(1 308)**	(1 202)	(1 168)	(1 085)
Net effect of settlements	**–**	–	–	(7 769)
Effect of curtailment	**–**	–	(280)	(455)
At the end of the year	**19 664**	20 223	18 989	16 651
Reconciliation of the movement in the fair value of plan assets:				
At the beginning of year	**5 880**	6 136	6 237	6 328
Expected return on plan assets	**529**	549	396	575
Actuarial (loss)/gain	**(1 276)**	(155)	349	(126)
Payments from plan assets	**–**	(650)	(846)	(540)
At the end of the year	**5 133**	5 880	6 136	6 237

The principal actuarial assumptions used were as follows:

Discount rate	9.25% (2007: 8.00%) compounded annually
Investment return	10.25% (2007: 9.00%) compounded annually
Rate of medical inflation	8.50% (2007: 7.25%) compounded annually
Salary inflation	8.00% (2007: 6.75%) compounded annually

The effect of a 1% increase/decrease on the assumed rate of medical inflation would be an increase in the liability in an amount of R1.8 million and a decrease of R1.5 million, respectively.

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
18. Other accounts payable		
Accruals	22 641	12 244
Loans from fellow subsidiary (refer to note 28.2)	–	31
Product-related credits	21 054	12 340
Sundry creditors	54 415	13 420
	98 110	38 035
19. Taxation		
South African Revenue Services		
Taxation owing by the Company	306	–
20. Contingent liabilities and commitments		
20.1 Guarantees and letters of credit and committed undrawn facilities		
Guarantees	331 494	391 335
Lending related	16 022	16 760
Mortgage	74 051	105 724
Performance	241 421	268 851
Letters of credit	6 886	19 937
Committed undrawn facilities	331 720	223 589
	670 100	634 861
20.2 Commitments under operating leases		
The total minimum future lease payments under operating leases are as follows:		
Property rentals:		
Due within one year	16 244	3 304
Due between one and five years	7 824	4 289
	24 068	7 593
After tax effect on operating leases	17 329	5 467

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.

	2008 R'000	2007 R'000
20.3 Capital commitments		
Contracted for	79 383	–
Authorised but not yet contracted for	13 635	–
	93 018	–

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
21. Interest income		
Interest on:		
Loans to subsidiaries	7 445	6 627
Loans and receivables	631 982	435 237
Cash and cash equivalents	154 375	142 501
Negotiable securities	23 166	18 776
Structured loans	56 185	356
Loans and advances	398 256	273 604
Loans and receivables at fair value through profit and loss	26 680	30 549
Mortgage loans	5 384	4 187
Instalment sales and leases	3 695	3 246
Other advances	16 159	13 410
Corporate bonds	1 442	9 706
Held-for-trading		
Interest rate swaps	3 114	1 457
	669 221	473 870
22. Interest expenditure		
Interest on:		
Deposits	335 939	244 093
Repurchase agreements	–	2 095
Held-for-trading		
Interest rate swaps	1 974	3 904
	337 913	250 092
23. Non-interest income		
Fee and commission income	175 900	136 860
Loans and receivables at fair value through profit and loss	273	161
Loans and receivables	175 627	136 699
Trading income	81 441	51 861
Held-for-trading	75 960	57 609
Foreign currency	71 138	42 516
Foreign currency commissions	10 007	8 540
Derivative assets	(4 063)	(583)
Derivative liabilities	(1 122)	7 136
Loans and receivables at fair value through profit and loss	5 481	(6 653)
Loans and advances	5 030	(5 824)
Corporate bonds	451	(829)
Loans and receivables		
Profit on settlement	–	905
Investment income	2 614	2 183
Dividends	2 614	2 167
Rental income	–	16
	259 955	190 904

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
24. Fee and commission expenditure		
Foreign currency commissions	24 214	17 490
Commissions and transactions expenses	51 905	11 351
	76 119	28 841
25. Operating expenditure		
Auditors' remuneration		
Audit fees – current year	6 030	5 825
– prior year	(240)	273
Fees for other services – Taxation advisory fees	102	427
– Review of Regulatory returns	575	80
– Other	20	–
	6 487	6 605
Professional fees		
Collections	88	297
Consulting	2 189	1 203
Legal	1 049	853
Computer consulting and services	27 015	21 407
	30 341	23 760
Depreciation and amortisation (refer to notes 2 and 3)	13 856	12 595
Directors' emoluments (refer to note 28.3)		
Executive directors	8 738	7 737
Non-executive directors' fees	3 134	3 071
	11 872	10 808
Lease charges		
Motor vehicles	–	9
Equipment	14	104
	14	113
Staff costs		
Salaries, wages and allowances	108 972	88 629
Post-retirement medical benefits (refer to note 17)	188	1 490
Contributions to retirement funds	7 052	6 453
Share-based payments including directors	8 253	4 041
Other	8 973	5 748
	133 438	106 361
(Profit)/Loss on sale of property and equipment	(29)	13
Operating leases – premises	16 713	14 785
Marketing and communication	7 051	7 412
Indirect taxation		
Non-claimable Value-Added Tax	8 067	5 052
Skills development levy	563	929
	8 630	5 981
Other operating costs	30 793	32 699
Total operating expenditure	259 166	221 132
Number of persons employed by the Company at year-end	442	419

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
26. Taxation		
S.A. normal taxation	–	–
– Current year	–	–
– Prior year	–	–
Deferred taxation	159 028	–
– Current year	(71 489)	–
– Prior year	230 517	–
	159 028	–
Direct taxation		
South African normal taxation	–	–
South African tax rate reconciliation		
South African standard tax rate (%)	28.00	29.00
Exempt income (%)	(0.28)	(0.40)
Expenses not deductible for tax purposes (%)	0.39	0.70
Capital gain – 50% portion not taxed for 2008	(0.53)	0.00
Underprovision prior year (%)	0.00	0.00
Other timing differences recognised for the first time (%)	(5.99)	0.00
Deferred taxation not raised (%)	0.00	4.50
Tax losses recognised for the first time (%)	(82.94)	0.00
Tax losses (%)	0.00	(33.80)
Effective tax rate (%)	(61.35)	0.0
Estimated tax losses available for set-off against future taxable income	563 355	730 727

27. Cash flow notes

27.1 Cash receipts from customers

	2008 R'000	2007 R'000
Interest income	669 221	473 870
Non-interest income and net gain on disposal and revaluation of available-for-sale investments	269 794	196 498
Adjusted for: Dividends received	(2 614)	(2 167)
Net (gain) on disposal and revaluation of available-for-sale investments	(9 839)	(5 594)
Revaluation of fair value financial instruments	72 157	(33 166)
Recoveries in respect of amounts previously written off	902	1 849
Total cash receipts from customers	999 621	631 290

Notes to the annual financial statements
for the year ended 31 December 2008 (continued)

	2008 R'000	2007 R'000
27. Cash flow notes (continued)		
27.2 Cash paid to suppliers and employees		
Interest expenditure	(337 913)	(250 092)
Operating expenditure and fee and commission expenditure	(335 285)	(249 973)
Adjusted for: Depreciation and amortisation	13 856	12 595
(Profit)/Loss on sale of property and equipment	(29)	13
Share-based payments	8 250	4 041
Increase in provisions	6 153	3 443
Total cash paid to suppliers and employees	(644 968)	(479 973)
27.3 Reconciliation of profit before taxation to cash generated from operations		
Profit before taxation	259 199	164 945
Profit before taxation adjusted for:		
Dividends received	(2 614)	(2 167)
Net (gain) on disposal and revaluation of available-for-sale investments	(9 839)	(5 594)
Revaluation of fair value financial instruments	72 157	(33 166)
Net impairments raised	7 520	7 207
Depreciation and amortisation	13 856	12 595
(Profit)/Loss on sale of property and equipment	(29)	13
Share-based payments	8 250	4 041
Increase in provisions	6 153	3 443
Cash generated from operations	354 653	151 317
27.4 Taxation received		
Amounts at beginning of year	–	–
Income statement charge	–	–
Less: Amounts unpaid at end of year	306	–
Total taxation recovered	306	–
27.5 Net increase in income earning assets		
Decrease in negotiable securities	30 432	128 610
(Increase) in loans and advances	(602 498)	(748 036)
(Increase)/Decrease in bank term deposits	(153 677)	242 637
Net (increase) in income earning assets	(725 743)	(376 789)
27.6 Net increase in deposits and other accounts		
Increase in deposits	620 743	228 769
Increase/(Decrease) in other accounts	43 166	(10 649)
(Increase)/Decrease of treasury shares	(4 851)	376
Net increase in deposits and other accounts	659 058	218 496

Notes to the annual financial statements
for the year ended 31 December 2008 (continued)

28. Related-party information

28.1 Identity of related parties with whom transactions have occurred

The holding company and ultimate holding company is identified on page 5 in the Directors' report. Subsidiaries of the Company are identified below. All of these entities and the Directors are related parties. There are no other related parties with whom transactions have taken place, other than as listed below.

28.2 Related-party balances and transactions

The Company, in the ordinary course of business, enters into various financial services transactions with the ultimate holding company and its subsidiaries, the holding company, fellow subsidiaries, the share incentive trust and the Company's subsidiaries. These transactions are governed by terms no less favourable than those arranged with third parties. Loans to and from fellow subsidiaries and other transactions are detailed hereafter.

Balances with the holding company, subsidiaries, fellow subsidiaries and associated company:

	% Held	2008 R'000	2007 R'000
Loans to subsidiaries			
Portion 2 of Lot 8 Sandown (Pty) Limited	100	44 832	43 987
LSM (Troyeville) Properties (Pty) Limited	100	6 265	5 931
Less: Provisions held against loan accounts		(1 685)	(2 022)
		49 412	47 896
Loans to fellow subsidiaries and holding company			
Mercantile Bank Holdings Limited		10 793	9 825
Mercantile Insurance Brokers (Pty) Limited		467	162
Mercantile Registrars Limited		3 042	3 042
Less: Provisions held against loan accounts		(3 042)	(3 042)
		11 260	9 987
Loan from fellow subsidiary			
Mercantile Nominees (Pty) Limited		–	31
Loan to associated company			
Statman Investments (Pty) Limited		468	695
Deposits from holding company and fellow subsidiaries			
Mercantile Bank Holdings Limited		224	197
Mercantile Insurance Brokers (Pty) Limited		1 973	1 621
Mercantile Nominees (Pty) Limited		–	799
		2 197	2 617

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

28. Related-party information (continued)

28.2 Related-party balances and transactions (continued)

Transactions with the holding company, subsidiaries, fellow subsidiaries and associated company:

	2008 R'000	2007 R'000
Interest received from:		
Portion 2 of Lot 8 Sandown (Pty) Limited	6 527	5 862
LSM (Troyeville) Properties (Pty) Limited	918	765
Statman Investments (Pty) Limited	81	40
Interest paid to:		
Mercantile Insurance Brokers (Pty) Limited	100	81
Non-interest income earned from:		
Mercantile Insurance Brokers (Pty) Limited	164	68
Operating expenditure with:		
Portion 2 of Lot 8 Sandown (Pty) Limited	10 680	9 251
LSM (Troyeville) Properties (Pty) Limited	1 018	1 011

Balances and transactions with the ultimate holding company (CGD) and its subsidiary:

	2008 R'000	2007 R'000
CGD – Lisbon (Branch of CGD)	1 348 916	897 628
Nostro accounts	4 316	1 763
Vostro accounts	(2 142)	(2 994)
Deposit accounts	1 346 742	898 859
CGD – Paris (Branch of CGD)	(3 191)	152
Nostro accounts	84	174
Vostro accounts	(3 275)	(22)
CGD – London (Branch of CGD)		
Vostro accounts	(18)	(18)
CGD	1 345 707	897 762
Banco Comercial e de Investimentos (BCI) – Mozambique (Subsidiary of CGD)	(63 781)	(37 928)
Vostro accounts	(4 032)	(142)
Fixed deposits	(59 730)	(37 327)
Call and notice deposits	(19)	(459)
	1 281 926	859 834

Interest was paid to BCI amounting to R3.4 million (2007: R7.9 million).

Interest received from CGD in respect of the above balances during the year amounted to R41.1 million (2007: R73.1 million).

Post-retirement medical plan

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

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

28. Related-party information (continued)

28.3 Director and director-related activities

No loans were made to Directors during the year under review. There were no material transactions with Directors, other than the following:

Director	Directors' fees R'000	Salary R'000	Fringe benefits R'000	Retirement funds and medical aid contri-butions R'000	Perfor-mance bonus R'000	Total R'000
2008						
J A S de Andrade Campos	**1 199**	–	–	–	–	**1 199**
D J Brown	–	**2 368**	–	**251**	**3 500**	**6 119**
G P de Kock	**519**	–	–	–	–	**519**
L Hyne	**480**	–	–	–	–	**480**
A T Ikalafeng	**420**	–	–	–	–	**420**
J P M Lopes	–	**1 541**	**479**	**49**	**550**	**2 619**
T H Njikizana						
(appointed 6 November 2008)	**50**	–	–	–	–	**50**
S Rapeti	**466**	–	–	–	–	**466**
	3 134	**3 909**	**479**	**300**	**4 050**	**11 872**
2007						
J A S de Andrade Campos	1 100	–	–	–	–	1 100
D J Brown	–	2 146	–	236	2 681	5 063
G P de Kock	498	–	–	–	–	498
M J M Figueira						–
(resigned 28 February 2007)	–	259	59	–	–	318
L Hyne	452	–	–	–	–	452
A T Ikalafeng	347	–	–	–	–	347
J P M Lopes	–	1 429	383	44	500	2 356
A M Osman						
(resigned 21 November 2007)	226	–	–	–	–	226
S Rapeti	448	–	–	–	–	448
	3 071	3 834	442	280	3 181	10 808

	2008 R'000	2007 R'000
Share-based payments expense relating to Directors:		
D J Brown	**2 273**	1 458
Amounts paid by CGD to:		
M J M Figueira (resigned 28 February 2007)	–	124
J P M Lopes	**666**	560
	666	684

Notes to the annual financial statements
for the year ended 31 December 2008 (continued)

28. Related-party information (continued)

28.3 Director and director-related activities (continued)

Service agreements

D J Brown, Chief Executive Officer
Mr Brown’s employment as Chief Executive Officer commenced on 31 March 2004. The Board at a Board meeting held on 31 October 2008 approved the renewal of Mr Brown's service contract for a further three years, upon expiry in March 2009. The re-appointment of Mr Brown as an executive director with effect from 29 March 2009 upon expiry in terms of the Articles of Association of the Company, will be confirmed at the Annual General Meeting to be held on 28 May 2009.

In consideration for the rendering of his services under the Service Agreement, Mr Brown is also entitled to payment of an annual incentive bonus calculated in accordance with a performance plan as agreed with the Board from time to time.

J P M Lopes, Executive Director
Mr Lopes has been seconded to Mercantile by CGD.

Mr Lopes’s employment in Mercantile commenced on 9 November 2005, and his contract was renewed by the Board upon expiry on 9 November 2008 for three years. In terms of the service agreement Mr Lopes agreed to perform such duties, functions and services as are assigned to him from time to time by the Board of Directors and which are consistent and commensurate with his position as Executive Director.

Mr Lopes will in accordance with the Company's Articles of Association stand for re-election at the Annual General Meeting on 28 May 2009.

Share options

In terms of the share option scheme the following share options in MBHL have been granted to Mr Brown (refer to note 29):

- on 5 October 2004, 5 000 000 at an exercise price of 18 cents each;
- on 22 March 2006, 7 000 000 at an exercise price of 40 cents each; and
- on 26 February 2007, 8 000 000 at an exercise price of 34 cents each.

In terms of the Conditional Share Plan, 7 600 000 conditional share awards in MBHL were granted to Mr Brown on 27 May 2008 with a market value on the date of grant of 32 cents each (refer to note 29).

Directors’ interests

No Directors held beneficial and/or non-beneficial interests, directly or indirectly, in shares issued by MBHL (2007: nil).

29. Share incentive scheme

The options granted are in respect of the holding company, MBHL, to the employees of the Bank.

The number of shares, which could be utilised for the purposes of the share incentive schemes are 393 891 852 (2007: 393 891 852), which is 10% (2007: 10%) of the issued share capital of the Company at year-end. At 31 December 2008, 73 410 400 share options and Conditional Share Plan awards were outstanding under these schemes. The balance available to be utilised under these schemes is 320 481 452. The number of scheme shares that may be issued to a single participant is 59 083 778 or 1.5% of the total number of issued shares.

The Company recognised total expenses of R8.3 million (2007: R4.0 million) related to equity-settled share-based payment transactions.

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

29. Share incentive scheme (continued)

Share option scheme

Effective 18 July 2007, options can be exercised in respect of 33% of the option shares after the expiration of three years from the offer date, in respect of a further 33% after the expiration of four years from the offer date and the remaining option shares after the expiration of five years from the offer date. Options granted prior to this date may be exercised in respect of 33% of the option shares after the expiration of two years from the offer date, in respect of a further 33% after the expiration of three years from the offer date and the remaining option shares after the expiration of four years from the offer date. Such percentages are to be carried forward on a cumulative basis. Prior to 2008, should the options not be exercised by the fifth anniversary date of the offer, the option holder was obliged to exercise the option in respect of at least 20% of the options in question by the sixth anniversary date of the offer or else the said 20% of the options would lapse. The same rule applied for the seventh, eighth, ninth and tenth anniversary of the offer date until the options in question either lapsed or were exercised.

The scheme was modified in 2008 whereby the expiry condition from the sixth anniversary date was removed and all unexpired options now lapse after ten years from the date of issue. This modification had no material impact on the expense recognised in terms of share-based payments.

Conditional Share Plan ("CSP")

On 27 May 2008 the shareholders of MBHL approved the CSP incentive scheme which is in line with global best practice and emerging South African practice. The purpose of the scheme is to recognise contributions made by selected employees and to provide for an incentive for their continuing relationship with the Company, by providing them with the opportunity of receiving shares in MBHL, thereby providing participants with an incentive to advance the Company's interest and to ensure that the Company attracts and retains the core competencies required for formulating and implementing the Company's business strategies.

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

Share option scheme

Grant date	Exercise price (cents)	Options at beginning of year	Granted during year	Forfeited during year	Exercised during year	Options at end of year	Exercisable options at end of year	Relating to directors[1]
2008								
20 November 2001	32	954 400	–	(160 000)	–	794 400	794 400	–
11 February 2002	32	200 000	–	(40 000)	–	160 000	160 000	–
5 October 2004	18	5 000 000	–	–	–	5 000 000	5 000 000	5 000 000
7 October 2004	17	1 000 000	–	(85 000)	(165 000)	750 000	750 000	–
3 January 2005	15	700 000	–	(170 000)	(530 000)	–	–	–
11 February 2005	20	500 000	–	–	–	500 000	330 000	–
1 April 2005	39	–	–	–	–	–	–	–
27 July 2005	32	750 000	–	–	–	750 000	495 000	–
2 December 2005	31	350 000	–	(350 000)	–	–	–	–
9 February 2006	41	750 000	–	–	–	750 000	247 500	–
3 March 2006	38	500 000	–	–	–	500 000	165 000	–
22 March 2006	40	12 500 000	–	(1 900 000)	–	10 600 000	3 498 000	7 000 000
26 February 2007	34	21 250 000	–	(3 150 000)	–	18 100 000	–	8 000 000
1 June 2007	36	500 000	–	–	–	500 000	–	–
1 December 2007	36	1 000 000	–	–	–	1 000 000	–	–
		45 954 400	–	(5 855 000)	(695 000)	39 404 400	11 439 900	20 000 000

[1]Refer to note 28.3

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

29. Share incentive scheme (continued)

Share option scheme (continued)

Grant date	Exercise price (cents)	Options at beginning of year	Granted during year	Forfeited during year	Exercised during year	Options at end of year	Exercisable options at end of year	Relating to directors[1]
2007								
20 November 2001	32	3 943 000	–	(1 988 600)	(1 000 000)	954 400	954 400	–
11 February 2002	32	200 000	–	–	–	200 000	200 000	–
5 October 2004	18	5 000 000	–	–	–	5 000 000	3 300 000	5 000 000
7 October 2004	17	2 000 000	–	–	(1 000 000)	1 000 000	660 000	–
3 January 2005	15	700 000	–	–	–	700 000	231 000	–
11 February 2005	20	500 000	–	–	–	500 000	165 000	–
1 April 2005	39	1 000 000	–	(1 000 000)	–	–	–	–
27 July 2005	32	750 000	–	–	–	750 000	247 500	–
2 December 2005	31	350 000	–	–	–	350 000	115 500	–
9 February 2006	41	750 000	–	–	–	750 000	–	–
3 March 2006	38	500 000	–	–	–	500 000	–	–
22 March 2006	40	14 800 000	–	(2 300 000)	–	12 500 000	–	7 000 000
26 February 2007	34	–	24 000 000	(2 750 000)	–	21 250 000	–	8 000 000
1 June 2007	36	–	500 000	–	–	500 000	–	–
1 December 2007	36	–	1 000 000	–	–	1 000 000	–	–
		30 493 000	25 500 000	(8 038 600)	(2 000 000)	45 954 400	5 873 400	20 000 000

[1] Refer to note 28.3

The Company has not granted any share options in 2008 in terms of the share option scheme. The Inputs into the Black-Scholes model in determining the charge for share-based payments for options granted during the 2007 are as follows:

	2007
Weighted average fair value share price at grant date	34 cents
Weighted average exercise price	34 cents
Expected volatility	82.10%
Option life	10 years
Risk free rate	7,58%
Expected dividends	Nil

Expected volatility was determined by calculating the historical volatility of the MBHL share price from September 2004 to the grant date of each option. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

Notes to the annual financial statements

for the year ended 31 December 2008 (continued)

29. Share incentive scheme (continued)

Conditional Share Plan ("CSP")

Grant date	Market price at date of grant (cents)	Conditional awards at beginning of year	Granted during year	Forfeited during year	Vested during year	Conditional awards at end of year	Relating to directors[1]
2008							
22 February 2008	32	–	28 445 000	(2 314 000)	–	26 131 000	7 600 000
26 March 2008	31	–	4 000 000	–	–	4 000 000	–
7 May 2008	30	–	1 400 000	(1 400 000)	–	–	–
24 July 2008	26	–	375 000	–	–	375 000	–
1 October 2008	32	–	500 000	–	–	500 000	–
1 November 2008	28	–	2 200 000	–	–	2 200 000	–
1 December 2008	29	–	800 000	–	–	800 000	–
		–	37 720 000	(3 714 000)	–	34 006 000	7 600 000

[1]Refer to note 28.3

30. Presentation adjustments and explanatory notes

Balance sheet and cash flow statement

- Structured loans previously included under other categories of loans and advances are reported separately in 2008. Comparatives for the year ended 31 December 2007 have been reclassified accordingly for all affected disclosures.
- Bank term deposits with a residual maturity greater than three months from the reporting date previously presented with cash and cash equivalents are now presented separately in the balance sheet and the cash flow statement. Comparatives for the year ended 31 December 2007 have been reclassified accordingly for all affected disclosures.
- With the adoption of IFRIC 11 – IFRS 2 Group and Treasury transactions, a share-based payments reserve in respect of the Mercantile Share Option scheme is not required. This reserve is processed to accumulated loss with effect from 1 January 2008 in the Company whereas previously a share-based payments reserve was created in MBHL.

  In the case of the Mercantile Conditional Share Plan introduced in 2008, a share-based payments reserve has been created to separate the effects of this plan from other classes of reserves for management purposes.
- The new Bank Regulations, effective 1 January 2008, no longer require general credit-risk reserves. The balance of this reserve as at 31 December 2007 was transferred to accumulated loss in 2008.

Income statement

- Interest income relating to structured loans previously included under other categories of loans and advances is reported separately in 2008. Comparatives for the year ended 31 December 2007 have been reclassified accordingly for all affected disclosures.
- Expenditure directly attributable to fee and commission income previously included under operating expenditure is now presented separately in the income statement. Comparatives for the year ended 31 December 2007 have been reclassified accordingly for all affected disclosures.

Risk management and control

Risk management philosophy

The Company recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks. The Company operates in a dynamic environment where the past is not necessarily an acceptable guide to the future which has emerged even more clearly with the advent of the current global financial crisis. Risk management is a key focus of the Company and addresses a wide spectrum of risks that are continually evaluated and policies and procedures reviewed and stress tested to adapt to changing circumstances. In any economy there are sectors that are more vulnerable to cyclical downturn than others. Economic variances 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 we acknowledge the propensity to concentration risk in being a small bank and this is carefully monitored. Our business development efforts are focused on the stronger companies and individuals, establishing policy criteria, which eliminate weaker credit or investments from the portfolio. A passive role in the face of potential or actual adverse conditions is not accepted.

The Company remains well positioned to effectively manage identified threats in such a way that will minimise risks to the Company. An independent review of the risk management and control is planned to take place in 2009.

A philosophy of enterprise-wide risk management within a Risk Management Monitoring and Control Framework has been established to ensure that all business and operational risks are managed effectively within acceptable risk profiles, policies and parameters. The management of risk is an independent process from that of taking on/creating risk within the Company. Risk management policies are essentially conservative, with proper regard to the mix of risk and reward. The Company will take all necessary steps to safeguard its depositors' funds, its own asset base and shareholders' funds.

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. Risk dimensions will vary in importance based on the business activities of an organisation. The overall objective of enterprise-wide risk management is to ensure an integrated and effective risk management framework, where all risks are identified, quantified and managed in order to achieve an optimal risk reward profile. The presence of accurate measures of risk makes risk adjusted performance possible, creates the potential to generate increased shareholder returns and allows the risk taking behaviour to be more closely aligned with our strategic objectives.

Risk management is performed on a Company wide basis involving the Board, credit management, senior management, independent risk management, business line management, finance and control, legal/compliance, treasury and operations, with significant support from internal audit and information technology.

Risk management and control (continued)

Risk management life cycle/process

All of the Company's policies and procedures manuals are subject to ongoing review and are signed off by the relevant divisional heads. These standards are an integral part of the Company's governance infrastructure and risk management profile, reflecting the expectations and requirements of the Board in respect of key areas of control. The standards ensure alignment and consistency in the way that prevalent risk types are managed and form part of the four 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 obviously lend themselves more easily to measurability than others, but it is necessary to ascertain the magnitude of each risk.

Risk management (as an independent function)

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

Risk monitoring (and compliance with documented policies)

Open, two-way communication between the Company 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 and RMC in the first instance and to the SARB via the Finance Division through BA returns and periodic meetings.

Risk control (stress testing)

The Company follows a policy of ongoing stress testing. Critical variables are sensitive to market changes both domestic and international. These are identified and stress modelled to determine the possible impact of any deterioration of such identified variables on the Company's results. Both internal and external events are considered in formulating appropriate modelling criteria.

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 division within the Company and also forms a consistent common language for outside examiners and/or regulators to follow.

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

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

Board Committees monitor various aspects of the different identified risks, which include:

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

Risk management and control (continued)

Management of risk (continued)

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

The Board fully recognises that they are 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 significant control weaknesses identified.

A process is in place whereby the Top 10 risks faced by the Company are identified. These risks are assessed and evaluated in terms of a risk score attached to inherent risk and residual risk. Action plans are put in place to reduce the identified inherent risks to within acceptable residual risk parameters. The Top 10 risks are re-evaluated quarterly.

The Company subscribes to the 10 Principles of Sound Practices for the Effective Management and Supervision of Operational Risk as defined by the Basel Committee or Banking Supervision.

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

The Capital Management Committee under the auspices of the RMC proactively evaluates and manages the Capital requirements of the Company as determined by Basel II requirements. A comprehensive evaluation of the capital requirements under the Internal Capital Adequacy Assessment Process was undertaken during the year with consideration given to all risks impacting on the need for capital reserves within the Company. The basis of the assessment resulted in the Company identifying two risks – implementation of a new core system for the Company and the inherent concentration of the book given the nature of the Company's customers relative to its size which resulted in the prudent decision to hold a capital buffer in addition to the regulatory requirements.

Under the Enterprise-wide Risk Management Framework we have categorised the direct risks of the Company and report on those deemed to be of the most significance:

Credit risk

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

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

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

At year-end, the Company did not consider there to be any significant concentration of risk, which had not been adequately provided for. There were no material exposures in advances made to foreign entities at year-end, except for the deposits placed with CGD as disclosed in note 28.2.

A portfolio analysis report is prepared and presented to the RMC analysing the performance and makeup of the book including customer and segment concentration analyses.

Risk management and control (continued)

Management of risk (continued)

Credit risk (continued)

The Company has adopted a conservative approach to credit granting within a specifically defined and structured approval process. The granting of credit is managed via a mandated approval process whereby levels of credit approval are determined by the experience of the mandated individual with dual or multiple sign-off on all material values. An ongoing weekly review is also undertaken by the CREDCOM of all lending in excess of R2 million. In addition the early warning system is applied to actively manage all accounts within the risk structure. The system identifies a number of characteristics relating to the performance of the accounts and based on various predefined algorithms, flags issues of concern. Monitoring is done by the Early Warning Department and any concerns are raised with the Credit Department and Retail or Commercial banking units. The Company is in the process of further enhancing a Decision Support tool to assist credit decision makers through the provision of indicative performance criteria and other information necessary to assist in making increasingly informed decisions. Such indicative performance data will be measured against predefined acceptance bands and result in the allocation of an overall acceptability rating.

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

The table below summarises the Company's maximum exposure to credit risk at balance sheet date:

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2008				
Current accounts	**506 103**	**–**	**–**	**506 103**
Credit card	**22 420**	**19 364**	**–**	**41 784**
Mortgage loans	**1 622 704**	**312 357**	**–**	**1 935 061**
Instalment sales and leases	**373 744**	**–**	**–**	**373 744**
Structured loans	**285 225**	**–**	**–**	**285 225**
Other advances	**673 425**	**–**	**–**	**673 425**
Negotiable securities	**–**	**–**	**247 141**	**247 141**
Bank term deposits	**–**	**–**	**324 295**	**324 295**
Cash and cash equivalents	**–**	**–**	**1 464 959**	**1 464 959**
Guarantees	**–**	**–**	**331 494**	**331 494**
Letters of credit	**–**	**–**	**6 886**	**6 886**
	3 483 621	**331 721**	**2 374 775**	**6 190 117**
2007				
Current accounts	657 886	–	–	657 886
Credit card	21 555	32 679	–	54 234
Mortgage loans	1 241 399	190 910	–	1 432 309
Instalment sales and leases	304 588	–	–	304 588
Structured loans	131 191	–	–	131 191
Other advances	553 787	–	–	553 787
Negotiable securities	–	–	275 577	275 577
Bank term deposits	–	–	170 618	170 618
Cash and cash equivalents	–	–	1 252 376	1 252 376
Guarantees	–	–	391 335	391 335
Letters of credit	–	–	19 937	19 937
	2 910 406	223 589	2 109 843	3 545 267

Risk management and control (continued)

Management of risk (continued)

Operational risk

The Company subscribes to the 10 Principles of Sound Practices for the Effective Management and Supervision of Operational Risk.

Operational risks faced by the Company are extensive and *inter alia* include risks associated with reputation, robbery, fraud, theft of data, legal challenges, statutory and legislative compliance, operational processes, employment policies, documentation risk and business continuity. Strategies, procedures and action plans to monitor, manage and limit the risks associated with operational processes, systems and external events include:

- documented operational policies, processes and procedures with segregation of duties;
- training and upskilling staff on operational procedures and legislative compliance;
- an operational event logger wherein all losses associated with operational issues including theft and robbery are recorded and evaluated to facilitate corrective action;
- ongoing improvements to the Disaster Recovery and Business Continuity plans including conducting a variety of simulation exercises in the branches and critical operations environments; and
- conducting a variety of internal audits and reviews by both the Compliance and Internal Audit Departments in line with annual plans approved by the Board.

There have been no material losses during the reporting period that require specific identification.

Market risk

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

The Company does not currently have any proprietary trading positions and therefore has minimal exposure to market risk. Before the Company enters into a proprietary trading position, the Trading Committee will evaluate and approve such positions. This Committee will ensure that the Company is prudently positioned, taking into account agreed limits, policies, prevailing markets, available liquidity and the relationship between risk and reward primarily to the financial risks of changes in foreign currency exchange rates and interest rates. The Company enters into derivative financial instruments to manage its exposure to interest rate and foreign currency risk, including:

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

Detailed market risk reports are produced on a daily basis, which allows for monitoring against prescribed limits. In the unlikely event of an unauthorised limit violation, the ALM records such violation, which is immediately corrected and reported to the ALCO, which is a subcommittee of the RMC.

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

There has been no significant change to the Company's exposure to market risks or the manner in which it manages and measures the risk.

Foreign currency risk

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

The Company has conservative limits in terms of net open foreign currency positions which 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 R6.2 million (2007: R5.1 million).

Risk management and control (continued)

Management of risk (continued)

Foreign currency risk (continued)

The transaction exposures and foreign exchange contracts at balance sheet date are summarised as follows:

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2008					
Total foreign exchange assets	**1 361 063**	**35 327**	**26 585**	**12 277**	**1 435 252**
Total foreign exchange liabilities	**(129 695)**	**(13 782)**	**(12 828)**	**(130)**	**(156 435)**
Commitments to purchase foreign currency	**301 762**	**76 282**	**8 299**	**14 086**	**400 429**
Commitments to sell foreign currency	**(1 532 755)**	**(100 155)**	**(22 371)**	**(26 754)**	**(1 682 035)**
Year-end effective net open foreign currency positions	**375**	**(2 328)**	**(315)**	**(521)**	**(2 789)**
2007					
Total foreign exchange assets	913 287	65 356	30 444	8 116	1 017 203
Total foreign exchange liabilities	(60 493)	(18 578)	(20 794)	(89)	(99 954)
Commitments to purchase foreign currency	245 343	67 736	20 242	8 320	341 641
Commitments to sell foreign currency	(1 097 925)	(114 958)	(30 513)	(16 640)	(1 260 036)
Year-end effective net open foreign currency positions	212	(444)	(621)	(293)	(1 146)

Interest rate risk

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

The Company is exposed to interest rate risk as it takes deposits from clients at both fixed and floating interest rates. The Company manages the risk by maintaining an appropriate mix between fixed and floating rate funds and by the use of interest rate swap contracts.

Under interest rate swap contracts, the Company agrees to exchange the difference between fixed and floating rate interest amounts calculated on agreed notional principal amounts. Such contracts enable the Company 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 interest rate swaps reprice on a quarterly basis. The floating rate on the interest rate swaps is based on the three-month JIBAR and/or prime rate. The Company will settle the difference between the fixed and floating interest rate on a net basis.

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

To measure such risk, the Company aggregates interest rate sensitive assets and liabilities into fixed time bands in accordance with the respective interest repricing dates. The Company 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 on the yield curve.

In addition, the impact on equity and profit and loss resulting from a change in interest rates is calculated monthly based on management's forecast of the most likely change in interest rates.

Risk management and control (continued)

Management of risk (continued)

Interest rate risk (continued)

At reporting date, a 50 basis point change was applied as a sensitivity analysis to determine exposure to interest rates. If interest rates increased/decreased by 50 basis points and all other variables remained constant, the Company's net profit and equity at year-end would increase/decrease by R8.6 million (2007: increase/decrease by R13.6 million). This is mainly attributable to the Company's exposure to interest rates on its lending and borrowings in the banking book.

The table below summarises the Company's exposure to interest rate risk. Assets and liabilities are included at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates and also indicate their effective interest rates at year-end:

	Up to 1 month R'000	1 - 3 months R'000	3 - 12 months R'000	1 - 5 years R'000	Over 5 years R'000	Non-interest bearing R'000	Total R'000	Effective interest rate %
2008								
Assets								
Intangible assets	–	–	–	–	–	76 894	76 894	–
Property and equipment	–	–	–	–	–	35 995	35 995	–
Other accounts receivable	–	–	–	–	–	50 501	50 501	–
Interest in subsidiaries	51 097	–	–	–	–	39 936	91 033	–
Other investments	–	–	–	–	–	20 070	20 070	–
Deferred taxation assets	–	–	–	–	–	153 531	153 531	–
Non-current assets held for sale	–	–	–	–	–	5 289	5 289	–
Loans and advances	3 329 515	–	–	109 470	44 636	(79 832)	3 403 789	15.32
Derivative financial instruments	–	184	–	–	–	56 689	56 873	–
Negotiable securities	24 823	87 275	114 505	–	20 538	–	247 141	11.84
Bank term deposits	–	–	324 295	–	–	–	324 295	9.42
Cash and cash equivalents	947 999	410 808	–	–	–	106 152	1 464 959	9.42
Total assets	4 353 434	498 267	438 800	109 470	65 174	465 225	5 930 370	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	1 296 760	1 296 760	–
Deposits	2 815 292	550 288	1 012 189	8 161	–	5 613	4 391 543	8.30
Derivative financial instruments	7 091	1 906	–	–	–	86 094	95 091	–
Provisions	–	–	–	–	–	48 560	48 560	–
Other accounts payable	–	–	–	–	–	98 110	98 110	–
Taxation	–	–	–	–	–	306	306	–
Total equity and liabilities	2 822 383	552 194	1 012 189	8 161	–	1 535 443	5 930 370	
On balance sheet interest sensitivity gap	1 531 051	(53 927)	(573 389)	101 309	65 174	–	(1 070 218)	
Derivative financial instruments	27 559	119 758	–	(106 331)	(40 986)	–	–	
Total net interest sensitivity gap	1 558 610	65 831	(573 389)	(5 022)	24 188	–	(1 070 218)	

Risk management and control (continued)

Management of risk (continued)

Interest rate risk (continued)

	Up to 1 month R'000	1 - 3 months R'000	3 - 12 months R'000	1 - 5 years R'000	Over 5 years R'000	Non-interest bearing R'000	Total R'000	Effective interest rate %
2007								
Assets								
Intangible assets	–	–	–	–	–	23 568	23 568	–
Property and equipment	–	–	–	–	–	16 655	16 655	–
Other accounts receivable		–	–	–	–	33 593	33 593	–
Interest in subsidiaries	47 896	–	–	–	–	32 220	80 116	–
Other investments	–	–	–	–	–	8 917	8 917	–
Loans and advances	2 755 877	–	–	111 091	43 438	(95 663)	2 814 743	13.48
Derivative financial instruments	4 248	–	–	–	–	39 566	43 814	–
Negotiable securities	102 752	145 769	20 482	–	6 574	–	275 577	11.13
Bank term deposits	–	–	170 618	–	–	–	170 618	9.01
Cash and cash equivalents	784 050	371 528	-	–	–	96 798	1 252 376	9.01
Total assets	3 694 823	517 297	191 100	111 091	50 012	155 654	4 719 977	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	853 379	853 379	–
Deposits	2 125 366	590 292	802 812	146 742	348	105 240	3 770 800	7.06
Derivative financial instruments	7 875	–	–	–	–	7 481	15 356	–
Provisions	–	–	–	–	–	42 407	42 407	–
Other accounts payable	–	–	–	–	–	38 035	38 035	–
Total equity and liabilities	2 133 241	590 292	802 812	146 742	348	1 046 542	4 719 977	
On balance sheet interest sensitivity gap	1 561 582	(72 995)	(611 712)	(35 651)	49 664	–	(890 888)	
Derivative financial instruments	80 950	93 209	(21 500)	(110 101)	(42 558)	–	–	
Total net interest sensitivity gap	1 642 532	20 214	(633 212)	(145 752)	7 106	–	(890 888)	

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 Company is exposed to daily cash needs from overnight deposits, current accounts, maturing deposits, loan drawdowns and guarantees.

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

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

Through active liquidity management, the Company 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.

Risk management and control (continued)

Management of risk (continued)

Liquidity risk (continued)

To manage this risk, the Company performs, amongst others, the following:

- maintenance of stock of readily available, high quality liquid assets in excess of the statutory requirements as well as strong balance sheet liquidity ratios;
- assumptions based sensitivity analysis to assess potential cash flows at risk;
- management of concentration risk, being 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/cash flow requirements, including daily settlements and collateral management processes;
- creation and monitoring of prudential liquidity risk limits; and
- maintenance of an appropriate term mix of funding.

There were no significant changes in the Company's liquidity position during the current financial year or the manner in which it manages and measures the risk. The Company is adequately funded and able to meet all its current and future obligations.

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

	Assets R'000	Liabilities R'000	Total mismatch R'000
2008			
Maturing up to one month	**1 894 685**	**3 010 581**	**(1 115 896)**
Maturing between one and three months	**518 301**	**591 013**	**(72 712)**
Maturing between three and six months	**322 211**	**509 066**	**(186 855)**
Maturing between six months and one year	**181 561**	**505 792**	**(324 231)**
Maturing after one year	**2 699 358**	**17 158**	**2 682 200**
Non-contractual	**314 254**	**–**	**314 254**
	5 930 370	**4 633 610**	**1 296 760**
2007			
Maturing up to one month	1 934 713	2 163 481	(228 768)
Maturing between one and three months	592 655	751 773	(159 118)
Maturing between three and six months	258 494	519 894	(261 400)
Maturing between six months and one year	179 121	284 360	(105 239)
Maturing after one year	1 721 401	147 090	1 574 311
Non-contractual	33 593	–	33 593
	4 719 977	3 866 598	853 379

Risk management and control (continued)

Management of risk (continued)

Liquidity risk (continued)

The remaining period to contractual maturity of financial liabilities of the Company as at balance sheet 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 – 3 months R'000	3 – 6 months R'000	6 – 12 months R'000	Over 1 year R'000
2008					
Deposits	**2 824 277**	**565 940**	**529 882**	**551 597**	**9 669**
Derivative financial instruments	**45 937**	**37 929**	**2 774**	**2 306**	**6 202**
Other accounts payable	**98 110**	–	–	–	–
Taxation	**306**	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	**670 100**	–	–	–	–
Operating lease commitments	**1 377**	**2 755**	**4 149**	**7 963**	**7 824**
Capital commitments	**24 738**	**11 415**	**17 980**	**30 497**	**8 388**
	3 664 845	**618 039**	**554 785**	**592 363**	**32 083**
2007					
Deposits	2 058 045	768 400	537 375	306 368	175 918
Derivative financial instruments	3 444	3 344	1 850	1 322	7 018
Other accounts payable	38 035	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	634 861	–	–	–	–
Operating lease commitments	366	698	890	1 350	4 289
	2 734 751	772 442	540 115	309 040	187 225

Basel II – influencing risk management developments

The Basel Committee released the revised international Basel II Capital Accord in June 2004. The Accord is designed to differentiate minimum regulatory capital requirements in a risk sensitive manner and encourage and acknowledge sound risk management, internal control and governance practices.

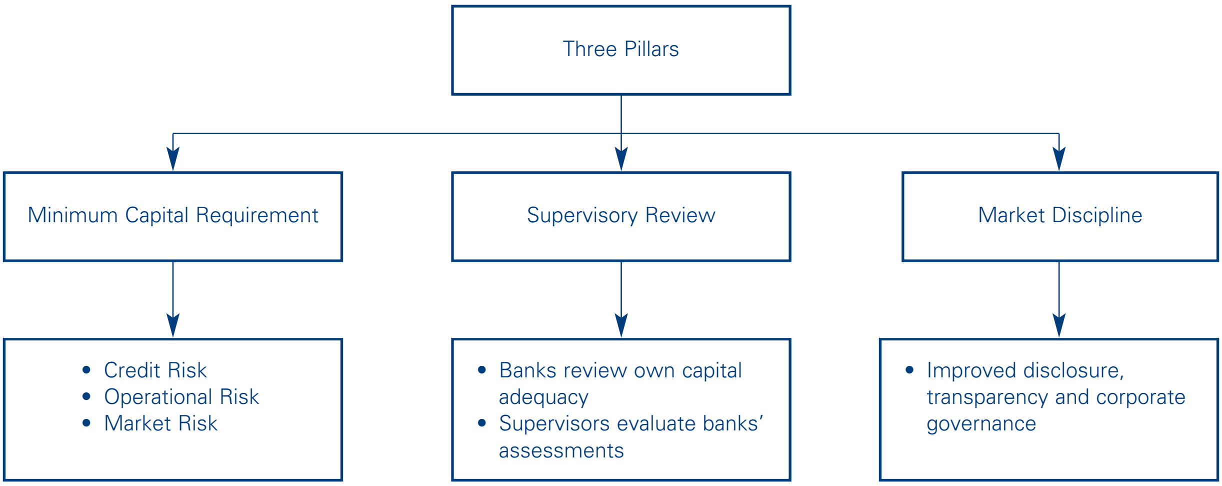
In today's complex environment, combining effective bank-level management with market discipline and regulatory supervision, best attains systemic safety and soundness. Building on these principles, the new Accord has far reaching implications for banks in terms of minimum capital standards linked to risks, risk measurement systems and methods, risk management practices and public disclosure of risk profile information. It focuses mainly on improving the management of credit and operational risks, enhancements to the supervisory review process and more extensive risk disclosure.

The overall objective of the new Accord is to improve the safety and soundness of the financial system. This will ensure a more resilient, more stable and a better source for credit, risk intermediation and growth. The principles of Basel II were built around three pillars. These pillars can briefly be summarised by the following diagram:

Risk management and control (continued)

Management of risk (continued)

Basel II – influencing risk management developments (continued)



The new Accord provides a range of approaches that vary in levels of sophistication for the measurement of credit, operational and market risk to determine capital levels. It provides a flexible structure in which banks, subject to supervisory review, will adopt approaches that best fit their level of sophistication and their risk profile. The Bank evaluated the various options available and decided that the most appropriate approaches to follow for the calculation of the minimum capital requirement in terms of the Banks Act would be the Standardised Approach for Credit, Operational and Market risk.

The Accord has been implemented with effect 1 January 2008. The Bank continues to form part of various Basel II committees in association with the SARB, The Banking Association and other financial institutions.

The Company recognises the significance of Basel II in aligning regulatory capital to risk and further entrenching risk reward principles and practices in bank management and decision making.

Capital management

The Bank is subject to minimum capital requirements as defined in the Banks Act and Regulations. The management of the Company's capital takes place under the auspices of the RMC, through the ALCO. The RMC considers the various risks faced by the Company and analyses the need to hold capital against these risks whilst taking account of the regulatory requirements. In addition, the level of capital required to support the Company's targeted business growth is taken into consideration.

Risk weighted capital is allocated to the different business units in line with their targeted growth requirements.

The objective of the Company's capital management approach is to ensure the maintenance of sound capital ratios, taking all the above requirements into account, whilst producing appropriate returns to shareholders. Capital to support the Company's needs is currently generated by retained earnings.

In terms of regulation, the Company is able to consider different tiers of capital. The capital of the Bank consists almost entirely of tier 1 capital. Following the recapitalisation of the MBHL in 2004, it has remained capitalised well beyond regulatory and internal requirements.

The approach to capital management has been enhanced over the past year in line with Basel II.

Risk management and control (continued)

Management of risk (continued)

Capital management(continued)

The level of capital for the Bank is as follows:

	Risk-weighted exposures 31 December 2008 R'000	Risk-weighted assets 31 December 2007 R'000
Banking book		
Cash, off-balance sheet activities and central government transactions		–
Letters of credit and other bank advances		76 844
Residential mortgage loans, performance-related guarantees and committed undrawn facilities		582 554
Other assets including counterparty risk exposure		2 462 631
Credit risk	3 338 517	
Operational risk	564 151	
Market risk	3 910	
Equity	22 162	
Other assets	375 074	
	4 303 814	3 122 029

	2008 R'000	2007 R'000
Primary capital	1 157 213	798 377
Share capital and share premium	1 483 299	1 483 299
Reserves	6 734	12 231
Less: Deductions/Impairments	(332 820)	(697 153)
Secondary capital	18 418	39 025
General debt provisions	18 384	39 025
Fifty per cent of a revaluation surplus	34	–
Net qualifying capital and reserves	1 175 631	837 402

	2008	2007
Capital adequacy ratio (%)	27.3	26.8
Primary capital (%)	26.9	25.6
Secondary capital (%)	0.4	1.2

2008 is presented in line with the amended Banks Act and Bank Regulations effective 1 January 2008, whereas 2007 is presented in line with the preceding Banks Act and Bank Regulations.

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