Mercantile Bank
Limited

Registration number 1965/006706/06
An authorised Financial Services
and Credit Provider NCRCP19
Member of CGD Group

2010 Annual Financial Statements

your bank, your partner, our focus

Mercantile Bank Limited

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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, No. 94 of 1990, as amended
BCM	Business Continuity Management
CGD	Caixa Geral de Depósitos S.A., a company registered in Portugal and the ultimate holding company
Companies Act	Companies Act, No. 61 of 1973, as amended
CREDCOM	Credit Committee
IFRS	International Financial Reporting Standards and Interpretations
MBHL	Mercantile Bank Holdings Limited, the holding company
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

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 2010 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 fair presentation of 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 52, have been approved by the Board and are signed on their behalf by:

J A S de Andrade Campos
Chairman

24 March 2011

D J Brown
Chief Executive Officer

24 March 2011

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 2010 all such returns as are required of a public company in terms of the Companies Act, and that all such returns are true, correct and up to date.

A de Villiers
Company Secretary

24 March 2011

Independent auditor's report

to the member of Mercantile Bank Limited

Report on the financial statements

We have audited the annual financial statements of the Company, which comprise the Directors' report, statement of financial position as at 31 December 2010, the statement of comprehensive income, the statement of changes in equity and cash flows for the year then ended, a summary of significant accounting policies and other explanatory notes as set out on pages 5 to 52.

Directors' responsibility for the financial statements

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

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance 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 auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by 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 2010, and of its financial performance and its cash flows for the year then ended in accordance with IFRS, and in the manner required by the Companies Act.

Deloitte & Touche
Registered Auditors

Per Riaan Eksteen
Partner

24 March 2011

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

National Executive: GG Gelink Chief Executive, AE Swiegers Chief Operating Officer, GM Pinnock Audit, DL Kennedy Risk Advisory, NB Kader Tax & Legal Services, L Geeringh Consulting, L Bam Corporate Finance, JK Mazzocco Human Resources, CR Beukman Finance, TJ Brown Clients, NT Mtoba Chairman of the Board, MJ Comber Deputy Chairman of the Board

A full list of partners and directors is available on request

B-BBEE rating: Level 2 contributor/AAA (certified by Empowerdex)

Member of Deloitte Touche Tohmatsu Limited

Directors' report

for the year ended 31 December 2010

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 2010.

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 commercial, business, 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 5 to 52 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 (2009: 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 (2009: 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°
K R Kumbier# (appointed 1 June 2010)
J P M Lopes*#
T H Njikizana^°
S Rapeti° (resigned 29 July 2010)

* Portuguese, ^ Zimbabwean, # Executive,
° Independent non-executive

The Company Secretary is Ms A de Villiers and the registered addresses of the Company are:

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

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

9. Special resolutions

There were no special resolutions during the year under review.

10. Events after the reporting period

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

Accounting policies

for the year ended 31 December 2010

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.

IFRSs which became effective in the current reporting period have had no impact on the Company.

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 statement of financial position when the Company has become a party to the contractual provisions of that instrument. Regular 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 have 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 profit and loss.

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 statement of financial position. Derivative financial instruments are initially recorded at cost and are remeasured to fair value excluding transaction costs at each subsequent reporting date. Changes in the fair value of derivatives are recognised in profit and loss.

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

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;

Accounting policies

for the year ended 31 December 2010 (continued)

3. Financial instruments (continued)

3.1 Derivative financial instruments (continued)

- 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 profit and loss.

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 designated as financial assets at fair value through profit and loss. Financial assets are designated at fair value through profit and loss, primarily to eliminate or significantly reduce the accounting mismatch. The 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, foreign banks and Money Market funds. These financial assets have been designated as loans and receivables and are measured at amortised cost.

Bank term deposits

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

Negotiable securities

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

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

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

Loans and advances

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

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

Other accounts receivable

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

Accounting policies

for the year ended 31 December 2010 (continued)

3. Financial instruments (continued)

3.3 Financial liabilities

The Company's financial liabilities include deposits, tax 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 profit and loss.

3.4 Fair value estimation

The fair value of publicly traded derivatives, securities and investments is based on quoted market values at the reporting date. In the case of an asset held by the 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 reporting date. Quoted market prices or dealer quotes for the same or similar instruments are used for the majority of securities, long-term investments and long-term debt. Other techniques, such as 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 to 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 financial assets. Portfolio impairments are maintained to cover potential losses, which although not specifically identified, may be present in the advances portfolio.

Advances which are deemed uncollectible are written off against the specific impairments. A direct reduction of an impaired financial asset occurs when the 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 profit and loss.

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

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

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

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. All gains and losses on the sale of subsidiaries are recognised in profit and loss.

6. Associated companies

Associated companies are those companies in which the Company exercises significant influence, but has no 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.

Accounting policies

for the year ended 31 December 2010 (continued)

6. Associated companies (continued)

The results and assets and liabilities of associated companies are incorporated in the financial statements as available-for-sale assets except when the investment is classified as non-current asset 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 statement of financial position at open-market fair value on the basis of their existing use at the date of revaluation, less any subsequent accumulated depreciation calculated using the straight-line method and subsequent accumulated impairment losses. The open-market fair value is based on capitalisation rates for open market net rentals for each property. Revaluations are performed annually by independent registered professional valuators.

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

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 profit and loss 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 for impairment where there are indicators of impairment, and adjusted if appropriate, at each reporting date.

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 or its value in use.

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

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

Gains and losses on disposal of property and equipment are determined by comparing proceeds with the carrying amount and are recognised in profit and loss. Depreciation of an asset begins when it is available for use and ceases at the earlier of the 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 programmes and the acquisition of software licences are recognised as intangible assets if they are expected to generate future economic benefits that exceed related costs beyond one year.

Computer software and licences that are recognised as intangible assets are amortised on the straight-line basis at rates appropriate to the expected useful lives of the assets, which 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 any indication of impairment and is written down when the carrying amount exceeds the recoverable amount.

Accounting policies

for the year ended 31 December 2010 (continued)

8. Intangible assets (continued)

Computer software (continued)

The recoverable amount is the higher of fair value less costs to sell or its 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 profit and loss.

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 within twelve months, the asset is available for immediate sale in its present condition and management is committed to the sale.

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

10. Tax

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

10.1 Current tax

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

10.2 Deferred tax

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

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

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

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

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

10.3 Current and deferred tax for the period

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

Accounting policies

for the year ended 31 December 2010 (continued)

11. Instalment sales and leases

11.1 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 profit and loss on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

11.2 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.

12. Interest income and interest expense

Except where interest is suspended, interest income and expense are recognised in profit and loss for all interest-bearing instruments measured at amortised cost using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the 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.

13. Fee, commission and dividend income

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

14. Retirement funds

The 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 profit and loss as accrued.

15. 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 profit and loss so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries, who value the plans annually.

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 profit and loss immediately.

16. 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 and 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.

17. 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.

17.1 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 profit and loss, 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.

Accounting policies

for the year ended 31 December 2010 (continued)

17. Critical accounting estimates and judgements (continued)

17.1 Impairment losses on loans and advances (continued)

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.

17.2 Fair value of financial instruments

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

17.3 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.

17.4 Income taxes

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

18. Recent accounting developments

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

- IFRS 9 Financial Instruments: Classification and Measurement, issued during November 2009 and subsequent amendments in 2010, is effective for annual periods beginning on or after 1 January 2013. The Company will comply with the applicable standard from the year ending 31 December 2013;
- IAS 12 Income Taxes: Limited scope amendment (recovery of underlying assets), issued during December 2010 is effective for annual periods beginning on or after 1 January 2012. The Company will comply with the applicable standard from the year ending 31 December 2012; and
- IAS 24 Related-party Disclosures: Revised definition of related parties, issued during November 2009 is effective for annual periods beginning on or after 1 January 2011. The Company will comply with the applicable standard from the year ending 31 December 2011.

The following revised standards and interpretations which have been issued but which are not yet effective, will have no effect on the Company:

- IFRS 1 First-time Adoption of IFRS: Limited exemption from comparative IFRS 7 disclosures for first-time adopters, issued during January 2010 and effective for annual periods beginning on or after 1 July 2010;
- IFRS 1 First-time Adoption of IFRS: Amendments resulting from May 2010 annual improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 January 2011;
- IFRS 1 First-time Adoption of IFRS: Replacement of 'fixed dates' for certain exceptions with 'the date of transition to IFRSs', issued during December 2010 and effective for annual periods beginning on or after 1 July 2011;
- IFRS 1 First-time Adoption of IFRS: Additional exemption for entities ceasing to suffer from severe hyperinflation, issued during December 2010 and effective for annual periods beginning on or after 1 July 2011;
- IFRS 3 Business Combinations: Amendments resulting from May 2010 annual improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 July 2010;

Accounting policies

for the year ended 31 December 2010 (continued)

18. Recent accounting developments (continued)

- IFRS 7 Financial Instruments: Disclosures: Amendments resulting from May 2010 annual improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 January 2011;
- IFRS 7 Financial Instruments: Disclosures: Amendments enhancing disclosures about transfers of financial assets, issued during October 2010 and effective for annual periods beginning on or after 1 July 2011;
- IAS 1 Presentation of Financial Statements: Amendments resulting from May 2010 annual improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 January 2011;
- IAS 21 The Effects of Changes in Foreign Exchange Rates: Amendments resulting from May 2010 annual improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 July 2010;
- IAS 27 Consolidated and Separate Financial Statements: Amendments resulting from May 2010 annual Improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 July 2010;
- IAS 28 Investments in Associates: Amendments resulting from May 2010 annual Improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 July 2010;
- IAS 31 Interest in Joint Ventures: Amendments resulting from May 2010 annual Improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 July 2010;
- IAS 32 Financial Instruments: Presentation: Amendments relating to classification of rights issues, issued during 2009 is effective for annual periods beginning on or after 1 February 2010;
- IAS 34 Interim Financial Reporting: Amendments resulting from May 2010 annual improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 January 2011;
- IFRIC 13 Customer Loyalty Programmes: Amendments resulting from May 2010 annual improvements to IFRSs, issued during May 2010 and effective for annual periods beginning on or after 1 January 2011;
- IFRIC 14 IAS 19: The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction: Amendments with respect to voluntary prepaid contributions, issued during November 2009 and effective for annual periods beginning on or after 1 July 2011; and
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments, issued during January 2009 and effective for annual periods beginning on or after 1 July 2010.

Statement of financial position

at 31 December 2010

	Note	2010 R'000	2009 R'000
ASSETS			
Intangible assets	2	**224 402**	170 325
Property and equipment	3	**27 508**	31 955
Other accounts receivable	4	**62 558**	41 742
Interest in subsidiaries	5	**94 095**	95 729
Other investments	6	**16 332**	29 957
Deferred tax	7	**57 548**	98 381
Non-current assets held for sale	8	**–**	5 510
Loans and advances	9	**3 720 907**	3 629 574
Derivative financial instruments	10	**34 717**	21 406
Negotiable securities	11	**265 028**	267 902
Bank term deposits	12	**–**	35 276
Cash and cash equivalents	13	**1 759 897**	1 400 937
Total assets		**6 262 992**	5 828 694
EQUITY AND LIABILITIES			
Shareholders' equity		**1 566 781**	1 465 234
Share capital and share premium	14	**1 483 300**	1 483 300
Share-based payments reserve		**3 190**	1 894
General reserve		**12 231**	12 231
Property revaluation reserve		**69**	69
Available-for-sale reserve		**57 331**	60 050
Retained earnings/(Accumulated loss)		**10 660**	(92 310)
Liabilities		**4 696 211**	4 363 460
Deposits	15	**4 567 004**	4 248 734
Derivative financial instruments	10	**28 122**	16 230
Provisions and other liabilities	16	**29 920**	38 142
Other accounts payable	18	**71 165**	60 354
Total equity and liabilities		**6 262 992**	5 828 694

Statement of comprehensive income

for the year ended 31 December 2010

	Note	2010 R'000	2009 R'000
Interest income	20	**456 115**	535 465
Interest expenditure	21	**(194 644)**	(261 412)
Net interest income		**261 471**	274 053
Net charge for credit losses	9.4	**(3 422)**	(9 323)
Net interest income after credit losses		**258 049**	264 730
Net gains on disposal of available-for-sale investments		**885**	1 583
Net non-interest income		**170 665**	203 062
Non-interest income	22	**273 130**	290 060
Fee and commission expenditure	23	**(102 465)**	(86 998)
Net interest and non-interest income		**429 599**	469 375
Operating expenditure	24	**(286 021)**	(253 778)
Profit before tax		**143 578**	215 597
Tax	25	**(41 362)**	(53 985)
Profit after tax		**102 216**	161 612
Other comprehensive (loss)/income			
(Losses)/Gains on remeasurement to fair value		**(2 363)**	10 096
Release to profit and loss on disposal of available-for-sale financial assets		**(885)**	(1 583)
Tax relating to other comprehensive loss/income		**529**	(899)
Other comprehensive (loss)/income net of tax		**(2 719)**	7 614
Total comprehensive income		**99 497**	169 226
Profit after tax attributable to:			
Equity holder of the Company		**102 216**	161 612
Total comprehensive income attributable to:			
Equity holder of the Company		**99 497**	169 226

Statement of changes in equity

for the year ended 31 December 2010

	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	Retained earnings/ (Accumulated loss) R'000	Total R'000
Shareholders' equity at 31 December 2008	124 969	1 358 331	4 650	12 231	69	52 436	(255 926)	1 296 760
Net movement for the year	–	–	(2 756)	–	–	7 614	163 616	168 474
Profit after tax	–	–	–	–	–	–	161 612	161 612
Other comprehensive income	–	–	–	–	–	8 513	–	8 513
Tax relating to other comprehensive income	–	–	–	–	–	(899)	–	(899)
Share-based payments expense/(write back)	–	–	(2 756)	–	–	–	2 004	(752)
Shareholders' equity at 31 December 2009	**124 969**	**1 358 331**	**1 894**	**12 231**	**69**	**60 050**	**(92 310)**	**1 465 234**
Net movement for the year	–	–	**1 296**	–	–	**(2 719)**	**102 970**	**101 547**
Profit after tax	–	–	–	–	–	–	**102 216**	**102 216**
Other comprehensive loss	–	–	–	–	–	**(3 248)**	–	**(3 248)**
Tax relating to other comprehensive loss	–	–	–	–	–	**529**	–	**529**
Vesting of shares in the conditional share plan	–	–	**(104)**	–	–	–	–	**(104)**
Share-based payments expense	–	–	**1 400**	–	–	–	**754**	**2 154**
Shareholders' equity at 31 December 2010	**124 969**	**1 358 331**	**3 190**	**12 231**	**69**	**57 331**	**10 660**	**1 566 781**

Statement of cash flows

for the year ended 31 December 2010

	Note	2010 R'000	2009 R'000
Cash flows from operating activities			
Cash receipts from customers	26.1	**719 869**	771 359
Cash paid to customers, suppliers and employees	26.2	**(560 467)**	(599 095)
Cash generated from operations	26.3	**159 402**	172 264
Dividends received		**3 474**	4 441
Tax (paid)	26.4	**–**	(40)
Net (increase)/decrease in income earning assets	26.5	**(53 431)**	35 506
Net increase/(decrease) in deposits and other accounts	26.6	**308 265**	(171 806)
Net cash inflow from operating activities		**417 710**	40 365
Cash flows from investing activities			
Purchase of intangible assets	2	**(74 896)**	(100 861)
Purchase of property and equipment	3	**(3 568)**	(2 795)
Acquisition of investments		**–**	(7 000)
Proceeds on sale of property and equipment		**–**	2
Proceeds on disposal of other investments		**13 740**	2 054
Decrease in interest in subsidiaries		**5 974**	4 213
Net cash (outflow) from investing activities		**(58 750)**	(104 387)
Net cash inflow/(outflow) for the year		**358 960**	(64 022)
Cash and cash equivalents at the beginning of the year		**1 400 937**	1 464 959
Cash and cash equivalents at the end of year	13	**1 759 897**	1 400 937

Notes to the annual financial statements

for the year ended 31 December 2010

1. Fair values of financial instruments

1.1 Categories and fair values of financial instruments

	2010		2009	
	Fair value R'000	**Carrying amount R'000**	Fair value R'000	Carrying amount R'000
Assets				
Available-for-sale	**129 659**	**129 659**	137 019	137 019
Other investments	**16 332**	**16 332**	22 275	22 275
Interest in subsidiaries	**94 095**	**94 095**	95 729	95 729
Negotiable securities – Government stock	**19 232**	**19 232**	19 015	19 015
Loans and receivables	**5 711 639**	**5 712 962**	5 227 456	5 227 667
Loans and advances				
Current accounts	**617 914**	**617 914**	593 688	593 688
Credit card	**14 249**	**14 249**	15 193	15 193
Mortgage loans	**1 813 965**	**1 813 965**	1 705 368	1 705 368
Instalment sales and leases	**263 906**	**263 906**	317 612	317 612
Structured loans	**211 045**	**211 045**	247 715	247 715
Other advances	**723 632**	**723 632**	621 249	621 249
Negotiable securities				
Treasury bills	**214 435**	**215 758**	197 367	197 578
Land Bank promissory notes	**30 038**	**30 038**	51 309	51 309
Bank term deposits	**–**	**–**	35 276	35 276
Cash and cash equivalents	**1 759 897**	**1 759 897**	1 400 937	1 400 937
Other accounts receivable	**62 558**	**62 558**	41 742	41 742
Designated at fair value through profit and loss	**76 196**	**76 196**	136 431	136 431
Loans and advances				
Mortgage loans	**38 641**	**38 641**	40 130	40 130
Instalment sales and leases	**66**	**66**	24 182	24 182
Other advances	**37 489**	**37 489**	64 437	64 437
Other investments	**–**	**–**	7 682	7 682
Held-for-trading				
Derivative financial instruments	**34 717**	**34 717**	21 406	21 406
	5 952 211	**5 953 534**	5 522 312	5 522 523
Liabilities				
Held-for-trading				
Derivative financial instruments	**28 122**	**28 122**	16 230	16 230
Amortised cost	**4 638 169**	**4 638 169**	4 309 088	4 309 088
Deposits	**4 567 004**	**4 567 004**	4 248 734	4 248 734
Other accounts payable	**71 165**	**71 165**	60 354	60 354
	4 666 291	**4 666 291**	4 325 318	4 325 318

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

1. Fair values of financial instruments (continued)

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

- Cash and cash equivalents have short terms to maturity. For this reason, the carrying amounts at the reporting date approximate the fair values.
- Treasury bills and Land Bank promissory notes have short terms to maturity and are carried at amortised cost. Fair value is based on quoted market values at the reporting date.
- The fair 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 publicly traded derivatives, securities and investments is based on quoted market values at the reporting date.
- The fair value of other financial assets and financial liabilities, excluding derivatives, is determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions and adjusted by relevant market pricing.
- The fair value of other unlisted investments which are an integral part of the Company's structured loan portfolio are valued in terms of the shareholders' agreement conditions. 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.

1.3 Fair value measurements recognised in the statement of financial position

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

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

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

1. Fair values of financial instruments (continued)

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

	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2010				
Assets				
Available-for-sale				
Other investments	**16 116**	**216**	**–**	**16 332**
Interest in subsidiaries	**–**	**94 095**	**–**	**94 095**
Negotiable securities – Government stock	**19 232**	**–**	**–**	**19 232**
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	**–**	**38 641**	**–**	**38 641**
Instalment sales and leases	**–**	**66**	**–**	**66**
Other advances	**–**	**37 489**	**–**	**37 489**
Held-for-trading				
Derivative financial instruments	**34 717**	**–**	**–**	**34 717**
	70 065	**170 507**	**–**	**240 572**
Liabilities				
Held-for-trading				
Derivative financial instruments	**28 122**	**–**	**–**	**28 122**
	28 122	**–**	**–**	**28 122**
2009				
Assets				
Available-for-sale				
Other investments	22 032	243	–	22 275
Interest in subsidiaries	–	95 729	–	95 729
Negotiable securities – Government stock	19 015	–	–	19 015
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	40 130	–	40 130
Instalment sales and leases	–	24 182	–	24 182
Other advances	–	64 437	–	64 437
Other investments	–	–	7 682	7 682
Held-for-trading				
Derivative financial instruments	21 406	–	–	21 406
	62 453	224 721	7 682	294 856
Liabilities				
Held-for-trading				
Derivative financial instruments	16 230	–	–	16 230
	16 230	–	–	16 230

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

A Level 3 investment was disposed of during the year.

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

1. Fair values of financial instruments (continued)

1.4 Reconciliation of Level 3 fair value measurements of financial assets

	2010 R'000	2009 R'000
Designated at fair value through profit and loss		
Other investments – unlisted equities		
Balance at the beginning of the year	**7 682**	–
Acquisitions	**–**	7 000
Gains on remeasurement to fair value in comprehensive income	**2 032**	682
Realisation	**(9 714)**	–
Balance at the end of the year	**–**	7 682

2. Intangible assets

	2010 R'000	2009 R'000
Computer software		
Cost at the beginning of the year	**221 803**	120 985
Additions	**74 896**	100 861
Net transfer from/(to) property and equipment*	**227**	(5)
Write-off of obsolete software	**–**	(38)
Cost at the end of the year	**296 926**	221 803
Accumulated amortisation and impairment losses at the beginning of the year	**(51 478)**	(44 091)
Amortisation	**(20 819)**	(7 428)
Net transfer (from)/to property and equipment*	**(227)**	3
Write-off of obsolete software	**–**	38
Accumulated amortisation and impairment losses at the end of the year	**(72 524)**	(51 478)
Net carrying amount at the end of the year	**224 402**	170 325

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

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

3. Property and equipment

	Owner-occupied property R'000	Leasehold improvements R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
2010							
Open market value/cost at the beginning the of the year	164	19 498	91 822	9 899	25 119	492	146 994
Additions	–	72	2 416	3	1 077	–	3 568
Transfer*	–	–	(227)	–	–	–	(227)
Write-off of obsolete assets	–	–	(31)	–	(5)	–	(36)
Open market value/cost at the end of the year	164	19 570	93 980	9 902	26 191	492	150 299
Accumulated depreciation and impairment losses at the beginning of the year	–	(15 404)	(70 266)	(9 159)	(19 820)	(390)	(115 039)
Depreciation	–	(734)	(5 529)	(179)	(1 520)	(48)	(8 010)
Transfer*	–	–	227	–	–	–	227
Write-off of obsolete assets	–	–	26	–	5	–	31
Accumulated depreciation and impairment losses at the end of the year	–	(16 138)	(75 542)	(9 338)	(21 335)	(438)	(122 791)
Net carrying amount at the end of the year	164	3 432	18 438	564	4 856	54	27 508
2009							
Open market value/cost at the beginning of the year	164	18 917	93 896	9 273	22 429	415	145 094
Additions	–	581	428	47	1 662	77	2 795
Transfer*	–	–	(1 854)	583	1 276	–	5
Write-off of obsolete assets	–	–	(648)	(4)	(248)	–	(900)
Open market value/cost at the end of the year	164	19 498	91 822	9 899	25 119	492	146 994
Accumulated depreciation and impairment losses at the beginning of the year	–	(14 621)	(68 523)	(8 354)	(17 257)	(344)	(109 099)
Depreciation	–	(783)	(4 245)	(241)	(1 510)	(46)	(6 825)
Transfer*	–	–	1 854	(568)	(1 291)	–	(5)
Write-off of obsolete assets	–	–	648	4	238	–	890
Accumulated depreciation and impairment losses at the end of the year	–	(15 404)	(70 266)	(9 159)	(19 820)	(390)	(115 039)
Net carrying amount at the end of the year	164	4 094	21 556	740	5 299	102	31 955

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

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 2010 (continued)

		2010 R'000	2009 R'000
4.	**Other accounts receivable**		
	Items in transit	**21 254**	12 941
	Loans to fellow subsidiary and holding company (refer to note 27.2)	**13 585**	12 236
	Prepayments and deposits	**3 839**	6 564
	Other receivables	**23 880**	10 001
		62 558	41 742
5.	**Interest in subsidiaries**		
	Unlisted		
	Shares at fair value based on net asset value		
	Portion 2 of Lot 8 Sandown (Pty) Limited	**54 493**	50 605
	Loans to subsidiaries	**39 602**	45 124
	Portion 2 of Lot 8 Sandown (Pty) Limited	**34 126**	40 390
	LSM (Troyeville) Properties (Pty) Limited	**6 784**	6 494
	Less: Provisions held against loan accounts	**(1 308)**	(1 760)
		94 095	95 729

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 plus 2% (2009: prime) and have no fixed terms of maturity.

		2010 R'000	2009 R'000
6.	**Other investments**		
	Available-for-sale		
	Unlisted equities	**216**	243
	Listed equities	**16 116**	22 032
	Mercantile Bank Holdings Limited (shares held by the Bank for the employee share option scheme)	**5 392**	6 395
	African Bank Investment Limited	–	751
	Capitec Bank Holdings Limited	–	13
	Kap International Limited	–	16
	Visa Inc.	**10 724**	14 857
	Designated at fair value through profit and loss		
	Unlisted equities	–	7 682
		16 332	29 957

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

		2010 R'000	2009 R'000
7.	**Deferred tax**		
	Balance at the beginning of the year	**98 381**	153 531
	Current year charge		
	Per the statement of comprehensive income	**(41 362)**	(54 251)
	Per the statement of changes in equity/other comprehensive income	**529**	(899)
		57 548	98 381
	Deferred tax is attributable to the following temporary differences		
	Property and equipment	**(28 948)**	(14 990)
	Intangibles	**3**	3
	Provisions and other liabilities	**(10 689)**	(4 105)
	Calculated tax losses	**82 307**	104 339
	Revaluations	**(5 866)**	(6 395)
	Leases	**1 784**	1 548
	Interest rate swaps	**1 270**	2 107
	Other	**17 687**	15 874
		57 548	98 381

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

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
8. Non-current assets held for sale		
Interest in associated company	–	3 234
Properties in possession	–	2 276
	–	5 510

Interest in associated company

This investment was classified as a non-current asset held for sale in 2008 and although the main underlying investments of this company were disposed of in 2009, Statman Investments (Pty) Limited was liquidated during 2010.

Properties in possession

The property was valued at the sale price less costs to sell and realised during the first quarter of 2010.

9. Loans and advances

9.1 Category analysis

	2010 R'000	2009 R'000
Amortised cost	**3 712 206**	3 565 474
Current accounts	**633 290**	598 961
Credit card	**18 968**	19 950
Mortgage loans	**1 824 348**	1 709 032
Instalment sales and leases	**268 408**	321 022
Structured loans	**230 036**	266 589
Other advances	**737 156**	649 920
Fair value through profit and loss	**76 285**	128 928
Mortgage loans	**38 665**	40 150
Instalment sales and leases	**66**	24 241
Other advances	**37 554**	64 537
Gross loans and advances	**3 788 491**	3 694 402
Less: Portfolio impairments for credit losses	**(5 513)**	(20 750)
Specific impairments for credit losses	**(62 071)**	(44 078)
	3 720 907	3 629 574

In 2010 gross loans and advances are reported net of suspended interest as this is the true reflection of the gross loans and advances balance prior to any impairment and as such the 2009 comparatives have been reclassified.

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

9.2 Maturity analysis

	2010 R'000	2009 R'000
Repayable on demand and maturing within one month	**703 519**	684 638
Maturing after one month but within six months	**151 228**	5 533
Maturing after six months but within 12 months	**38 919**	53 090
Maturing after 12 months	**2 894 825**	2 951 141
	3 788 491	3 694 402

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 2010 (continued)

9. Loans and advances (continued)

9.3 Detailed category analysis of loans and advances

	Gross amount R'000	Portfolio impairments R'000	Specific impairments R'000	Net balance R'000
2010				
Current accounts	**633 290**	**1 633**	**13 743**	**617 914**
Credit card	**18 968**	**658**	**4 061**	**14 249**
Mortgage loans	**1 863 013**	**1 145**	**9 262**	**1 852 606**
Instalment sales and leases	**268 474**	**650**	**3 852**	**263 972**
Structured loans	**230 036**	**88**	**18 903**	**211 045**
Other advances	**774 710**	**1 339**	**12 250**	**761 121**
	3 788 491	**5 513**	**62 071**	**3 720 907**
2009				
Current accounts	598 961	1 918	3 355	593 688
Credit card	19 950	917	3 840	15 193
Mortgage loans	1 749 182	870	2 814	1 745 498
Instalment sales and leases	345 263	841	2 628	341 794
Structured loans	266 589	15 088	3 786	247 715
Other advances	714 457	1 116	27 655	685 686
	3 694 402	20 750	44 078	3 629 574

9.4 Impairments for credit losses

	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
2010							
Balance at the beginning of the year	**64 828**	**5 273**	**4 757**	**3 684**	**3 469**	**18 874**	**28 771**
Movements for the year:							
Credit losses written off	**(2 542)**	**(4)**	**(694)**	**(230)**	**(442)**	**–**	**(1 172)**
Net impairments raised/(released)	**5 298**	**10 107**	**656**	**6 953**	**1 475**	**117**	**(14 010)**
	67 584	**15 376**	**4 719**	**10 407**	**4 502**	**18 991**	**13 589**
2009							
Balance at the beginning of the year	58 849	2 072	5 246	4 143	2 310	30 430	14 648
Movements for the year:							
Credit losses written off	(4 255)	(1 786)	(597)	(381)	(159)	–	(1 332)
Net impairments raised/(released)	10 234	4 987	108	(78)	1 318	(11 556)	15 455
	64 828	5 273	4 757	3 684	3 469	18 874	28 771

	2010 R'000	2009 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	**(5 298)**	(10 234)
Recoveries in respect of amounts previously written off	**1 876**	911
	(3 422)	(9 323)

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

9. Loans and advances (continued)

9.5 Category analysis of performing loans and advances

	Gross amount R'000	Portfolio impairment R'000	Net balance R'000
2010			
Current accounts	**608 089**	**1 633**	**606 456**
Credit card	**14 884**	**658**	**14 226**
Mortgage loans	**1 761 523**	**1 145**	**1 760 378**
Instalment sales and leases	**257 594**	**650**	**256 944**
Structured loans	**181 207**	**88**	**181 119**
Other advances	**736 184**	**1 339**	**734 845**
	3 559 481	**5 513**	**3 553 968**
2009			
Current accounts	585 251	1 918	583 333
Credit cards	16 110	917	15 193
Mortgage loans	1 699 485	870	1 698 615
Instalment sales and leases	332 687	841	331 846
Structured loans	213 228	15 088	198 140
Other advances	668 707	1 116	667 591
	3 515 468	20 750	3 494 718

	2010 R'000	2009 R'000
9.6 Category analysis of performing loans and advances excluding loans and advances with renegotiated terms		
Current accounts	**608 089**	585 251
Credit card	**14 884**	16 110
Mortgage loans	**1 749 528**	1 661 970
Instalment sales and leases	**256 885**	331 231
Structured loans	**181 207**	213 228
Other advances	**726 588**	662 137
	3 537 181	3 469 927
9.7 Category analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired		
Current accounts	**–**	–
Credit card	**–**	–
Mortgage loans	**11 995**	37 515
Instalment sales and leases	**709**	1 456
Structured loans	**–**	–
Other advances	**9 596**	6 570
	22 300	45 541

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

9. Loans and advances (continued)

9.8 Category age analysis of loans and advances that are past due but not individually impaired

	Past due for: 1–30 days R'000	31–60 days R'000	61–90 days R'000	Total gross amount R'000	Fair value of collateral and other credit enhancements R'000
2010					
Current accounts	–	–	–	–	–
Credit card	–	–	–	–	–
Mortgage loans	**10 213**	**6 295**	**16 490**	**32 999**	**31 241**
Instalment sales and leases	**299**	–	–	**299**	**203**
Structured loans	–	–	**20 446**	**20 446**	**13 195**
Other advances	**1 536**	**4 345**	**3 563**	**9 444**	**6 032**
	12 049	**10 641**	**40 498**	**63 188**	**50 671**
2009					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	18 718	20 346	1 901	40 965	37 905
Instalment sales and leases	933	608	159	1 700	1 136
Structured loans	–	–	–	–	–
Other advances	3 353	1 340	2 962	7 655	2 963
	23 004	22 294	5 022	50 320	42 004

9.9 Category analysis of loans and advances that are individually impaired

	Gross amount R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhancements R'000
2010				
Current accounts	**25 201**	**13 743**	**11 458**	**8 076**
Credit card	**4 084**	**4 061**	**23**	–
Mortgage loans	**101 490**	**9 262**	**92 228**	**97 716**
Instalment sales and leases	**10 880**	**3 852**	**7 028**	**7 128**
Structured loans	**48 829**	**18 903**	**29 926**	**36 233**
Other advances	**38 526**	**12 250**	**26 276**	**28 749**
	229 010	**62 071**	**166 939**	**177 902**
2009				
Current accounts	13 710	3 355	10 355	5 279
Credit cards	3 840	3 840	–	–
Mortgage loans	49 697	2 814	46 883	46 120
Instalment sales and leases	12 576	2 628	9 948	8 947
Structured loans	53 361	3 786	49 575	27 233
Other advances	45 750	27 655	18 095	30 405
	178 934	44 078	134 856	117 984

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

9. Loans and advances (continued)

9.10 Collateral held as security and other credit enhancements

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

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

Description of collateral held as security and other credit enhancements	Method of valuation
Cession of debtors	15% – 75% of debtors due and payable under 90 days and depending on debtor credit quality
Pledge of shares	variable depending 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 a loan and advance can be realised in accordance with the terms of the agreement or the facility conditions applicable thereto. Cash collateral and pledged assets that can be realised in accordance with the terms of the pledge and cession or suretyship are applied in reduction of related exposures. Pledged assets, other than cash or cash equivalent collateral, and tangible security articles are appropriated and disposed of, where necessary after legal action, in compliance with the applicable Court rules and directives.

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

9.11 Structured loans

The Company has unlisted equity options attached to certain loans in this category which have been recognised at cost in accordance with accounting policy 3.2 on page 7.

10. Derivative financial instruments

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
2010				
Held-for-trading				
Foreign exchange contracts	**1 319 956**	**34 658**	**363 419**	**23 525**
Interest rate swaps	**7 000**	**59**	**67 159**	**4 597**
	1 326 956	**34 717**	**430 578**	**28 122**
2009				
Held-for-trading				
Foreign exchange contracts	744 076	21 353	269 289	8 652
Interest rate swaps	7 000	53	116 210	7 578
	751 076	21 406	385 499	16 230

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
11. Negotiable securities		
Loans and receivables		
Treasury bills	**215 758**	197 578
Promissory notes – Land Bank	**30 038**	51 309
Available-for-sale		
Government stock	**19 232**	19 015
	265 028	267 902
Maturity analysis		
Maturing within one month	**49 782**	19 894
Maturing after one month but within six months	**191 188**	228 993
Maturing after six months but within 12 months	**4 826**	–
Maturing after one year but within five years	**19 232**	–
Maturing after five years	**–**	19 015
	265 028	267 902

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

	2010 R'000	2009 R'000
12. Bank term deposits		
Domestic bank balances	**–**	35 276
	–	35 276
Maturity analysis		
Maturing after six months but within 12 months	**–**	35 276
	–	35 276
13. Cash and cash equivalents		
Cash on hand	**20 504**	24 003
Central Bank balances	**103 248**	86 249
Money Market funds	**305 787**	493 136
Domestic bank balances	**185 378**	91 506
Foreign bank balances*	**1 144 980**	706 043
	1 759 897	1 400 937

*Refer to note 27.2 for balances with CGD included in this amount.

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
14. Share capital and share premium				
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 (2009: 62 630 000 shares) with a par value of R2,00 per share.

No shares were issued during the financial years ended 31 December 2009 and 31 December 2010.

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

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
15. Deposits		
Call deposits and current accounts	**2 367 784**	2 218 329
Savings accounts	**175 595**	181 826
Term and notice deposits	**1 719 410**	1 610 863
Negotiable certificates of deposit	**103 867**	27 576
Foreign deposits	**200 348**	210 140
	4 567 004	4 248 734
Maturity analysis		
Repayable on demand and maturing within one month	**3 054 193**	3 283 928
Maturing after one month but within six months	**817 335**	562 306
Maturing after six months but within 12 months	**622 906**	396 940
Maturing after 12 months	**72 570**	5 560
	4 567 004	4 248 734

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

16. Provisions and other liabilities

	Staff incentives R'000	Audit fees R'000	Post-retirement medical benefits R'000	Leave pay R'000	Other risks R'000	Total R'000
At 31 December 2008	20 600	3 630	14 531	9 089	710	48 560
Additional provision raised	8 615	6 200	–	3 017	508	18 340
Charged to provision	(19 026)	(6 130)	(668)	(2 584)	(350)	(28 758)
At 31 December 2009	**10 189**	**3 700**	**13 863**	**9 522**	**868**	**38 142**
Additional provision raised	–	**7 520**	**1 286**	**2 087**	**778**	**11 671**
Reversal of provision	**(1 270)**	–	–	–	–	**(1 270)**
Charged to provision	**(8 919)**	**(6 610)**	–	**(2 168)**	**(926)**	**(18 623)**
At 31 December 2010	–	**4 610**	**15 149**	**9 441**	**720**	**29 920**

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 against the Company, the outcome of which cannot at present be foreseen. Such claims are not regarded as material either on an individual basis or in aggregate. Provisions are raised for all liabilities that are expected to materialise.

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

17. Post-retirement medical benefits

The Bank operates a partly funded post-retirement medical scheme. The assets of the funded plans are held independently of the Company's assets in a separate trustee-administered fund. Independent actuaries value this scheme annually and the last valuation was carried out at 31 December 2010. The actuary's opinion is that the plan is in a sound financial position.

	2010 R'000	2009 R'000	2008 R'000	2007 R'000	2006 R'000
The amounts recognised in the statement of financial position are as follows (refer to note 16):					
Present value of total service liabilities	**20 648**	19 370	19 664	20 223	18 989
Fair value of plan assets	**(5 499)**	(5 507)	(5 133)	(5 880)	(6 136)
Provident fund	**(1 832)**	(1 674)	(922)	(838)	(1 457)
Endowment bond	**(2 530)**	(2 718)	(3 118)	(3 446)	(3 729)
Annuities	**(1 137)**	(1 115)	(1 093)	(1 596)	(950)
Liability in the statement of financial position	**15 149**	13 863	14 531	14 343	12 853
The amounts recognised in the statement of comprehensive income are as follows (refer to note 24):					
Current service cost	**50**	92	89	116	115
Interest costs	**1 767**	1 785	1 568	1 539	1 365
Expected return on plan assets	**(578)**	(526)	(529)	(549)	(396)
Actuarial gain/(loss)	**1 488**	(660)	368	936	1 957
Employer benefit payments	**(1 441)**	(1 359)	(1 308)	(1 202)	(1 168)
Payments from plan assets	**–**	–	–	650	846
Effect on curtailment	**–**	–	–	–	(280)
Total included in staff costs	**1 286**	(668)	188	1 490	2 439
Reconciliation of the movement in the present value of total service liabilities:					
At the beginning of the year	**19 370**	19 664	20 223	18 989	16 651
Current service cost	**50**	92	89	116	115
Interest costs	**1 767**	1 785	1 568	1 539	1 365
Actuarial gain/(loss)	**902**	(812)	(908)	781	2 306
Employer benefit payments	**(1 441)**	(1 359)	(1 308)	(1 202)	(1 168)
Effect of curtailment	**–**	–	–	–	(280)
At the end of the year	**20 648**	19 370	19 664	20 223	18 989
Reconciliation of the movement in the fair value of plan assets:					
At the beginning of the year	**5 507**	5 133	5 880	6 136	6 237
Expected return on plan assets	**578**	526	529	549	396
Actuarial (loss)/gain	**(586)**	(152)	(1 276)	(155)	349
Payments from plan assets	**–**	–	–	(650)	(846)
At the end of the year	**5 499**	5 507	5 133	5 880	6 136

The principal actuarial assumptions used were as follows:

Discount rate	**8.25%**	(2009: 9.50%) compounded annually
Investment return	**9.25%**	(2009: 10.50%) compounded annually
Rate of medical inflation	**7.00%**	(2009: 8.00%) compounded annually
Salary inflation	**6.50%**	(2009: 7.50%) 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 R1.973 million (2009: R2.047 million) and a decrease of R1.680 million (2009: R1.730 million) respectively.

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
18. Other accounts payable		
Accruals	**19 929**	16 528
Product-related credits	**31 096**	18 577
Sundry creditors	**20 140**	25 249
	71 165	60 354

19. Contingent liabilities and commitments

19.1 Guarantees, letters of credit and committed undrawn facilities

	2010 R'000	2009 R'000
Guarantees	**305 669**	303 514
Lending related	**8 850**	15 983
Airways releases	–	1 813
Mortgage	**65 113**	27 925
Performance	**231 706**	257 793
Letters of credit	**10 260**	12 330
Committed undrawn facilities	**129 903**	190 834
	445 832	506 678

19.2 Commitments under operating leases

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

	2010 R'000	2009 R'000
Property rentals:		
Due within one year	**18 407**	17 344
Due between one and five years	**11 352**	7 011
	29 759	24 355
After tax effect on operating leases	**21 426**	17 536

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.

The 2009 comparative amounts have been adjusted due to an error in disclosure. The restatement only affected the 2009 figures and did not affect any other year's comparative disclosure.

19.3 Capital commitments

	2010 R'000	2009 R'000
Contracted for consulting services for the core banking system	**5 360**	51 628
	5 360	51 628

20. Interest income

	2010 R'000	2009 R'000
Loans to subsidiaries	**5 197**	5 880
Loans and receivables	**438 991**	511 272
Cash and cash equivalents and bank term deposits	**64 515**	84 747
Negotiable securities	**18 791**	24 212
Loans and advances	**355 685**	402 313
Loans and receivables designated at fair value through profit and loss		
Loans and advances	**11 867**	17 689
Held-for-trading		
Interest rate swaps	**60**	624
	456 115	535 465

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
21. Interest expenditure		
Deposits	**190 854**	257 429
Held-for-trading		
Interest rate swaps	**3 790**	3 983
	194 644	261 412
22. Non-interest income		
Fee and commission income		
Loans and receivables*	**206 820**	223 118
Trading income	**62 836**	62 501
Held-for-trading	**61 622**	62 463
Foreign currency	**60 261**	61 991
Derivative assets	**2**	(48)
Derivative liabilities	**1 359**	520
Designated at fair value through profit and loss	**1 214**	38
Loans and advances	**(818)**	(644)
Other investments	**2 032**	682
Investment income		
Dividends	**3 474**	4 441
	273 130	290 060

* In 2010 foreign currency commission is included in fee and commission income and therefore the 2009 comparatives have been adjusted accordingly.

	2010 R'000	2009 R'000
23. Fee and commission expenditure		
Foreign currency	**21 452**	19 766
Commissions and transactions	**81 013**	67 232
	102 465	86 998

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
24. Operating expenditure		
Amortisation (refer to note 2)	**20 819**	7 428
Auditors' remuneration		
Audit fees – Current year	**7 500**	6 200
– Prior year	**–**	20
Fees for other services – Tax advisory fees	**160**	–
– Secondment of staff	**51**	–
Administrative and IT staff	**309**	403
Less: Amounts capitalised to intangible assets	**(258)**	–
– Quality assessment review of internal audit	**–**	203
– Other	**23**	–
	7 785	6 826
Depreciation (refer to note 3)	**8 010**	6 825
Directors' emoluments (refer to note 27.3)		
Executive directors	**7 904**	7 365
Non-executive directors' fees	**3 848**	3 758
	11 752	11 123
Indirect tax		
Non-claimable Value-Added Tax	**8 705**	4 600
Skills development levy	**1 086**	716
	9 791	5 316
Lease charges – equipment	**56**	3
Loss on sale of property and equipment	**6**	10
Marketing and communication	**6 602**	6 555
Operating leases – premises	**21 838**	18 416
Other operating costs	**28 616**	27 572
Professional fees		
Consulting	**2 867**	3 925
Legal	**252**	325
Computer consulting and services	**37 586**	34 405
	40 705	38 655
Staff costs		
Salaries, wages and incentives	**115 046**	114 734
Post-retirement medical benefits (refer to note 17)	**1 286**	(668)
Contributions to retirement funds	**8 174**	7 975
Share-based payments expense/(write back) including Directors	**2 154**	(752)
Other	**3 381**	3 760
	130 041	125 049
Total operating expenditure	**286 021**	253 778
Number of persons employed by the Company at year-end	**439**	435

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
25. Tax		
South African normal tax	–	266
Current year	–	–
Prior year	–	266
Deferred tax	**(41 362)**	(54 251)
Current year	**(39 507)**	(59 001)
Prior year	**(1 855)**	4 750
	(41 362)	(53 985)
Direct tax		
South African normal tax	–	266
South African tax rate reconciliation		
South African standard tax rate (%)	**28.00**	28.00
Exempt income (%)	**(0.67)**	(0.93)
Expenses not deductible for tax purposes (%)	**0.41**	0.55
Additional allowances for tax purposes (%)	**(0.14)**	(0.15)
Capital gain – 50% portion not taxable (%)	**(0.09)**	(0.10)
Under/(Over) provision prior year (%)	**1.30**	(2.33)
Effective tax rate (%)	**28.81**	25.04
Estimated tax losses available for set-off against future taxable income	**293 953**	372 639
26. Notes to statement of cash flows		
26.1 Cash receipts from customers		
Interest income	**456 115**	535 465
Non-interest income and net gain on disposal of available-for-sale investments	**274 015**	291 643
Adjusted for: Dividends received	**(3 474)**	(4 441)
Net (gain) on disposal of available-for-sale investments	**(885)**	(1 583)
Revaluation of fair value financial instruments	**(7 778)**	(50 636)
Recoveries in respect of amounts previously written off	**1 876**	911
	719 869	771 359
26.2 Cash paid to customers, suppliers and employees		
Interest expenditure	**(194 644)**	(261 412)
Operating expenditure and fee and commission expenditure	**(388 486)**	(340 776)
Adjusted for: Amortisation	**20 819**	7 428
Depreciation	**8 010**	6 825
Loss on sale of property and equipment	**6**	10
Vesting of shares in the conditional share plan	**(104)**	–
Share-based payments expense/(write back)	**2 154**	(752)
(Decrease) in provisions	**(8 222)**	(10 418)
	(560 467)	(599 095)

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

	2010 R'000	2009 R'000
26. Notes to statement of cash flows (continued)		
26.3 Reconciliation of profit before tax to cash generated from operations		
Profit before tax	**143 578**	215 597
Profit before tax adjusted for:		
Dividends received	**(3 474)**	(4 441)
Net (gain) on disposal of available-for-sale investments	**(885)**	(1 583)
Revaluation of fair value financial instruments	**(7 778)**	(50 636)
Net impairments raised	**5 298**	10 234
Amortisation	**20 819**	7 428
Depreciation	**8 010**	6 825
Loss on sale of property and equipment	**6**	10
Share-based payments expense	**2 154**	(752)
Vesting of shares in the conditional share plan	**(104)**	–
(Decrease) in provisions	**(8 222)**	(10 418)
Cash generated from operations	**159 402**	172 264
26.4 Tax		
Amounts at the beginning of the year	–	(306)
Statement of comprehensive income recovery	–	266
Total tax (paid)	–	(40)
26.5 Net movement in income earning assets		
Decrease/(Increase) in negotiable securities	**3 597**	(21 778)
(Increase) in loans and advances	**(92 304)**	(231 735)
Decrease in bank term deposits	**35 276**	289 019
Net (increase)/decrease in income earning assets	**(53 431)**	35 506
26.6 Net movement in deposits and other accounts		
Increase/(Decrease) in deposits	**318 270**	(142 809)
(Increase)/Decrease in other accounts receivable	**(20 816)**	8 759
Increase/(Decrease) in other accounts payable	**10 811**	(37 756)
Net increase/(decrease) in deposits and other accounts	**308 265**	(171 806)

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

27. Related-party information

27.1 Identity of related parties with whom transactions have occurred

The holding company is identified on page 5 in the Directors' report and the associated company is disclosed in note 8 (liquidated during 2010) to the annual financial statements. 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.

27.2 Related-party balances and transactions

The Company its subsidiaries and associated company, in the ordinary course of business, enter into various financial services transactions with the ultimate holding company and its subsidiaries, other entities within the group and the associated company. Except for the interest free loan from the Bank to MBHL, transactions are governed by terms no less favourable than those arranged with third parties.

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

	% Held	**2010 R'000**	2009 R'000
Loans to subsidiaries			
Portion 2 of Lot 8 Sandown (Pty) Limited	100	**34 126**	40 390
LSM (Troyeville) Properties (Pty) Limited	100	**6 784**	6 494
Less: Provisions held against loan accounts		**(1 308)**	(1 760)
		39 602	45 124
Loans to fellow subsidiary and holding company			
Mercantile Bank Holdings Limited		**12 757**	11 946
Mercantile Insurance Brokers (Pty) Limited		**828**	290
		13 585	12 236
Deposits from holding company and fellow subsidiaries			
Mercantile Bank Holdings Limited		**223**	224
Mercantile Insurance Brokers (Pty) Limited		**2 794**	1 912
		3 017	2 136
Deposit from associated company			
Statman Investments (Pty) Limited		–	3 636

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

27. Related-party information (continued)

27.2 Related-party balances and transactions (continued)

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

	2010 R'000	2009 R'000
Interest received from:		
Portion 2 of Lot 8 Sandown (Pty) Limited	**4 409**	5 121
LSM (Troyeville) Properties (Pty) Limited	**787**	759
Statman Investments (Pty) Limited	**–**	25
Interest paid to:		
Mercantile Insurance Brokers (Pty) Limited	**86**	96
Statman Investments (Pty) Limited	**707**	86
Non-interest income earned from:		
Mercantile Insurance Brokers (Pty) Limited	**158**	190
Dividends earned from:		
Statman Investments (Pty) Limited	**3 126**	4 059
Operating expenditure with:		
Portion 2 of Lot 8 Sandown (Pty) Limited	**13 921**	11 813
LSM (Troyeville) Properties (Pty) Limited	**1 052**	1 072
Balances and transactions with the ultimate holding company (CGD) and its subsidiary:		
CGD – Lisbon (Branch of CGD)	**1 084 225**	614 171
Nostro accounts*	**2 530**	3 698
Vostro accounts	**(1 912)**	(1 568)
Deposit accounts*	**1 083 607**	612 041
CGD – Paris (Branch of CGD)	**225**	68
Nostro accounts*	**261**	92
Vostro accounts	**(36)**	(24)
CGD – London (Branch of CGD)		
Vostro accounts	**(16)**	(17)
CGD	**1 084 434**	614 222
Banco Comercial e de Investimentos (BCI)–Mozambique (Subsidiary of CGD)	**(107 659)**	(37 215)
Vostro accounts	**(3 326)**	(4)
Fixed deposits	**(103 800)**	(37 100)
Call and notice deposits	**(533)**	(111)
Total CGD	**976 775**	577 007

* These balances are included as part of note 13 cash and cash equivalents – foreign bank balances.

	2010 R'000	2009 R'000
Transactions between the ultimate holding company (CGD) and the Bank:		
Interest paid by CGD to the Bank	**1 353**	10 518
Interest paid by BCI to the Bank	**–**	268
Interest paid by the Bank to BCI	**2 294**	3 084

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 2010 (continued)

27. Related-party information (continued)

27.3 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:

	Directors' fees R'000	Salary R'000	Fringe benefits R'000	Retirement funds and medical aid contributions R'000	Performance bonus R'000	Total R'000
2010						
Non-executive Directors						
J A S de Andrade Campos	**1 413**	–	–	–	–	**1 413**
G P de Kock	**602**	–	–	–	–	**602**
L Hyne	**567**	–	–	–	–	**567**
A T Ikalafeng	**480**	–	–	–	–	**480**
T H Njikizana	**475**	–	–	–	–	**475**
S Rapeti (resigned 29 July 2010)	**311**	–	–	–	–	**311**
Executive Directors						
D J Brown	–	**2 837**	–	**301**	–	**3 138**
J P M Lopes	–	**1 771**	**568**	**44**	–	**2 383**
K R Kumbier (appointed 1 June 2010)*	–	**2 227**	–	**156**	–	**2 383**
	3 848	**6 835**	**568**	**501**	–	**11 752**
2009						
Non-executive Directors						
J A S de Andrade Campos	1 343	–	–	–	–	1 343
G P de Kock	560	–	–	–	–	560
L Hyne	525	–	–	–	–	525
A T Ikalafeng	445	–	–	–	–	445
T H Njikizana	382	–	–	–	–	382
S Rapeti	503	–	–	–	–	503
Executive Directors	–					
D J Brown	–	2 609	–	273	2 000	4 882
J P M Lopes	–	1 662	516	55	250	2 483
	3 758	4 271	516	328	2 250	11 123

* A sign on bonus of R0.925 million included under 'salary' was awarded to Mr Kumbier as part of his appointment in June 2010.

	2010 R'000	2009 R'000
Share-based payments expense relating to executive Directors		
D J Brown	**656**	94
K R Kumbier (appointed 1 June 2010)	**135**	–
Amounts paid by CGD to executive Directors		
J P M Lopes	**552**	585

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

27. Related-party information (continued)

27.3 Director and Director-related activities (continued)

Service agreements

D J Brown Chief Executive Officer

Mr Brown's employment contract as Chief Executive Officer was extended by the Board to March 2014.

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' employment contract was extended by the Board to July 2014. In terms of his 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.

K R Kumbier Executive Director

Mr Kumbier was employed by Mercantile as Director: Finance and Business on 1 June 2010. His appointment will be affirmed at the AGM to be held on 1 June 2011.

Share options and conditional share awards

In terms of the share option scheme, the following share options in the Company have been granted to Mr Brown (refer to note 28):

- 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, the following conditional share awards were granted to Mr Brown (refer to note 28):

- on 22 February 2008, 7 600 000 with a market value on the date of grant of 32 cents each;
- on 18 May 2009, 5 000 000 with a market value on the date of grant of 26 cents each; and
- on 25 February 2010, 5 000 000 with a market value on the date of grant of 20 cents each.

In terms of the Conditional Share Plan, the following conditional share awards were granted to Mr Kumbier (refer to note 28):

- on 1 June 2010, 10 000 000 with a market value on the date of grant of 24 cents each.

Directors' interests

Except for Mr Kumbier (appointed 1 June 2010), who holds 2 016 851 shares directly, no other Directors held beneficial and/or non-beneficial interests, directly or indirectly, in shares issued by the Company (2009: nil).

28. Share incentive schemes

The number of shares which could be utilised for the purposes of the share incentive schemes is 393 891 852 (2009: 393 891 852), which is 10% (2009: 10%) of the issued share capital of MBHL at year-end. At the reporting date, 107 694 400 (2009: 83 128 400) share options and Conditional Share Plan awards were outstanding under these schemes. The balance available to be utilised under these schemes is 286 197 452 (2009: 310 763 452). The number of scheme shares that may be issued to a single participant is 59 083 778 (2009: 59 083 778) or 1.5% (2009: 15%) of the total number of issued shares.

The Company recognised expenses of R2.154 million (2009: R0.752 million write back of expenses) relating to equity-settled share-based payment transactions (refer to note 24).

Share option scheme

In terms of the Trust Deed, as amended in 2007, options can be exercised in respect of 33% of the option shares after the expiration of three years from the offer date, 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. Prior to 2008, should the options not have been 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.

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

28. Share incentive schemes (continued)

Share option scheme (continued)

The scheme was modified in 2008 to remove the expiry condition from the sixth anniversary date 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. The scheme was replaced by the Conditional Share Plan and no further options were granted after implementation of the Conditional Share Plan.

The Mercantile Share Incentive Trust acts as agent on behalf of the Bank in respect of this scheme.

Conditional Share Plan

The Conditional Share Plan incentive scheme, implemented in 2008, aims to attract, retain and reward selected employees who are able to contribute to the growth of MBHL and provide for an incentive to encourage their continued employment relationship with the Company. By providing them the opportunity to receive shares in the Company, participants are incentivised 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 awards, other than a guaranteed 25% of all awards, are subject to performance conditions measured over a period of three years.

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

	Exercise price (cents)	Options at the beginning of the year	Forfeited during the year	Exercised during the year	Options at the end of the year	Exercisable options at the end of the year	Relating to Directors*
Share option scheme							
Grant date							
2010							
20 November 2001	**32**	**394 400**	–	–	**394 400**	**394 400**	–
11 February 2002	**32**	**160 000**	–	–	**160 000**	**160 000**	–
5 October 2004	**18**	**5 000 000**	–	–	**5 000 000**	**5 000 000**	**5 000 000**
7 October 2004	**17**	**750 000**	–	**(500 000)**	**250 000**	**250 000**	–
11 February 2005	**20**	**500 000**	–	–	**500 000**	**500 000**	–
27 July 2005	**32**	**750 000**	–	–	**750 000**	**750 000**	–
9 February 2006	**41**	**750 000**	–	–	**750 000**	**750 000**	–
22 March 2006	**40**	**10 600 000**	**(800 000)**	–	**9 800 000**	**9 800 000**	**7 000 000**
26 February 2007	**34**	**17 600 000**	**(1 450 000)**	–	**16 150 000**	**10 659 000**	**8 000 000**
1 June 2007	**36**	**500 000**	–	–	**500 000**	**330 000**	–
		37 004 400	**(2 250 000)**	**(500 000)**	**34 254 400**	**28 593 400**	**20 000 000**
2009							
20 November 2001	32	794 400	(400 000)	–	394 400	394 400	–
11 February 2002	32	160 000	–	–	160 000	160 000	–
5 October 2004	18	5 000 000	–	–	5 000 000	5 000 000	5 000 000
7 October 2004	17	750 000	–	–	750 000	750 000	–
11 February 2005	20	500 000	–	–	500 000	500 000	–
27 July 2005	32	750 000	–	–	750 000	750 000	–
9 February 2006	41	750 000	–	–	750 000	495 000	–
3 March 2006	38	500 000	(500 000)	–	–	–	–
22 March 2006	40	10 600 000	–	–	10 600 000	6 996 000	7 000 000
26 February 2007	34	18 100 000	(500 000)	–	17 600 000	5 808 000	8 000 000
1 June 2007	36	500 000	–	–	500 000	165 000	–
1 December 2007	36	1 000 000	(1 000 000)	–	–	–	–
		39 404 400	(2 400 000)	–	37 004 400	21 018 400	20 000 000

The Company has not granted employees any further share options since 2007.

*Refer to note 27.3

Notes to the annual financial statements

for the year ended 31 December 2010 (continued)

28. Share incentive schemes (continued)

Conditional Share Plan

Grant date	Market price at date of grant (cents)	Conditional awards at the beginning of the year	Granted during the year	Forfeited during the year	Exercised during the year	Conditional awards at the end of the year	Relating to Directors*
2010							
22 February 2008	**32**	**22 749 000**	**–**	**(974 522)**	**(259 478)**	**21 515 000**	**7 600 000**
26 March 2008	**31**	**4 000 000**	**–**	**–**	**–**	**4 000 000**	**–**
24 July 2008	**26**	**375 000**	**–**	**–**	**–**	**375 000**	**–**
1 November 2008	**28**	**2 200 000**	**–**	**(200 000)**	**–**	**2 000 000**	**–**
18 March 2009	**26**	**15 800 000**	**–**	**(1 214 977)**	**(85 023)**	**14 500 000**	**5 000 000**
1 July 2009	**25**	**1 000 000**	**–**	**–**	**–**	**1 000 000**	**–**
25 February 2010	**20**	**–**	**20 050 000**	**–**	**–**	**20 050 000**	**5 000 000**
1 June 2010	**24**	**–**	**10 000 000**	**–**	**–**	**10 000 000**	**10 000 000**
1 December 2010	**20**	**–**	**1 500 000**	**–**	**–**	**1 500 000**	**–**
		46 124 000	**31 550 000**	**(2 389 499)**	**(344 501)**	**74 940 000**	**27 600 000**
2009							
22 February 2008	32	26 131 000	–	(3 382 000)	–	22 749 000	7 600 000
26 March 2008	31	4 000 000	–	–	–	4 000 000	–
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)	–	–	–
18 March 2009	26	–	16 660 000	(860 000)	–	15 800 000	5 000 000
1 July 2009	25	–	1 000 000	–	–	1 000 000	–
		34 006 000	17 660 000	(5 542 000)	–	46 124 000	12 600 000

*Refer to note 27.3

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 that have become all too evident during the ongoing global financial crisis. The Company operates in a dynamic environment where the past is not necessarily an acceptable guide to the future. 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 variables are monitored to assist in managing exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a balanced portfolio. However, we acknowledge the potential of concentration risk in being a small bank and this is carefully monitored and where appropriate corrective action is taken. Our business development efforts are focused on the stronger companies and individuals within established policy criteria, which policy serves to eliminate weaker credit from the portfolio. The Company remains well positioned to effectively manage identified threats in such a way that minimises risks to the Company. An independent review of risk management and controls was deferred and will take place during 2011.

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

A number of risk initiatives were implemented during the year. These included:

- full implementation of a Risk Control Self Assessment process across all key areas of the Bank;
- a Treasury Middle Office has been implemented and all functions identified to improve on segregation and effective management have been migrated for both the treasury front and back offices;
- further enhancements to the Asset Liability Management monitoring and reporting were implemented;
- full implementation and further expansion of a prudential management schedule wherein all risk related ratios are monitored and reported to the ALCO and Board on a monthly basis; and
- a Risk Tolerance Strategy was documented and presented to the Board.

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 vary in importance dependent upon the business activities of an organisation and the related risks. The overall objective of enterprise-wide risk management is to ensure an integrated and effective risk management framework, where all risks are identified, quantified and managed in order to achieve an optimal risk reward profile. The presence of accurate measures of risk makes risk-adjusted performance measurement possible, creates the potential to generate increased shareholder returns and allows 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 and its various committees, credit management, senior management, risk management, business line management, finance and control, legal/compliance, treasury and operations, with significant support from internal audit and information technology.

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 business unit 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. We have implemented a system of Risk Control Self Assessment across the Bank. The challenge is to ensure effective utilisation and evaluation against the deliverables identified and ongoing training is being scheduled. The standards and implementation of Risk Control Self Assessment ensure alignment and consistency in the way that prevalent risk types are identified, 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 determination and measurability than others, but it is necessary to ascertain the magnitude of each risk, whether quantifiable or not and whether direct or indirect.

Risk management (as an independent function)

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

Risk management and control
(continued)

Risk management life cycle/process (continued)

Risk control (stress and back 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 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. A policy of back testing for identified key variables has been approved by the Board and will be implemented during the first quarter 2011.

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 identified risks within the Enterprise-wide Risk Management Framework, which include:

Direct risks	**Indirect risks**
Credit risk	Strategic risk
Counterparty risk	Reputation risk
Currency risk	Legal risk
Liquidity risk	Fraud risk
Interest rate risk	International risk
Market (position) risk	Political risk
Solvency risk	Competitive risk
Operational risk	Pricing risk
Technology risk	
Compliance risk	

The responsibility for understanding the risks incurred by the 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 and tolerance levels. 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 on any 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 and any changes approved by the RMC.

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 on 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 requirements. A comprehensive re-evaluation of the capital requirements under the Internal Capital Adequacy Assessment Process is regularly undertaken with consideration being given to all risks impacting on the need for capital reserves within the Company. The outcome of these assessments resulted in the Company identifying different levels of risk related to specific characteristics of its business where it was deemed prudent to hold a capital buffer in addition to the regulatory capital 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.

Risk management and control

(continued)

Management of risk (continued)
Credit risk (continued)
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 value of contracts it enters into with any one party to within pre-approved transactional limits.

At year-end, the Company did not have 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 27.2.

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.

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 new and renewal proposals for lending in excess of R2 million. In addition an early warning system is applied to actively manage all accounts within the risk structure. The system identifies a number of characteristics relating to the performance of the accounts and based on various predefined algorithms, flags issues of concern. Monitoring is done by the Portfolio Management Department and any concerns are raised with the Credit Department and Business or Commercial banking units. The Company is implementing an enhanced Decision Support tool to assist credit decision makers through the provision of indicative performance criteria and other information by industry necessary to assist in making more informed decisions. Such indicative performance data will be measured against predefined acceptance bands and result in the allocation of an overall acceptability rating. The model is currently being tested. Once testing is complete, it will be submitted to the RMC for approval.

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 the reporting date:

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2010				
Current accounts	**633 290**	**–**	**–**	**633 290**
Credit card	**18 968**	**14 848**	**–**	**33 816**
Mortgage loans	**1 863 013**	**115 055**	**–**	**1 978 068**
Instalment sales and leases	**268 474**	**–**	**–**	**268 474**
Structured loans	**230 036**	**–**	**–**	**230 036**
Other advances	**774 710**	**–**	**–**	**774 710**
Negotiable securities	**–**	**–**	**265 028**	**265 028**
Cash and cash equivalents	**–**	**–**	**1 759 897**	**1 759 897**
Guarantees	**–**	**–**	**305 669**	**305 669**
Letters of credit	**–**	**–**	**10 260**	**10 260**
	3 788 491	**129 903**	**2 340 854**	**6 259 248**
2009				
Current accounts	593 688	–	–	593 688
Credit card	15 193	15 285	–	30 478
Mortgage loans	1 745 498	175 549	–	1 921 047
Instalment sales and leases	341 794	–	–	341 794
Structured loans	247 715	–	–	247 715
Other advances	685 686	–	–	685 686
Negotiable securities	–	–	267 902	267 902
Bank term deposits	–	–	35 276	35 276
Cash and cash equivalents	–	–	1 400 937	1 400 937
Guarantees	–	–	303 514	303 514
Letters of credit	–	–	12 330	12 330
	3 629 574	190 834	2 019 959	5 840 367

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 include risks associated with reputation, robbery, fraud, theft of data, systems access and controls, 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;
- ongoing training and up skilling of 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 critical operations environments;
- 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;
- comprehensive data security and protection;
- ongoing review of the bank-wide Risk Control Self Assessment Process rolled out to job functional level in high-risk operational processing areas during 2010; and
- limiting access to systems and enforcing strong password controls.

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 prudential and regulatory limits. In the unlikely event of an unauthorised limit violation, the ALM forum 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 on a daily basis 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 initial and variation margins. A detailed sensitivity analysis is performed for liquidity and interest rate risk (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. Various additional conservative prudential risk limits were introduced during 2009 and expanded in 2010. The results of the prudential risk limits and various sensitivities are reported to the ALCO, RMC and Board on a regular basis.

Basel III proposes various changes to the management and supervision of liquidity risk. The Company is monitoring these developments and will ensure that it is well positioned to meet the added requirements of Basel III prior to the implementation by the SARB.

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 that are well below the limits allowed by the SARB. For the year under review the highest net open position recorded for any single day was R4.75 million (2009: R10.02 million). An adverse movement in the exchange rate of 10% would reduce the Company's income by R0.5 million (2009: R1.0 million).

Risk management and control

(continued)

Management of risk (continued)

Foreign currency risk (continued)

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

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2010					
Total foreign exchange assets	**1 104 488**	**25 697**	**6 856**	**8 145**	**1 145 186**
Total foreign exchange liabilities	**(172 412)**	**(19 874)**	**(7 910)**	**(337)**	**(200 533)**
Commitments to purchase foreign currency	**179 019**	**121 800**	**26 828**	**10 156**	**337 803**
Commitments to sell foreign currency	**(1 110 368)**	**(128 435)**	**(25 831)**	**(16 800)**	**(1 281 434)**
Year-end effective net open foreign currency positions	**727**	**(812)**	**(57)**	**1 164**	**1 022**
2009					
Total foreign exchange assets	615 326	48 369	32 490	9 877	706 062
Total foreign exchange liabilities	(182 815)	(16 896)	(7 253)	(3 176)	(210 140)
Commitments to purchase foreign currency	127 566	100 434	3 003	15 579	246 582
Commitments to sell foreign currency	(559 551)	(131 475)	(27 953)	(21 859)	(740 838)
Year-end effective net open foreign currency positions	526	432	287	421	1 666

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, RMC and Board.

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, by the use of interest rate swap contracts and by matching the maturities of deposits and assets as appropriate.

The objective with the management of interest rate risk is to ensure a higher degree of interest rate margin stability and lower interest rate risk over an interest rate cycle. This is achieved by hedging material exposures and by not allowing any proprietary interest rate positions. 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 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.

Risk management and control

(continued)

Management of risk (continued)

Interest rate risk (continued)

The yield on assets declined further during 2010, which can mainly be attributed to the steep decline in the prevailing prime and repo rates in South Africa during this period. South Africa was not immune to the global credit and liquidity crisis and this, together with market uncertainty in respect of the longer-term interest rate trends, resulted in the cost of funding contributing to the decline in margin. In addition, margins were further squeezed by the impact of lower interest rates on non-interest bearing deposits. Pressure on margins is likely to continue during 2011. Net interest income was also adversely impacted by the negative endowment effect due to the current high levels of excess capital of the Company.

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.

The impact on equity and profit and loss resulting from a change in interest rates is calculated monthly based on management's forecast of the most likely change in interest rates. In addition to the above, the impact of a static bank specific favourable and unfavourable interest rate movement of 50 and 200 basis points respectively is calculated and monitored daily by the ALM forum. Various prudential limits that were approved and implemented during the 2009 financial year were refined and expanded during 2010.

At the reporting date, a 50 basis point change in prevailing interest rates was applied as a sensitivity analysis to determine the impact on earnings as a result of a change in interest rates. If interest rates increased/decreased by 50 basis points and all other variables remained constant, the Company's net profit and equity at year-end would increase/decrease by R10.6 million (2009: increase/decrease by R9.8 million). This is mainly attributable to the Company's exposure to interest rates on its surplus capital and 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. The repricing profile indicates that the Company remains asset-sensitive as interest-earning assets reprice sooner than interest-paying liabilities, before and after derivative hedging activities. Thus, future net interest income remains vulnerable to a decrease in market interest rates.

	Up to 1 month R'000	1–3 months R'000	3–12 months R'000	1–5 years R'000	Over five years R'000	Non-interest sensitive R'000	Total R'000	Effective interest rate %
2010								
Assets								
Intangible assets	–	–	–	–	–	224 402	224 402	–
Property and equipment	–	–	–	–	–	27 508	27 508	–
Other accounts receivable	–	–	–	–	–	62 558	62 558	–
Interest in subsidiaries	40 910	–	–	–	–	53 185	94 095	–
Other investments	–	–	–	–	–	16 332	16 332	–
Deferred tax assets	–	–	–	–	–	57 548	57 548	–
Loans and advances	3 749 310	–	–	45 499	30 786	(104 688)	3 720 907	8.62
Derivative financial instruments	59	–	–	–	–	34 658	34 717	–
Negotiable securities	49 782	63 161	132 853	19 232	–	–	265 028	6.72
Cash and cash equivalents	1 574 773	–	–	–	–	185 124	1 759 897	5.26
Total assets	5 414 834	63 161	132 853	64 731	30 786	556 627	6 262 992	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	1 566 781	1 566 781	–
Deposits	2 848 816	340 102	679 748	30 643	–	667 695	4 567 004	4.17
Derivative financial instruments	2 860	1 736	–	–	–	23 526	28 122	–
Provisions and other liabilities	–	–	–	–	–	29 920	29 920	–
Other accounts payable	–	–	–	–	–	71 165	71 165	–
Total equity and liabilities	2 851 676	341 838	679 748	30 643	–	2 359 087	6 262 992	
Financial position interest sensitivity gap	2 563 158	(278 677)	(546 895)	34 088	30 786	–	1 802 460	
Derivative financial instruments	17 630	35 604	7 000	(33 975)	(26 259)	–	–	
Total net interest sensitivity gap	2 580 788	(243 073)	(539 895)	113	4 527	–	1 802 460	

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 five years R'000	Non-interest sensitive R'000	Total R'000	Effective interest rate %
2009								
Assets								
Intangible assets	–	–	–	–	–	170 325	170 325	–
Property and equipment	–	–	–	–	–	31 955	31 955	–
Other accounts receivable	–	–	–	–	–	41 742	41 742	–
Interest in subsidiaries	46 884	–	–	–	–	48 845	95 729	–
Other investments	–	–	–	–	–	29 957	29 957	–
Deferred tax assets	–	–	–	–	–	98 381	98 381	–
Non-current assets held for sale	–	–	–	–	–	5 510	5 510	–
Loans and advances	3 652 205	–	–	62 420	–	(85 051)	3 629 574	12.57
Derivative financial instruments	–	53	–	–	–	21 353	21 406	–
Negotiable securities	19 895	114 007	114 985	–	19 015	–	267 902	9.34
Bank term deposits	–	–	35 276	–	–	–	35 276	7.22
Cash and cash equivalents	1 290 685	–	–	–	–	110 252	1 400 937	7.22
Total assets	5 009 669	114 060	150 261	62 420	19 015	473 269	5 828 694	
Equity and liabilities								
Shareholders' equity	–	–	–	–	–	1 465 234	1 465 234	–
Deposits	2 678 232	292 106	666 650	5 560	–	606 186	4 248 734	6.73
Derivative financial instruments	6 140	1 438	–	–	–	8 652	16 230	–
Provisions and other liabilities	–	–	–	–	–	38 142	38 142	–
Other accounts payable	–	–	–	–	–	60 354	60 354	–
Total equity and liabilities	2 684 372	293 544	666 650	5 560	–	2 178 568	5 828 694	
Financial position interest sensitivity gap	2 325 297	(179 484)	(516 389)	56 860	19 015		1 705 299	
Derivative financial instruments	49 684	59 526	–	(70 501)	(38 709)	–	–	
Total net interest sensitivity gap	2 374 981	(119 958)	(516 389)	(13 641)	(19 694)	–	1 705 299	

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.

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

- the maintenance of a stock of readily available, high-quality liquid assets in excess of the statutory requirements as well as strong statement of financial position liquidity ratios;
- 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;

Risk management and control

(continued)

Management of risk (continued)

Liquidity risk (continued)

- 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.

While international financial markets experienced significant stress in 2009, the South African domestic money market liquidity remained largely unaffected. Overall the Company's key liquidity risk metrics, which have been formulated to achieve a prudent liquidity profile, were maintained at acceptable levels. Through increased stress testing, scenario analysis and contingency planning, the Company continues to actively manage its stress funding sources and liquidity buffers to ensure that it exceeds the estimated stress funding requirements which could emanate from moderate to high-stressed liquidity events. Overall the Company's liquidity position remains strong.

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 remaining period to contractual maturity of financial liabilities of the Company as at the reporting date which includes the interest obligation on unmatured deposits and derivatives calculated up to the 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
2010					
Deposits	**3 054 863**	**574 149**	**253 830**	**658 218**	**80 601**
Derivative financial instruments	**1 316**	**19 985**	**2 077**	**147**	**4 597**
Other accounts payable	**71 165**	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	**445 832**	–	–	–	–
Operating lease commitments	**1 529**	**3 060**	**4 609**	**9 209**	**11 352**
Capital commitments	**4 106**	**1 254**	–	–	–
	3 578 811	**598 448**	**260 516**	**667 574**	**96 550**
2009					
Deposits	3 285 860	295 726	276 889	418 630	6 066
Derivative financial instruments	1 720	5 742	1 190	–	7 578
Other accounts payable	60 354	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	506 678	–	–	–	–
Operating lease commitments	1 487	2 974	4 452	8 431	7 011
Capital commitments	17 209	25 814	8 605	–	–
	3 873 308	330 256	291 136	427 061	20 655

Risk management and control
(continued)

Management of risk (continued)

Liquidity risk (continued)

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

	Assets R'000	Liabilities R'000	Total mismatch R'000
2010			
Maturing up to one month	**2 579 550**	**3 156 594**	**(577 044)**
Maturing between one and three months	**83 572**	**589 407**	**(505 835)**
Maturing between three and six months	**281 223**	**249 990**	**31 233**
Maturing between six months and one year	**47 455**	**623 053**	**(575 598)**
Maturing after one year	**2 942 409**	**77 167**	**2 865 242**
Non-contractual	**328 783**	**–**	**328 783**
	6 262 992	**4 696 211**	**1 566 781**
2009			
Maturing up to one month	2 150 785	3 384 146	(1 233 361)
Maturing between one and three months	122 559	298 338	(175 779)
Maturing between three and six months	122 715	270 899	(148 184)
Maturing between six months and one year	89 494	396 940	(307 446)
Maturing after one year	2 986 362	13 137	2 973 225
Non-contractual	356 779	–	356 779
	5 828 694	4 363 460	1 465 234

Basel III – influencing risk management developments at the Bank

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 implementation of Basel III is expected to have far reaching implications for banks in terms of minimum capital standards and liquidity requirements. In addition to this it is anticipated that the reforms will be accompanied by enhancements in supervision, risk management and governance requirements including added transparency and disclosure requirements. The Bank is monitoring developments and will ensure that it is well positioned to meet the added requirements of Basel III as approved for implementation by SARB.

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

Risk management and control

(continued)

Capital management

The Company 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 capital management strategy is focused on maximising shareholder value over time by optimising the level and mix of capital resources whilst ensuring sufficient capital is available to support the growth objectives of the Company. Decisions on the allocation of capital resources, conducted as part of the strategic planning and budget review, are based on a number of factors including growth objectives, return on economic and regulatory capital and the residual risk inherent to specific business lines. This is conducted as part of the Internal Capital Adequacy Assessment Process and strategic planning review on a regular basis. 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.

Capital adequacy and the use of regulatory capital are monitored by employing techniques based on the guidelines documented in the Bank Regulations and implemented by the SARB for supervisory purposes. The SARB uses the capital adequacy ratio of banks as a key supervisory tool. In terms of regulation, the 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 Company in 2004, it has remained capitalised well beyond regulatory and internal requirements.

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

Capital to support the Company's needs is currently generated by retained earnings.

The approach to capital management has been further enhanced over the past year in line with Basel II and will remain a focus area for the future.

The level of capital for the Bank is as follows:

	2010 R'000	2009 R'000
Risk weighted assets – Banking book		
Credit risk	**4 335 032**	3 917 762
Operational risk	**808 095**	775 636
Market risk	**2 350**	1 914
Equity	**10 940**	23 561
Other assets	**234 963**	169 447
	5 391 380	4 888 320
Net qualifying capital and reserves		
Primary capital	**1 276 395**	1 225 749
Share capital and share premium	**1 483 299**	1 483 299
Retained earnings	**10 660**	–
General reserves	**12 231**	12 231
Less: Deductions	**(229 795)**	(269 781)
Secondary capital	**5 161**	19 331
General allowance for credit impairment	**5 127**	19 297
Surplus resulting from a revaluation of specified assets	**34**	34
	1 281 556	1 245 080
Capital adequacy ratio (%)	**23.8**	25.5
Primary capital (%)	**23.7**	25.1
Secondary capital (%)	**0,1**	0.4

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