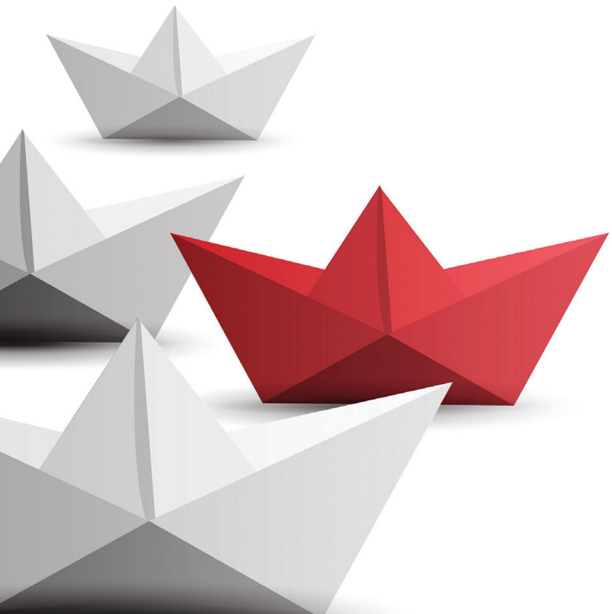
Mercantile Bank Limited

The Business Bank inspired by entrepreneurs

Audited Annual Financial Statements 2014

Mercantile Bank Limited
The Business Bank inspired by entrepreneurs



In terms of section 29(1)(e)(ii) of the Companies Act, it is confirmed that the preparation of these annual financial statements is the responsibility of MEL Teixeira (CA)SA, the Chief Financial Officer of the Bank.

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

www.mercantile.co.za

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

Mark Shuttleworth

MERCANTILE BANK LIMITED
Registration number: 1965/006706/06
Member of CGD Group
An Authorised Financial Services and Credit Provider NCRCP19

GLOSSARY OF TERMS

ABBREVIATION	DEFINITION/DESCRIPTION
AC	Audit Committee
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
CGD	Caixa Geral de Depósitos S.A., a company registered in Portugal and the ultimate holding company
Companies Act	Companies Act, No. 71 of 2008
CREDCOM	Credit Committee
IFRS	International Financial Reporting Standards and Interpretations
MBHL	Mercantile Bank Holdings Limited, the holding company
Mercantile	Mercantile Bank Limited
RMC	Risk and Capital Management Committee
SARB	South African Reserve Bank
the Bank	Mercantile Bank Limited
the Board	The Board of Directors
the Company	Mercantile Bank Limited

DIRECTORS' RESPONSIBILITY STATEMENT

In terms of the Companies Act, the Directors are required to maintain adequate accounting records and prepare annual financial statements that fairly present the financial position at year-end and the results and cash flows for the year ended 31 December 2014 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, and financial and specific audits, and co-ordinates audit coverage with the External Auditors.

The External Auditors are responsible for reporting on the fair presentation of the Company's annual financial statements.

The Company's annual financial statements are prepared in accordance with IFRS issued by the International Accounting Standards Board and incorporate responsible disclosures in line with the accounting policies of the 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 4 to 63, have been approved by the Board and are signed on their behalf by:

NF Thomaz
Chairman

KR Kumbier
Chief Executive Officer

24 March 2015

CERTIFICATE FROM THE COMPANY SECRETARY

In terms of the provisions of the Companies Act, I certify that, to the best of my knowledge and belief, the Company has lodged with the Registrar of Companies for the financial year ended 31 December 2014, all such returns as are required of a public company in terms of the Companies Act, and that all such returns are true, correct and up to date.

T Singh
Company Secretary

24 March 2015

INDEPENDENT AUDITOR'S REPORT

to the shareholder of Mercantile Bank Limited

REPORT ON THE FINANCIAL STATEMENTS

We have audited the financial statements of the Company set out on pages 7 to 63, which comprise the statement of financial position at 31 December 2014, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and the notes, comprising a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The Company's Directors are responsible for the preparation and fair presentation of these financial statements in accordance with IFRS and the requirements of the Companies Act of South Africa, and for such internal control as the Directors determine is necessary to enable the preparation of 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 about whether the financial statements are free from material misstatement.

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

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the financial statements present fairly, in all material respects, the financial position of Mercantile Bank Limited as at 31 December 2014, and its financial performance and cash flows for the year then ended in accordance with IFRS and the requirements of the Companies Act of South Africa.

OTHER REPORTS REQUIRED BY THE COMPANIES ACT

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

Deloitte & Touche

Deloitte & Touche
Registered Auditor
Per: Danie Crowther
Partner

24 March 2015

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

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

A full list of partners and directors is available on request

** Partner and Registered Auditor*

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

Member of Deloitte Touche Tohmatsu Limited

AUDIT COMMITTEE REPORT

for the year ended 31 December 2014

The Audit Committee ("AC") is a committee of the MBHL Board and has assumed the responsibilities of an audit committee in respect of all subsidiaries of MBHL, and therefore a separate AC has not been formed for the Bank. The AC assists the Board in fulfilling its monitoring and controlling responsibilities in terms of applicable legislation.

TERMS OF REFERENCE

The AC is a Board Committee appointed by the Board and is accountable to it. Its powers and terms of reference are delegated to it by the Board, and are formalised in its charter which is reviewed annually and approved by the Board. The AC has executed its duties during the past financial year in accordance with its charter and the Companies Act.

COMPOSITION

The AC comprises four independent Non-Executive Directors. At 31 December 2014 the members were:

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

The Chief Executive Officer, Executive Officer, Chief Financial Officer, heads of Risk and Internal Audit, and representatives from the External Auditors attend the committee meetings by invitation. The External and Internal Auditors have unrestricted access to the AC Chairman or any other member of the Committee, as required.

MEETINGS

The AC held five meetings during the period under review. During their tenure as members of the Committee, all members attended each of these meetings.

STATUTORY DUTIES

In execution of its statutory duties during the financial year under review, the AC:

- nominated for appointment, as external auditor, Deloitte & Touche which, in its opinion, is independent of the Company;
- determined the fees to be paid to Deloitte & Touche as disclosed in note 25 to the annual financial statements;
- determined Deloitte & Touche's terms of engagement;
- believes the appointment of Deloitte & Touche complies with the relevant provisions of the Companies Act and King III;
- pre-approved all non-audit service contracts with Deloitte & Touche in accordance with its policy;
- received no complaints with regard to accounting practices and the internal audit of the Company, the content or auditing of its financial statements, the internal financial controls of the Company, and any other related matters; and
- advised the Board that regarding matters concerning the Company's accounting policies, financial control, records and reporting, it concurs that the adoption of the going concern premise in the preparation of the financial statements is appropriate.

INTERNAL FINANCIAL CONTROL AND INTERNAL AUDIT

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

- reviewed and recommended the Internal Audit charter for approval;
- evaluated the independence, effectiveness and performance of the internal audit function;
- reviewed the effectiveness of the Company's system of internal financial controls;
- reviewed significant issues raised by the external and internal audit process, and the adequacy of corrective action in response to such findings; and
- reviewed policies and procedures for preventing and detecting fraud.

The head of Internal Audit functionally reported to the AC, had unrestricted access to the AC Chairman, and is of the opinion that significant internal financial controls operated effectively during the period under review.

Based on the processes and assurances obtained, the AC believes that significant internal financial controls are effective.

REGULATORY COMPLIANCE

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

EXTERNAL AUDIT

Based on processes followed and assurances received, the AC is satisfied that both Deloitte & Touche and the partner, Danie Crowther, are independent of the Bank. The AC confirmed that no reportable irregularities were identified and reported by the external auditors in terms of the Auditing Professions Act, No. 26 of 2005.

Based on our satisfaction with the results of the activities outlined above, the AC has recommended to the Board that Deloitte & Touche should be reappointed for 2015.

FINANCE FUNCTION

The AC believes that MEL Teixeira, the Chief Financial Officer, who is responsible for Finance, possesses the appropriate expertise and experience to meet her responsibilities in that position. We are also satisfied with the expertise and adequacy of resources within the Finance function.

In making these assessments, we have obtained feedback from both External and Internal Audit.

Based on the processes and assurances obtained, we believe that the accounting practices are effective.

FINANCIAL STATEMENTS

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

On behalf of the AC

L Hyne
Chairman of the AC

24 March 2015

DIRECTORS' REPORT

for the year ended 31 December 2014

The Directors have pleasure in presenting their report, which forms part of the audited annual financial statements of the Company for the year ended 31 December 2014.

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 7 to 63 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 (2013: nil). The authorised and issued share capital of the Company is detailed in note 13 to the annual financial statements.

5. DIVIDENDS

A dividend of R25,668 million was declared on 27 February 2015 in respect of the year ended 31 December 2014 (2013: R25,701 million).

6. DIRECTORS, COMPANY SECRETARY AND REGISTERED ADDRESSES

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

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

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

FJ Schutte, who was serving as Company Secretary, resigned with effect from 1 August 2014 and T Singh was appointed as Company Secretary with effect from 1 August 2014.

The registered addresses of the Company are:

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

7. 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.

8. SPECIAL RESOLUTIONS

There were no special resolutions passed during the year under review.

9. EVENTS AFTER THE REPORTING PERIOD

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

ACCOUNTING POLICIES

for the year ended 31 December 2014

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

1. BASIS OF PRESENTATION

The Company'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.

IFRS that 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 retaining control of the asset.

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

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

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.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

3. FINANCIAL INSTRUMENTS continued

3.1 Derivative financial instruments continued

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 recorded at cost and are measured to fair value, excluding transaction costs, at each reporting date. Changes in the fair value of derivatives are recognised in profit and loss.

Derivatives in unlisted equity options, where the underlying 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.

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

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, which measures fair value gains and losses in profit and loss, it significantly reduces measurement inconsistency that would otherwise arise from measuring derivatives and such designated financial assets, at amortised cost.

Available-for-sale financial assets

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

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held by the 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.

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 or disposed of. At that time, the cumulative gains or losses previously recognised in other comprehensive income are included in profit and loss.

Negotiable securities

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

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

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

Loans and advances

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

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

Other accounts receivable

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

3.3 Financial liabilities

The Company's financial liabilities include deposits 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 involve 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, except for the reversal of an impairment of equity instruments designated as available-for-sale, which is recognised in other comprehensive income.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

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.

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

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

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

Gains and losses on disposal of property and equipment are determined by comparing proceeds with the carrying amount, and are recognised in profit and loss. Depreciation of an asset begins when it is available for use, and ceases at the earlier of the 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 are usually between three and five years, but where appropriate, over a maximum of 10 years and are carried at cost less any accumulated amortisation and any accumulated impairment losses. 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.

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

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

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.

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 are 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.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

10. TAX continued

10.2 Deferred tax

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 that 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 when the Company intends to settle its current tax assets and liabilities on a net basis.

10.3 Current and deferred tax for the year

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

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 rate method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the 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 is intended to offset the expected costs relating to the post-retirement medical benefits. The costs of the defined benefit plan are assessed using the projected unit credit method. Under this method, the cost of providing post-retirement medical benefits is charged to profit and loss, so as to spread the regular cost over the service lives of employees in accordance with the advice of qualified actuaries, who value the plans annually. The interest cost and expected return on plan assets used in the previous version of IAS 19 are replaced with a "net interest" amount under IAS 19 (as revised in 2011), as well as the effect of settlements on the liability and plan assets are recognised immediately in profit and loss and any remeasurements of the defined benefit liability and assets (which includes actuarial gains and losses) are recognised immediately through other comprehensive income in order for the net post-retirement asset or liability recognised in the consolidated statement of financial position to reflect the full value of the plan deficit or surplus.

16. KEY ACCOUNTING ESTIMATES AND JUDGEMENTS APPLIED BY MANAGEMENT

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.

16.1 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 Group, or national or local economic conditions that correlate with defaults on assets in the Company.

Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment, similar to those in the portfolio when scheduling its future cash flows.

The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

ACCOUNTING POLICIES continued

for the year ended 31 December 2014

16. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS continued

16.2 Fair value of financial instruments

The fair value of financial instruments that are not quoted in active markets is determined by using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. The models are calibrated to ensure that outputs reflect actual data and comparative market prices. To this 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.

16.3 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.

16.4 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.

17. 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, and will be applied for years ending after 31 December 2014:

	Standard/Interpretation	Effective date
IFRS 2 IFRS 3 IFRS 8 IAS 16 IAS 24 IAS 38	Amendments resulting from annual improvements 2010 – 2012 cycle	Annual periods beginning on or after 1 July 2014
IFRS 3 IFRS 13 IAS 40	Amendments resulting from annual improvements 2011 – 2013 cycle	Annual periods beginning on or after 1 July 2014
IFRS 5 IFRS 7 IAS 19 IAS 34	Amendments resulting from September 2014 annual improvements to IFRSs	Annual periods beginning on or after 1 January 2016

	Standard/Interpretation	Effective date
IFRS 7	**Financial instruments:** Disclosures	Annual periods beginning on or after 1 January 2018
IFRS 9	Financial instruments	Annual periods beginning on or after 1 January 2018
IFRS 10	**Consolidated financial statements:** Amendments regarding the sale or contribution of assets between an investor and its associate or joint venture; and amendments regarding the application of the consolidation exception	Annual periods beginning on or after 1 January 2016
IFRS 11	**Joint arrangements:** Amendments regarding the accounting for acquisitions of an interest in a joint operation	Annual periods beginning on or after 1 January 2016
IFRS 12	**Disclosure of interests in other entities:** Amendments regarding the application of the consolidation exception	Annual periods beginning on or after 1 January 2016
IFRS 14	Regulatory deferral accounts	Annual periods beginning on or after 1 January 2016
IFRS 15	Revenue from contracts with customers	Annual periods beginning on or after 1 January 2017
IAS 1	**Presentation of financial statements:** Amendments resulting from the disclosure initiative	Annual periods beginning on or after 1 January 2016
IAS 16	**Property, plant and equipment:** Amendments regarding the clarification of acceptable methods of depreciation and amortisation; and Amendments bringing bearer plants into the scope of IAS 16	Annual periods beginning on or after 1 January 2016
IAS 19	**Employee benefits:** Amended to clarify the requirements that relate to how contributions from employees or third parties are linked to service should be attributed to periods of service	Annual periods beginning on or after 1 July 2014
IAS 27	**Separate financial statements:** Amendments reinstating the equity method as an accounting option for investments in subsidiaries, joint ventures and associates in an entity's separate financial statements	Annual periods beginning on or after 1 January 2016
IAS 28	**Investments in associates and joint ventures:** Amendments regarding the application of the consolidation exception	Annual periods beginning on or after 1 January 2016
IAS 38	**Intangible assets:** Amendments regarding the clarification of acceptable methods of depreciation and amortisation	Annual periods beginning on or after 1 January 2016
IAS 41	**Agriculture:** Amendments bringing bearer plants into the scope of IAS 16	Annual periods beginning on or after 1 January 2016

STATEMENT OF FINANCIAL POSITION

at 31 December 2014

	Note	2014 R'000	2013 R'000
ASSETS			
Intangible assets	2	**188 476**	196 466
Property and equipment	3	**26 943**	27 254
Tax	4	**–**	1 220
Other accounts receivable	5	**120 822**	86 357
Interest in subsidiaries	6	**184 667**	154 790
Other investments	7	**6 326**	5 737
Non-current assets held-for-sale	8	**13 482**	13 470
Loans and advances	9	**5 903 625**	5 083 585
Derivative financial instruments	10	**6 069**	10 630
Negotiable securities	11	**440 767**	496 608
Cash and cash equivalents	12	**1 492 707**	1 490 681
Total assets		**8 383 884**	7 566 798
EQUITY AND LIABILITIES			
Shareholders' equity		**1 915 578**	1 804 089
Share capital and share premium	13	**1 483 300**	1 483 300
General reserve		**12 231**	12 231
Property revaluation reserve		**69**	69
Employee benefits reserve		**(7 453)**	(6 186)
Available-for-sale reserve		**55 354**	45 619
Retained earnings		**372 077**	269 056
Liabilities		**6 468 306**	5 762 709
Deferred tax	14	**30 422**	34 204
Long-term funding	15	**437 539**	493 173
Deposits	16	**5 797 103**	5 048 268
Derivative financial instruments	10	**8 727**	11 459
Provisions and other liabilities	17	**78 384**	71 311
Tax	4	**5 204**	–
Other accounts payable	19	**110 927**	104 294
Total equity and liabilities		**8 383 884**	7 566 798

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2014

	Note	2014 R'000	2013 R'000
Interest income	21	**605 603**	567 889
Interest expense	22	**(265 211)**	(235 470)
Net interest income		**340 392**	332 419
Net charge for credit losses	9.4	**(28 066)**	(15 185)
Net interest income after credit losses		**312 326**	317 234
Net gain on disposal of available-for-sale investments		**–**	16 310
Net non-interest income		**226 569**	193 821
Non-interest income	23	**410 522**	339 852
Fee and commission expenditure	24	**(183 953)**	(146 031)
Net interest and non-interest income		**538 895**	527 365
Operating expenditure	25	**(359 472)**	(337 617)
Profit before tax		**179 423**	189 748
Tax	26	**(50 701)**	(50 738)
Profit after tax		**128 722**	139 010
Other comprehensive income			
Gains on remeasurement to fair value		**11 458**	25 822
Remeasurement of defined benefit obligation		**(1 760)**	1 541
Release to profit and loss on disposal of available-for-sale financial assets		**–**	(16 310)
Tax relating to other comprehensive income		**(1 230)**	(2 179)
Other comprehensive income net of tax		**8 468**	8 874
Total comprehensive income		**137 190**	147 884
Profit after tax attributable to:			
Equity holder of the Company		**128 722**	139 010
Total comprehensive income attributable to:			
Equity holder of the Company		**137 190**	147 884

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2014

	Share capital R'000	Share premium R'000	Employee benefits reserve R'000	General reserve R'000	Property revalu-ation reserve R'000	Available-for-sale reserve R'000	Retained earnings R'000	Total R'000
Balance at 1 January 2013	124 969	1 358 331	(7 296)	12 231	69	37 855	159 718	1 685 877
Net movement for the year	–	–	1 110	–	–	7 764	109 338	118 212
Total comprehensive loss/income for the year	–	–	1 110	–	–	7 764	139 010	147 884
Profit after tax	–	–	–	–	–	–	139 010	139 010
Other comprehensive income	–	–	1 541	–	–	9 512	–	11 053
Tax relating to other comprehensive income	–	–	(431)	–	–	(1 748)	–	(2 179)
Dividend paid	–	–	–	–	–	–	(29 672)	(29 672)
Balance at 31 December 2013	**124 969**	**1 358 331**	**(6 186)**	**12 231**	**69**	**45 619**	**269 056**	**1 804 089**
Net movement for the year	**–**	**–**	**(1 267)**	**–**	**–**	**9 735**	**103 021**	**137 190**
Total comprehensive income for the year	**–**	**–**	**(1 267)**	**–**	**–**	**9 735**	**128 722**	**137 190**
Profit after tax	**–**	**–**	**–**	**–**	**–**	**–**	**128 722**	**128 722**
Other comprehensive (loss)/income	**–**	**–**	**(1 760)**	**–**	**–**	**11 458**	**–**	**9 698**
Tax relating to other comprehensive loss/income	**–**	**–**	**493**	**–**	**–**	**(1 723)**	**–**	**(1 230)**
Dividend paid	**–**	**–**	**–**	**–**	**–**	**–**	**(25 701)**	**(25 701)**
Shareholders' equity at 31 December 2014	**124 969**	**1 358 331**	**(7 453)**	**12 231**	**69**	**55 354**	**372 077**	**1 915 578**

STATEMENT OF CASH FLOWS

for the year ended 31 December 2014

	Note	2014 R'000	2013 R'000
Cash flows from operating activities			
Cash receipts from customers	27.1	**1 019 713**	906 589
Cash paid to customers, suppliers and employees	27.2	**(758 239)**	(680 001)
Cash generated from operations	27.3	**261 474**	226 588
Dividends received		**103**	–
Tax (paid)	27.4	**(49 289)**	(48 682)
Net (increase) in income-earning assets	27.5	**(798 897)**	(169 423)
Net increase in deposits and other accounts	27.6	**718 026**	330 508
Net cash inflow from operating activities		**131 417**	338 991
Cash flows from investing activities			
Purchase of intangible assets	2	**(15 697)**	(25 402)
Purchase of property and equipment	3	**(15 695)**	(17 595)
Proceeds on disposal of property and equipment		**1 080**	–
Acquisition of non-current assets held-for-sale		**(12)**	(17)
Dividends paid		**(25 701)**	(29 672)
Proceeds on disposal of investments		**–**	16 310
(Increase) in interest in subsidiaries		**(17 732)**	(11 945)
Net cash (outflow) from investing activities		**(73 757)**	(68 321)
Cash flows from financing activities			
(Decrease)/Increase in long-term funding	15	**(55 634)**	1 297
Net cash (outflow)/inflow from financing activities		**(55 634)**	1 297
Net cash inflow for the year		**2 026**	271 967
Cash and cash equivalents at the beginning of the year		**1 490 681**	1 218 714
Cash and cash equivalents at the end of the year	12	**1 492 707**	1 490 681

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2014

	2014 Fair value R'000	2014 Carrying amount R'000	2013 Fair value R'000	2013 Carrying amount R'000
1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS				
1.1 Category analysis of financial instruments				
ASSETS				
Available-for-sale	**369 867**	**369 867**	177 863	177 863
Other investments	**6 326**	**6 326**	5 737	5 737
Interest in subsidiaries	**184 667**	**184 667**	154 790	154 790
Negotiable securities – Government stock	**178 874**	**178 874**	17 336	17 336
Loans and receivables	**7 764 738**	**7 764 641**	7 114 297	7 116 259
Loans and advances				
Current accounts	**1 477 032**	**1 477 032**	1 504 851	1 504 851
Credit cards	**15 744**	**15 744**	16 365	16 365
Mortgage loans	**2 431 852**	**2 431 852**	2 139 444	2 139 444
Instalment sales and leases	**336 356**	**336 356**	276 469	276 469
Structured loans	**80 539**	**80 539**	27 158	27 158
Medium-term loans	**1 547 696**	**1 547 696**	1 095 662	1 095 662
Negotiable securities				
Treasury bills	**205 633**	**205 565**	382 881	384 812
Land Bank promissory notes	**56 357**	**56 328**	94 429	94 460
Cash and cash equivalents	**1 492 707**	**1 492 707**	1 490 681	1 490 681
Other accounts receivable	**120 822**	**120 822**	86 357	86 357
Designated at fair value through profit and loss	**14 406**	**14 406**	23 636	23 636
Loans and advances				
Mortgage loans	**14 406**	**14 406**	22 741	22 741
Medium-term loans	**–**	**–**	895	895
Held-for-trading				
Derivative financial instruments	**6 069**	**6 069**	10 630	10 630
	8 155 080	**8 154 983**	7 326 426	7 328 388
LIABILITIES				
Held-for-trading				
Derivative financial instruments	**8 727**	**8 727**	11 459	11 459
Amortised cost	**6 345 569**	**6 345 569**	5 645 735	5 645 735
Long-term funding	**437 539**	**437 539**	493 173	493 173
Deposits	**5 797 103**	**5 797 103**	5 048 268	5 048 268
Other accounts payable	**110 927**	**110 927**	104 294	104 294
	6 354 296	**6 354 296**	5 657 194	5 657 194

1. CATEGORIES AND 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 value.
- Treasury bills and Land Bank promissory notes have short terms to maturity and are carried at amortised cost. Fair value is based on quoted market values at the reporting date.
- The fair value of loans and advances that are carried at amortised cost approximates the fair value reported as it bears variable rates of interest. The fair value is adjusted for deterioration of credit quality through the application of the credit impairment models.
- Long-term funding is carried at amortised cost and approximates the fair value reported as it bears variable rates of interest.
- Deposits generally have short terms to maturity and thus the values reported approximate the fair value.
- The fair value of publicly traded derivatives, securities and investments, is based on quoted market values at the reporting date.
- The fair value of other financial assets and financial liabilities, excluding derivatives, is determined in accordance with generally accepted pricing models, based on discounted cash flow analysis, using prices from observable current market transactions and adjusted by relevant market pricing.
- Depending on the business and nature of the underlying investment, the fair value of other unlisted investments which are an integral part of the Bank's structured loan portfolio is valued in terms of the shareholder's agreement conditions, net asset value or an EBITDA multiple (based on the latest management accounts available). The fair value of other investments and interest in subsidiaries which are unlisted, is determined by reference to the net asset value of the entity and/or the underlying net asset value of its investment holdings.
- The fair value of loans and advances, designated at fair value through profit and loss, is calculated using the credit spread observed at origination. The fair value is adjusted for deterioration of credit quality through the application of the credit impairment models.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

1.3 Fair value measurements recognised in the statement of financial position

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

- Level 1 fair value measurements are those derived from quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).
- 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).

	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2014				
ASSETS				
Available-for-sale				
Other investments	**–**	**–**	**6 326**	**6 326**
Interest in subsidiaries	**–**	**184 667**	**–**	**184 667**
Negotiable securities – Government stock	**178 874**	**–**	**–**	**178 874**
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	**–**	**14 406**	**–**	**14 406**
Medium-term loans	**–**	**–**	**–**	**–**
Held-for-trading				
Derivative financial instruments	**6 069**	**–**	**–**	**6 069**
	184 943	**199 073**	**6 326**	**390 342**
LIABILITIES				
Held-for-trading				
Derivative financial instruments	**8 727**	**–**	**–**	**8 727**
	8 727	**–**	**–**	**8 727**
2013				
ASSETS				
Available-for-sale				
Other investments	–	–	5 737	5 737
Interest in subsidiaries	–	154 790	–	154 790
Negotiable securities – Government stock	17 336	–	–	17 336
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	22 741	–	22 741
Medium-term loans	–	895	–	895
Held-for-trading				
Derivative financial instruments	10 630	–	–	10 630
	27 966	178 426	5 737	212 129
LIABILITIES				
Held-for-trading				
Derivative financial instruments	11 459	–	–	11 459
	11 459	–	–	11 459

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

	2014 R'000	2013 R'000
1. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued		
1.4 Reconciliation of Level 3 fair value measurements of financial assets		
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning of the year	**5 737**	4 991
Gains on remeasurement to fair value in comprehensive income	**589**	746
Balance at the end of the year	**6 326**	5 737

	2014 R'000	2013 R'000
2. INTANGIBLE ASSETS		
Computer software		
Cost at the beginning of the year	**323 353**	317 956
Additions	**15 697**	25 402
Net transfer from/(to) property and equipment	**5 955**	(8)
Write-off of obsolete computer software	**(27 258)**	(19 997)
Cost at the end of the year	**317 747**	323 353
Accumulated amortisation and impairment losses at the beginning of the year	**(126 887)**	(120 133)
Amortisation	**(29 236)**	(26 751)
Write-off of obsolete computer software	**26 852**	19 997
Accumulated amortisation and impairment losses at the end of the year	**(129 271)**	(126 887)
Net carrying amount at the end of the year	**188 476**	196 466

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	Owner-occupied properties R'000	Leasehold improve-ments R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
3. PROPERTY AND EQUIPMENT							
2014							
Open market value/cost at the beginning of the year	164	15 873	98 734	9 749	28 556	550	153 626
Additions	–	783	3 075	6 214	5 383	240	15 695
Disposals	–	–	–	–	–	(144)	(144)
Transfer*	–	–	(5 955)	–	–	–	(5 955)
Write-off of obsolete assets	–	(2 361)	(65 795)	(4 772)	(10 067)	–	(82 995)
Open market value/cost at the end of the year	164	14 295	30 059	11 191	23 872	646	80 227
Accumulated depreciation and impairment losses at the beginning of the year	–	(13 019)	(84 777)	(7 208)	(20 907)	(461)	(126 372)
Depreciation	–	(622)	(4 004)	(582)	(2 998)	(80)	(8 286)
Disposals	–	–	–	–	–	144	144
Write-off of obsolete assets	–	1 929	65 301	4 719	9 281	–	81 230
Accumulated depreciation and impairment losses at the end of the year	–	(11 712)	(23 480)	(3 071)	(14 624)	(397)	(53 284)
Net carrying amount at the end of the year	164	2 583	6 579	8 120	9 248	249	26 943

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

3. PROPERTY AND EQUIPMENT continued

	Owner-occupied properties R'000	Leasehold improvements R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
2013							
Open market value/cost at the beginning of the year	164	18 509	91 821	9 837	28 446	438	149 215
Additions	–	1 433	10 189	2 393	3 468	112	17 595
Disposals	–	–	(1)	(6)	(299)	–	(306)
Transfer*	–	–	8	(414)	414	–	8
Write-off of obsolete assets	–	(4 069)	(3 283)	(2 061)	(3 473)	–	(12 886)
Open market value/cost at the end of the year	164	15 873	98 734	9 749	28 556	550	153 626
Accumulated depreciation and impairment losses at the beginning of the year	–	(16 431)	(82 495)	(9 446)	(21 338)	(436)	(130 146)
Depreciation	–	(618)	(5 216)	(120)	(2 899)	(25)	(8 878)
Disposals	–	–	–	5	225	–	230
Transfer*	–	–	–	266	(266)	–	–
Write-off of obsolete assets	–	4 030	2 934	2 087	3 371	–	12 422
Accumulated depreciation and impairment losses at the end of the year	–	(13 019)	(84 777)	(7 208)	(20 907)	(461)	(126 372)
Net carrying amount at the end of the year	164	2 854	13 957	2 541	7 649	89	27 254

**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. Due to unresolved issues with the City Council the transfer of the property has not yet materialised.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	2014 R'000	2013 R'000
4. TAX		
South African Revenue Service		
Tax overpaid	–	1 220
Tax owing	**5 204**	–

	2014 R'000	2013 R'000
5. OTHER ACCOUNTS RECEIVABLE		
Items in transit	**72 597**	52 604
Loan to fellow subsidiary (refer to note 28.2)	**146**	94
Prepayments and deposits	**10 289**	7 327
Other receivables	**37 790**	26 332
	120 822	86 357

	2014 R'000	2013 R'000
6. INTEREST IN SUBSIDIARIES		
Unlisted		
Shares at fair value		
Portion 2 of Lot 8 Sandown (Pty) Ltd	**65 137**	50 834
Loans to/(from) subsidiaries	**119 530**	103 956
Portion 2 of Lot 8 Sandown (Pty) Ltd	**6 877**	(4 608)
Mercantile Acquiring (Pty) Ltd	**7 266**	7 819
Mercantile Rental Finance (Pty) Ltd	**112 315**	105 515
Less: Provisions held against loan accounts	**(6 928)**	(4 770)
	184 667	154 790

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

The loans to Portion 2 of Lot 8 Sandown (Pty) Ltd and Mercantile Acquiring (Pty) Ltd bear interest at the prevailing prime rate plus 2% (2013: prime rate plus 2%) and are repayable on demand.

The loan to Mercantile Rental Finance (Pty) Ltd bears interest at 12% (2013: 12%) and has no fixed terms of maturity.

	2014 R'000	2013 R'000
7. OTHER INVESTMENTS		
Available-for-sale		
Unlisted equities	**6 326**	5 737
	6 326	5 737

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

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

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

	2014 R'000	2013 R'000
9. LOANS AND ADVANCES		
9.1 Product analysis		
Amortised cost	**5 928 216**	5 100 205
Current accounts	**1 489 153**	1 527 609
Credit cards	**17 942**	19 521
Mortgage loans	**2 441 378**	2 144 070
Instalment sales and leases	**338 663**	279 677
Structured loans	**85 691**	27 535
Medium-term loans	**1 555 389**	1 101 793
Fair value through profit and loss	**14 412**	23 644
Mortgage loans	**14 412**	22 748
Medium-term loans	**–**	896
Gross loans and advances	**5 942 628**	5 123 849
Less: Portfolio impairments for credit losses	**(11 005)**	(7 072)
Specific impairments for credit losses	**(27 998)**	(33 192)
	5 903 625	5 083 585

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

	2014 R'000	2013 R'000
9.2 Maturity analysis		
Repayable on demand and maturing within one month	**1 548 815**	1 590 178
Maturing after one month but within six months	**15 262**	36 812
Maturing after six months but within 12 months	**265 396**	234 551
Maturing after 12 months	**4 113 155**	3 262 308
	5 942 628	5 123 849

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	Gross amount R'000	Portfolio impair-ments R'000	Specific impair-ments R'000	Net balance R'000
9. LOANS AND ADVANCES continued				
9.3 Detailed product analysis of loans and advances				
2014				
Current accounts	**1 489 153**	**(4 685)**	**(7 436)**	**1 477 032**
Credit cards	**17 942**	**(840)**	**(1 358)**	**15 744**
Mortgage loans	**2 455 790**	**(1 050)**	**(8 482)**	**2 446 258**
Instalment sales and leases	**338 663**	**(914)**	**(1 393)**	**336 356**
Structured loans	**85 691**	**(57)**	**(5 095)**	**80 539**
Medium-term loans	**1 555 389**	**(3 459)**	**(4 234)**	**1 547 696**
	5 942 628	**(11 005)**	**(27 998)**	**5 903 625**
2013				
Current accounts	1 527 609	(2 733)	(20 025)	1 504 851
Credit cards	19 521	(1 115)	(2 041)	16 365
Mortgage loans	2 166 818	(695)	(3 938)	2 162 185
Instalment sales and leases	279 677	(493)	(2 715)	276 469
Structured loans	27 535	(377)	–	27 158
Medium-term loans	1 102 689	(1 659)	(4 473)	1 096 557
	5 123 849	(7 072)	(33 192)	5 083 585

9. LOANS AND ADVANCES continued

9.4 Impairments for credit losses

	Total R'000	Current accounts R'000	Credit cards R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Medium-term loans R'000
2014							
Balance at the beginning of the year	**(40 264)**	**(22 758)**	**(3 156)**	**(4 633)**	**(3 208)**	**(377)**	**(6 132)**
Movements for the year							
Credit losses written off	**31 797**	**23 372**	**962**	**163**	**1 339**	**–**	**5 961**
Net impairments (raised)/released	**(30 536)**	**(12 735)**	**(4)**	**(5 062)**	**(438)**	**(4 775)**	**(7 522)**
Balance at the end of the year	**(39 003)**	**(12 121)**	**(2 198)**	**(9 532)**	**(2 307)**	**(5 152)**	**(7 693)**
2013							
Balance at the beginning of the year	(75 251)	(27 801)	(4 620)	(10 216)	(8 767)	(9 351)	(14 496)
Movements for the year							
Credit losses written off	50 068	25 223	1 038	8 154	6 313	1 080	8 260
Net impairments (raised)/released	(15 081)	(20 180)	426	(2 571)	(754)	7 894	104
Balance at the end of the year	(40 264)	(22 758)	(3 156)	(4 633)	(3 208)	(377)	(6 132)

	2014 R'000	2013 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	**(30 536)**	(15 081)
Amounts written off directly to comprehensive income	**(564)**	(495)
Recoveries in respect of amounts previously written off	**3 034**	391
	(28 066)	(15 185)

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

9. LOANS AND ADVANCES continued

9.5 Product analysis of performing loans and advances

	Gross amount R'000	Portfolio impairment R'000	Net balance R'000
2014			
Current accounts	**1 472 293**	**(4 685)**	**1 467 608**
Credit cards	**16 584**	**(840)**	**15 744**
Mortgage loans	**2 323 572**	**(1 050)**	**2 322 522**
Instalment sales and leases	**329 660**	**(914)**	**328 746**
Structured loans	**69 547**	**(57)**	**69 490**
Medium-term loans	**1 520 893**	**(3 459)**	**1 517 434**
	5 732 549	**(11 005)**	**5 721 544**
2013			
Current accounts	1 487 222	(2 733)	1 484 489
Credit cards	17 480	(1 115)	16 365
Mortgage loans	2 067 916	(695)	2 067 221
Instalment sales and leases	272 695	(493)	272 202
Structured loans	27 535	(377)	27 158
Medium-term loans	1 064 046	(1 659)	1 062 387
	4 936 894	(7 072)	4 929 822

	2014 R'000	2013 R'000
9.6 Product analysis of performing loans and advances excluding loans and advances with renegotiated terms		
Current accounts	**1 418 275**	1 487 222
Credit cards	**16 584**	16 276
Mortgage loans	**2 274 028**	2 057 189
Instalment sales and leases	**329 660**	272 695
Structured loans	**69 547**	27 535
Medium-term loans	**1 505 604**	934 797
	5 613 698	4 795 714
9.7 Product analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired		
Current accounts	**54 018**	–
Credit cards	**–**	1 204
Mortgage loans	**49 544**	10 727
Instalment sales and leases	**–**	–
Structured loans	**–**	–
Medium-term loans	**15 289**	129 249
	118 851	141 180

9. LOANS AND ADVANCES continued

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

	Past due for 1 – 30 days R'000	31 – 60 days R'000	61 – 90 days R'000	Total gross amount R'000	Fair value of collateral and other credit enhance-ments R'000
2014					
Current accounts	**–**	**–**	**–**	**–**	**–**
Credit cards	**–**	**–**	**–**	**–**	**–**
Mortgage loans	**12 365**	**2 673**	**1 645**	**16 683**	**13 148**
Instalment sales and leases	**1 206**	**–**	**–**	**1 206**	**961**
Structured loans	**–**	**–**	**–**	**–**	**–**
Medium-term loans	**6 959**	**466**	**406**	**7 831**	**6 511**
	20 530	**3 139**	**2 051**	**25 720**	**20 620**
2013					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	22 037	1 505	40 291	63 833	70 899
Instalment sales and leases	713	–	–	713	359
Structured loans	–	–	–	–	–
Medium-term loans	4 395	51 602	515	56 512	9 973
	27 145	53 107	40 806	121 058	81 231

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

9. LOANS AND ADVANCES continued

9.9 Product analysis of loans and advances that are individually impaired

	Gross amount R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhancements R'000
2014				
Current accounts	**16 860**	**(7 436)**	**9 424**	**8 609**
Credit cards	**1 358**	**(1 358)**	**–**	**–**
Mortgage loans	**132 218**	**(8 482)**	**123 736**	**127 036**
Instalment sales and leases	**9 003**	**(1 393)**	**7 610**	**5 411**
Structured loans	**16 144**	**(5 095)**	**11 049**	**10 851**
Medium-term loans	**34 496**	**(4 234)**	**30 262**	**29 460**
	210 079	**(27 998)**	**182 081**	**181 367**
2013				
Current accounts	40 387	(20 025)	20 362	16 829
Credit cards	2 041	(2 041)	–	–
Mortgage loans	98 902	(3 938)	94 964	95 236
Instalment sales and leases	6 982	(2 715)	4 267	2 145
Structured loans	–	–	–	–
Medium-term loans	38 643	(4 473)	34 170	27 112
	186 955	(33 192)	153 763	141 322

9. LOANS AND ADVANCES continued

9.10 Collateral held as security and other credit enhancements

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

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

Description of collateral held as security and other credit enhancements	Method of valuation
Cession of debtors	15% – 75% of debtors due and payable under 90 days and depending on debtor credit quality
Pledge of shares	50% of listed shares' value; nil for unlisted shares
Pledge and cession of assets (specific and general)	Variable depending on asset type and value
Cession of life and endowment policies	100% of surrender value
Pledge of call and savings accounts, fixed and notice deposits	100% of asset value
Vacant land	50% of professional valuation
Residential properties	80% of official valuation
Commercial and industrial properties	70% of professional valuation
Catering, industrial and office equipment	Variable depending on asset type and depreciated value
Trucks	Variable depending on asset type and depreciated value
Earthmoving equipment	Variable depending on asset type and depreciated value
Motor vehicles	Variable depending on asset type and depreciated value
General notarial bond	Variable depending on asset type and depreciated value
Special notarial bond	Variable depending on asset type and depreciated value

All collateral held by the 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 will be disposed of in accordance with the applicable legislation. In the case of insolvent and deceased estates, the duly appointed liquidator/trustee will dispose of all assets.

9.11 Structured loans

The Bank has acquired zero cost equity options attached to certain structured loans that have been recognised at cost in accordance with accounting policy 3.1.

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
10. DERIVATIVE FINANCIAL INSTRUMENTS				
2014				
Held-for-trading				
Foreign exchange contracts	**282 285**	**6 049**	**341 281**	**8 558**
Interest rate swaps	**3 963**	**20**	**14 888**	**169**
	286 248	**6 069**	**356 169**	**8 727**
2013				
Held-for-trading				
Foreign exchange contracts	422 370	10 561	507 193	10 856
Interest rate swaps	–	69	25 203	603
	422 370	10 630	532 396	11 459

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

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

	2014 R'000	2013 R'000
12. CASH AND CASH EQUIVALENTS		
Cash on hand	**31 820**	46 949
Central Bank balances	**261 651**	148 284
Money market funds	**784 745**	1 084 222
Rand-denominated domestic bank balances	**7 373**	3 969
Foreign currency-denominated bank balances	**407 118**	207 257
	1 492 707	1 490 681

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
13. SHARE CAPITAL AND SHARE PREMIUM				
At 31 December 2013 and 31 December 2014	**62 484 352**	**124 969**	**1 358 331**	**1 483 300**

The total authorised number of ordinary shares is 62 630 000 shares (2013: 62 630 000 shares) with a par value of R2,00 per share.

No shares were issued during the financial years ended 31 December 2014 and 31 December 2013.

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

	2014 R'000	2013 R'000
14. DEFERRED TAX		
Balance at the beginning of the year	**34 204**	30 009
Movements relating to prior years provision	**–**	406
Current year charge		
Per the statement of comprehensive income	**(5 012)**	1 610
Per the statement of changes in equity/other comprehensive income	**1 230**	2 179
	30 422	34 204
Deferred tax (asset)/liability* is attributable to the following temporary differences:		
Property and equipment	**2 233**	–
Intangible assets	**41 862**	48 398
Provisions and other liabilities	**(18 282)**	(16 879)
Impairments on loans and advances	**29 587**	29 909
Leased assets	**(3 257)**	(3 349)
Revaluations	**8 438**	6 715
Interest rate swaps	**(42)**	(150)
Current assets	**(29 827)**	(31 516)
Other	**(290)**	1 076
	30 422	34 204

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

	2014 R'000	2013 R'000
15. LONG-TERM FUNDING		
International Finance Corporation ("IFC")	**437 539**	493 173
Short-term portion payable in the next 12 months	**117 845**	59 602
Portion payable after 12 months but within five years	**319 694**	433 571
	437 539	493 173

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

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	2014 R'000	2013 R'000
16. DEPOSITS		
Call deposits and current accounts	**2 926 422**	2 299 586
Savings accounts	**172 436**	174 507
Term and notice deposits	**2 543 586**	2 455 212
Negotiable certificates of deposit	**18 346**	30 542
Foreign deposits	**136 313**	88 421
	5 797 103	5 048 268
Maturity analysis		
Repayable on demand and maturing within one month	**3 597 149**	2 905 385
Maturing after one month but within six months	**1 082 634**	1 320 124
Maturing after six months but within 12 months	**389 230**	451 996
Maturing after 12 months	**728 090**	370 763
	5 797 103	5 048 268

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

	Deferred bonus scheme R'000	Staff incentives R'000	Audit fees R'000	Post-retirement medical benefits R'000	Leave pay R'000	Other risks R'000	Total R'000
17. PROVISIONS AND OTHER LIABILITIES							
At 1 January 2013	8 029	16 000	3 704	19 472	9 995	13 454	70 654
Provision raised	5 733	16 000	7 305	–	2 517	6 162	37 717
Charged to provision	(6 655)	(16 000)	(7 087)	(1 202)	(1 702)	(4 414)	(37 060)
At 31 December 2013	**7 107**	**16 000**	**3 922**	**18 270**	**10 810**	**15 202**	**71 311**
Provision raised	**3 620**	**19 030**	**7 008**	**–**	**4 176**	**2 334**	**36 168**
Reversal of provision	**–**	**–**	**(80)**	**–**	**–**	**(3 570)**	**(3 650)**
Charged to provision	**(3 203)**	**(16 000)**	**(5 283)**	**2 219**	**(2 717)**	**(461)**	**(25 445)**
At 31 December 2014	**7 524**	**19 030**	**5 567**	**20 489**	**12 269**	**13 505**	**78 384**

Post-retirement medical benefits

Refer to note 18 for detailed disclosure of this provision.

Leave pay

In terms of the Bank's 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 Bank, the outcome of which cannot be foreseen. Such claims are not regarded as material, either on an individual basis, or in aggregate. Provisions are raised for all liabilities that are expected to materialise.

18. 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 Bank's assets in a separate trustee-administered fund. Independent actuaries value this scheme annually (the last valuation was carried out at 31 December 2014). The actuary's opinion is that the plan is in a sound financial position.

	2014 R'000	2013 R'000	2012 R'000	2011 R'000	2010 R'000
The amounts recognised in the statement of financial position are as follows (refer to note 17):					
Present value of total service liabilities	**21 715**	19 900	21 575	18 577	20 648
Fair value of plan assets	**(1 226)**	(1 630)	(2 103)	(2 528)	(5 499)
Provident fund	**(914)**	(782)	(1 315)	(1 800)	(1 832)
Endowment bond	**(312)**	(848)	(788)	(728)	(2 530)
Annuities	**–**	–	–	–	(1 137)
Liability in the statement of financial position	**20 489**	18 270	19 472	16 049	15 149
The amounts recognised in the statement of comprehensive income are as follows:					
Staff cost (refer to note 25):	**(1 060)**	(1 030)	(1 494)	(994)	(1 391)
Current service cost	**19**	22	13	53	50
Payments from plan assets	**540**	540	–	–	–
Employer benefit payments	**(1 619)**	(1 592)	(1 507)	(1 533)	(1 441)
Discharge of liability and related plan asset	**–**	–	–	486	–
Net interest cost (refer to note 22):	**1 519**	1 369	1 232	1 127	1 189
Interest costs	**1 636**	1 502	1 466	1 636	1 767
Expected return on plan assets	**(117)**	(133)	(234)	(509)	(578)
Total included in comprehensive income	**459**	339	(262)	133	(202)
The amounts recognised in the statement of other comprehensive income are as follows:					
Remeasurement of defined benefit obligation	**1 760**	(1 541)	3 685	767	1 488
Total included in other comprehensive income	**1 760**	(1 541)	3 685	767	1 488

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	2014 R'000	2013 R'000	2012 R'000	2011 R'000	2010 R'000
18. POST-RETIREMENT MEDICAL BENEFITS continued					
Reconciliation of the movement in the present value of total service liabilities:					
At the beginning of the year	**19 900**	21 575	18 577	20 648	19 370
Current service cost	**19**	22	13	53	50
Interest costs	**1 636**	1 502	1 466	1 636	1 767
Discharge of liability	**–**	–	–	(1 891)	–
Remeasurement of defined benefit obligation	**1 779**	(1 607)	3 026	(336)	902
Employer benefit payments	**(1 619)**	(1 592)	(1 507)	(1 533)	(1 441)
At the end of the year	**21 715**	19 900	21 575	18 577	20 648
Reconciliation of the movement in the fair value of plan assets:					
At the beginning of the year	**1 630**	2 103	2 528	5 499	5 507
Expected return on plan assets	**117**	133	234	509	578
Payments from plan assets	**(540)**	(540)	–	–	–
Non-qualifying plan assets as a result of discharge of liability	**–**	–	–	(2 377)	–
Remeasurement of defined benefit obligation	**19**	(66)	(659)	(1 103)	(586)
At the end of the year	**1 226**	1 630	2 103	2 528	5 499
The principal actuarial assumptions used were as follows:					
Discount rate	**7,8%**	(2013: 8,6%) compounded annually			
Investment return	**7,8%**	(2013: 8,6%) compounded annually			
Rate of medical inflation	**7,6%**	(2013: 8,3%) compounded annually			
Salary inflation	**7,1%**	(2013: 7,8%) compounded annually			

The effect of a 1% increase/decrease on the assumed rate of medical inflation would be an increase in the liability in an amount of R1,791 million (2013: R1,806 million) and a decrease of R1,510 million (2013: R1,524 million) respectively.

	2014 R'000	2013 R'000
19. OTHER ACCOUNTS PAYABLE		
Loan from the holding company (refer to note 28.2)	**347**	460
Accruals	**29 201**	21 503
Product-related credits	**33 975**	47 399
Sundry creditors	**47 404**	34 932
	110 927	104 294

	2014 R'000	2013 R'000
20. CONTINGENT LIABILITIES AND COMMITMENTS		
20.1 Guarantees, letters of credit and committed undrawn facilities		
Guarantees	**468 748**	400 147
Shipping	**–**	117
Lending-related	**6 762**	6 914
Mortgage	**153 739**	111 670
Performance	**308 247**	281 446
Letters of credit	**42 567**	16 024
Committed undrawn facilities	**174 292**	105 747
	685 607	521 918
20.2 Commitments under operating leases		
The total minimum future lease payments under operating leases are as follows:		
Property rentals		
Due within one year	**23 842**	21 306
Due between one and five years	**46 987**	63 732
	70 829	85 039
After-tax effect on operating leases	**50 997**	61 228

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.

	2014 R'000	2013 R'000
21. INTEREST INCOME		
Loans to subsidiaries and fellow subsidiaries	**28 866**	35 392
Loans and receivables at amortised cost	**574 828**	529 773
Cash and cash equivalents	**66 942**	62 339
Negotiable securities	**26 138**	17 187
Loans and advances	**481 748**	450 247
Loans and receivables designated at fair value through profit and loss		
Loans and advances	**1 909**	2 724
	605 603	567 889

	2014 R'000	2013 R'000
22. INTEREST EXPENSE		
Deposits	**221 795**	195 047
Long-term funding	**41 431**	38 228
Held-for-trading		
Interest rate swaps	**460**	816
Net interest on defined benefit obligation	**1 519**	1 369
Other	**6**	10
	265 211	235 470

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	2014 R'000	2013 R'000
23. NON-INTEREST INCOME		
Fee and commission income		
Loans and receivables	**308 862**	261 095
Trading income	**101 557**	78 757
Held-for-trading	**94 007**	70 315
Foreign currency	**93 657**	69 401
Derivative assets and liabilities	**350**	914
Designated at fair value through profit and loss	**7 550**	8 442
Loans and advances	**(1 007)**	(583)
Other investments	**8 557**	9 025
Investment income		
Dividends	**103**	–
	410 522	339 852

	2014 R'000	2013 R'000
24. FEE AND COMMISSION EXPENDITURE		
Relating to non-interest income earned from:		
Foreign currency	**42 393**	29 926
Fees and commissions*	**141 560**	116 105
	183 953	146 031

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

	2014 R'000	2013 R'000
25. OPERATING EXPENDITURE		
Amortisation (refer to note 2)	**29 236**	26 751
Auditors' remuneration		
Audit fees – Current year	**6 928**	7 075
Fees for other services – Tax advisory fees	**230**	207
– Regulatory reviews	**–**	58
– Accounting services	**–**	382
– Other	**–**	44
	7 158	7 766
Depreciation (refer to note 3)	**8 286**	8 878
Directors' remuneration (refer to note 28.3)		
Executive Directors	**13 531**	16 350
Non-Executive Directors' fees	**3 819**	8 482
	17 350	24 832
Indirect tax		
Non-claimable value-added tax	**10 659**	9 911
Skills development levy	**1 602**	1 569
	12 261	11 480
Loss on sale and write-off of intangible assets and property and equipment	**1 091**	100
Marketing	**4 622**	2 343
Operating leases for premises and related costs	**28 802**	26 399
Other operating costs*	**37 977**	32 943
Professional fees		
Consulting	**3 748**	2 242
Legal and collection	**4 505**	2 387
Computer consulting and services	**35 370**	36 122
	43 623	40 751
Staff costs		
Salaries, allowances and incentives	**162 335**	148 771
Post-retirement medical benefits (refer to note 19)	**(1 060)**	(1 030)
Deferred bonus scheme expense including Directors	**3 619**	5 113
Other	**4 172**	2 520
	169 066	155 374
Total operating expenditure	**359 472**	337 617
Number of persons employed by the Company at year-end	**411**	389

** VISA and MasterCard fees, which are directly attributable to fee and commission income, were previously included under operating expenditure but are now disclosed under fee and commission expenditure. Comparatives for 2013 (totalling R9,537 million) have been adjusted accordingly (refer to note 24).*

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

	2014 R'000	2013 R'000
26. TAX		
South African normal tax	**55 713**	49 128
Current year	**55 476**	49 128
Prior year	**237**	–
Deferred tax	**(5 012)**	1 610
Current year	**(5 819)**	1 207
Prior year	**807**	403
	50 701	50 738
Direct tax		
South African normal tax	**55 713**	49 128
South African tax rate reconciliation		
South African standard tax rate (%)	**28,00**	28,00
Exempt income (%)	**(0,02)**	–
Expenses not deductible for tax purposes (%)	**0,17**	–
Additional allowances for tax purposes (%)	**(0,02)**	(0,67)
Capital gain not taxable on realised portion (%)	**–**	(0,80)
Underprovision prior year (%)	**0,13**	0,21
Effective tax rate (%)	**28,26**	26,74

	2014 R'000	2013 R'000
27. NOTES TO STATEMENTS OF CASH FLOWS		
27.1 Cash receipts from customers		
Interest income	**605 603**	567 889
Non-interest income and gains on disposal of investments	**410 522**	356 162
Adjusted for:		
Dividends received	**(103)**	–
Net (gain) on disposal of investments	**–**	(16 310)
Revaluation of fair value financial instruments	**657**	(1 543)
Recoveries in respect of amounts previously written off	**3 034**	391
	1 019 713	906 589
27.2 Cash paid to customers, suppliers and employees		
Interest expense	**(265 211)**	(235 470)
Operating expenditure and fee and commission expenditure	**(543 425)**	(483 648)
Adjusted for:		
Amortisation	**29 236**	26 751
Depreciation	**8 286**	8 878
Write-off of obsolete intangible assets	**406**	–
Write-off of obsolete property and equipment	**1 765**	464
Loss on sale and write-off of intangible assets and property and equipment	**1 091**	100
Deferred bonus scheme expense	**3 619**	5 113
Increase/(Decrease) in provisions and other liabilities	**5 994**	(2 189)
	(758 239)	(680 001)

	2014 R'000	2013 R'000
27. NOTES TO STATEMENTS OF CASH FLOWS continued		
27.3 Reconciliation of profit before tax to cash generated from operations		
Profit before tax	**179 423**	189 748
Profit before tax adjusted for:		
Dividends received	**(103)**	–
Net (gain) on disposal of investments	**–**	(16 310)
Revaluation of fair value financial instruments	**657**	(1 543)
Net impairments raised	**31 100**	15 576
Amortisation	**29 236**	26 751
Depreciation	**8 286**	8 878
Write-off of obsolete intangible assets	**406**	-
Write-off of obsolete property and equipment	**1 765**	464
Loss on sale and write-off of intangible assets and property and equipment	**1 091**	100
Deferred bonus scheme expense	**3 619**	5 113
Increase/(Decrease) in provisions and other liabilities	**5 994**	(2 189)
Cash generated from operations	**261 474**	226 588
27.4 Tax		
Amounts overpaid at the beginning of the year	**1 220**	1 666
Statement of comprehensive income (charge)	**(55 713)**	(49 128)
Less: Amounts underpaid/(overpaid) at the end of the year	**5 204**	(1 220)
Total tax (paid)	**(49 289)**	(48 682)
27.5 Net movement in income-earning assets		
Decrease/(Increase) in negotiable securities	**52 900**	(239 346)
(Increase)/Decrease in loans and advances	**(851 797)**	69 923
Net (increase) in income-earning assets	**(798 897)**	(169 423)
27.6 Net movement in deposits and other accounts		
Increase in deposits	**748 835**	310 032
(Increase) in other accounts receivable	**(34 465)**	(24 910)
Increase in other accounts payable	**3 656**	45 386
Net increase in deposits and other accounts	**718 026**	330 508

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

28. RELATED PARTY INFORMATION

28.1 Identity of related parties with whom transactions have occurred

The ultimate holding company (CGD), holding company (MBHL), direct and fellow subsidiaries, a joint venture (Mercantile E-Bureau (Pty) Ltd) and Directors are related parties. There are no other related parties with whom transactions have taken place, other than as listed below.

28.2 Related party balances and transactions

The Company, in the ordinary course of business, enters into various financial services transactions with related parties. Except for the interest-free loan between the Bank and MBHL, transactions are governed by commercial terms.

	% held	**2014 R'000**	2013 R'000
Balances with the holding company, direct and fellow subsidiaries and joint venture			
Loans to/(from) subsidiaries			
Portion 2 of Lot 8 Sandown (Pty) Ltd	100	**6 877**	(4 608)
Mercantile Acquiring (Pty) Ltd	100	**7 266**	7 819
Mercantile Rental Finance (Pty) Ltd	74,9	**275 197**	391 718
Shareholder loan (refer to note 6)		**112 315**	105 515
Current account (included as part of loans and advances – refer to note 9)		**162 882**	286 203
Less: Provisions held against loan accounts		**(6 928)**	(4 770)
		282 412	390 159
Loans to/(from) the holding company, fellow subsidiary and joint venture			
Mercantile Bank Holdings Limited		**(347)**	(460)
Mercantile Insurance Brokers (Pty) Ltd		**146**	94
Mercantile E-Bureau (Pty) Ltd		**4 071**	1 556
		3 870	1 190
Deposits from the holding company, subsidiary, fellow subsidiary and joint venture			
Mercantile Bank Holdings Limited		**4 166**	4 292
The Mercantile Bank Foundation (NPC)		**84**	65
Mercantile Insurance Brokers (Pty) Ltd		**648**	2 262
Mercantile E-Bureau (Pty) Ltd		**1 966**	446
		6 864	7 065
Transactions with the holding company, direct and fellow subsidiaries and joint venture:			
Interest received from:			
Portion 2 of Lot 8 Sandown (Pty) Ltd		**201**	–
Mercantile Acquiring (Pty) Ltd		**837**	810
Mercantile Rental Finance (Pty) Ltd		**27 828**	34 582
Interest paid to:			
Portion 2 of Lot 8 Sandown (Pty) Ltd		**185**	984
Mercantile Insurance Brokers (Pty) Ltd		**59**	79
Non-interest income earned from:			
Mercantile Insurance Brokers (Pty) Ltd		**1**	1
Mercantile Rental Finance (Pty) Ltd		**90**	281
Mercantile E-Bureau (Pty) Ltd		**44 174**	29 553

	2014 R'000	2013 R'000
28. RELATED PARTY INFORMATION continued		
28.2 Related party balances and transactions continued		
Transactions with the holding company, direct and fellow subsidiaries and joint venture continued:		
Dividends paid to:		
Mercantile Bank Holdings Limited	**25 701**	29 672
Donations paid to:		
The Mercantile Bank Foundation (NPC)	**1 000**	1 000
Operating expenditure paid to:		
Portion 2 of Lot 8 Sandown (Pty) Ltd	**18 546**	17 345
Mercantile Acquiring (Pty) Ltd	**1 897**	1 188
Balances and transactions with the ultimate holding company (CGD) and the Bank:		
CGD – Lisbon (Branch of CGD)	**69 083**	64 950
Nostro accounts	**682**	3 500
Vostro accounts	**(953)**	(934)
Call deposit	**(152)**	(149)
Foreign currency placements	**69 506**	62 533
CGD – Paris (Branch of CGD)		
Nostro accounts	**(114)**	(28)
CGD – New York (Branch of CGD)		
Foreign currency placements	**80 968**	–
CGD – London (Branch of CGD)		
Vostro accounts	**(11)**	(12)
CGD	**149 926**	64 910
Banco Comercial e de Investimentos ("BCI") – Mozambique (Subsidiary of CGD)	**(52 029)**	(100 662)
Foreign currency placements	**92 577**	–
Vostro accounts	**(3 900)**	(405)
Fixed deposits	**(136 806)**	(100 256)
Call and notice deposits	**(3 900)**	(1)
Banco Caixa Geral Totta Angola SA ("BCGTA") (Subsidiary of CGD)		
Call deposit	**(5 053)**	(3 744)
Total placements with/(deposits from) CGD	**92 844**	(39 496)
Transactions between the ultimate holding company (CGD) and the Bank:		
Interest paid by the Bank to CGD – Lisbon	**–**	2
Interest paid by the Bank to BCI	**8 851**	6 569
Interest paid by the Bank to BCGTA	**115**	69
Interest received by the Bank from CGD – Lisbon	**613**	7
Interest received by the Bank from CGD – New York	**14**	–
Interest received by the Bank from BCI	**59**	–

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

continued

for the year ended 31 December 2014

29. RELATED PARTY INFORMATION continued

28.3 Director and Director-related activities

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

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

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

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

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

Service agreements and deferred bonus scheme awards

KR Kumbier, CEO

Mr Kumbier was employed by Mercantile as Executive Director: Finance and Business on 1 June 2010. He was subsequently appointed as Deputy CEO (effective 1 April 2012), and thereafter as CEO from 1 April 2013. The Remuneration Committee's annual bonus decision for Mr Kumbier considered performance during the year against Bank and individual performance measures. The Remuneration Committee noted performance against key financial and non-financial measures contained in the balanced scorecard and the strong personal contribution made by Mr Kumbier during 2014, particularly in building and embedding a strong leadership team.

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

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

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

In 2014, Mercantile amended elements of the CEO's remuneration structure in response to the remuneration regulations outlined under the Capital Requirements Directive IV, a European Union legislative requirement impacting our parent company, CGD (and consequently MBHL). The CEO's 7 000 000 phantom awards granted under the deferred bonus scheme for 2014 were cancelled and a role-based non-pensionable allowance of R2,55 million was paid to the CEO in the 2014 financial year (refer to the remuneration table on page 46).

R Calico, Executive Director

Mr Calico has been seconded to Mercantile by CGD and took up office at Mercantile on 1 July 2014. In terms of his service agreement, Mr Calico has agreed to perform such duties, functions and services as are assigned to him from time to time by the Board of Directors and which are consistent and commensurate with his position as Executive Director.

JPM Lopes, Executive Director

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

RISK MANAGEMENT AND CONTROL

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

Cyril Ramaphosa

RISK MANAGEMENT PHILOSOPHY

The Bank recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks that have become all too evident during the extended global financial crisis. Risk management is a key focus of the Bank and addresses a wide spectrum of risks that are continually evaluated, and policies and procedures are reviewed and stress-tested to adapt to changing circumstances. In any economy, there are sectors that are more vulnerable to cyclical downturns than others. Changing economic variables are monitored to assist in managing exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a balanced portfolio. However, the Bank acknowledges the potential of concentration risk in being a niche bank – this is carefully monitored and, where appropriate, corrective action is taken. Our business development efforts are focused on the stronger companies and individuals within established policy criteria, which policy serves to eliminate weaker credit from the portfolio. The Bank remains well positioned to effectively manage identified threats in a way that minimises risks to the Bank. Continuous risk management and control reviews are undertaken by senior staff members to identify material control weaknesses and action is taken as required to address any areas of weakness.

A philosophy of enterprise-wide risk management within a Risk Management Monitoring and Control Framework has been implemented to ensure that all business and operational risks are managed effectively within acceptable risk profiles, policies and parameters. Risk management policies are essentially conservative, with proper regard to the mix of risk and reward. Existing policies, methodologies, processes, systems and infrastructure are frequently evaluated for relevance, to ensure that they remain at the forefront of risk management and in line with regulatory developments and emerging best practices. The Bank takes all necessary steps to safeguard its depositors' funds, its own asset base, and shareholder's funds.

A number of risk initiatives were implemented and others further entrenched during the year. These included:

- further enhancements to the Asset Liability Management monitoring and reporting process;
- compliance with amended regulations introduced as part of Basel III implementation;
- enhancements to the Risk Tolerance Framework approved by the Board;
- additions to the prudential management schedule, wherein all risk-related ratios are monitored and reported to the ALCO and Board on a monthly basis;
- further improvements to the Treasury operations risk control self-assessment templates;
- streamlining of risk management methodologies and techniques in subsidiary companies together with rewrites of processes and procedures in use;
- expansion of stress testing;
- review and enhancement to the application of the Principles for the Sound Management of Operational Risk;
- review and enhancement to the application of the Principles for Sound Liquidity Risk Management and Supervision;
- expanded utilisation of an online training application to ensure that staff stay abreast with regulatory and other changes;
- re-engineering and review of Treasury back office processes to ensure mitigation of identified risks;
- implementation of a workflow solution in various departments;
- enhancements to operational risk data collection and reporting;
- comprehensive documentation and amalgamation of information relating to the Bank's ICAAP ("Internal Capital Adequacy Assessment Process");
- Bank-wide review of the Enterprise-wide Risk Management Framework to factor in changes in risk profiles; and
- review of the Funding Policy and Contingent Funding plan.

ENTERPRISE-WIDE RISK MANAGEMENT

An Enterprise-wide Risk Management Framework is adopted to ensure appropriate and focused management of all risks. Risk assessment is a dynamic process and is reviewed regularly in line with changing circumstances. Risk dimensions vary in importance, depending upon the business activities of an organisation and the related risks. The overall objective of enterprise-wide risk management is to ensure an integrated and effective risk management framework where all risks are identified, quantified and managed to achieve an optimal risk-reward profile. The presence of accurate measures of risk makes risk-adjusted performance measurement possible, creates the potential to generate increased shareholder returns, and allows risk-taking behaviour to be more closely aligned with strategic objectives.

Risk management is performed on a Bank-wide basis, involving the Board and its various committees, credit management, senior management, risk management,

RISK MANAGEMENT AND CONTROL continued

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

RISK MANAGEMENT LIFE CYCLE/PROCESS

All of the Bank'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 Bank's governance structure and risk management profile, reflecting the expectations and requirements of the Board in respect of key areas of control. The standards and effective maintenance of the risk control self-assessment process ensure alignment and consistency in the way that prevalent risk types are identified and managed, and form part of the various phases of the risk management life cycle, defined as:

Risk identification (and comprehension)

Risk identification focuses on recognising and understanding existing risks, or risks that may arise from positions taken, and future business activity as a continuing practice.

Risk measurement (and evaluation using a range of analytical tools)

Once risks have been identified, they need to be measured. Certain risks will lend themselves more easily to determination and measurability than others, but it is necessary to ascertain the magnitude of each risk to the extent it is quantifiable, whether direct or indirect.

To consider risk appetite and the alignment against broader financial targets, the Bank mainly considers the level of earnings, growth and volatility that it is willing to accept from certain risks that are core to its business. Economic and regulatory capital required for such transactions is also considered, together with the resultant return on the required capital. The Bank also maintains a capital buffer for unforeseen events and business expansion.

Risk management (as an independent function)

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

Risk monitoring (and compliance with documented policies)

Open, two-way communication between the Bank and the SARB is fundamental to the entire risk monitoring and supervisory process. To achieve this, responsible line heads are required to document conclusions and communicate findings to the ALCO, RMC and CREDCOM, and to the SARB (through Banks Act returns and periodic meetings).

Risk control (stress and back-testing)

The Bank 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 Bank's results. Both internal and external events are considered in formulating appropriate modelling criteria. A policy of back-testing for identified key variables has been approved by the Board and deployed within the Bank.

MANAGEMENT OF RISK

Principal risk categories have been identified, defined and categorised into direct and indirect risks. This set of risk definitions forms the basis of management and control relative to each unit within the Bank, and also forms a consistent common language for outside examiners and/or regulators to follow.

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

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

Board committees monitor various aspects of the identified risks within the Enterprise-wide Risk Management Framework, which include:

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

The responsibility for understanding the risks incurred by the Bank, 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 Bank's strategic objectives within predefined risk management policies and tolerance levels. Major risks are managed, controlled and reviewed by an independent risk function.

The Board fully recognises that it is accountable for the process of risk management and the system of internal control. Management reports regularly to the Board on the effectiveness of internal control systems and on any significant control weaknesses identified.

A process is in place whereby the Top 10 risks faced by the Bank are identified. These risks are assessed and evaluated in terms of a risk score attached to inherent risk and residual risk. Action plans are put in place to reduce the identified inherent risks to within acceptable residual risk parameters. The Top 10 risks are re-evaluated quarterly and any changes are approved by the RMC. Business and Operating units are integrally involved in the process in both risk identification and evaluation.

The Bank subscribes to the Principles for the Sound Management of Operational Risk as defined by the Basel Committee on Banking Supervision.

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

The Capital Management Committee, under the auspices of the RMC, proactively evaluates and manages the capital requirements of the Bank as determined by Basel requirements. A comprehensive re-evaluation of the capital requirements under the Internal Capital Adequacy Assessment Process is regularly undertaken with consideration being given to all risks impacting the need for capital reserves within the Bank. The outcome of these assessments resulted in the Bank identifying different levels of risk related to specific characteristics of the business where it was deemed prudent to hold a capital buffer in addition to the regulatory capital requirements. Such buffer requirements are re-evaluated at least half-yearly and adjusted where appropriate.

The Bank employs a size-appropriate approach to stress testing that is a component of business planning. Stress testing measures potential volatility of earnings under various scenarios.

Under the Enterprise-wide Risk Management Framework, the direct risks of the Bank have been categorised and those deemed to be of the most significance are reported on below:

Credit risk

Credit parameters and tolerance levels are clearly defined and reflected in governing procedures and policies. The Bank offers a spread of banking products common to the banking industry, with a specific focus on small- and medium-sized businesses, across a wide variety of industries. No specific targeting of the broader personal retail-based market is done. However, the Private Bank was launched during the year and it will specifically target entrepreneurs with the view to ultimately acquiring their business accounts. To manage the related credit risk, a new Head of Credit: Private Bank was appointed at the beginning of the year with the post reporting to the Head of Credit.

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

Counterparties to derivatives expose the Bank to credit-related losses in the event of non-performance. The counterparties to these contracts are financial institutions. The Bank 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 Bank did not have any significant concentration of risk that had not been adequately provided for. There were no material exposures in advances made to foreign entities at year-end. The Bank does not lend to foreign-registered companies but does provide banking to a number of locally registered companies that have foreign

RISK MANAGEMENT AND CONTROL continued

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

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

The Bank has adopted a conservative approach to credit granting, within a specifically defined and structured approval process. The granting of credit is managed via a mandated approval process, whereby levels of credit approval are determined by the experience of the mandated individual, with dual or multiple sign-off on all material values. An ongoing weekly review is also undertaken by the CREDCOM of all new and renewal proposals for lending in excess of R2 million (in aggregate). Adverse behavioural patterns such as continual excesses above approved limits are monitored closely by the Credit department and discussed at the weekly CREDCOM meeting with appropriate actions being taken.

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

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

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

The table below summarises the Bank's maximum exposure to credit risk at reporting date:

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2014				
Current accounts	**1 489 153**	**–**	**–**	**1 489 153**
Credit cards	**17 942**	**13 643**	**–**	**31 585**
Mortgage loans	**2 455 790**	**160 649**	**–**	**2 616 439**
Instalment sales and leases	**338 663**	**–**	**–**	**338 663**
Structured loans	**85 691**	**–**	**–**	**85 691**
Medium-term loans	**1 555 389**	**–**	**–**	**1 555 389**
Negotiable securities	**–**	**–**	**440 767**	**440 767**
Cash and cash equivalents	**–**	**–**	**1 492 707**	**1 492 707**
Guarantees	**–**	**–**	**468 748**	**468 748**
Letters of credit	**–**	**–**	**42 567**	**42 567**
	5 942 628	**174 292**	**2 444 789**	**8 561 709**
2013				
Current accounts	1 527 609	–	–	1 527 609
Credit cards	19 521	13 019	–	32 540
Mortgage loans	2 166 818	92 728	–	2 259 546
Instalment sales and leases	279 677	–	–	279 677
Structured loans	27 535	–	–	27 535
Medium-term loans	1 102 689	–	–	1 102 689
Negotiable securities	–	–	496 608	496 608
Cash and cash equivalents	–	–	1 490 681	1 490 681
Guarantees	–	–	400 147	400 147
Letters of credit	–	–	16 024	16 024
	5 123 849	105 747	2 403 460	7 633 056

Operational risk

Operational risk is defined as the risk of loss from inadequate or failed internal processes, people, and systems, or from external events. Operational risks faced by the Bank are extensive and include robbery, fraud, theft of data, unauthorised systems access, legal challenges, statutory and legislative non-compliance, ineffective operational processes, and business continuity. Operational risk can also cause reputational damage and, therefore, efforts to identify, manage and mitigate operational risk are equally sensitive to reputational risk, as well as the risk of financial loss.

Operational risk management's aim is to enhance the level of risk maturity across the Bank by implementing and embedding process-based risk and control identification and assessments, and integrating the operational risk management process in all business units to ensure adequate risk management in an ever-changing business and financial industry. The Operational Risk Committee meets at least quarterly and has representation from all business units.

Strategies, procedures and action plans to monitor, manage and limit the risks associated with operational processes, systems and external events include:

- documented operational policies, processes and procedures with segregation of duties;
- ongoing training and up-skilling of staff on operational procedures and legislative compliance;
- an internal operational loss database, wherein all losses associated with operational issues, including theft and robbery, are recorded and evaluated to facilitate corrective action;
- development of appropriate risk mitigation actions in line with the Bank's Risk Appetite as approved by the Board;
- ongoing improvements to the Disaster Recovery and Business Continuity plans, including conducting a variety of simulation exercises in critical operations environments;

RISK MANAGEMENT AND CONTROL continued

- conducting monitoring and reviews by both the Compliance and Internal Audit functions, in line with annual plans approved by the Board;
- comprehensive data security and protection;
- ongoing review of the Bank-wide risk control self-assessment process, rolled out to job functional level in high-risk operational processing areas;
- ongoing review of key risk indicators as a tool to further assist with risk identification and assessment;
- limiting access to systems and enforcing strong password controls; and
- a comprehensive insurance programme to safeguard the Bank's financial and non-financial assets.

Disaster recovery and business continuity management facilities are outsourced to specialist service providers.

The Bank further benchmarks itself and stays abreast of developments with regard to operational risk by actively participating as a member of the Banking Association of South Africa's operational risk forum and task group as well as being a member of the industry working group on accounting impact events.

The Bank subscribes to the Principles for the Sound Management of Operational Risk. Compliance with the principles has been reviewed, and action plans have been put in place to ensure ongoing compliance.

Technology risk

Technology risk management forms a key component of the Enterprise-wide Risk Management Framework and is effectively managed under the auspices of the IT Steering Committee, a Board-appointed committee. The compliance and governance aspects are independently managed within the risk environment and are reported on independently to the Technology Committee.

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

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

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

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

Market risk

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

The Bank does not currently take proprietary trading positions and, therefore, has minimal exposure to market risk. Should the Bank consider entering into a proprietary trading position, the Trading Committee and RMC will have to evaluate and approve entering into such a position. The Trading Committee will ensure that the Bank is sensibly positioned, taking into account agreed limits, policies, prevailing market conditions, available liquidity, and the risk-reward trade-off, mainly in respect of changes in foreign currency exchange rates and interest rates.

The Bank enters into derivative financial instruments to manage its exposure to interest rate and foreign currency risk, including:

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

Market risk reports are produced on a daily basis, which allows for monitoring against prescribed prudential and regulatory limits. In the event of a limit violation, the ALM forum records same, and it is immediately corrected and reported to the ALCO (a management committee accountable to the RMC).

The Bank does not perform a detailed sensitivity analysis on the potential impact of a change in exchange rates on a daily basis because the Bank does not currently have any proprietary trading positions. The impact of changes in foreign currency customer positions is, however, modelled to take cognisance of credit risks associated with volatility in foreign currency exchange rates, with the purpose of covering adverse positions by calling for initial and variation margins. A detailed sensitivity analysis is performed for interest rate and liquidity risk (described on pages 56 to 60).

There has been no significant change to the Bank's exposure to market risks, or the manner in which it manages and measures the risk. Controls are in place to monitor foreign exchange exposures on a real-time basis through the Treasury system (BaNCS Treasury). Various conservative prudential risk limits are in place and associated exposures relating thereto are reported to the ALCO, RMC and Board on a regular basis.

Foreign currency risk

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

The Bank has conservative net open foreign currency position limits that are well below the limits allowed by the SARB. For the year under review, the highest net open position recorded, for any single day, was R15,7 million (2013: R53,6 million). An adverse movement in the exchange rate of 10% would reduce the Bank's income by R1,6 million (2013: R5,4 million).

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

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2014					
Total foreign exchange assets	**372 055**	**31 074**	**1 370**	**2 434**	**406 933**
Total foreign exchange liabilities	**(113 700)**	**(18 500)**	**(1 478)**	**(327)**	**(134 005)**
Commitments to purchase foreign currency	**116 601**	**87 306**	**8 881**	**13 942**	**226 730**
Commitments to sell foreign currency	**(370 251)**	**(96 740)**	**(7 254)**	**(14 416)**	**(488 661)**
Year-end effective net open foreign currency positions	**4 705**	**3 140**	**1 519**	**1 633**	**10 997**
2013					
Total foreign exchange assets	199 414	568	4 608	3 849	208 439
Total foreign exchange liabilities	(79 672)	(8 542)	(1 428)	–	(89 642)
Commitments to purchase foreign currency	87 414	70 641	5 208	2 752	166 015
Commitments to sell foreign currency	(207 672)	(62 630)	(6 877)	(4 256)	(281 435)
Year-end effective net open foreign currency positions	(516)	37	1 511	2 345	3 377

RISK MANAGEMENT AND CONTROL continued

Interest rate risk

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

The Bank is exposed to interest rate risk as it takes deposits from customers at both fixed- and floating interest rates. The Bank manages the risk by maintaining an appropriate mix between fixed- and floating rate funds, as well as by using interest rate swap contracts, and matching the maturities of deposits and assets, as appropriate.

The objective in management of interest rate risk is to ensure a higher degree of interest rate margin stability and lower interest rate risk over an interest rate cycle. This is achieved by hedging material exposures and by not allowing any proprietary interest rate positions. Under interest rate swap contracts, the Bank agrees to exchange the difference between fixed- and floating interest rate amounts, calculated on agreed notional principal amounts. Such contracts enable the Bank 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 Bank will settle/receive the difference between the fixed- and floating interest rate, on a net basis.

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

To measure interest rate risk, the Bank aggregates interest rate-sensitive assets and liabilities into defined time bands, in accordance with the respective interest re-pricing dates. The Bank uses both dynamic maturity gap and duration analysis, which measures the mismatch level between the average time over which the cash inflows are generated and cash outflows are required. Various reports are prepared taking alternative strategies and interest rate forecasts into consideration. These reports are presented to the ALCO and RMC on a regular basis.

To monitor the effect of the gaps on net interest income, a regular forecast of interest rate-sensitive asset and liability scenarios is produced. It includes relevant banking activity performance and trends, different forecasts of market rates, and expectations reflected in the yield curve.

The yield on assets remained under pressure during 2014 as a result of the low interest rate environment in South Africa. South Africa was also not immune to the global credit and liquidity crisis or market uncertainty in respect of the longer-term interest rate trends. Pressure on margins is likely to continue during 2015.

For regulatory purposes, the assessment and measurement of interest rate risk is based on the accumulated impact of interest rate-sensitive instruments, resulting from a parallel movement of plus or minus 200 basis points in the yield curve.

The impact on equity and profit and loss resulting from a change in interest rates is calculated monthly based on management's forecast of the most likely change in interest rates. In addition to the above, the impact of a static bank-specific favourable and unfavourable interest rate movement, of 50 and 200 basis points respectively, is calculated and monitored by the ALM forum. Various approved prudential limits are in place and monitored by the ALM forum. The results are reported to the ALCO and Board regularly.

At the reporting date, a 50 basis point change in prevailing interest rates was applied as a sensitivity analysis to determine the impact on earnings as a result of a change in interest rates. If interest rates increased/decreased by 50 basis points, and all other variables remained constant, the Bank's net profit and equity at year-end would increase by R8,1 million, or decrease by R13,3 million respectively (2013: increase/decrease by R8,4 million/R11,9 million). This is mainly attributable to the Bank's exposure to interest rates on its surplus capital and lending and borrowings in the banking book.

The tables on page 57 and 58 summarises the Bank's exposure to interest rate risk. Assets and liabilities are included at carrying amounts, categorised by the earlier of contractual re-pricing or maturity dates, and also indicate their effective interest rates at year-end. The re-pricing profile indicates that the Bank remains asset-sensitive as interest-earning assets re-price sooner than interest-paying liabilities, before and after derivative hedging activities. Thus, future net interest income remains vulnerable to a decrease in market interest rates.

	Up to 1 month R'000	1 – 3 months R'000	4 – 12 months R'000	1 – 5 years R'000	Non-interest-sensitive R'000	Total R'000	Effective interest rate %
2014							
ASSETS							
Intangible assets	–	–	–	–	188 476	188 476	–
Property and equipment	–	–	–	–	26 943	26 943	–
Other accounts receivable	–	–	–	–	120 822	120 822	–
Interest in subsidiaries	126 459	–	–	–	58 208	184 667	–
Other investments	–	–	–	–	6 326	6 326	–
Non-current assets held-for-sale	–	–	–	–	13 482	13 482	–
Loans and advances	5 963 230	–	2 241	11 616	(73 462)	5 903 625	9,3
Derivative financial instruments	–	–	–	–	6 069	6 069	–
Negotiable securities	–	215 074	52 223	173 470	–	440 767	6,1
Cash and cash equivalents	961 304	–	69 506	–	461 897	1 492 707	4,7
Total assets	**7 050 993**	**215 074**	**123 970**	**185 086**	**808 761**	**8 383 884**	
EQUITY AND LIABILITIES							
Total equity	–	–	–	–	1 915 578	1 915 578	–
Deferred tax liabilities	–	–	–	–	30 422	30 422	–
Long-term funding	–	437 212	–	–	327	437 539	8,1
Deposits	3 581 647	336 299	603 321	79 776	1 196 060	5 797 103	4,2
Derivative financial instruments	–	–	–	–	8 727	8 727	–
Provisions and other liabilities	–	–	–	–	78 384	78 384	–
Tax	–	–	–	–	5 204	5 204	–
Other accounts payable	–	–	–	–	110 927	110 927	–
Total equity and liabilities	**3 581 647**	**773 511**	**603 321**	**79 776**	**3 345 629**	**8 383 884**	
Financial position interest sensitivity gap	**3 469 346**	**(558 437)**	**(479 351)**	**105 310**		**2 536 868**	
Derivative financial instruments	**281**	**13 857**	**(2 241)**	**(11 897)**		**–**	
Total net interest sensitivity gap	**3 469 627**	**(544 580)**	**(481 592)**	**93 413**		**2 536 868**	

RISK MANAGEMENT AND CONTROL continued

	Up to 1 month R'000	1 – 3 months R'000	4 – 12 months R'000	1 – 5 years R'000	Non-interest-sensitive R'000	Total R'000	Effective interest rate %
2013							
ASSETS							
Intangible assets	–	–	–	–	196 466	196 466	–
Property and equipment	–	–	–	–	27 254	27 254	–
Tax	–	–	–	–	1 220	1 220	–
Other accounts receivable	–	–	–	–	86 357	86 357	–
Interest in subsidiaries	108 726	–	–	–	46 064	154 790	–
Other investments	–	–	–	–	5 737	5 737	–
Non-current assets held-for-sale	–	–	–	–	13 470	13 470	–
Loans and advances	5 125 111	–	–	21 451	(62 977)	5 083 585	9,4
Derivative financial instruments	–	–	–	–	10 630	10 630	–
Negotiable securities	36 940	106 820	335 512	17 336	–	496 608	5,5
Cash and cash equivalents	1 087 234	62 533	–	–	340 914	1 490 681	4,6
Total assets	6 358 011	169 353	335 512	38 787	665 135	7 566 798	
EQUITY AND LIABILITIES							
Total equity	–	–	–	–	1 804 089	1 804 089	–
Deferred tax liabilities	–	–	–	–	34 204	34 204	–
Long-term funding	–	495 103	–	–	(1 930)	493 173	7,8
Deposits	3 128 656	477 580	512 813	55 522	873 697	5 048 268	4,0
Derivative financial instruments	–	–	–	–	11 459	11 459	–
Provisions and other liabilities	–	–	–	–	71 311	71 311	–
Other accounts payable	–	–	–	–	104 294	104 294	–
Total equity and liabilities	3 128 656	972 683	512 813	55 522	2 897 124	7 566 798	
Financial position interest sensitivity gap	3 229 355	(803 330)	(177 301)	(16 735)		2 231 989	
Derivative financial instruments	(232)	21 504	–	(21 272)		–	
Total net interest sensitivity gap	3 229 123	(781 826)	(177 301)	(38 007)		2 231 989	

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 Bank is exposed to daily cash needs from overnight deposits, current accounts, maturing deposits, loan draw-downs and guarantees.

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

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

Through active liquidity management, the Bank 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 Bank performs, among others, the following:

- the maintenance of a stock of readily available, high-quality liquid assets (in excess of the statutory requirements), as well as strong statement of financial position liquidity ratios;
- an assumptions-based sensitivity analysis to assess potential cash flows at risk;
- the management of concentration risk (i.e. undue reliance on any single counterparty or counterparty group, sector, market, product, instrument, currency and tenor);
- the maintenance of sources of funding for contingency funding needs;
- the monitoring of daily cash flow movements and requirements, including daily settlements and collateral management processes;
- targeting a diversified funding base to avoid undue concentrations by investor, market source and maturity;
- the creation and monitoring of prudential liquidity risk limits; and
- the maintenance of an appropriate term mix of funding.

Overall, the Bank'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 Bank continues to actively manage its stress funding sources and liquidity buffers to ensure that it exceeds the estimated stress funding requirements that could emanate from moderate- to high-stressed liquidity events. The Bank subscribes to the Bank of International Settlement's Principles for Sound Liquidity Risk Management and Supervision. Overall, the Bank's liquidity position remains strong.

Macro-economic conditions continued to impede growth in advances and deposits as the South African banking sector is characterised by certain structural features, such as a low discretionary propensity to save, and a higher degree of contractual savings with institutions such as pension funds, provident funds and asset management services. The Bank will continue to focus on gathering retail customer- and longer-term deposits to reshape the structure of the balance sheet, and to ensure compliance with the Basel III liquidity requirements (effective 2015).

The two key liquidity ratios that were introduced by Basel III are the liquidity coverage ratio ("LCR"), designed to promote short-term resilience of the one-month liquidity profile by ensuring that banks have sufficient high-quality liquid assets to meet potential outflows in a stressed environment; and the net stable funding ratio ("NSFR"), designed to measure the stability of long-term structural funding.

Both the LCR and the NSFR are subject to a monitoring period, which commenced in January 2013, with phased-in implementation and compliance of the LCR and NSFR commencing in 2015 and 2018 respectively. The Bank also monitors other Basel III-related ratios, such as the leverage ratio, which is a measure of qualifying capital to both on- and off-balance-sheet exposures. The Bank currently meets all the requirements of the new regulations.

There were no significant changes in the Bank's liquidity position during the current financial year, or in the manner in which it manages and measures the risk. The Bank is adequately funded and able to meet all of its current and future obligations. During 2011, the Bank entered into a R491 million seven-year term loan with the International Finance Corporation that has been fully utilised.

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

RISK MANAGEMENT AND CONTROL continued

The table below summarises assets and liabilities of the Bank 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
2014			
Maturing up to one month	**3 095 587**	**3 793 574**	**(697 987)**
Maturing between one and three months	**220 563**	**800 130**	**(579 567)**
Maturing between three and six months	**111 574**	**288 705**	**(177 131)**
Maturing between six months and one year	**288 479**	**389 355**	**(100 876)**
Maturing after one year	**4 286 642**	**1 165 774**	**3 120 868**
Non-contractual	**381 039**	**30 768**	**350 271**
	8 383 884	**6 468 306**	**1 915 578**
2013			
Maturing up to one month	3 149 945	3 088 400	61 545
Maturing between one and three months	186 505	1 035 231	(848 726)
Maturing between three and six months	232 649	287 410	(54 761)
Maturing between six months and one year	360 089	452 466	(92 377)
Maturing after one year	3 279 728	864 539	2 415 189
Non-contractual	357 882	34 662	323 220
	7 566 798	5 762 708	1 804 090

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

	Up to 1 month R'000	1 – 3 months R'000	4 – 6 months R'000	7 – 12 months R'000	Over 1 year R'000
2014					
Deposits	**3 461 487**	**803 930**	**291 218**	**408 566**	**786 504**
Long-term funding	**–**	**–**	**–**	**–**	**526 522**
Derivative financial instruments	**2 257**	**1 935**	**4 266**	**124**	**145**
Other accounts payable	**110 927**	**–**	**–**	**–**	**–**
Guarantees, letters of credit and committed undrawn facilities	**685 607**	**–**	**–**	**–**	**–**
Operating lease commitments	**2 045**	**4 092**	**6 118**	**11 586**	**46 988**
	4 262 323	**809 957**	**301 602**	**420 276**	**1 360 159**
2013					
Deposits	2 891 727	1 040 249	292 350	472 154	401 990
Long-term funding	–	–	–	–	594 275
Derivative financial instruments	7 869	1 581	936	470	603
Other accounts payable	104 294	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	521 918	–	–	–	–
Operating lease commitments	1 835	3 597	5 352	10 522	63 732
	3 527 643	1 045 427	298 638	483 146	1 060 600

BASEL III – INFLUENCING RISK MANAGEMENT DEVELOPMENTS

In today's complex environment, combining effective bank-level management with market discipline and regulatory supervision best achieves systemic safety and soundness. The Bank recognises the significance of Basel III in aligning regulatory capital to risk and further entrenching risk-reward principles and practices in bank management and decision-making. This framework focuses on strengthening and harmonising global liquidity standards to ensure that internationally-active banks are adequately capitalised.

South Africa embraced the principles of the Basel III capital framework, which was successfully implemented by the Bank on 1 January 2013. Full compliance with all the regulations will only be required in January 2019.

The Bank's capital adequacy was largely unaffected by the new regulations, which impose tighter restrictions on the quality and type of capital that qualifies as Tier 1 capital. The Bank's capital still consists almost entirely of Tier 1 capital. The new regulations also increase the required minimum regulatory capital. The Bank's internal capital targets remain well in excess of the new minimum requirements.

The other most significant changes introduced by Basel III are the liquidity coverage ratio ("LCR") and the net stable funding ratio ("NSFR"). The banking industry in South Africa will find it difficult to fully meet the new liquidity ratios (LCR and the NSFR) as a result of the structural characteristics and constraints with regard to qualifying liquid assets in South Africa.

The SARB made committed liquidity facilities available to banks with insufficient high quality liquid assets ("HQLA") due to the fact that South Africa has virtually no Level II HQLA. This will enable banks to meet the phased-in LCR requirement by 2015. The cost for this facility ranges from 15 to 30 basis points (weighted average) if not utilised. Utilisation of this facility will be 31 calendar days at a cost of SARB's repo rate plus 100 basis points.

The Bank currently complies with the requirements of the LCR and NSFR but continues to monitor these ratios on a monthly basis. The Bank also calculates various sensitivities on these ratios to identify potential constraints in meeting the requirements timeously.

The Bank will continue to seek and adopt market best-practice in accordance with these regulatory requirements. The focus in 2015 will remain on lengthening the maturity of the Bank's deposits and putting appropriate funding structures in place to further enhance these ratios.

CAPITAL MANAGEMENT

The Bank is subject to specific capital requirements, as defined in the Banks Act and Regulations. The management of the Bank's capital takes place under the auspices of the RMC, through the ALCO. The capital management strategy is focused on maximising shareholder value over time, by optimising the level and mix of capital resources while ensuring sufficient capital is available to support the growth objectives of the Bank. Decisions on the allocation of capital resources, conducted as part of the strategic planning and budget review, are based on a number of factors, including growth objectives, return on economic and regulatory capital, and the residual risk inherent to specific business lines. This is conducted on a regular basis as part of the Internal Capital Adequacy Assessment Process ("ICAAP") and strategic planning review. The RMC considers the various risks faced by the Bank and analyses the need to hold capital against these risks while taking account of the regulatory requirements.

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

Capital adequacy and the use of regulatory capital are monitored by employing techniques based on the guidelines documented in the Bank Regulations and implemented by the SARB for supervisory purposes. The SARB uses the capital adequacy ratio of banks as a key supervisory signal. Despite the regulations allowing the Bank to consider different tiers of capital, the capital of the Bank consists almost entirely of Tier 1 capital. Following the recapitalisation of the Bank in 2004, it has remained capitalised well beyond regulatory and internal requirements.

Risk-weighted capital is allocated to the different business units in line with their assessed operational risk profile and targeted growth requirements. Capital to support the Bank's needs is currently generated by retained earnings and the surplus capital held.

The approach to capital management has been further enhanced over the past year in line with Basel III, and will remain a focus area for the future. The Bank was largely unaffected by the new regulations, which impose tighter restrictions on the quality and type of capital that qualifies as Tier 1 capital and raised the minimum required regulatory capital.

RISK MANAGEMENT AND CONTROL continued

The Bank complies with the provisions of section 46 of the Companies Act, whereby all dividends and distributions are authorised by the Board. The Board authorises a distribution after assuring itself that the Bank will fulfil the solvency and liquidity test immediately after completing the distribution.

The level of capital for the Bank is as follows:

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

FRAUD

Payment card fraud

The Bank is an issuer of MasterCard and VISA cards and has, in line with the card associations' regulations, adopted proactive measures to prevent fraudulent use of these products. The Bank makes use of fraud monitoring reports, based on a set of parameters prescribed by the card associations, and which are reviewed on a daily basis with the aim of identifying suspicious transactional behaviour.

In addition to standard monitoring measures, the Bank offers an SMS notification service on both its credit- and debit card products. Since its introduction, this service has contributed to the early detection of fraudulent transactions and mitigation of losses.

If fraudulent activity is confirmed, action is taken to prevent further use of the card/card number. Confirmed fraudulent transactions are investigated and reported to the relevant card associations and the South African Banking Risk Information Centre ("SABRIC"), which determines common trends and then alerts the industry accordingly.

The Bank will start issuing integrated circuit cards (also known as "smart" or "chip" cards) during the first quarter of 2015. These cards use advanced encryption, embedded card risk analysis capabilities, and online and offline authentication. The traditional methods used to steal card data or to clone cards using magstripe technology are rendered worthless by implementing these cards.

Verified-by-Visa functionality was implemented in the second quarter of 2014. Verified-by-Visa is a unique service offered by Visa International that uses a One Time PIN ("OTP") or personal password to protect a cardholder against unauthorised use when making online purchases (also known as e-Commerce transactions).

The Bank currently offers merchants point-of-sale devices to acquire transactions on behalf of VISA and MasterCard.

Fraud other than payment card fraud

The Bank has adopted a zero-tolerance approach toward all types of fraud and theft. The Forensic Investigators investigate all incidents relating to external fraud while internal fraud is investigated by the Internal Audit function.

If an incident of fraud is brought to the Bank's attention, it is investigated immediately, evidence is collected, and statements are taken. If the incident was perpetrated externally, criminal charges are laid. If the incident was perpetrated internally, disciplinary action is instituted in addition to criminal charges being laid. All fraud incidents are reported to the SABRIC and the South African Police Service.

Fraud awareness

Fraud awareness training is conducted on a regular basis and awareness newsletters are compiled and disseminated to all staff. These newsletters address a wide range of topics and are not limited to payment card fraud only. Fraud awareness newsletters are also compiled and distributed to customers. Fraud awareness material on prevalent modus operandi is also made available to customers and staff members on the Bank's website in the Fraud Prevention webpage.

The issuance of additional modules of the Fraud Awareness User Guide was discarded and replaced with Fraud Alerts. These Fraud Alerts contain warnings of the recently identified fraud trends as well as relevant Fraud Prevention and Awareness material related to the incident. The aim of the Fraud Alerts is to cover specific and current fraud trends as and when they are identified as well as to create awareness of the most prevalent fraud incidents.

Fraud department staff members attend meetings of industry role players and use Internet-based sources to stay abreast of fraud trends and the prevention thereof. The Bank also works closely with SABRIC, the Payment Association of South Africa, and card associations.

WHISTLE-BLOWING

The Bank has a comprehensive Protected Disclosures Policy based on the Act of the same name. The policy addresses the reporting of corrupt activities, as well as any improper conduct, under a section on whistle-blowing. Employees are encouraged to make disclosures in good faith and on reasonable grounds.

All employees receive, twice annually, an electronic step-by-step guide on what to report and how to report it.

To this end, an enhanced anonymous reporting system is in place to enable employees to report directly to Compliance and Internal Audit, using a web-based tool. This system simplifies the anonymous reporting procedure and encourages employees to make use of the process.

NOTES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