Mercantile Bank Limited

The Business Bank inspired by entrepreneurs

2017 AUDITED ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December

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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 (Chartered Accountant) South Africa, the CFO 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.

Registration number: 1965/006706/06 | Member of CGD Bank | An Authorised Financial Services and Credit Provider

NCRCP19 | Web: **mercantile.co.za**

Glossary of terms

Abbreviation	Definition/Description
ALCO	Asset and Liability Committee
ALM	Asset and Liability Management
Bank Regulations	Regulations relating to banks issued under section 90 of the Banks Act, No. 94 of 1990, as amended
Banks Act	Banks Act, No. 94 of 1990, as amended
CEO	Chief Executive Officer
CFO	Chief Financial Officer
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
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards and Interpretations
IT	Information technology
MBHL	Mercantile Bank Holdings Limited, the holding company
RMC	Risk and Capital Management Committee
SARB	South African Reserve Bank
the Bank	Mercantile Bank Limited
the Board	The Board of Directors
the Company	Mercantile Bank Limited

Directors' responsibility 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 2017 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 inspection, 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 the Companies Act and International Financial Reporting Standards 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, it continues to adopt the going concern basis in preparing the annual financial statements.

These annual financial statements, set out on pages 8 to 57, have been approved by the Board and are signed on its behalf by:

GP de Kock	KR Kumbier
Acting Chairman	*CEO*

20 March 2018

Certificate from the Company Secretary

In terms of the provisions of the Companies Act, I certify that, to the best of my knowledge and belief, the Company has lodged with the Registrar of Companies for the financial year ended 31 December 2017, all such returns as are required of a public company in terms of the Companies Act, and that all such returns are true, correct and up to date.

T Singh
Company Secretary

20 March 2018

Independent Auditor's report

To the shareholder of Mercantile Bank Limited

Opinion

We have audited the financial statements of the Company set out on pages 8 to 56, which comprise the statement of financial position as at 31 December 2017, and the statement of comprehensive income, statement of changes in equity, and statement of cash flows for the year then ended, and the notes, including a summary of significant accounting policies.

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

Basis for opinion

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

Other information

The Directors are responsible for the other information. The other information comprises the Directors' report, as required by the Companies Act of South Africa, Certificate from the Company Secretary, Audit Committee report and supplementary information as disclosed on page 57. The other information does not include the Company's financial statements and our auditor's report thereon.

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

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

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

Responsibilities of the Directors for the financial statements

The Directors are responsible for the preparation and fair presentation of the Company's financial statements in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa, and for such internal control as the Directors determine is necessary to enable the preparation of the Company's financial statements that are free from material misstatement, whether due to fraud or error.

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

Auditor's responsibilities for the audit of the financial statements

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

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

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors;

Independent Auditor's report continued

- conclude on the appropriateness of the Directors' use of the going concern basis of accounting and based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the Company's financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the Company's financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation; and
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Company to express an opinion on the financial statements. We are responsible for the direction, supervision and performance of the audit. We remain solely responsible for our audit opinion.

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

Report on other legal and regulatory requirements

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

Deloitte & Touche
Registered Auditor
Per: Diana Jorge
Partner

20 March 2018

Audit Committee report

for the year ended 31 December 2017

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

The Audit Committee duties include its statutory duties in terms of section 94(7) of the Companies Act as well as additional duties assigned to it by the Board. The Audit Committee is a committee of the MBHL Board and has assumed the responsibilities of an audit committee in respect of all subsidiaries of MBHL, with the exception of the securitisation vehicle, Compass Securitisation (RF) Limited, which has a separate audit committee, and therefore a separate committee has not been formed for the Bank. The Audit Committee's main objective is to assist the Board in fulfilling its oversight responsibilities, in particular with regard to evaluation of the adequacy and efficiency of accounting policies, internal controls and financial and corporate reporting processes. In addition, the Audit Committee assesses the effectiveness of the Internal Auditors and the independence and effectiveness of the External Auditors.

Terms of reference

The Audit Committee is both a statutory and a Board Committee. Its powers and terms of reference are derived from the Companies Act and are formalised in its charter, which is reviewed annually and approved by the Board. The Audit Committee has executed its duties during the past financial year in accordance with its charter and the Companies Act.

Composition

The Audit Committee comprises four independent Non-Executive Directors. At 31 December 2017 the members were:

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

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

Meetings

The Audit Committee 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 Audit Committee:

- nominated for appointment, as External Auditor, Deloitte & Touche which, in its opinion, is independent of the Company;
- determined the fees to be paid to Deloitte & Touche as disclosed in note 26 to the annual financial statements;
- determined Deloitte & Touche's terms of engagement;
- believes the appointment of Deloitte & Touche complies with the relevant provisions of the Companies Act and King III;
- pre-approved all non-audit service contracts with Deloitte & Touche in accordance with its policy;
- received no complaints with regard to accounting practices and the internal audit of the Company, the content or auditing of its financial statements, the internal financial controls of the Company, and any other related matters; and
- advised the Board that, regarding matters concerning the Company's accounting policies, financial control, records and reporting, it concurs that the adoption of the going concern premise in the preparation of the financial statements is appropriate.

Internal financial control and internal audit

In the execution of its delegated duties in this area, the Audit Committee 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;
- reviewed policies and procedures for preventing and detecting fraud; and
- undertaken a deep dive on the requirements of IFRS 9: Financial instruments and reviewed a detailed project plan, including principles, major risks, timelines and resources, in advance of the implementation in 2018.

The head of Internal Audit functionally reported to the Audit Committee, had unrestricted access to the Audit Committee 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 Audit Committee believes that significant internal financial controls are effective.

Audit Committee report continued

for the year ended 31 December 2017

Regulatory compliance

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

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

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

External audit

Based on processes followed and assurances received, the Audit Committee is satisfied that both Deloitte & Touche and the audit partner, D Jorge, are independent of the Bank. The Audit Committee confirmed that no reportable irregularities were identified and reported by the External Auditor in terms of the Auditing Professions Act, No. 26 of 2005.

Based on its satisfaction with the results of the activities outlined above, the Audit Committee has recommended to the Board that Deloitte & Touche should be reappointed for 2018. The reappointment of the External Auditor is subject to approval by the shareholder at the upcoming Annual General Meeting.

Combined assurance

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

Finance function

The Audit Committee received regular reports from the CFO regarding the financial performance of the Company, the tracking and monitoring of key performance indicators, details of budgets, forecasts, long-term plans and capital expenditures, financial reporting controls and processes, and the adequacy and reliability of management information used during the financial reporting process. The Audit Committee believes that the CFO, MEL Teixeira, who is responsible for Finance, possesses the appropriate expertise and experience to meet her responsibilities in that position. We are also satisfied with the expertise and adequacy of resources within the Finance function.

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

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

Annual financial statements

The Audit Committee reviewed and discussed the financial statements, reporting process and financial information included in the financial statements after considering recommendations from the Social, Ethics and Transformation Committee, the Remuneration Committee, the Risk and Capital Management Committee, and the Directors' Affairs Committee.

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

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

On behalf of the Audit Committee

TH Njikizana
Chairman of the Audit Committee

20 March 2018

Directors' report

for the year ended 31 December 2017

The Directors have pleasure in presenting their report, which forms part of the audited annual financial statements of the Company for the year ended 31 December 2017.

Nature of business

The Company is a registered bank, incorporated in the Republic of South Africa, and provides its clients with a full spectrum of domestic and international banking and financial services to niche markets in business, commercial and alliance banking.

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.

Financial results

Details of the financial results are set out on pages 8 to 57 and, in the opinion of the Directors, require no further comment.

Share capital

There were no changes to the authorised and issued share capital of the Company during the current and previous year. The authorised and issued share capital of the Company is detailed in note 20 to the annual financial statements.

Dividends

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

Directors, Company Secretary and registered addresses

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

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

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

T Singh is the Company Secretary.

The registered addresses of the Company are:

Postal
PO Box 782699, Sandton 2146

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

Special resolutions

The following special resolutions were adopted during 2017:

- The approval of the fees and remuneration payable to Non-Executive Directors and Executive Directors;
- Intra-group companies provide financial assistance to each other in the ordinary course of business; and
- The approval of the conversion to equity of the shareholder loan in the wholly owned subsidiary, Mercantile Rental Finance Proprietary Limited.

Change in accounting policy

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

Events after the reporting period

Apart from the dividends declared and the sale of MBHL (refer to note 32 on page 45), no other material events have occurred between the accounting date and the date of this report that require adjustment to the disclosure in the annual financial statements.

Accounting policies

for the year ended 31 December 2017

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

1. Basis of presentation

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

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

Amendments to IAS 7 Disclosure initiative

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

All other IFRSs 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 an asset when it obtains control of a resource as a result of past events and from which future economic benefits are expected to flow to the Company.

2.2 Liabilities

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

2.3 Provisions

A provision is 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 can be made.

2.4 Contingent liabilities

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

3. Financial instruments

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

The 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 the consideration paid, including any non-cash assets transferred or liabilities assumed, is recognised in profit or 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 returns:

- Forward exchange contracts;
- Foreign currency swaps;
- Interest rate swaps; and
- Unlisted equity instruments.

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

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

A derivative's notional principal amount 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 or loss

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

Available-for-sale financial assets

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

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, deposits held by the 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 equity investments which 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 or loss.

Negotiable securities

Negotiable securities consist of government stock and treasury bills.

Government stock acquired prior to 31 December 2014 has been designated as available-for-sale. These assets are measured at fair value at each reporting date, with the resultant gains or losses being recognised in other comprehensive income until sold or otherwise disposed of. At that time, the cumulative gains or losses previously recognised in other comprehensive income are included in profit or loss.

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

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

Loans and advances

Loans and advances principally comprise amounts advanced to third parties in terms of certain products.

Fixed rate loans and advances are designated at fair value through profit or loss, with resultant gains and losses being included in profit or loss.

Variable rate loans and advances are designated as loans and receivables and are measured at amortised cost.

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

Investment in debt securities

Investment in debt securities consists of investments in commercial paper. These assets have been designated as held-to-maturity and are measured at amortised cost.

Other accounts receivable

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

3.3 Financial liabilities

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

3.4 Fair value estimation

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

In assessing the fair value of non-publicly traded financial instruments, the Company uses a variety of valuation methods which take into consideration input assumptions which are based, as far as possible, on objective market information and risks existing at each reporting date. Quoted market prices or dealer quotes for the same or similar instruments are used for the majority of securities, long-term investments and long-term debt. Other valuation techniques, such as earnings multiples, option pricing models, discounted cash flows, replacement cost and net asset values of underlying investee entities, are used to determine fair values.

3.5 Amortised cost

Amortised cost is determined using the effective interest rate method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, the Company estimates cash flows considering all contractual terms of the financial instrument but

Accounting policies continued

for the year ended 31 December 2017

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.

3.6 Impairment

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

Advances 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 policies set 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 or loss.

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

If the recoverable amount of the advance is estimated to be less than the carrying amount, the carrying amount of the advance is reduced to its recoverable amount by recognising a specific impairment expense. Where the impairment subsequently reverses, the carrying amount of the advance is increased to the revised estimate of its recoverable amount, subject to the increased carrying amount not exceeding the carrying amount that would have been determined had no impairment loss been recognised in prior years. The reversal of an impairment is recognised through profit or loss, except for the reversal of an impairment of equity instruments designated as available-for-sale, which reversal is recognised in other comprehensive income.

4. Foreign currency transactions

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

5. Subsidiaries

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

6. 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.

7. Property and equipment

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

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

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

Depreciation of an asset begins when it is available for use and ceases at the earlier of the dates that the asset is classified as held-for-sale or derecognised. The estimated useful lives of 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

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

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

8. Intangible assets

Computer software

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

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

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

At the end of each reporting period, the Company reviews the carrying amounts of intangible assets to determine whether there is any indication of impairment. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment.

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

9. Tax

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

9.1 Current tax

Current tax is determined based on taxable profits for the period. Taxable profit may differ from accounting profit as it may exclude, or include, items of income or expense that are taxable or deductible in other periods, and it would further exclude items that are neither taxable nor deductible. The Company's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date.

9.2 Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases of such items and is determined using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences, and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that sufficient taxable temporary differences or taxable profits will be available against which those deductible temporary differences may be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from initial recognition of goodwill or from a transaction that affects neither the taxable profit nor the accounting profit.

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

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

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset 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.

9.3 Current and deferred tax

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

10. Instalment sales and leases

10.1 The Company as the lessee

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

10.2 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.

11. Interest income and interest expense

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

12. 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.

13. Retirement funds

The Company operates a defined contribution fund that is funded by payments from employees and by the Company.

Accounting policies continued

for the year ended 31 December 2017

The Company contributions to the retirement funds are based on a percentage of the payroll and are charged to profit or loss as accrued.

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

15. Key assumptions and estimates applied by management

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

15.1 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 recognised, the Company makes judgements as to whether there is any observable data indicating a measurable decrease in the estimated future cash flows from a portfolio of loans, before the decrease can be attributed to an individual loan in that portfolio. This evidence may include observable data, indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in the group.

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

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

15.2 Fair value of financial instruments

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

15.3 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.

16. Recent accounting developments

There are a number of new and revised standards in issue that are not yet effective and that the Company has no plans to early adopt. These include the following standards that could be applicable to the business of the Company and may have an impact on future financial statements. Except for IFRS 9 (refer to page 13), the impact of initial application of the following standards and interpretations is not expected to be significant to the Company:

Standard	Standard name and detail	Effective date
IFRS 1 IFRS 12 IAS 28	Amendments resulting from annual improvements 2014 – 2016 cycle	Annual periods beginning on or after 1 January 2018
IFRS 3 IFRS 11 IAS 12 IAS 23	Amendments resulting from annual improvements 2015 – 2017 cycle	Annual periods beginning on or after 1 January 2019
IFRS 2	**Share-based payment:** Amendments to clarify the classification and measurement of share-based payment transactions	Annual periods beginning on or after 1 January 2018
IFRS 4	**Insurance contracts:** Amendments regarding the interaction of IFRS 4 and IFRS 9	Annual periods beginning on or after 1 January 2018
IFRS 7	**Financial instruments:** Additional hedge accounting disclosures	Annual periods beginning on or after 1 January 2018
IFRS 9	**Financial instruments** In July 2014, the IASB issued IFRS 9 Financial instruments, which replaces IAS 39 Financial instruments: Recognition and measurement. IFRS 9, which is effective for the Company for the financial year commencing 1 January 2018, introduces: • a principles-based approach to the classification of financial assets according to an entity's business model and the nature of the cash flows of the asset; • an expected credit loss impairment model for all financial assets not measured at fair value through profit and loss; and • a new hedge accounting model. The Company has assessed all its assets and liabilities against the classification and measurement criteria and, although certain classifications will change, the impact of these changes is not significant. The change from an IAS 39 'incurred loss' model to an IFRS 9 'expected loss' model has resulted in the Company having to build a new model to cater for this. The IFRS 9 model, built during 2017, is still being refined and going through internal governance processes, and has not yet been audited. While we expect a transitional increase in balance sheet provisions in line with the requirements of the standard, management does not anticipate this having a significant impact on the Company's capital adequacy levels. The Company does not apply hedge accounting and hence there is no impact on the Company.	Annual periods beginning on or after 1 January 2018
IFRS 9	**Financial instruments:** Amendments regarding prepayment features with negative compensation and modifications of financial liabilities	Annual periods beginning on or after 1 January 2019
IFRS 10	**Consolidated financial statements:** Amendments regarding the sale or contribution of assets between an investor and its associate or joint venture	Deferred indefinitely
IFRS 15	**Revenue from contracts with customers**	Annual periods beginning on or after 1 January 2018
IFRS 16	**Leases**	Annual periods beginning on or after 1 January 2019
IFRS 17	**Insurance contracts**	Annual periods beginning on or after 1 January 2021
IAS 28	**Investments in associates and joint ventures:** Amendments regarding long-term interests in associates and joint venture	Annual periods beginning on or after 1 January 2019
IAS 40	**Investment property:** Amendments to clarify transfers of property to, or from, investment property	Annual periods beginning on or after 1 January 2018
IFRIC 22	**Foreign currency transactions and advance consideration**	Annual periods beginning on or after 1 January 2018
IFRIC 23	**Uncertainty over income tax treatments**	Annual periods beginning on or after 1 January 2019

Statement of financial position

at 31 December 2017

	Note	2017 R'000	Restated 2016 R'000	Restated 2015 R'000
ASSETS				
Cash and cash equivalents	2	1 710 285	2 212 605	1 564 652
Derivative financial instruments	3	104 016	29 442	56 775
Negotiable securities	4	904 166	509 874	551 494
Loans and advances	5	9 061 243	8 283 617	6 907 838
Other investments	6	6 923	6 651	5 897
Other accounts receivable	7	653 675	269 394	130 118
Non-current assets held-for-sale	8	22 500	–	–
Interest in subsidiaries	9	40 243	137 162	121 154
Investment in debt securities	10	104 220	–	–
Property and equipment	11	49 390	54 250	39 680
Intangible assets	12	153 263	178 446	191 799
Deferred tax assets	13	15 088	804	–
Total assets		12 825 012	11 682 245	9 569 407
EQUITY AND LIABILITIES				
Liabilities		10 544 800	9 563 346	7 593 140
Other accounts payable	14	488 824	253 664	135 716
Current tax payable	15	6 111	7 324	12 245
Provisions and other liabilities	16	116 907	93 328	93 774
Derivative financial instruments	3	128 044	43 731	62 955
Deposits	18	9 341 861	8 477 678	6 726 640
Long-term funding	19	463 053	687 621	556 193
Deferred tax liabilities	13	–	–	5 617
Shareholders' equity		2 280 212	2 118 899	1 976 267
Share capital and share premium	20	1 483 300	1 483 300	1 483 300
Employee benefits reserve		(6 218)	(7 319)	(8 354)
Available-for-sale reserve		5 237	4 778	2 733
Retained earnings		797 893	638 140	498 588
Total equity and liabilities		12 825 012	11 682 245	9 569 407

Statement of comprehensive income

for the year ended 31 December 2017

	Note	2017 R'000	Restated 2016 R'000
Interest income	22	1 077 393	955 495
Interest expense	23	(571 327)	(479 946)
Net interest income		506 066	475 549
Net charge for credit losses	5.4	(30 303)	(32 017)
Net interest income after credit losses		475 763	443 532
Net non-interest income		310 263	270 645
Non-interest income	24	609 275	496 245
Fee and commission expenditure	25	(299 012)	(225 600)
Net interest and non-interest income		786 026	714 177
Operating expenditure	26	(515 810)	(479 492)
Profit before tax		270 216	234 685
Tax	27	(75 237)	(65 936)
Profit after tax		194 979	168 749
Other comprehensive income			
Items that will not be reclassified to profit or loss:			
Gains on remeasurement to fair value		616	3 078
Remeasurement of defined benefit obligation		1 530	1 438
Deferred tax thereon	12	(586)	(1 436)
Other comprehensive income net of tax		1 560	3 080
Total comprehensive income		196 539	171 829
Profit after tax attributable to:			
Equity holder of the Company		194 979	168 749
Total comprehensive income attributable to:			
Equity holder of the Company		196 539	171 829

Statement of changes in equity

for the year ended 31 December 2017

	Share capital R'000	Share premium R'000	Employee benefits reserve R'000	Available-for-sale reserve R'000	Retained earnings R'000	Total R'000
Balance at 1 January 2016 (as previously reported)	124 969	1 358 331	(8 354)	65 010	498 588	2 038 544
Adjustments due to a change in accounting policy (refer to note 29)	–	–	–	(62 277)	–	(62 277)
Balance at 1 January 2016 (restated)	124 969	1 358 331	(8 354)	2 733	498 588	1 976 267
Net movement for the year	–	–	1 035	2 045	139 552	142 632
Total comprehensive income for the year	–	–	1 035	2 045	168 749	171 829
Profit after tax	–	–	–	–	168 749	168 749
Other comprehensive income	–	–	1 438	3 078	–	4 516
Tax relating to other comprehensive income	–	–	(403)	(1 033)	–	(1 436)
Dividend paid	–	–	–	–	(29 197)	(29 197)
Balance at 31 December 2016	124 969	1 358 331	(7 319)	4 778	638 140	2 118 899
Net movement for the year	–	–	1 101	459	159 753	161 313
Total comprehensive income for the year	–	–	1 101	459	194 979	196 539
Profit after tax	–	–	–	–	194 979	194 979
Other comprehensive income	–	–	1 530	616	–	2 146
Tax relating to other comprehensive income	–	–	(429)	(157)	–	(586)
Dividend paid	–	–	–	–	(35 226)	(35 226)
Balance at 31 December 2017	124 969	1 358 331	(6 218)	5 237	797 893	2 280 212

Statement of cash flows

for the year ended 31 December 2017

	Note	2017 R'000	2016 R'000
Cash flows from operating activities			
Cash receipts from customers	28.1	1 696 593	1 452 677
Cash paid to customers, suppliers and employees	28.2	(1 299 418)	(1 115 841)
Cash generated from operations	28.3	397 175	336 836
Tax (paid)	28.4	(91 320)	(78 714)
Net (increase) in income-earning assets	28.5	(1 206 736)	(1 364 837)
Net increase in deposits and other accounts	28.6	698 604	1 688 610
Net cash (outflow)/inflow from operating activities		(202 277)	581 895
Cash flows from investing activities			
Purchase of intangible assets	12	(23 270)	(26 960)
Purchase of property and equipment	11	(9 797)	(30 721)
Proceeds on disposal of property and equipment		120	5 501
Dividends paid		(35 226)	(29 197)
Investment in debt securities	10	(104 220)	–
Decrease in interest in subsidiaries		96 918	16 007
Net cash (outflow) from investing activities		(75 475)	(65 370)
Cash flows from financing activities			
Net (decrease)/increase in long-term funding	19	(224 568)	131 428
Proceeds from long-term borrowings		132 862	246 930
Repayments of long-term borrowings		323 243	115 502
(Gains) on exchange rate movements *		(34 188)	–
Net cash (outflow)/inflow from financing activities		(224 568)	131 428
Net cash (outflow)/inflow for the year		(502 320)	647 953
Cash and cash equivalents at the beginning of the year		2 212 605	1 564 652
Cash and cash equivalents at the end of the year	2	1 710 285	2 212 605

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

Notes to the annual financial statements

for the year ended 31 December 2017

1. Categories and fair values of financial instruments

1.1 Category analysis of financial instruments

	2017		2016	
	Fair value R'000	**Carrying amount R'000**	Fair value R'000	Carrying amount R'000
Assets				
Available-for-sale	6 923	6 923	58 048	58 048
Other investments	6 923	6 923	6 651	6 651
Negotiable securities – Government stock	–	–	51 397	51 397
Held-to-maturity				
Negotiable securities – Government stock	51 093	50 997	204 549	206 314
Investment in debt securities	104 220	104 220	–	–
Amortised cost	12 279 086	12 278 372	11 017 049	11 017 049
Loans and advances				
Current accounts	2 306 130	2 306 130	2 053 556	2 053 556
Credit cards	36 448	36 448	30 946	30 946
Mortgage loans	4 787 057	4 787 057	4 266 096	4 266 096
Instalment sales and leases	609 781	609 781	449 621	449 621
Structured loans	193 683	193 683	210 584	210 584
Medium-term loans	1 128 144	1 128 144	1 272 084	1 272 084
Negotiable securities				
Treasury bills	853 883	853 169	252 163	252 163
Cash and cash equivalents	1 710 285	1 710 285	2 212 605	2 212 605
Other accounts receivable	653 675	653 675	269 394	269 394
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	–	730	730
Held-for-trading				
Derivative financial instruments	104 016	104 016	29 442	29 442
	12 545 338	12 544 528	11 309 818	11 311 583
Liabilities				
Held-for-trading				
Derivative financial instruments	128 044	128 044	43 731	43 731
Amortised cost	10 293 738	10 293 738	9 418 963	9 418 963
Long-term funding	463 053	463 053	687 621	687 621
Deposits	9 341 861	9 341 861	8 477 678	8 477 678
Other accounts payable	488 824	488 824	253 664	253 664
	10 421 782	10 421 782	9 462 694	9 462 694

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 and are carried at amortised cost. For this reason, the carrying amounts at the reporting date approximate the fair value.
- Treasury bills are carried at amortised cost. Fair value is based on quoted market values at the reporting date.
- The fair value of loans and advances that are carried at amortised cost approximate the fair value reported as they bear variable rates of interest. The fair value is adjusted for deterioration of credit quality through the application of the credit impairment models.
- Long-term funding 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 and securities is based on quoted market values at the reporting date.
- The fair value of other financial assets and financial liabilities, excluding derivatives, is determined in accordance with generally accepted pricing models, based on discounted cash flow analysis, using prices from observable current market transactions and adjusted by relevant market pricing.
- The fair value of other investments that are unlisted is determined by reference to the net asset value of the entity and/or the underlying net asset value of its investment holdings.
- Investment in debt securities is carried at amortised cost and approximates the fair value reported as it bears variable rates of interest.
- The fair value of loans and advances, designated at fair value through profit and loss, is calculated using the credit spread observed at origination. The fair value is adjusted for deterioration of credit quality through the application of the credit impairment models.

1.3 Fair value measurements as required by IFRS 13

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

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

Notes to the annual financial statements continued

for the year ended 31 December 2017

1. Categories and fair values of financial instruments continued

1.3 Fair value measurements as required by IFRS 13 continued

	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
2017				
Assets				
Available-for-sale				
Other investments	–	–	6 923	6 923
Negotiable securities – Government stock	–	–	–	–
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	–	–	–
Held-for-trading				
Derivative financial instruments	–	104 016	–	104 016
	–	104 016	6 923	110 939
Liabilities				
Held-for-trading				
Derivative financial instruments	–	128 044	–	128 044
	–	128 044	–	128 044
2016				
Assets				
Available-for-sale				
Other investments	–	–	6 651	6 651
Negotiable securities – Government stock	51 397	–	–	51 397
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	–	730	730
Held-for-trading				
Derivative financial instruments	–	29 442	–	29 442
	51 397	29 442	7 381	88 220
Liabilities				
Held-for-trading				
Derivative financial instruments	–	43 731	–	43 731
	–	43 731	–	43 731

1. Categories and fair values of financial instruments continued

1.4 Reconciliation of Level 3 fair value measurements of financial assets

	2017 R'000	2016 R'000
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning of the year	6 651	5 897
Gains on remeasurement to fair value in other comprehensive income	272	754
Balance at the end of the year	6 923	6 651
Fair value through profit and loss		
Loans and advances – mortgage loans		
Balance at the beginning of the year	730	5 210
Repayment of loans and advances	(730)	(4 732)
Gains on remeasurement to fair value in comprehensive income	–	252
Balance at the end of the year	–	730

2. Cash and cash equivalents

	2017 R'000	2016 R'000
Cash on hand	37 635	37 290
Central Bank balances	328 239	500 587
Money market funds	426 674	1 022 498
Rand-denominated domestic bank balances	156 451	52 259
Foreign currency-denominated bank balances	761 286	599 971
	1 710 285	2 212 605

3. Derivative financial instruments

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
2017				
Held-for-trading				
Foreign exchange contracts	1 085 190	104 016	1 353 728	128 044
Interest rate swaps	–	–	–	–
	1 085 190	104 016	1 353 728	128 044
2016				
Held-for-trading				
Foreign exchange contracts	809 652	29 442	1 156 396	43 731
Interest rate swaps	175	–	175	–
	809 827	29 442	1 156 571	43 731

Notes to the annual financial statements continued

for the year ended 31 December 2017

4. Negotiable securities

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

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

5. Loans and advances

5.1 Product analysis

	2017 R'000	2016 R'000
Amortised cost	9 181 585	8 371 983
Current accounts	2 342 085	2 075 021
Credit cards	39 539	33 971
Mortgage loans	4 819 294	4 303 121
Instalment sales and leases	618 123	456 080
Structured loans	193 874	211 189
Medium-term loans	1 168 670	1 292 601
Fair value through profit and loss		
Mortgage loans	–	730
Gross loans and advances	9 181 585	8 372 713
Less: Portfolio impairments for credit losses	(24 946)	(26 214)
Specific impairments for credit losses	(95 396)	(62 882)
	9 061 243	8 283 617

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

5.2 Maturity analysis

	2017 R'000	2016 R'000
Repayable on demand and maturing within one month	2 446 066	2 153 334
Maturing after one month but within six months	131 148	224 613
Maturing after six months but within 12 months	133 695	54 061
Maturing after 12 months	6 470 676	5 940 705
	9 181 585	8 372 713

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

Notes to the annual financial statements continued

for the year ended 31 December 2017

5. Loans and advances continued

5.3 Detailed product analysis of loans and advances

	Gross amount R'000	Portfolio impairments R'000	Specific impairments R'000	Net balance R'000
2017				
Current accounts	2 342 085	(12 894)	(23 061)	2 306 130
Credit cards	39 539	(549)	(2 542)	36 448
Mortgage loans	4 819 294	(4 752)	(27 485)	4 787 057
Instalment sales and leases	618 123	(2 426)	(5 916)	609 781
Structured loans	193 874	(191)	–	193 683
Medium-term loans	1 168 670	(4 134)	(36 392)	1 128 144
	9 181 585	(24 946)	(95 396)	9 061 243
2016				
Current accounts	2 075 021	(9 212)	(12 253)	2 053 556
Credit cards	33 971	(841)	(2 184)	30 946
Mortgage loans	4 303 851	(4 965)	(32 060)	4 266 826
Instalment sales and leases	456 080	(1 425)	(5 034)	449 621
Structured loans	211 189	(605)	–	210 584
Medium-term loans	1 292 601	(9 166)	(11 351)	1 272 084
	8 372 713	(26 214)	(62 882)	8 283 617

5.4 Impairments for credit losses

	Total R'000	Current accounts R'000	Credit cards R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Medium-term loans R'000
2017							
Balance at the beginning of the year	(89 096)	(21 465)	(3 025)	(37 025)	(6 459)	(605)	(20 517)
Movements for the year							
Credit losses written off	3 743	525	115	2 339	165	–	599
Net impairments (raised)/ released	(34 989)	(15 015)	(181)	2 449	(2 048)	414	(20 608)
Balance at the end of the year	(120 342)	(35 955)	(3 091)	(32 237)	(8 342)	(191)	(40 526)
2016							
Balance at the beginning of the year	(59 464)	(18 151)	(2 381)	(7 177)	(3 660)	(342)	(27 753)
Movements for the year							
Credit losses written off	3 303	1 183	143	547	495	–	935
Net impairments (raised)/ released	(32 935)	(4 497)	(787)	(30 395)	(3 294)	(263)	6 301
Balance at the end of the year	(89 096)	(21 465)	(3 025)	(37 025)	(6 459)	(605)	(20 517)

5. Loans and advances continued

5.4 Impairments for credit losses continued

	2017 R'000	2016 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	(34 989)	(32 935)
Reversal of impairments for properties in possession previously impaired	4 500	–
Recoveries in respect of amounts previously written off	186	918
	(30 303)	(32 017)

5.5 Product analysis of performing loans and advances

	Gross amount R'000	Portfolio impairment R'000	Net balance R'000
2017			
Current accounts	2 281 773	(12 894)	2 268 879
Credit cards	36 997	(549)	36 448
Mortgage loans	4 675 384	(4 752)	4 670 632
Instalment sales and leases	610 909	(2 426)	608 483
Structured loans	193 874	(191)	193 683
Medium-term loans	1 061 908	(4 134)	1 057 774
	8 860 845	(24 946)	8 835 899
2016			
Current accounts	2 051 132	(9 212)	2 041 920
Credit cards	31 787	(841)	30 946
Mortgage loans	4 180 982	(4 965)	4 176 017
Instalment sales and leases	448 057	(1 425)	446 632
Structured loans	211 189	(605)	210 584
Medium-term loans	1 268 132	(9 166)	1 258 966
	8 191 279	(26 214)	8 165 065

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

	2017 R'000	2016 R'000
Current accounts	2 261 928	1 998 680
Credit cards	36 997	31 787
Mortgage loans	4 439 397	4 156 120
Instalment sales and leases	610 909	448 057
Structured loans	193 874	210 902
Medium-term loans	1 025 149	1 173 963
	8 568 254	8 019 509

Notes to the annual financial statements continued

for the year ended 31 December 2017

5. Loans and advances continued

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

	2017 R'000	2016 R'000
Current accounts	19 845	52 452
Credit cards	–	–
Mortgage loans	235 987	24 862
Instalment sales and leases	–	–
Structured loans	–	287
Medium-term loans	36 759	94 169
	292 591	171 770

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

	Past due for				
	1 – 30 days R'000	31 – 60 days R'000	61 – 90 days R'000	Total gross amount R'000	Fair value of collateral and other credit enhance-ments R'000
2017					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	12 429	49 833	2 097	64 359	43 576
Instalment sales and leases	–	3 018	16	3 034	1 853
Structured loans	–	–	–	–	–
Medium-term loans	–	4 575	–	4 575	–
	12 429	57 426	2 113	71 968	45 429
2016					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	21 531	15 546	9 557	6 226	38 263
Instalment sales and leases	138	404	–	2 315	466
Structured loans	–	–	–	–	–
Medium-term loans	3 555	–	38 062	37 436	35 280
	25 224	15 950	47 619	45 977	74 009

5. Loans and advances continued

5.9 Product analysis of loans and advances that are individually impaired

	Gross amount R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhance-ments R'000
2017				
Current accounts	60 312	(23 061)	37 251	48 519
Credit cards	2 542	(2 542)	–	–
Mortgage loans	143 910	(27 485)	116 425	165 811
Instalment sales and leases	7 214	(5 916)	1 298	1 530
Structured loans	–	–	–	–
Medium-term loans	106 762	(36 392)	70 370	94 674
	320 740	(95 396)	225 344	310 534
2016				
Current accounts	23 889	(12 253)	11 636	15 120
Credit cards	2 184	(2 184)	–	–
Mortgage loans	122 869	(32 060)	90 809	114 889
Instalment sales and leases	8 023	(5 034)	2 989	3 076
Structured loans	–	–	–	–
Medium-term loans	24 469	(11 351)	13 118	15 508
	181 434	(62 882)	118 552	148 593

5.10 Collateral held as security and other credit enhancements

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

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

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

Notes to the annual financial statements continued

for the year ended 31 December 2017

5. Loans and advances continued

5.10 Collateral held as security and other credit enhancements continued

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 and in compliance with the applicable Court rules and directives.

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

6. Other investments

	2017 R'000	2016 R'000
Available-for-sale		
Unlisted equities	6 923	6 651
	6 923	6 651

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

7. Other accounts receivable

	2017 R'000	2016 R'000
Items in transit	269 231	164 437
Loan to fellow subsidiary (refer to note 30.2)	111	41
Prepayments and deposits	18 018	16 195
Properties in possession	–	18 550
Structured loans accrued income	11 076	9 996
Other receivables	355 239	60 175
	653 675	269 394

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

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

Structured loans accrued income relates to the present value of future cash flows.

Properties in possession has been reclassified to non-current assets held for sale (refer to note 8).

8. Non-current assets held for sale

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

The Bank purchased this property out of a loan default during 2012. An offer to purchase was received during 2017 and, although certain suspensive conditions remain to be met, the property has been accounted for at the offer to purchase value. The property was previously disclosed under other accounts receivable (refer to note 7).

9. Interest in subsidiaries

	2017 R'000	Restated 2016 R'000
Unlisted		
Shares at cost	107 195	31 482
Portion 2 of Lot 8 Sandown Proprietary Limited	98	98
Mercantile Rental Finance Proprietary Limited	107 097	31 384
Loans (from)/to subsidiaries	(66 952)	105 680
Portion 2 of Lot 8 Sandown Proprietary Limited	(66 952)	(64 140)
Mercantile Rental Finance Proprietary Limited	–	169 820
	40 243	137 162

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

The loan from Portion 2 of Lot 8 Sandown Proprietary Limited bears interest at prevaling market rates for the current and prior year and is repayable on demand.

The loan to Mercantile Rental Finance Proprietary Limited bears interest at 12% (2016: 12%) and was repaid in June 2017.

10. Investment in debt securities

	2017 R'000	2016 R'000
Investment in Compass Securitisation (RF) Limited D notes	104 220	–
	104 220	–

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

During 2017 the Bank invested in "D" notes commercial paper in the securitisation vehicle of Mercantile Rental Finance Proprietary Limited. The notes are unsecured, mature on 6 June 2020 and the interest on the notes is linked to JIBAR.

Notes to the annual financial statements continued

for the year ended 31 December 2017

11. Property and equipment

	Leasehold improvements R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
2017						
Open market value/cost at the beginning of the year	13 280	53 210	12 411	29 896	954	109 751
Additions	2 061	6 627	445	664	–	9 797
Disposals	(2 925)	(404)	(546)	(2 929)	(173)	(6 977)
Transfer	928	(70)	(681)	(177)	–	–
Open market value/cost at the end of the year	13 344	59 363	11 629	27 454	781	112 571
Accumulated depreciation and impairment losses at the beginning of the year	(4 550)	(29 261)	(3 327)	(17 784)	(579)	(55 501)
Depreciation – disclosed in operating expenditure	(1 681)	(3 776)	(1 142)	(4 118)	(172)	(10 889)
Depreciation – disclosed in fee and commission expenditure	–	(3 606)	–	–	–	(3 606)
Disposals	2 876	392	503	2 871	173	6 815
Transfer	(275)	38	150	87	–	–
Accumulated depreciation and impairment losses at the end of the year	(3 630)	(36 213)	(3 816)	(18 944)	(578)	(63 181)
Net carrying amount at the end of the year	9 714	23 150	7 813	8 510	203	49 390
2016						
Open market value/cost at the beginning of the year	11 463	35 825	11 597	29 610	834	89 329
Additions	3 761	22 681	1 444	2 578	257	30 721
Disposals	(1 944)	(5 296)	(630)	(2 292)	–	(10 162)
Write-off of obsolete assets	–	–	–	–	(137)	(137)
Open market value/cost at the end of the year	13 280	53 210	12 411	29 896	954	109 751
Accumulated depreciation and impairment losses at the beginning of the year	(4 708)	(26 018)	(2 827)	(15 688)	(408)	(49 649)
Depreciation - disclosed in operating expenditure	(1 263)	(3 684)	(1 115)	(4 283)	(171)	(10 516)
Depreciation - disclosed in fee and commission expenditure	–	(986)	–	–	–	(986)
Disposals	1 421	1 427	615	2 187	–	5 650
Accumulated depreciation and impairment losses at the end of the year	(4 550)	(29 261)	(3 327)	(17 784)	(579)	(55 501)
Net carrying amount at the end of the year	8 730	23 949	9 084	12 112	375	54 250

12. Intangible assets

	2017 R'000	2016 R'000
Computer software		
Cost at the beginning of the year	381 772	354 824
Additions	23 270	26 960
Write-off of obsolete computer software	(206)	(12)
Cost at the end of the year	404 836	381 772
Accumulated amortisation and impairment losses at the beginning of the year	(203 326)	(163 025)
Amortisation	(48 453)	(40 313)
Write-off of obsolete computer software	206	12
Accumulated amortisation and impairment losses at the end of the year	(251 573)	(203 326)
Net carrying amount at the end of the year	153 263	178 446

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

13. Deferred tax assets

	2017 R'000	Restated 2016 R'000
Balance at the beginning of the year	804	(5 617)
Current year charge		
Per the statement of comprehensive income	14 870	7 857
Per the statement of changes in equity/other comprehensive income	(586)	(1 436)
	15 088	804
Tax effects of temporary differences between tax and book value for:		
Intangible assets	(23 232)	(31 281)
Provisions and other liabilities	20 509	18 246
Impairments on loans and advances	5 953	7 004
Leased assets	2 785	2 330
Revaluations	(1 511)	(1 355)
Current assets	10 584	5 860
	15 088	804

Notes to the annual financial statements continued

for the year ended 31 December 2017

14. Other accounts payable

	2017 R'000	2016 R'000
Loan from the holding company (refer to note 30.2)	–	53
Accruals	39 786	26 094
Product-related credits	436 709	134 976
Sundry creditors	12 329	92 541
	488 824	253 664

15. Current tax payable

	2017 R'000	2016 R'000
South African Revenue Service		
Income tax payable	6 111	7 324

16. Provisions and other liabilities

	Deferred bonus scheme R'000	Staff incentives R'000	Audit fees R'000	Post-retirement medical benefits R'000	Leave pay R'000	Other risks R'000	Total R'000
At 1 January 2016	8 378	23 766	4 576	22 080	12 240	22 734	93 774
Provision raised	19 201	30 737	8 011	1 875	4 173	1 536	65 533
Reversal of provision	–	–	–	–	–	(1 944)	(1 944)
Charged to provision	(3 453)	(23 209)	(8 550)	(3 331)	(3 351)	(22 141)	(64 035)
At 31 December 2016	24 126	31 294	4 037	20 624	13 062	185	93 328
Provision raised	29 786	36 151	8 426	1 980	8 766	1 363	86 472
Reversal of provision	–	–	–	–	–	(1 236)	(1 236)
Charged to provision	(12 998)	(30 028)	(8 187)	(3 570)	(6 866)	(8)	(61 657)
At 31 December 2017	40 914	37 417	4 276	19 034	14 962	304	116 907

Post-retirement medical benefits

Refer to note 17 for detailed disclosure of this provision.

Leave pay

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

Other risks

Consists of provisions for legal claims and other risks. At any time, there are legal or potential claims against the 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.

17. Post-retirement medical benefits

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

	2017 R'000	2016 R'000
The amounts recognised in the statement of financial position are as follows (refer to note 16):		
Present value of total service liabilities	19 034	20 624
Liability in the statement of financial position	19 034	20 624
The amounts recognised in the statement of comprehensive income are as follows:		
Net interest cost (refer to note 23)	1 805	1 853
Staff cost (refer to note 26)	(1 865)	(1 871)
Current service cost	7	22
Benefits paid	(1 872)	(1 893)
Total included in comprehensive income	(60)	(18)
The amounts recognised in the statement of other comprehensive income are as follows :		
Remeasurement of defined benefit obligation	(1 530)	(1 438)
Total included in other comprehensive income	(1 530)	(1 438)
Reconciliation of the movement in the present value of total service liabilities:		
At the beginning of the year	20 624	22 080
Current service cost	7	22
Interest costs	1 805	1 853
Remeasurement of defined benefit obligation	(1 530)	(1 438)
Employer benefit payments	(1 872)	(1 893)
At the end of the year	19 034	20 624
The principal actuarial assumptions used were as follows:		
Discount rate	9,6%	9,2%
Rate of medical inflation	8,5%	8,6%
Salary inflation	8,0%	8,1%

The effect of a 1% increase/decrease on the assumed rate of medical inflation would be an increase in the liability in an amount of R1,880 million (2016: R1,967 million) and a decrease of R1,615 million (2016: R1,677 million), respectively.

Notes to the annual financial statements continued

for the year ended 31 December 2017

18. Deposits

	2017 R'000	2016 R'000
Call deposits and current accounts	5 121 481	4 600 594
Savings accounts	187 990	179 471
Term and notice deposits	3 419 534	3 072 704
Negotiable certificates of deposit	23 423	22 246
Foreign deposits	589 433	602 663
	9 341 861	8 477 678
Maturity analysis		
Repayable on demand and maturing within one month	6 530 923	5 800 294
Maturing after one month but within six months	1 229 008	1 287 751
Maturing after six months but within 12 months	259 686	314 387
Maturing after 12 months	1 322 244	1 075 246
	9 341 861	8 477 678

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

19. Long-term funding

	2017 R'000	2016 R'000
International Finance Corporation (IFC)	90 945	207 017
Short-term portion payable in the next 12 months	90 945	117 053
Portion payable after 12 months but within five years	–	89 964
Banco Nacional Ultramarino S.A. (BNU Macau)	247 737	480 604
Short-term portion payable in the next 12 months	247 737	–
Portion payable after 12 months but within five years	–	480 604
Bank One Limited		
Short-term portion payable in the next 12 months	124 371	–
	463 053	687 621
Long-term funding before non-cash movements	497 241	687 621
Exchange rate (gains)	(34 188)	*
	463 053	687 621

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

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

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

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

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

20. Share capital and share premium

20.1 Issued

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
At 31 December 2016 and 31 December 2017	62 484 352	124 969	1 358 331	1 483 300

20.2 Authorised

The total authorised number of ordinary shares is 62 630 000 shares (2016: 62 630 000 shares) with a par value of R2,00 per share.

20.3 Unissued

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

20.4 Rights, preferences and restrictions of shares

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

21. Contingent liabilities and commitments

21.1 Guarantees, letters of credit and committed undrawn facilities

	2017 R'000	2016 R'000
Guarantees	673 249	547 473
Lending-related	745	1 631
Mortgage	212 206	175 017
Performance	460 298	370 825
Letters of credit	10 144	20 979
Committed undrawn facilities	142 185	302 372
	825 578	870 824

21.2 Commitments under operating leases

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

	2017 R'000	2016 R'000
Property rentals		
Due within one year	29 982	27 046
Due between one and five years	91 008	15 731
	120 990	42 777
After-tax effect on operating leases	87 113	30 799

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.

Notes to the annual financial statements continued

for the year ended 31 December 2017

22. Interest income

	2017 R'000	2016 R'000
Loans to subsidiaries and fellow subsidiaries	53 103	42 301
Loans and receivables at amortised cost	1 011 035	886 785
Cash and cash equivalents	97 375	83 802
Negotiable securities	27 660	8 157
Loans and advances	886 000	794 826
Loans and receivables designated as available-for-sale		
Negotiable securities	2 430	10 568
Loans and receivables designated as held-to-maturity		
Negotiable securities	10 825	15 561
Loans and receivables designated at fair value through profit and loss		
Loans and advances	–	280
	1 077 393	955 495

23. Interest expense

	2017 R'000	2016 R'000
Deposits	497 339	427 423
Long-term funding	72 159	50 613
Held-for-trading - Interest rate swaps	–	26
Net interest on defined benefit obligation	1 812	1 853
Other	17	31
	571 327	479 946

24. Non-interest income

	2017 R'000	2016 R'000
Fee and commission income		
Loans and receivables	386 739	315 687
Trading income	222 536	180 558
Held-for-trading	222 536	180 586
Foreign currency	222 536	180 577
Derivative assets and liabilities	–	9
Designated at fair value through profit and loss	–	(28)
Loans and advances	–	(28)
	609 275	496 245

25. Fee and commission expenditure

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

26. Operating expenditure

	2017 R'000	2016 R'000
Amortisation (refer to note 12)	48 453	40 313
Auditors' remuneration		
Audit fees – Current year	8 426	8 011
– Prior year	–	150
Fees for other services – Tax advisory fees	324	239
– Regulatory reviews	75	–
– Other	–	35
	8 825	8 435
Depreciation (refer to note 11)	10 889	10 516
Directors' remuneration (refer to note 30.3)		
Executive Directors	17 947	17 037
Non-Executive Directors' fees	4 484	4 231
	22 431	21 268
Indirect tax		
Non-claimable value added tax	16 627	15 166
Skills development levy	2 303	2 044
	18 930	17 210
Loss/(Profit) on sale and write-off of intangible assets and property and equipment	42	(852)
Marketing	8 620	7 806
Operating leases for premises and other related costs	33 418	31 688
Other operating costs	41 259	51 829
Professional fees		
Consulting	2 698	1 443
Legal and collection	2 422	3 581
Computer consulting and services	50 997	49 967
	56 117	54 991
Staff costs		
Salaries, allowances and incentives	233 621	213 251
Post-retirement medical benefits (refer to notes 16 and 17)	(1 865)	(1 871)
Deferred bonus scheme	29 786	19 201
Other	5 284	5 707
	266 826	236 288
Total operating expenditure	515 810	479 492
Number of persons employed by the Company at year-end	470	479

Notes to the annual financial statements continued

for the year ended 31 December 2017

27. Tax

	2017 R'000	2016 R'000
South African normal tax	90 107	73 793
Current year	90 107	73 076
Prior year	–	717
Deferred tax	(14 870)	(7 857)
Current year	(14 373)	(7 429)
Prior year	(497)	(428)
	75 237	65 936
Direct tax		
South African normal tax	90 107	73 793
South African tax rate reconciliation		
South African standard tax rate (%)	28,00	28,00
Expenses not deductible for tax purposes (%)	0,04	0,03
Additional allowances for tax purposes (%)	(0,0)	(0,07)
(Over)/Underprovision prior year (%)	(0,18)	0,13
Effective tax rate (%)	27,84	28,10

28. Notes to statement of cash flows

	2017 R'000	2016 R'000
28.1 Cash receipts from clients		
Interest income	1 077 393	955 495
Non-interest income	609 275	496 245
Adjusted for: Revaluation of fair value financial instruments	9 739	19
Recoveries in respect of amounts previously written off	186	918
	1 696 593	1 452 677
28.2 Cash paid to customers, suppliers and employees		
Interest expense	(571 327)	(479 946)
Operating expenditure and fee and commission expenditure	(814 822)	(705 092)
Adjusted for: Amortisation	48 453	40 313
Depreciation	14 495	11 502
Write-off of obsolete property and equipment	162	4 649
Loss/(Profit) on sale and write-off of intangible assets and property and equipment	42	(852)
Deferred bonus scheme expense	29 786	19 201
(Decrease) in provisions and other liabilities	(6 207)	(5 616)
	(1 299 418)	(1 115 841)
28.3 Reconciliation of profit before tax to cash generated from operations		
Profit before tax	270 216	234 685
Profit before tax adjusted for:		
Revaluation of fair value financial instruments	9 739	19
Net impairments raised	30 489	32 935
Amortisation	48 453	40 313
Depreciation	14 495	11 502
Write-off of obsolete property and equipment	162	4 649
Loss/(Profit) on sale and write-off of intangible assets and property and equipment	42	(852)
Deferred bonus scheme expense	29 786	19 201
(Decrease) in provisions and other liabilities	(6 207)	(5 616)
Cash generated from operations	397 175	336 836
28.4 Tax		
Amounts (underpaid) at the beginning of the year	(7 324)	(12 245)
Statement of comprehensive income (charge)	(90 107)	(73 793)
Less: Amounts underpaid at the end of the year	6 111	7 324
Total tax (paid)	(91 320)	(78 714)

Notes to the annual financial statements continued

for the year ended 31 December 2017

28. Notes to statement of cash flows continued

	2017 R'000	2016 R'000
28.5 Net movement in income-earning assets		
(Increase)/Decrease in negotiable securities	(394 121)	43 896
(Increase) in loans and advances	(812 615)	(1 408 733)
Net (increase) in income-earning assets	(1 206 736)	(1 364 837)
28.6 Net movement in deposits and other accounts		
Increase in deposits	864 183	1 711 108
(Increase) in other accounts receivable	(402 281)	(135 823)
Increase in other accounts payable	236 702	113 325
Net increase in deposits and other accounts	698 604	1 688 610

29. Change in accounting policy

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

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

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

	2017 R'000	2016 R'000
Effect on the statement of other comprehensive income		
Gains on remeasurement to fair value on financial assets designated as available-for-sale	–	(14 146)
Tax relating to other comprehensive income	–	4 138
Net decrease in other comprehensive income	–	(10 008)

	2017 R'000	2016 R'000	2015 R'000
Effect on the statement of financial position			
Assets			
Decrease in Interest in subsidiaries	–	(84 769)	(70 623)
Reconciled as follows:			
Opening balance of interest in subsidiaries as previously reported	–	84 867	70 721
Adjustment as a result of the change in accounting policy	–	(84 769)	(70 623)
Closing balance of interest in subsidiaries as a result of the effect of the change in accounting policy	–	98	98
Liabilities			
Decrease in deferred tax liabilities	–	(12 484)	(8 346)
Equity			
Decrease in available-for-sale reserves	–	(72 285)	(62 277)

30. Related party information

30.1 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 Payment Solutions Proprietary Limited) and Directors are related parties. Other than as listed below, there are no other related parties with whom transactions have taken place.

30.2 Related party balances and transactions

The Company, in the ordinary course of business, enters into various financial services transactions with related parties.

	2017 R'000	2016 R'000
Balances with the holding company, direct and fellow subsidiaries and joint venture		
Loans to/(from) subsidiaries		
Portion 2 of Lot 8 Sandown Proprietary Limited	(66 952)	(64 140)
Mercantile Rental Finance Proprietary Limited	483 230	479 250
Shareholder loan (refer to note 9)*	–	169 820
Current account (included as part of loans and advances - refer to note 5)	483 230	309 430
	416 278	415 110
Loans to/(from) the holding company, fellow subsidiary and joint venture		
Mercantile Bank Holdings Limited	–	(53)
Mercantile Insurance Brokers Proprietary Limited	111	41
Mercantile Payment Solutions Proprietary Limited	2 971	2 292
	3 082	2 280
Investment in debt securities		
Compass Securitisation (RF) Limited	104 220	–
Deposits from the holding company, subsidiary, fellow subsidiary and joint venture		
Mercantile Bank Holdings Limited	4 159	4 134
The Mercantile Bank Foundation (NPC)	41	39
Mercantile Insurance Brokers Proprietary Limited	485	463
Mercantile Payment Solutions Proprietary Limited	140	96
	4 825	4 732

** During 2017, the shareholder loan to Mercantile Rental Finance Proprietary Limited was repaid, partly in cash and partly by the issue of new no par value shares.*

Notes to the annual financial statements continued

for the year ended 31 December 2017

30. Related party information continued

30.2 Related party balances and transactions (continued)

	2017 R'000	2016 R'000
Transactions with the holding company, direct and fellow subsidiaries and joint venture		
Interest received from:		
Portion 2 of Lot 8 Sandown Proprietary Limited	–	245
Mercantile Rental Finance Proprietary Limited	43 265	42 056
Compass Securitisation (RF) Limited	9 838	–
Interest paid to:		
Portion 2 of Lot 8 Sandown Proprietary Limited	2 618	209
Mercantile Insurance Brokers Proprietary Limited	–	11
Non-interest income earned from:		
Mercantile Rental Finance Proprietary Limited	736	314
Mercantile Payment Solutions Proprietary Limited	67 328	55 769
Dividends paid to:		
Mercantile Bank Holdings Limited	35 226	29 197
Donations paid to:		
The Mercantile Bank Foundation (NPC)	915	1 161
Operating expenditure paid to:		
Portion 2 of Lot 8 Sandown Proprietary Limited	23 311	21 860

30. Related party information continued

30.2 Related party balances and transactions (continued)

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

Notes to the annual financial statements continued

for the year ended 31 December 2017

30. Related party information continued

30.3 Director and Director-related activities

There were no material transactions with the 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 contri-butions R'000	Perfor-mance bonus^ R'000	Total R'000
2017							
Non-Executive Directors							
GP de Kock	1 219	–	–	–	–	–	1 219
L Hyne	836	–	–	–	–	–	836
AT Ikalafeng	708	–	–	–	–	–	708
DR Motsepe	796	–	–	–	–	–	796
TH Njikizana	925	–	–	–	–	–	925
Executive Directors							
RS Caliço	–	3 290	–	646	–	2 000	5 936
KR Kumbier	–	3 881	2 862	–	661	4 607	12 011
	4 484	7 171	2 862	646	661	6 607	22 431
2016							
Non-Executive Directors							
GP de Kock	1 150	–	–	–	–	–	1 150
L Hyne	789	–	–	–	–	–	789
AT Ikalafeng	668	–	–	–	–	–	668
DR Motsepe	751	–	–	–	–	–	751
TH Njikizana	873	–	–	–	–	–	873
Executive Directors							
RS Caliço	–	3 015	–	578	85	1 800	5 478
KR Kumbier	–	3 887	2 700	–	622	4 350	11 559
	4 231	6 902	2 700	578	707	6 150	21 268

** Refer to page 45 for nature of the role-based allowance.*

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

30. Related party information continued

30.3 Director and Director-related activities continued

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

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

Service agreements

KR Kumbier, CEO

Mr Kumbier was employed by Mercantile as Executive Director: Finance and Business on 1 June 2010. He was subsequently appointed as Deputy CEO (effective 1 April 2012), and thereafter as CEO from 1 April 2013. The Remuneration Committee's annual bonus decision for Mr Kumbier considered performance during the year against 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, particularly in building and embedding a strong leadership team.

RS Caliço, Deputy CEO

Mr Caliço has been seconded to Mercantile by CGD and took up office at Mercantile on 1 July 2014 as Executive Director. In July 2015, Mr Caliço was appointed the Deputy CEO of the Bank. In terms of his service agreement, Mr Caliço has agreed to perform such duties, functions and services as are assigned to him from time to time by the Board of Directors and which are consistent and commensurate with his position as Executive Director/Deputy CEO.

31. Going concern

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

32. Events after the reporting period

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

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

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

Risk management and control

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 became 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 related policies and procedures are reviewed and stress tested to adapt to changing circumstances. Risks inherent to existing activities are maintained within the approved risk tolerance levels, thereby optimising the risk return parameters for the creation of sustainable growth and value for all stakeholders.

In any economy there are sectors that are more vulnerable to cyclical downturns than others. Changing economic variables are monitored to assist in managing exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a balanced portfolio. However, the Bank acknowledges the potential for concentration risk and this is carefully monitored and, where appropriate, corrective action is taken. Our business development efforts are focused on the stronger companies and individuals within established policy criteria, which policy serves to eliminate weaker credit from the portfolio. The 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 Framework within a Risk Management Monitoring and Control Framework has been implemented to ensure that all business and operational risks are managed effectively within acceptable risk profiles, policies and parameters. Risk management policies are essentially conservative with proper regard to the mix of risk and reward. Existing policies, methodologies, processes, systems and infrastructure are frequently evaluated for relevance and to ensure that they remain at the forefront of risk management and in line with regulatory developments and emerging best practices. The 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, *inter alia*:

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

Enterprise-wide Risk Management Framework

An Enterprise-wide Risk Management Framework is adopted to ensure appropriate and focused management of all risks. Risk assessment is a dynamic process and is reviewed regularly in line with changing circumstances. Risk dimensions vary in importance, depending upon the business activities of an organisation and the related risks. The overall objective of Enterprise-wide Risk Management Framework 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, 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 procedure manuals are subject to ongoing review and are signed off, at least annually, by the relevant business unit heads. These standards are an integral part of the 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 and control self-assessment process ensure alignment and consistency in the way that prevalent risk types are identified and managed, and form part of the various phases of the risk management life cycle, defined as:

Risk identification (and comprehension)

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

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

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

To consider risk appetite and the alignment against broader financial targets, the Bank mainly considers the levels of earnings, growth and volatility that it is willing to accept from certain risks that are core to its business. Economic and regulatory capital required for such transactions is also considered, together with the resultant return on the required capital. The 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 applicable stress testing. Critical variables are sensitive to market changes, both domestic and international. These are identified and modelled to determine the possible impact of any deterioration of such identified variables on the 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	Reputational risk
Currency risk	Legal risk
Liquidity risk	Fraud risk
Interest rate risk	International risk
Market (position) risk	Political risk
Solvency risk	Competitive risk
Operational risk	Pricing risk
Technology (including cyber) risk	Compliance risk
Investment risk	Market conduct risk

The responsibility for understanding the risks incurred by the 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 and within laid-down parameters, delegated to line heads and line managers 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 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.

Risk management and control continued

The top risks are re-evaluated quarterly and any changes are approved by the RMC. Business and operating units are integrally involved in the process in both risk identification and evaluation.

The 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 ALCO (which incorporates capital management), under the auspices of the RMC, proactively evaluates and manages the capital requirements of the Bank as determined by internal assessments and regulatory requirements. A comprehensive re-evaluation of the capital requirements under the ICAAP is regularly undertaken with consideration being given to all risks impacting the need for capital reserves within the 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

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

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

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

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

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

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

The Bank continues to adopt a conservative approach to credit granting, within a specifically defined and structured approval process. The granting of credit is managed via a mandated approval process, whereby levels of credit approval are determined by the experience of the mandated individual, with dual or multiple sign-off on all material values.

An ongoing weekly review is also undertaken by the CREDCOM of all new and renewal proposals for lending in excess of R2 million (in aggregate). This meeting covers a wide variety of topics that includes reporting on excess reports, arrear reports, security-related matters, possible changes in risk grades, and any other relevant credit-related matters requiring a specific mention or discussion. Adverse behavioural patterns, such as continual excesses above approved limits, are monitored closely by the Credit Department and discussed at the weekly CREDCOM meeting with appropriate actions being taken. Identified accounts with continued behavioural concerns and/or financial underperformance are monitored by way of 'Watch List' reporting.

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

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

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

The table below summarises the 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
2017				
Current accounts	2 342 085	–	–	2 342 085
Credit cards	39 539	84 164	–	123 703
Mortgage loans	4 819 294	58 021	–	4 877 315
Instalment sales and leases	618 123	–	–	618 123
Structured loans	193 874	–	–	193 874
Medium-term loans	1 168 670	–	–	1 168 670
Negotiable securities	–	–	904 166	904 166
Cash and cash equivalents	–	–	1 710 285	1 710 285
Guarantees	–	–	673 249	673 249
Letters of credit	–	–	10 144	10 144
	9 181 585	142 185	3 297 844	12 621 614
2016				
Current accounts	2 075 021	196 236	–	2 271 257
Credit cards	33 971	78 888	–	112 859
Mortgage loans	4 303 851	27 248	–	4 331 099
Instalment sales and leases	456 080	–	–	456 080
Structured loans	211 189	–	–	211 189
Medium–term loans	1 292 601	–	–	1 292 601
Negotiable securities	–	–	509 874	509 874
Cash and cash equivalents	–	–	2 212 605	2 212 605
Guarantees	–	–	547 473	547 473
Letters of credit	–	–	20 979	20 979
	8 372 713	302 372	3 290 931	11 966 016

Risk management and control continued

Operational risk

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

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

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

- documented operational policies, processes and procedures with segregation of duties;
- ongoing training and up-skilling of staff on operational procedures and legislative compliance;
- an internal operational loss database, wherein all losses associated with operational issues, including theft and robbery, are recorded and evaluated to facilitate corrective action;
- development of appropriate risk mitigation actions in line with the 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 operational environments;
- conducting monitoring and reviews by both the Compliance and Internal Audit functions, in line with annual plans approved by the Board;
- comprehensive data security and protection;
- ongoing review of the Bank-wide risk and control self-assessment process, rolled out to job functional level in high-risk operational processing areas;
- ongoing review of key risk indicators as a tool to further assist with risk identification and assessment;
- the Bank has embarked on a programme to comply with the requirements of BCBS 239 to ensure accurate, complete, consistent and timely risk information. The Board is fully supportive of this project and has committed human and financial resources;
- limiting access to systems and enforcing strong password controls; and
- a comprehensive insurance programme to safeguard the 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 (BASA) operational risk forum as well as of industry working groups tasked with investigating and making recommendations to BASA on topical issues.

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

Technology risk

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

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

The following key milestones were achieved during the year:

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

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

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

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

Market risk

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

The 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 such action. 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 this 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 client positions is, however, modelled to take cognisance of credit risks associated with volatility in foreign currency exchange rates, with the purpose of covering adverse positions by calling for initial and variation margins. A detailed sensitivity analysis is performed for interest rate and liquidity risk (described on pages 52 to 56).

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 Bank's Treasury system. Various conservative prudential risk limits are in place and associated exposures relating thereto are reported to the ALCO, RMC and Board on a regular basis.

Foreign currency risk

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

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

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

Risk management and control continued

Interest rate risk

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

The Bank is exposed to interest rate risk as it takes deposits from clients at both fixed and variable 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 the management of interest rate risk is to ensure a higher degree of interest rate margin stability and lower interest rate risk over an interest rate cycle. This is achieved by hedging material exposures and by not allowing any intentional proprietary interest rate positions. Under interest rate swap contracts, the Bank agrees to exchange the difference between fixed and variable 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 repricing 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 repricing 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.

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

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

At the reporting date, a 50 basis-point change in prevailing interest rates was applied as a sensitivity analysis to determine the impact on earnings as a result of a change in interest rates. If interest rates increased/decreased by 50 basis points, and all other variables remained constant, the Bank's net profit and equity at year-end would increase by R10,7 million or decrease by R16,5 million, respectively (2016: increase/decrease by R8,3 million/R14,7 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 table below summarises the Bank's exposure to interest rate risk. Assets and liabilities are included at carrying amounts, categorised by the earlier of contractual repricing or maturity dates, and also indicate their effective interest rates at year-end. The repricing profile indicates that the Bank remains asset-sensitive, although to a lesser extent than previously, as interest-earning assets reprice sooner than interest-paying liabilities, before and after derivative hedging activities. Thus, future net interest income remains vulnerable to a decrease in market interest rates.

	Up to 1 month R'000	1 to 3 months R'000	3 to 12 months R'000	1 to 5 years R'000	Non-interest-sensitive R'000	Total R'000	Effective interest rate %
2017							
Assets							
Cash and cash equivalents	678 238	–	–	–	1 032 047	1 710 285	5,7
Derivative financial instruments	–	–	–	–	104 016	104 016	–
Negotiable securities	29 901	197 674	650 829	25 762	–	904 166	8,9
Loans and advances	9 272 796	–	–	–	(211 553)	9 061 243	10,6
Other accounts receivable	–	–	–	–	653 675	653 675	–
Non-current assets held for sale	–	–	–	–	22 500	22 500	–
Other investments	–	–	–	–	6 923	6 923	–
Interest in subsidiaries	(66 951)		–	–	107 194	40 243	–
Investment in debt securities	–	104 220	–	–	–	104 220	16,7
Property and equipment	–	–	–	–	49 390	49 390	–
Intangible assets	–	–	–	–	153 263	153 263	–
Deferred tax assets	–	–	–	–	15 088	15 088	–
Total assets	9 913 985	301 894	650 829	25 762	1 932 540	12 825 012	
Equity and liabilities							
Other accounts payable	–	–	–	–	488 824	488 824	–
Derivative financial instruments	–	–	–	–	128 044	128 044	–
Current tax payable	–	–	–	–	6 111	6 111	–
Provisions and other liabilities	–	–	–	–	116 907	116 907	–
Deposits	6 599 607	317 916	455 727	144 971	1 823 640	9 341 861	5,7
Long-term funding	372 108	87 485	–	–	3 460	463 053	10,2
Deferred tax liabilities	–	–	–	–	–	–	–
Total equity	–	–	–	–	2 280 212	2 280 212	–
Total equity and liabilities	6 971 715	405 401	455 727	144 971	4 847 198	12 825 012	
Financial position interest sensitivity gap	2 942 270	(103 507)	195 102	(119 209)		2 914 656	
Derivative financial instruments	–	–	–	–		–	
Total net interest sensitivity gap	2 942 270	(103 507)	195 102	(119 209)		2 914 656	

Risk management and control continued

	Up to 1 month R'000	1 to 3 months R'000	3 to 12 months R'000	1 to 5 years R'000	Non–interest-sensitive R'000	Total R'000	Effective interest rate %
Restated							
2016							
Assets							
Cash and cash equivalents	1 369 392	–	–	–	843 213	2 212 605	6,0
Derivative financial instruments	–	–	–	–	29 442	29 442	–
Negotiable securities	–	140 407	318 339	51 128	–	509 874	6,8
Loans and advances	8 434 985	–	731	–	(152 099)	8 283 617	10,7
Other accounts receivable	–	–	–	–	269 394	269 394	–
Other investments	–	–	–	–	6 651	6 651	–
Interest in subsidiaries	105 680	–	–	–	31 482	137 162	–
Property and equipment	–	–	–	–	54 250	54 250	–
Intangible assets	–	–	–	–	178 446	178 446	–
Deferred tax assets	–	–	–	–	804	804	–
Total assets	9 910 057	140 407	319 070	51 128	1 261 583	11 682 245	
Equity and liabilities							
Other accounts payable	–	–	–	–	253 664	253 664	–
Derivative financial instruments	–	–	–	–	43 731	43 731	–
Current tax payable	–	–	–	–	7 324	7 324	–
Provisions and other liabilities	–	–	–	–	93 328	93 328	–
Deposits	5 791 727	346 950	487 908	44 854	1 806 239	8 477 678	5,7
Long-term funding	480 604	204 153	–	–	2 864	687 621	9,7
Total equity	–	–	–	–	2 118 899	2 118 899	–
Total equity and liabilities	6 272 331	551 103	487 908	44 854	4 326 049	11 682 245	
Financial position interest sensitivity gap	3 637 726	(410 696)	(168 838)	6 274		3 064 466	
Derivative financial instruments	–	–	–	–		–	
Total net interest sensitivity gap	3 637 726	(410 696)	(168 838)	6 274		3 064 466	

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 on a regular basis. Ultimate responsibility for liquidity risk management rests with the Board. An appropriate liquidity risk management framework has been developed for the management of the 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:

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

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

Overall, the Bank's key liquidity risk metrics, which have been formulated to achieve a prudent liquidity profile, were maintained at acceptable levels. Through stress testing, scenario analysis and contingency planning, the 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 continue to impede growth in advances and deposits as the South African banking sector is characterised by certain structural features, such as a low discretionary propensity to save, and a higher degree of contractual savings with institutions such as pension funds, provident funds and asset management services. The Bank was successful in raising commercial, retail and wholesale funding, while ensuring compliance with the Basel III liquidity requirements.

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

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
2017			
Maturing up to one month	4 876 474	7 182 208	(2 305 734)
Maturing between one and three months	248 105	1 343 620	(1 095 515)
Maturing between three and six months	502 516	216 382	286 134
Maturing between six months and one year	431 302	480 344	(49 042)
Maturing after one year	6 599 439	1 322 246	5 277 193
Non-contractual	167 176	–	167 176
	12 825 012	10 544 800	2 280 212
Restated			
2016			
Maturing up to one month	4 625 932	6 164 270	(1 538 338)
Maturing between one and three months	366 298	1 015 311	(649 013)
Maturing between three and six months	129 183	786 558	(657 375)
Maturing between six months and one year	261 738	314 893	(53 155)
Maturing after one year	5 991 879	1 282 262	4 709 617
Non-contractual	307 215	52	307 163
	11 682 245	9 563 346	2 118 899

Risk management and control continued

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 to 3 months R'000	4 to 6 months R'000	7 to 12 months R'000	Over 1 year R'000
2017					
Deposits	6 531 699	1 037 159	206 937	275 153	1 451 225
Long-term funding	–	249 595	–	222 067	–
Derivative financial instruments	39 445	67 357	15 564	5 678	–
Other accounts payable	488 824	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	825 578	–	–	–	–
Operating lease commitments	2 511	5 024	7 561	15 134	91 881
	7 888 057	1 359 135	230 062	518 032	1 543 106
2016					
Deposits	5 801 049	1 007 433	298 859	333 041	1 179 592
Long-term funding	–	–	500 515	–	225 859
Derivative financial instruments	9 710	17 670	15 846	507	–
Other accounts payable	253 611	–	–	–	53
Guarantees, letters of credit and committed undrawn facilities	870 824	–	–	–	–
Operating lease commitments	2 252	4 508	6 746	13 540	15 731
	6 937 446	1 029 611	821 966	347 088	1 421 235

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 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.

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. The Bank remains well capitalised beyond regulatory and internal requirements.

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

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:

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

Notes

Addresses

Mercantile Bank

Head office

142 West Street, Sandown 2196
PO Box 782699, Sandton 2146
Tel: +27 11 302 0300
Fax: +27 11 883 7765

Mercantile Bank business centres

Bedford business centre

Shop U33 Bedford Shopping Centre,
Banking Mall, Cnr Smith and Van der
Linde Roads, Bedfordview 2008
PO Box 31558, Braamfontein 2017
Tel: +27 11 624 1450
Fax: +27 11 614 9611

Boksburg business centre

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

Cape Town City business centre

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

Cape Town Tygerberg business centre

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

Comaro Crossing business centre

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

Durban business centre

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

Horizon business centre

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

Pretoria Menlyn business centre

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

Sandton business centre

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

Strijdom Park business centre

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

Vanderbijlpark business centre

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

Welkom business centre

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

Mercantile Bank Limited

www.mercantile.co.za