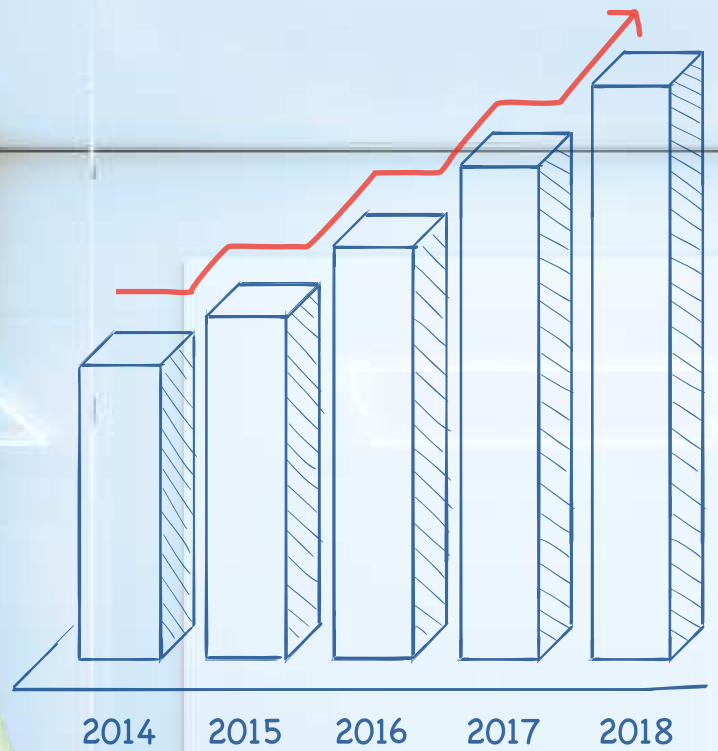
Mercantile Bank
Limited
The Business Bank inspired by entrepreneurs



2018 AUDITED ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December

CONTENTS

Glossary of terms	1
Directors' responsibility statement	2
Company Secretary's certificate	2
Independent Auditor's report	3
Audit Committee report	5
Directors' report	8
Accounting policies	9
Statement of financial position	16
Statement of comprehensive income	17
Statement of changes in equity	18
Statement of cash flows	19
Notes to the annual financial statements	20
Risk management and control	50
Addresses	ibc

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 FD 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 Group | An Authorised Financial Services and Credit Provider

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

GLOSSARY OF TERMS

ABBREVIATION	DEFINITION OR DESCRIPTION
AGM	Annual General Meeting
ALCO	Asset and Liability Committee (a Management Committee accountable to the RMC)
ALM	Asset and Liability Management
Bank Regulations	Regulations relating to banks issued in terms of 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
CGD	Caixa Geral de Depósitos S.A., a company registered in Portugal and parent company of Mercantile Bank Holdings Limited
Companies Act	Companies Act, No. 71 of 2008
CREDCOM	Credit Committee
EAD	Exposure at Default
ECL	Expected Credit Loss/Losses
FD	Financial Director
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards and Interpretations
IT	Information technology
King IV	King IV Report on Corporate Governance for South Africa 2016
LGD	Loss Given Default
MBHL	Mercantile Bank Holdings Limited, the holding company
PD	Probability of Default
RMC	Risk and Capital Management Committee
SARB	South African Reserve Bank
SICR	Significant Increase in Credit Risk
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 2018 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, though 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 risk-based audits.

The External Auditor is 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 IFRS, issued by the International Accounting Standards Board and incorporate responsible disclosures in line with the accounting policies of the Company. The Company's annual financial statements are based on consistently applied, appropriate accounting policies, 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 64, have been approved by the Board of Mercantile Bank Limited and are signed on its behalf by:

GP de Kock
Chairman

KR Kumbier
CEO

26 March 2019

COMPANY SECRETARY'S CERTIFICATE

In terms of the provisions of the Companies Act, I certify that, to the best of my knowledge and belief, the Company has lodged with the Registrar of Companies, for the financial year ended 31 December 2018, all such returns as are required of a public company in terms of the Companies Act and that all such returns are true, correct and up-to-date.

T Singh
Company Secretary

26 March 2019

INDEPENDENT AUDITOR'S REPORT

To the shareholder of Mercantile Bank Limited

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS

OPINION

We have audited the annual financial statements of Mercantile Bank Limited set out on pages 9 to 63 which comprise the statement of financial position as at 31 December 2018, 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 annual financial statements present fairly, in all material respects, the Company's financial position as at 31 December 2018, 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 Company Secretary's Certificate, the Audit Committee Report and the Directors' Report as required by the Companies Act of South Africa and the supplementary information as disclosed on page 64. The other information does not include the Company's annual financial statements and our auditor's report thereon.

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

In connection with our audit of the Company's annual financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the 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 ANNUAL FINANCIAL STATEMENTS

The Directors are responsible for the preparation and fair presentation of the Company's annual financial statements in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa, and for such internal control as the Directors determine is necessary to enable the preparation of the Company's annual 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 annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of 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;
- 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 Mercantile Bank Limited for 17 years.

Deloitte & Touche
Registered Auditor
Per: Diana Jorge
Partner

26 March 2019

National Executive: *LL Bam Chief Executive Officer, *TMM Jordan Deputy Chief Executive Officer; Clients & Industries, *MJ Jarvis Chief Operating Officer, *AF Mackie Audit & Assurance, *N Singh Risk Advisory, *NB Kader Africa Tax & Legal, TP Pillay Consulting, S Gwala BPS, *JK Mazzocco Talent & Transformation, MG Dicks Risk Independence & Legal, *TJ Brown Chairman of the Board.

Regional leader: MN Alberts

**Partner and Registered Auditor*

A full list of partners and directors is available on request

B-BBEE rating: Level 1 contributor in terms of the DTI Generic Scorecard as per the amended Codes of Good Practice

Associate of Deloitte Africa, a Member of Deloitte Tohmatsu Limited

AUDIT COMMITTEE REPORT

for the year ended 31 December 2018

The Audit Committee is pleased to present its report for the 2018 financial year. This report has been prepared based on the requirements of the Companies Act, the Bank's Act, King IV and other applicable regulatory requirements.

The 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. The role of the Audit Committee has never been more fundamental in ensuring that trust and integrity are maintained over corporate reporting, entrenched by the efficiency of internal controls, the effectiveness of the Internal Audit function, the independence of the External Auditor and optimised through a combined assurance model. The 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 audit activity and the independence and effectiveness of the External Auditor.

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

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

The CEO, FD, heads of Risk, Internal Audit, Compliance Management and Treasury, as well as the heads of CGD Group Compliance and Internal Audit and representatives from the External Auditor are permanent attendees to the committee meetings. The External and Internal Auditors have unrestricted access to the 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.

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

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 and the auditor's scope and terms of engagement, ensuring the fees agreed do not impinge on the auditor's ability to perform adequate procedures as disclosed in note 27 to the annual financial statements;
- Believes the appointment of Deloitte & Touche complies with the relevant provisions of the Banks Act, the Companies Act and King IV;
- Pre-approved all non-audit service contracts with Deloitte & Touche in accordance with its policy;
- Received no complaints with regard to accounting practices and the internal audit of the Company, the content or auditing of its annual financial statements, the internal financial controls of the Company or any other related matters; and
- Advised the Board that, regarding matters concerning the Company's accounting policies, financial control, records and reporting, it concurs that the adoption of the going concern premise in the preparation of the annual financial statements is appropriate.

INTERNAL FINANCIAL CONTROL AND INTERNAL AUDIT

In the execution of its delegated duties in this area, the 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 implementation thereof in 2018. Refer to pages 52 to 56 for the detail.

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

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.

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

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

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

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

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

Based on processes followed and assurances received, the Audit Committee is satisfied that both Deloitte & Touche and the audit partner, D Jorge, are independent of the Company. The Audit Committee confirms 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 2019. The reappointment of the External Auditor is subject to approval by the shareholder at the upcoming AGM.

EXTERNAL AUDITOR'S SERVICES: NON-AUDIT SERVICES

The Company will not contract its External Auditor for non-audit services where such an engagement compromises their independence and, in particular, the following areas are specifically excluded from services that may be procured from the External Auditor:

- Bookkeeping or other services related to accounting records or annual financial statements;

- Financial information systems design and implementation;
- Appraisal or valuation services, fairness opinions or contribution-in-kind reports for financial reporting purposes;
- Actuarial services;
- Internal Audit outsourcing and/or co-sourcing;
- Performance of management functions;
- Staff-recruitment agents;
- Broker-dealer, investment adviser or investment banking services; and
- Legal services.

The following is a summary of the policy adopted by the Audit Committee to ensure proper governance and approval of the use of the External Auditor to provide non-audit services.

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

- The External Auditor confirms in writing, prior to providing a service for non-audit services, that such does not impair their independence and that they may provide such service;
- The CEO may approve non-auditing services projects up to R250 000;
- The Audit Committee approves non-auditing services projects exceeding R250 000;
- The cumulative total of non-audit services fees paid to the External Auditor may not exceed 25% of the audit fee for that year. Where the engagement of services would take the cumulative total of non-audit services fees paid to the External Auditor over 25% of the audit fee for that year, the engagement must be approved by the Audit Committee in advance of the engagement commencing;
- Management includes a report on non-audit services provided by the External Auditor for notification at the Audit Committee meetings; and
- Services rendered by other audit firms are not subject to the above and the CEO can approve such from time to time in accordance with the Company's general limits of authorities.

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

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

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

ANNUAL FINANCIAL STATEMENTS

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

The Audit Committee remains satisfied with the overall control environment, including those supporting the annual financial statements for 2018, as confirmed by Internal Audit.

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

On behalf of the Audit Committee

TH Njikizana
Chairman of the Audit Committee

26 March 2019

DIRECTORS' REPORT

for the year ended 31 December 2018

The Directors have pleasure in presenting their report, which forms part of the audited annual financial statements of the Company for the year ended 31 December 2018.

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 10 to 64 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 21 to the annual financial statements.

DIRECTORS, COMPANY SECRETARY AND REGISTERED ADDRESSES

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

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

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

T Singh is the Company Secretary.

The registered addresses of the Company are:

Postal
PO Box 782699, Sandton 2146

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

DIVIDENDS

A dividend of R49.886 million was declared on 27 February 2019 in respect of the year ended 31 December 2018 (2017: R42.458 million and paid in 2018).

SPECIAL RESOLUTIONS

Two special resolutions were adopted during 2018 at the AGM held on 6 June 2018. The first was to approve the fees and remuneration respectively payable to Non-Executive Directors and Executive Directors; the second was in terms of section 45 of the Companies Act to authorise the Company to provide any financial assistance to intra-group companies, in terms of and subject to the provisions of section 45 of the Companies Act. During 2018, there were two instances of intra-group financial assistance approved by the Board in terms of the aforementioned authority granted to it, to the subsidiaries, Mercantile Rental Finance Proprietary Limited and Mercantile Payment Solutions Proprietary Limited.

EVENTS AFTER THE REPORTING PERIOD

Apart from the dividends declared and the ongoing sale of MBHL (refer to note 32 on page 49), no other material events have occurred between the accounting date and the date of this report that require adjustment to the disclosure in the annual financial statements.

ACCOUNTING POLICIES

for the year ended 31 December 2018

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

1. BASIS OF PRESENTATION

The 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 2018.

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

3.1 DERIVATIVE FINANCIAL INSTRUMENTS

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 and are held only to cover economic exposures. All derivatives are recognised on the statement of financial position. Derivatives are initially recorded at cost and are subsequently measured to fair value, excluding transaction costs, at each reporting date. Changes in the fair value of derivatives are recognised in profit or loss.

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

A derivative's notional principal amount reflects the value of the 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

Business model assessment

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

- How the economic activities of our businesses generate benefits, for example through trading revenue, enhancing yields or hedging funding or other costs and how such economic activities are evaluated and reported to key management personnel; and
- The significant risks affecting the performance of our businesses, for example market risk, credit risk or other risks as described in the Risk Management section, and the activities undertaken to manage those risks.

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

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

Solely payments of principal and interest assessment

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

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

Financial assets at amortised cost

The Company has classified loans, trade receivables, negotiable securities and cash at banks as financial assets at amortised cost. Amortised cost is determined using the effective interest rate method. The effective interest rate is the rate that discounts expected future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period, to the net carrying amount of the financial asset. When calculating the effective interest rate, the Company estimates cash flows considering all contractual terms of the financial instrument.

Financial assets at fair value through profit or loss

Financial assets are designated at fair value through profit or loss primarily to eliminate or significantly reduce an accounting mismatch. The 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.

Financial assets at fair value through other comprehensive income

Financial assets that are held for collection of contractual cash flows, where the assets' cash flows solely represent payments of principal and interest and that are not designated at amortised cost or at fair value through profit or loss, are measured at fair value through other comprehensive income.

Movements in the carrying amount are taken through other comprehensive income, except for impairment gains or losses, interest revenue, foreign exchange gains and losses on the instruments and amortised cost, which are recognised in profit or loss.

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

Cash and cash equivalents

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

Negotiable securities

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

Loans and advances

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

Investment in debt securities

Investment in debt securities consists of investments in commercial paper and are measured at fair value through profit or loss.

Other accounts receivable

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

Other investments

Investments consist of unlisted equity investments. 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 otherwise disposed of. At that time, the cumulative gains or losses previously recognised in other comprehensive income may subsequently be reclassified within equity.

3.3 FINANCIAL LIABILITIES

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

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, less ECL. The calculation includes all fees and basis points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

3.6 IMPAIRMENT

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

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

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

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

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

    Includes financial assets that have objective evidence of impairment at the reporting date. ECL are calculated and recognised based on their lifetime probability of default. Interest is only recognised insofar as it is expected to be recovered, i.e. on the net carrying value (value of the exposure less calculated ECL).

The amount of ECL is measured as the probability-weighted present value of all cash shortfalls over the expected life of the financial asset discounted at its original effective interest rate. The Bank considers its historical loss experience and adjusts this for current observable data. In addition, the Bank uses reasonable and supportable expert judgement on future economic conditions, including estimating the amount of an ECL.

3.7 MODIFICATION

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

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

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

3.8 DERECOGNITION

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

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. 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 any subsequent accumulated depreciation and 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

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

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

An intangible asset is derecognised on disposal or when future economic benefits are no longer expected from its use or disposal. Gains and losses on the disposal of intangible assets are determined by deducting 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 annual financial statements and the corresponding tax bases of such items and is determined using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that sufficient taxable temporary differences or taxable profits will be available against which those deductible temporary differences may be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from initial recognition of goodwill or from a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences associated with investments in subsidiaries and associates and interests in joint ventures, except where the 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, 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

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

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

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

The interest income or interest expense is calculated by applying the effective interest rate to the gross carrying amount of non-credit impaired financial assets (i.e. at the amortised cost of the financial asset before adjusting for any ECL allowance) or to the amortised cost of financial liabilities.

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

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. 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, 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 ECL ON LOANS AND ADVANCES

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

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

- Determining criteria for SICR:

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

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

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

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. The impact of initial application of the following standards and interpretations is not expected to be significant to the Company:

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

STATEMENT OF FINANCIAL POSITION

as at 31 December 2018

	Note	2018 R'000	2017 R'000
ASSETS			
Cash and cash equivalents	3	**3 123 604**	1 710 285
Derivative financial instruments	4	**17 903**	104 016
Negotiable securities	5	**790 810**	904 166
Loans and advances	6	**9 322 697**	9 061 243
Other investments	7	**8 016**	6 923
Other accounts receivable	8	**492 078**	653 675
Non-current assets held-for-sale	9	**22 500**	22 500
Interest in subsidiaries	10	**109 271**	40 243
Investment in debt securities	11	**151 629**	104 220
Property and equipment	12	**47 847**	49 390
Intangible assets	13	**128 394**	153 263
Deferred tax assets	14	**42 961**	15 088
Total assets		**14 257 710**	12 825 012
LIABILITIES AND EQUITY			
Liabilities		**11 810 836**	10 544 800
Other accounts payable	15	**419 125**	488 824
Current tax payable	16	**5 726**	6 111
Provisions and other liabilities	17	**136 381**	116 907
Derivative financial instruments	4	**15 437**	128 044
Deposits	19	**10 491 287**	9 341 861
Long-term funding	20	**742 880**	463 053
Shareholders' equity		**2 446 874**	2 280 212
Share capital and share premium	21	**1 483 300**	1 483 300
Employee benefits reserve		**(5 632)**	(6 218)
Other reserves		**5 758**	5 237
Retained earnings		**963 448**	797 893
Total liabilities and equity		**14 257 710**	12 825 012

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December 2018

	Note	2018 R'000	2017 R'000
Interest income	23	**1 167 202**	1 077 393
Interest expense	24	**(615 799)**	(571 327)
Net interest income		**551 403**	506 066
Net charge for credit losses	6.4	**(21 765)**	(30 303)
Net interest income after credit losses		**529 638**	475 763
Net non-interest income		**355 605**	310 263
Non-interest income	25	**769 914**	609 275
Fee and commission expenditure	26	**(414 309)**	(299 012)
Net interest and non-interest income		**885 243**	786 026
Operating expenditure	27	**(554 533)**	(515 810)
Profit before tax		**330 710**	270 216
Tax	28	**(92 432)**	(75 237)
Profit after tax		**238 278**	194 979
Other comprehensive income			
Items that will not be reclassified to profit or loss:			
Gains on remeasurement to fair value		**672**	616
Remeasurement of defined benefit obligation	18	**815**	1 530
Deferred tax thereon	14	**(380)**	(586)
Other comprehensive income net of tax		**1 107**	1 560
Total comprehensive income		**239 385**	196 539
Profit after tax attributable to equity holder of the Company		**238 278**	194 979
Total comprehensive income attributable to equity holder of the Company		**239 385**	196 539

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December 2018

	Share capital R'000	Share premium R'000	Employee benefits reserve R'000	Other reserves R'000	Retained earnings R'000	Total R'000
Balance as at 1 January 2017	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 as at 31 December 2017	124 969	1 358 331	(6 218)	5 237	797 893	2 280 212
Changes on initial application of IFRS 9 (refer to note 1)	–	–	–	–	(30 265)	(30 265)
Restated balance as at 1 January 2018	**124 969**	**1 358 331**	**(6 218)**	**5 237**	**767 628**	**2 249 947**
Net movement for the year	**–**	**–**	**586**	**521**	**195 820**	**196 927**
Total comprehensive income for the year	**–**	**–**	**586**	**521**	**238 278**	**239 385**
Profit after tax	**–**	**–**	**–**	**–**	**238 278**	**238 278**
Other comprehensive income	**–**	**–**	**815**	**672**	**–**	**1 487**
Tax relating to other comprehensive income	**–**	**–**	**(229)**	**(151)**	**–**	**(380)**
Dividend paid	**–**	**–**	**–**	**–**	**(42 458)**	**(42 458)**
Balance as at 31 December 2018	**124 969**	**1 358 331**	**(5 632)**	**5 758**	**963 448**	**2 446 874**

STATEMENT OF CASH FLOWS

for the year ended 31 December 2018

	Note	2018 R'000	2017 R'000
Cash flows from operating activities			
Cash receipts from clients	29.1	**1 910 864**	1 696 593
Cash paid to clients, suppliers and employees	29.2	**(1 495 290)**	(1 299 418)
Cash generated from operations	29.3	**415 574**	397 175
Tax (paid)	29.4	**(109 300)**	(91 320)
Net (increase) in income-earning assets	29.5	**(212 086)**	(1 206 736)
Net increase in deposits and other accounts	29.6	**1 241 664**	698 604
Net cash inflow/(outflow) from operating activities		**1 335 852**	(202 277)
Cash flows from investing activities			
Purchase of intangible assets	13	**(28 601)**	(23 270)
Purchase of property and equipment	12	**(14 873)**	(9 797)
Proceeds on disposal of property and equipment		**9**	120
Dividends paid		**(42 458)**	(35 226)
Investment in debt securities	11	**(47 409)**	(104 220)
(Increase)/Decrease in interest in subsidiaries		**(69 028)**	96 918
Net cash (outflow) from investing activities		**(202 360)**	(75 475)
Cash flows from financing activities			
Net increase/(decrease) in long-term funding	20	**279 827**	(224 568)
Proceeds from long-term borrowings		**740 010**	132 862
Repayments of long-term borrowings		**(459 477)**	(323 243)
(Gain) on exchange rate movements		**(706)**	(34 188)
Net cash inflow/(outflow) from financing activities		**279 827**	(224 568)
Net cash inflow/(outflow) for the year		**1 413 319**	(502 320)
Cash and cash equivalents at the beginning of the year		**1 710 285**	2 212 605
Cash and cash equivalents at the end of year	3	**3 123 604**	1 710 285

NOTES TO THE ANNUAL FINANCIAL STATEMENTS

for the year ended 31 December 2018

1. CHANGE IN ACCOUNTING POLICY

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

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

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

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

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

Effect on the statement of financial position	R'000
ASSETS	
Decrease in net loans and advances	(41 965)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	9 061 243
Adjustment due to change in classification of interest in suspense in terms of IFRS 9	91 241
Adjustment as a result of IFRS 9 ECL (refer to note 6.4)	(133 206)
Restated opening balance in terms of IFRS 9 on 1 January 2018	9 019 278
Decrease in cash and cash equivalents	(54)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	1 710 285
Adjustment as a result of IFRS 9 ECL	(54)
Restated opening balance in terms of IFRS 9 on 1 January 2018	1 710 231
Decrease in negotiable securities	(16)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	904 166
Adjustment as a result of IFRS 9 ECL	(16)
Restated opening balance in terms of IFRS 9 on 1 January 2018	904 150
Increase in deferred tax assets	11 770
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	15 088
Adjustment as a result of IFRS 9 ECL	11 770
Restated opening balance in terms of IFRS 9 on 1 January 2018	26 858
EQUITY	
Decrease in retained earnings	(30 265)
Reconciled as follows:	
Opening balance in terms of IAS 39 on 1 January 2018	797 893
Adjustment on initial application of IFRS 9	(30 265)
Restated opening balance in terms of IFRS 9 on 1 January 2018	767 628

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS

2.1 CATEGORY ANALYSIS OF FINANCIAL INSTRUMENTS

	2018		2017	
	Fair value R'000	**Carrying amount R'000**	Fair value R'000	Carrying amount R'000
ASSETS				
Amortised cost	**13 727 782**	**13 729 201**	12 279 086	12 278 372
Loans and advances				
Current accounts	**2 187 905**	**2 187 905**	2 306 130	2 306 130
Credit cards	**41 800**	**41 800**	36 448	36 448
Mortgage loans	**4 952 970**	**4 952 970**	4 787 057	4 787 057
Instalment sales and leases	**901 854**	**901 854**	609 781	609 781
Structured loans	**134 126**	**134 126**	193 683	193 683
Medium-term loans	**1 104 042**	**1 104 042**	1 128 144	1 128 144
Negotiable securities				
Government stock	**25 292**	**25 800**	*	*
Treasury bills	**764 111**	**765 022**	853 883	853 169
Cash and cash equivalents	**3 123 604**	**3 123 604**	1 710 285	1 710 285
Other accounts receivable	**492 078**	**492 078**	653 675	653 675
Fair value through profit or loss	**169 532**	**169 532**		
Derivative financial instruments	**17 903**	**17 903**	*	*
Investment in debt securities	**151 629**	**151 629**	*	*
Fair value through other comprehensive income				
Other investments	**8 016**	**8 016**	*	*
Available-for-sale				
Other investments	*	*	6 923	6 923
Held-to-maturity			155 313	155 217
Negotiable securities – Government stock	*	*	51 093	50 997
Investment in debt securities	*	*	104 220	104 220
Held-for-trading				
Derivative financial instruments	*	*	104 016	104 016
	13 905 330	**13 906 749**	12 545 338	12 544 528
LIABILITIES				
Fair value through profit or loss				
Derivative financial instruments	**15 437**	**15 437**	*	*
Held-for-trading				
Derivative financial instruments	*	*	128 044	128 044
Amortised cost	**11 653 292**	**11 653 292**	10 293 738	10 293 738
Long-term funding	**742 880**	**742 880**	463 053	463 053
Deposits	**10 491 287**	**10 491 287**	9 341 861	9 341 861
Other accounts payable	**419 125**	**419 125**	488 824	488 824
	11 668 729	**11 668 729**	10 421 782	10 421 782

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

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.2 VALUATION TECHNIQUES AND ASSUMPTIONS APPLIED FOR THE PURPOSE OF MEASURING FAIR VALUE

- Cash and cash equivalents have short terms to maturity and are carried at amortised cost. For this reason, the carrying amounts at the reporting date approximate the fair value.
- Treasury bills are carried at amortised cost. Fair value is based on quoted market values at the reporting date.
- The fair value of loans and advances that are carried at amortised cost approximate the fair value reported as they bear variable rates of interest. The fair value is adjusted for deterioration of credit quality through the application of the credit impairment models.
- Long-term funding 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 fair value through profit or loss. Fair value is based on contractual cash flows which bear variable rates of interest adjusted for increased credit risk.

2.3 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).

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.3 FAIR VALUE MEASUREMENTS AS REQUIRED BY IFRS 13 continued

	2018			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
ASSETS				
Fair value through other comprehensive income				
Other investments	–	–	8 016	8 016
Fair value through profit or loss				
Derivative financial instruments	–	17 903	–	17 903
Investment in debt securities	–	–	151 629	151 629
Amortised cost				
Loans and advances				
Current accounts	–	–	2 187 905	2 187 905
Credit cards	–	–	41 800	41 800
Mortgage loans	–	–	4 952 970	4 952 970
Instalment sales and leases	–	–	901 854	901 854
Structured loans	–	–	134 126	134 126
Medium-term loans	–	–	1 104 042	1 104 042
Negotiable securities				
Government stock	–	–	25 292	25 292
Treasury bills	–	–	764 111	764 111
Cash and cash equivalents	–	–	#	–
Other accounts receivable	–	–	492 078	492 078
	–	17 903	10 763 823	10 781 726
LIABILITIES				
Fair value through profit or loss				
Derivative financial instruments	–	15 437	–	15 437
Amortised cost				
Long-term funding	–	–	742 880	742 880
Deposits	–	–	10 491 287	10 491 287
Other accounts payable	–	–	419 125	419 125
	–	15 437	11 653 292	11 668 729

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

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.3 FAIR VALUE MEASUREMENTS AS REQUIRED BY IFRS 13 continued

	2017			
	Level 1 R'000	Level 2 R'000	Level 3 R'000	Total R'000
ASSETS				
Available-for-sale				
Other investments	–	–	6 923	6 923
Held-for-trading				
Derivative financial instruments	–	104 016	–	104 016
Amortised cost^				
Loans and advances				
Current accounts	–	–	2 306 130	2 306 130
Credit cards	–	–	36 448	36 448
Mortgage loans	–	–	4 787 057	4 787 057
Instalment sales and leases	–	–	609 781	609 781
Structured loans	–	–	193 683	193 683
Medium-term loans	–	–	1 128 144	1 128 144
Negotiable securities				
Treasury bills	–	–	853 883	853 883
Cash and cash equivalents	–	–	#	–
Other accounts receivable	–	–	653 675	653 675
	–	104 016	10 575 724	10 679 740
LIABILITIES				
Held-for-trading				
Derivative financial instruments	–	128 044	–	128 044
Amortised cost^				
Long-term funding	–	–	463 053	463 053
Deposits	–	–	9 341 861	9 341 861
Other accounts payable	–	–	488 824	488 824
	–	128 044	10 293 738	10 421 782

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

^ Additional disclosure relating to fair value measurements in respect of the prior year has been included.

2. CATEGORIES AND FAIR VALUES OF FINANCIAL INSTRUMENTS continued

2.4 RECONCILIATION OF LEVEL 3 FAIR VALUE MEASUREMENTS OF FINANCIAL ASSETS

	2018 R'000	2017 R'000
Fair value through other comprehensive income (2017: Available for sale*)		
Other investments – unlisted equities		
Balance at the beginning of the year	**6 923**	6 651
Additions	**421**	–
Gains on remeasurement to fair value in other comprehensive income	**672**	272
Balance at the end of the year	**8 016**	6 923
Fair value through profit or loss		
Loans and advances – mortgage loans		
Balance at the beginning of the year	**–**	730
Repayment of loans and advances	**–**	(730)
Balance at the end of the year	**–**	–
Fair value through profit or loss (2017: Held-to-maturity*)		
Investment in debt securities		
Balance at the beginning of the year	**104 220**	–
Additions	**47 409**	104 220
Balance at the end of the year	**151 629**	104 220

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

3. CASH AND CASH EQUIVALENTS

	2018 R'000	2017 R'000
Cash on hand	**29 981**	37 635
Central Bank balances	**309 252**	328 239
Money market funds	**1 565 038**	426 674
Rand-denominated domestic bank balances	**414 047**	156 451
Foreign currency-denominated bank balances	**805 411**	761 286
Less: ECL on performing cash and cash equivalents (stage 1)	**(125)**	–
	3 123 604	1 710 285

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

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

5. NEGOTIABLE SECURITIES

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

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

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

6. LOANS AND ADVANCES

6.1 PRODUCT ANALYSIS

	2018 R'000	2017 R'000
Amortised cost		
Current accounts	**2 236 794**	2 342 085
Credit cards	**44 022**	39 539
Mortgage loans	**4 991 393**	4 819 294
Instalment sales and leases	**913 193**	618 123
Structured loans	**134 126**	193 874
Medium-term loans	**1 179 997**	1 168 670
Gross loans and advances	**9 499 525**	9 181 585
Less: ECL on performing loans and advances (stage 1)	**(67 660)**	*
ECL on underperforming loans and advances (stage 2)	**(19 713)**	*
ECL on non-performing loans and advances (stage 3)	**(89 455)**	*
Portfolio impairments for credit losses	*	(24 946)
Specific impairments for credit losses	*	(95 396)
Net loans and advances	**9 322 697**	9 061 243

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

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

6.2 MATURITY ANALYSIS

	2018 R'000	2017 R'000
Repayable on demand and maturing within one month	**2 296 598**	2 446 066
Maturing after one month but within six months	**147 351**	131 148
Maturing after six months but within 12 months	**78 575**	133 695
Maturing after 12 months	**6 977 001**	6 470 676
	9 499 525	9 181 585

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

6. LOANS AND ADVANCES continued

6.3 DETAILED PRODUCT ANALYSIS OF LOANS AND ADVANCES

	Gross amount R'000	ECL Stage 1 R'000	ECL Stage 2 R'000	ECL Stage 3 R'000	Net balance R'000
2018					
Current accounts	**2 236 794**	**(29 274)**	**(2 567)**	**(17 048)**	**2 187 905**
Credit cards	**44 022**	**(391)**	**(56)**	**(1 775)**	**41 800**
Mortgage loans	**4 991 393**	**(6 198)**	**(5 788)**	**(26 437)**	**4 952 970**
Instalment sales and leases	**913 193**	**(3 371)**	**(2 107)**	**(5 861)**	**901 854**
Structured loans	**134 126**	**–**	**–**	**–**	**134 126**
Medium-term loans	**1 179 997**	**(28 426)**	**(9 195)**	**(38 334)**	**1 104 042**
	9 499 525	**(67 660)**	**(19 713)**	**(89 455)**	**9 322 697**

	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

6.3.1 Off-balance sheet ECL included in product analysis

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

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

2017

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

6. LOANS AND ADVANCES continued

6.3 DETAILED PRODUCT ANALYSIS OF LOANS AND ADVANCES continued

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

	2018 R'000	2017 R'000
Gross investment in lease receivables		
Less than one year	**74 223**	–
One to five years	**129 937**	–
More than five years	**–**	–
Gross investment in lease receivables	**204 160**	–
Unearned finance income	**(40 220)**	–
Net investment in lease receivables	**163 940**	–
Net lease receivable		
Less than one year	**60 473**	–
One to five years	**103 467**	–
More than five years	**–**	–
Net investment in lease receivables	**163 940**	–
Less: ECL	**(4 389)**	–
Net lease receivable	**159 551**	–

During 2018, the Bank acquired a loan book consisting of rental assets from Mercantile Rental Finance Proprietary Limited. Prior to this transaction, no rental assets were held by the Bank.

6.4 CREDIT IMPAIRMENTS BY PRODUCT

	Total R'000	Current accounts R'000	Credit cards R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Medium-term loans R'000
2018							
Balance at the beginning of the year	**(120 342)**	**(35 955)**	**(3 091)**	**(32 237)**	**(8 342)**	**(191)**	**(40 526)**
Transitional adjustments in terms of IFRS 9	**(133 206)**	**(51 074)**	**1 046**	**(35 637)**	**2 238**	**191**	**(49 970)**
Restated balance at the beginning of the year	**(253 548)**	**(87 029)**	**(2 045)**	**(67 874)**	**(6 104)**	**–**	**(90 496)**
Movements for the year							
Credit losses written off*	**105 703**	**27 784**	**950**	**51 734**	**2 778**	**–**	**22 457**
Net impairments (raised)/released	**(28 982)**	**10 356**	**(1 127)**	**(22 282)**	**(8 013)**	**–**	**(7 916)**
Balance at the end of the year	**(176 827)**	**(48 889)**	**(2 222)**	**(38 422)**	**(11 339)**	**–**	**(75 955)**
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)

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

6. LOANS AND ADVANCES continued

6.4 CREDIT IMPAIRMENTS BY PRODUCT continued

	2018 R'000	2017 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	**(28 982)**	(34 989)
Interest adjustment on impaired advances	**6 975**	–
Reversal of impairments for properties in possession previously impaired	**–**	4 500
Recoveries in respect of amounts previously written off	**242**	186
	(21 765)	(30 303)

6.5 ECL BY STAGE

	ECL			
	Stage 1 R'000	Stage 2 R'000	Stage 3 R'000	Total R'000
2018				
Balance at the beginning of the year	**(24 946)**	**–**	**(95 396)**	**(120 342)**
Transitional adjustments in terms of IFRS 9	**(57 211)**	**(13 698)**	**(62 297)**	**(133 206)**
Restated balance at the beginning of the year	**(82 157)**	**(13 698)**	**(157 693)**	**(253 548)**
Transfers*				
Transfer to stage 1	**(4 738)**	**4 524**	**214**	**–**
Transfer to stage 2	**222**	**(222)**	**–**	**–**
Transfer to stage 3	**318**	**127**	**(445)**	**–**
Movements for the year	**24 389**	**(12 991)**	**(73 774)**	**(62 376)**
New financial assets originated or purchased	**(10 405)**	**(3 353)**	**(2 556)**	**(16 314)**
Financial assets that have been derecognised	**4 775**	**5 835**	**39 095**	**49 705**
Credit losses written-off	**–**	**–**	**105 703**	**105 703**
Balance at the end of the year	**(67 596)**	**(19 778)**	**(89 456)**	**(176 830)**

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

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

2017

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

6. LOANS AND ADVANCES continued

6.6 PRODUCT ANALYSIS OF PERFORMING LOANS AND ADVANCES

	Gross amount R'000	ECL Stage 1 R'000	ECL Stage 2 R'000	Net balance R'000
2018				
Current accounts	**2 203 374**	**(29 274)**	**(2 567)**	**2 171 533**
Credit cards	**41 011**	**(391)**	**(56)**	**40 564**
Mortgage loans	**4 786 074**	**(6 198)**	**(5 788)**	**4 774 088**
Instalment sales and leases	**900 746**	**(3 371)**	**(2 107)**	**895 268**
Structured loans	**134 126**	**–**	**–**	**134 126**
Medium-term loans	**1 071 213**	**(28 426)**	**(9 195)**	**1 033 592**
	9 136 544	**(67 660)**	**(19 713)**	**9 049 171**

	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

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

	2018 R'000	2017 R'000
Current accounts	**2 203 374**	2 261 928
Credit cards	**41 011**	36 997
Mortgage loans	**4 651 706**	4 439 397
Instalment sales and leases	**890 648**	610 909
Structured loans	**134 126**	193 874
Medium-term loans	**1 033 807**	1 025 149
	8 954 672	8 568 254

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

	2018 R'000	2017 R'000
Current accounts	**–**	19 845
Credit cards	**–**	–
Mortgage loans	**134 368**	235 987
Instalment sales and leases	**10 098**	–
Structured loans	**–**	–
Medium-term loans	**37 406**	36 759
	181 872	292 591

6. LOANS AND ADVANCES continued

6.9 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
2018					
Current accounts	**–**	**–**	**–**	**–**	**–**
Credit cards	**–**	**–**	**–**	**–**	**–**
Mortgage loans	**88 453**	**22 955**	**16 658**	**128 066**	**183 972**
Instalment sales and leases	**2 853**	**389**	**–**	**3 242**	**4 328**
Structured loans	**–**	**–**	**–**	**–**	**–**
Medium-term loans	**3 601**	**738**	**748**	**5 087**	**2 114**
	94 907	**24 082**	**17 406**	**136 395**	**190 414**
2017					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	12 429	49 833	2 097	64 359	43 576
Instalment sales and leases	–	3 018	16	3 034	1 853
Structured loans	–	–	–	–	–
Medium-term loans	–	4 575	–	4 575	–
	12 429	57 426	2 113	71 968	45 429

6.10 PRODUCT ANALYSIS OF LOANS AND ADVANCES THAT ARE INDIVIDUALLY IMPAIRED

	Gross amount R'000	ECL Stage 3 R'000	Net balance R'000	Fair value of collateral and other credit enhance-ments R'000
2018				
Current accounts	**33 420**	**(17 048)**	**16 372**	**53 951**
Credit cards	**3 011**	**(1 775)**	**1 236**	**–**
Mortgage loans	**205 319**	**(26 437)**	**178 882**	**254 392**
Instalment sales and leases	**12 447**	**(5 861)**	**6 586**	**39 983**
Structured loans	**–**	**–**	**–**	**–**
Medium-term loans	**108 784**	**(38 334)**	**70 450**	**53 858**
	362 981	**(89 455)**	**273 526**	**402 184**

6. LOANS AND ADVANCES continued

6.10 PRODUCT ANALYSIS OF LOANS AND ADVANCES THAT ARE INDIVIDUALLY IMPAIRED continued

	Gross amount R'000	Specific impairments 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

6.11 COLLATERAL HELD AS SECURITY AND OTHER CREDIT ENHANCEMENTS

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

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

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

6. LOANS AND ADVANCES continued

6.11 COLLATERAL HELD AS SECURITY AND OTHER CREDIT ENHANCEMENTS continued

All collateral held by the 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.

7. OTHER INVESTMENTS

	2018 R'000	2017 R'000
Fair value through other comprehensive income (2017: Available for sale*)		
Unlisted equities	**8 016**	6 923
	8 016	6 923

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

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

8. OTHER ACCOUNTS RECEIVABLE

	2018 R'000	2017 R'000
Items in transit	**414 350**	269 231
Loan to fellow subsidiary (refer to note 30.2)	**111**	111
Prepayments and deposits	**18 307**	18 018
Structured loans accrued income	**–**	11 076
Other receivables	**59 310**	355 239
	492 078	653 675

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.

9. NON-CURRENT ASSETS HELD-FOR-SALE

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

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

10. INTEREST IN SUBSIDIARIES

	2018 R'000	2017 R'000
Unlisted		
Shares at cost	**107 195**	107 195
Portion 2 of Lot 8 Sandown Proprietary Limited	**98**	98
Mercantile Rental Finance Proprietary Limited	**107 097**	107 097
Loans to/(from) subsidiaries	**2 076**	(66 952)
Mercantile Payment Solutions Proprietary Limited (joint venture)	**2 076**	–
Portion 2 of Lot 8 Sandown Proprietary Limited	**–**	(66 952)
	109 271	40 243

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 prevailing market rates for the prior year and was repaid in 2018.

11. INVESTMENT IN DEBT SECURITIES

	2018 R'000	2017 R'000
Fair value through profit or loss (2017: Held-to-maturity*)		
Investment in Compass Securitisation (RF) Limited D notes	**151 629**	104 220
	151 629	104 220

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

The notes of R1 000 000 each are subordinated, 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 to the value of R103 million. The notes are secured, mature on 6 June 2020 and the interest on the notes is linked to JIBAR. In December 2018, an additional R47 million in notes were taken up by the Bank. These notes are also linked to JIBAR with interest repayable quarterly and maturing on 6 December 2021.

12. 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
2018						
Open market value or cost at the beginning of the year	**13 344**	**59 363**	**11 629**	**27 454**	**781**	**112 571**
Additions	**271**	**13 384**	**583**	**635**	**–**	**14 873**
Write-off of obsolete assets	**(44)**	**(62)**	**–**	**(24)**	**–**	**(130)**
Open market value or cost at the end of the year	**13 571**	**72 685**	**12 212**	**28 065**	**781**	**127 314**
Accumulated depreciation and impairment losses at the beginning of the year	**(3 630)**	**(36 213)**	**(3 816)**	**(18 944)**	**(578)**	**(63 181)**
Depreciation – disclosed in operating expenditure	**(1 847)**	**(2 935)**	**(1 168)**	**(3 770)**	**(116)**	**(9 836)**
Depreciation – disclosed in fee and commission expenditure	**–**	**(6 540)**	**–**	**–**	**–**	**(6 540)**
Write-off of obsolete assets	**41**	**28**	**–**	**21**	**–**	**90**
Accumulated depreciation and impairment losses at the end of the year	**(5 436)**	**(45 660)**	**(4 984)**	**(22 693)**	**(694)**	**(79 467)**
Net carrying amount at the end of the year	**8 135**	**27 025**	**7 228**	**5 372**	**87**	**47 847**
2017						
Open market value or 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 or 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

13. INTANGIBLE ASSETS

	2018 R'000	2017 R'000
Computer software		
Cost at the beginning of the year	**404 836**	381 772
Additions	**28 601**	23 270
Transfer	**(22)**	–
Write-off of obsolete computer software	**–**	(206)
Cost at the end of the year	**433 415**	404 836
Accumulated amortisation and impairment losses at the beginning of the year	**(251 573)**	(203 326)
Amortisation	**(53 470)**	(48 453)
Transfer	**22**	–
Write-off of obsolete computer software	**–**	206
Accumulated amortisation and impairment losses at the end of the year	**(305 021)**	(251 573)
Net carrying amount at the end of the year	**128 394**	153 263

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

14. DEFERRED TAX ASSETS

	2018 R'000	2017 R'000
Balance at the beginning of the year	**15 088**	804
Current year charge		
Per the statement of comprehensive income	**16 483**	14 870
IFRS 9 transitional adjustment (refer to note 1)	**11 770**	*
Other comprehensive income	**(380)**	(586)
Balance at the end of the year	**42 961**	15 088
Tax effects of temporary differences between tax and book value for:		
Intangible assets	**(15 673)**	(23 232)
Provisions and other liabilities	**25 799**	20 509
Impairments on loans and advances	**21 839**	5 953
Leased assets	**769**	2 785
Revaluations	**(1 662)**	(1 511)
Current assets	**11 889**	10 584
	42 961	15 088

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

15. OTHER ACCOUNTS PAYABLE

	2018 R'000	2017 R'000
Accruals	**35 462**	39 786
Product-related credits	**368 162**	436 709
Sundry creditors	**15 501**	12 329
	419 125	488 824

16. CURRENT TAX PAYABLE

	2018 R'000	2017 R'000
South African Revenue Service		
Current tax payable	**5 726**	6 111

17. 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
As at 1 January 2017	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)
As at 31 December 2017	**40 914**	**37 417**	**4 276**	**19 034**	**14 962**	**304**	**116 907**
Provision raised	**41 007**	**40 177**	**10 571**	**2 220**	**14 478**	**2 069**	**110 522**
Reversal of provision	**–**	**–**	**–**	**–**	**–**	**(505)**	**(505)**
Charged to provision	**(25 984)**	**(34 960)**	**(10 199)**	**(3 162)**	**(14 963)**	**(1 275)**	**(90 543)**
As at 31 December 2018	**55 937**	**42 634**	**4 648**	**18 092**	**14 477**	**593**	**136 381**

POST-RETIREMENT MEDICAL BENEFITS

Refer to note 18 for detailed disclosure of this provision.

LEAVE PAY

In terms of the Bank's policy, employees are, 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.

18. POST-RETIREMENT MEDICAL BENEFITS

The Bank operates a post-retirement medical scheme. Independent actuaries value this scheme annually (the last valuation was carried out at 31 December 2018). It is the actuary's opinion that the plan is in a sound financial position.

	2018 R'000	2017 R'000
The amounts recognised in the statement of financial position are as follows (refer to note 17):		
Present value of total service liabilities	**18 092**	19 034
Liability in the statement of financial position	**18 092**	19 034
The amounts recognised in the statements of comprehensive income are as follows:		
Net interest cost (refer to note 24)	**1 731**	1 805
Staff cost (refer to note 27)	**(1 858)**	(1 865)
Current service cost	**7**	7
Benefits paid	**(1 865)**	(1 872)
Total included in comprehensive income	**(127)**	(60)
The amounts recognised in the statement of other comprehensive income are as follows:		
Remeasurement of defined benefit obligation	**(815)**	(1 530)
Total included in other comprehensive income	**(815)**	(1 530)
Reconciliation of the movement in the present value of total service liabilities:		
Balance as at the beginning of the year	**19 034**	20 624
Current service cost	**7**	7
Interest costs	**1 731**	1 805
Remeasurement of defined benefit obligation	**(815)**	(1 530)
Employer benefit payments	**(1 865)**	(1 872)
Balance as at the end of the year	**18 092**	19 034
The principal actuarial assumptions used were as follows:		
Discount rate (%)	**9.4**	9.6
Rate of medical inflation (%)	**7.7**	8.5
Salary inflation (%)	**7.2**	8.0

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

19. DEPOSITS

	2018 R'000	2017 R'000
Call deposits and current accounts	**6 026 192**	5 121 481
Savings accounts	**186 515**	187 990
Term and notice deposits	**3 628 721**	3 419 534
Negotiable certificates of deposit	**–**	23 423
Foreign deposits	**649 859**	589 433
	10 491 287	9 341 861
Maturity analysis		
Repayable on demand and maturing within one month	**7 472 807**	6 530 923
Maturing after one month but within six months	**1 386 567**	1 229 008
Maturing after six months but within 12 months	**328 392**	259 686
Maturing after 12 months	**1 303 521**	1 322 244
	10 491 287	9 341 861

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

20. LONG-TERM FUNDING

	2018 R'000	2017 R'000
International Finance Corporation (IFC)	**742 880**	90 945
Short-term portion payable in the next 12 months	–	90 945
Portion payable after 12 months but within five years	**742 880**	–
Banco Nacional Ultramarino S.A. (BNU Macau)		
Short-term portion payable in the next 12 months	–	247 737
Bank One Limited		
Short-term portion payable in the next 12 months	–	124 371
	742 880	463 053
Long term funding before non-cash movements	**743 586**	497 241
(Gain) on exchange rate movement	**(706)**	(34 188)
	742 880	463 053

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

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

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

21. SHARE CAPITAL AND SHARE PREMIUM

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
21.1 ISSUED				
As at 31 December 2017 and 31 December 2018	**62 484 352**	**124 969**	**1 358 331**	**1 483 300**

21.2 AUTHORISED

The total authorised number of ordinary shares is 62 630 000 shares (2017: 62 630 000 shares) with a par value of R2.00 per share.

21.3 UNISSUED

The unissued shares are under the control of the shareholder until the next AGM of MBHL.

21.4 RIGHTS, PREFERENCES AND RESTRICTIONS OF SHARES

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

22. CONTINGENT LIABILITIES AND COMMITMENTS

22.1 GUARANTEES, LETTERS OF CREDIT AND COMMITTED UNDRAWN FACILITIES

	2018 R'000	2017 R'000
Guarantees	**1 003 723**	673 249
Lending-related	**692**	745
Mortgage	**213 611**	212 206
Performance	**789 420**	460 298
Letters of credit	**8 213**	10 144
Committed undrawn facilities	**279 882**	142 185
	1 291 818	825 578

22.2 COMMITMENTS IN TERMS OF OPERATING LEASES

The total minimum future lease payments in terms of operating leases are as follows:

	2018 R'000	2017 R'000
Property rentals		
Due within one year	**30 776**	29 982
Due between one and five years	**60 229**	91 008
	91 005	120 990
After-tax effect on operating leases	**65 524**	87 113

A register containing details of the existence and terms of renewal and escalation clauses is available for inspection at the registered office of the Company.

23. INTEREST INCOME

	2018 R'000	2017 R'000
Loans to subsidiaries and fellow subsidiaries	**54 764**	53 103
Amortised cost	**1 094 991**	1 001 197
Cash and cash equivalents	**100 242**	97 375
Negotiable securities	**67 036**	27 660
Loans and advances	**927 713**	876 162
Fair value through profit or loss		
Investment in debt securities	**17 447**	*
Available-for-sale		
Investment in debt securities	*	2 430
Held-to-maturity		
Negotiable securities	*	10 825
Investment in debt securities	*	9 838
	1 167 702	1 077 393

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

24. INTEREST EXPENSE

	2018 R'000	2017 R'000
Deposits	**539 473**	497 339
Long-term funding	**74 593**	72 159
Net interest on defined benefit obligation	**1 731**	1 812
Other	**2**	17
	615 799	571 327

25. NON-INTEREST INCOME

	2018 R'000	2017 R'000
Fee and commission income		
Loans and receivables	**506 713**	386 739
Trading income		
Fair value through profit or loss		
Foreign currency	**263 201**	*
Held-for-trading		
Foreign currency	*	222 536
	769 914	609 275

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

26. FEE AND COMMISSION EXPENDITURE

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

27. OPERATING EXPENDITURE

	2018 R'000	2017 R'000
Amortisation (refer to note 13)	**53 470**	48 453
Auditor's remuneration		
Audit fees – Current year	**10 521**	8 426
Fees for other services – Tax advisory fees	**210**	324
– Regulatory reviews	**(5)**	75
	10 726	8 825
Depreciation (refer to note 12)	**9 836**	10 889
Directors' remuneration (refer to note 30.3)		
Executive Directors	**17 031**	17 947
Non-Executive Directors' fees	**4 718**	4 484
	21 749	22 431
Indirect tax		
Non-claimable value added tax	**15 184**	16 627
Skills development levy	**2 535**	2 303
	17 719	18 930
(Profit)/Loss on sale of intangible assets and property and equipment	**(9)**	42
Marketing	**10 007**	8 620
Operating leases for premises and related costs	**35 338**	33 418
Other operating costs	**44 989**	41 259
Professional fees		
Consulting	**2 000**	2 698
Legal and collection	**3 131**	2 422
Computer consulting and services	**56 796**	50 997
	61 927	56 117
Staff costs		
Salaries, allowances and incentives	**242 751**	233 621
Post-retirement medical benefits (refer to notes 17 and 18)	**(1 858)**	(1 865)
Deferred bonus scheme	**41 007**	29 786
Other	**6 881**	5 284
	288 781	266 826
Total operating expenditure	**554 533**	515 810
Number of persons employed by the Company at year-end	**472**	470

28. TAX

	2018 R'000	2017 R'000
South African normal tax	**108 915**	90 107
Current year	**108 332**	90 107
Prior year	**583**	–
Deferred tax	**(16 483)**	(14 870)
Current year	**(15 282)**	(14 373)
Prior year	**(1 201)**	(497)
Total tax	**92 432**	75 237
Direct tax		
South African normal tax	**108 915**	90 107
South African tax rate reconciliation		
South African standard tax rate (%)	**28.00**	28.00
Expenses not deductible for tax purposes (%)	**0.02**	0.04
Additional allowances for tax purposes (%)	**–**	(0.02)
Capital gain inclusion on unrealised portion not taxable (%)	**0.02**	–
Overprovision prior year (%)	**(0.09)**	(0.18)
Effective tax rate (%)	**27.95**	27.84

29. NOTES TO STATEMENTS OF CASH FLOWS

	2018 R'000	2017 R'000
29.1 CASH RECEIPTS FROM CLIENTS		
Interest income	**1 167 202**	1 077 393
Non-interest income	**769 914**	609 275
Adjusted for: Revaluation of fair value financial instruments	**(26 494)**	9 739
Recoveries in respect of amounts previously written off	**242**	186
	1 910 864	1 696 593
29.2 CASH PAID TO CLIENTS, SUPPLIERS AND EMPLOYEES		
Interest expense	**(615 799)**	(571 327)
Operating expenditure and fee and commission expenditure	**(968 842)**	(814 822)
Adjusted for: Amortisation	**53 470**	48 453
Depreciation	**16 376**	14 495
Write-off of obsolete property and equipment	**40**	162
(Profit)/Loss on sale of intangible assets and property and equipment	**(9)**	42
Deferred bonus scheme expense	**41 007**	29 786
(Decrease) in provisions and other liabilities	**(21 533)**	(6 207)
	(1 495 290)	(1 299 418)

29. NOTES TO STATEMENTS OF CASH FLOWS continued

	2018 R'000	2017 R'000
29.3 RECONCILIATION OF PROFIT BEFORE TAX TO CASH GENERATED FROM OPERATIONS		
Profit before tax	**330 710**	270 216
Profit before tax adjusted for:		
Revaluation of fair value financial instruments	**(26 494)**	9 739
Net impairments raised	**22 007**	30 489
Amortisation	**53 470**	48 453
Depreciation	**16 376**	14 495
Write-off of obsolete property and equipment	**40**	162
(Profit)/Loss on sale of intangible assets and property and equipment	**(9)**	42
Deferred bonus scheme expense	**41 007**	29 786
(Decrease) in provisions and other liabilities	**(21 533)**	(6 207)
Cash generated from operations	**415 574**	397 175
29.4 TAX		
Amounts (underpaid) at the beginning of the year	**(6 111)**	(7 324)
Statement of comprehensive income (charge)	**(108 915)**	(90 107)
Less: Amounts underpaid at the end of the year	**5 726**	6 111
Total tax (paid)	**(109 300)**	(91 320)
29.5 NET MOVEMENT IN INCOME-EARNING ASSETS		
(Increase) in negotiable securities	**113 340**	(394 121)
(Increase) in loans and advances	**(325 426)**	(812 615)
Net (increase) in income-earning assets	**(212 086)**	(1 206 736)
29.6 NET MOVEMENT IN DEPOSITS AND OTHER ACCOUNTS		
Increase in deposits	**1 149 426**	864 183
Decrease/(Increase) in other accounts receivable	**161 597**	(402 281)
(Decrease)/Increase in other accounts payable	**(69 359)**	236 702
Net increase in deposits and other accounts	**1 241 664**	698 604

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.

	2018 R'000	2017 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)
Mercantile Rental Finance Proprietary Limited	**364 967**	483 230
	364 967	416 278
Loans to/(from) the holding company, fellow subsidiary and joint venture		
Mercantile Insurance Brokers Proprietary Limited	**111**	111
Mercantile Payment Solutions Proprietary Limited	**3 377**	2 971
	3 488	3 082
Investment in debt securities		
Compass Securitisation (RF) Limited	**151 629**	104 220
Deposits from the holding company, subsidiary, fellow subsidiary and joint venture		
Mercantile Bank Holdings Limited	**3 821**	4 159
Portion 2 of Lot 8 Sandown (Proprietary) Limited	**69 462**	–
The Mercantile Bank Foundation (NPC)	**41**	41
Mercantile Insurance Brokers Proprietary Limited	**485**	485
Mercantile Payment Solutions Proprietary Limited	**–**	140
	73 809	4 825

30. RELATED PARTY INFORMATION continued

30.2 RELATED PARTY BALANCES AND TRANSACTIONS continued

	2018 R'000	2017 R'000
Transactions with the holding company, direct and fellow subsidiaries and joint venture		
Interest received from:		
Mercantile Rental Finance Proprietary Limited	**37 317**	43 265
Compass Securitisation (RF) Limited	**17 447**	9 838
Interest paid to:		
Portion 2 of Lot 8 Sandown Proprietary Limited	**2 540**	2 618
Non-interest income earned from:		
Mercantile Rental Finance Proprietary Limited	**484**	736
Mercantile Payment Solutions Proprietary Limited	**98 213**	67 328
Dividends paid to:		
Mercantile Bank Holdings Limited	**42 458**	35 226
Donations paid to:		
The Mercantile Bank Foundation (NPC)	**1 158**	915
Operating expenditure paid to:		
Portion 2 of Lot 8 Sandown Proprietary Limited	**25 056**	23 311
Purchase of rental finance assets from:		
Mercantile Rental Finance Proprietary Limited	**199 915**	–

30. RELATED PARTY INFORMATION continued

30.2 RELATED PARTY BALANCES AND TRANSACTIONS continued

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

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
2018							
Non-Executive Directors							
RS Caliço *(appointed 18 June 2018)^*	**–**	**–**	**–**	**–**	**–**	**–**	**–**
GP de Kock	**1 282**	**–**	**–**	**–**	**–**	**–**	**1 282**
L Hyne	**880**	**–**	**–**	**–**	**–**	**–**	**880**
AT Ikalafeng	**745**	**–**	**–**	**–**	**–**	**–**	**745**
DR Motsepe	**838**	**–**	**–**	**–**	**–**	**–**	**838**
TH Njikizana	**973**	**–**	**–**	**–**	**–**	**–**	**973**
Executive Directors							
RS Caliço *(resigned 16 June 2018)*	**–**	**1 570**	**–**	**296**	**–**	**–**	**1 866**
KR Kumbier	**–**	**4 052**	**3 034**	**–**	**693**	**4 791**	**12 570**
MEL Teixeira *(appointed 15 June 2018)*	**–**	**1 402**	**–**	**–**	**197**	**996**	**2 595**
	4 718	**7 024**	**3 034**	**296**	**890**	**5 787**	**21 749**
2017							
Non-Executive Directors							
GP de Kock	1 219	–	–	–	–	–	1 219
L Hyne	836	–	–	–	–	–	836
AT Ikalafeng	708	–	–	–	–	–	708
DR Motsepe	796	–	–	–	–	–	796
TH Njikizana	925	–	–	–	–	–	925
Executive Directors							
RS Caliço	–	3 290	–	646	–	2 000	5 936
KR Kumbier	–	3 881	2 862	–	661	4 607	12 011
	4 484	7 171	2 862	646	661	6 607	22 431

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

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

30. RELATED PARTY INFORMATION continued

30.3 DIRECTOR AND DIRECTOR-RELATED ACTIVITIES continued

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

Service agreements

KR Kumbier, CEO

Mr Kumbier was employed by Mercantile as Executive Director: Finance and Business on 1 June 2010. He was subsequently appointed Deputy CEO (effective 1 April 2012) and, thereafter, as CEO from 1 April 2013. The Remuneration Committee's annual bonus decision for Mr Kumbier considered performance during the year against 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 was seconded to Mercantile by CGD in July 2014 as Executive Director and Mr Caliço was appointed Deputy CEO of the Bank from July 2015. Mr Caliço stepped down as Deputy CEO on 16 June 2018. He remains in service to CGD and continues to serve Mercantile as a Non-Executive Director, effective 18 June 2018.

MEL Teixeira, FD

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

31. 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 R49.886 million, which was approved by the Board on 27 February 2019. During March 2017, CGD announced its intention to sell MBHL. On 22 November 2018, the Portuguese government approved the resolution selecting the proposal of Capitec Bank Limited, to acquire 100% of the share capital of MBHL. As at 31 December 2018, the sale of MBHL was still in progress pending regulatory approvals. The Shares Purchase and Sale Agreement was signed on 23 January 2019. No other material events occurred between the accounting date and the date of this report that require adjustment to the disclosure in the annual financial statements.

RISK MANAGEMENT AND CONTROL

RISK MANAGEMENT PHILOSOPHY

The Bank recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks. Risk management is a key focus of the Bank and addresses a wide spectrum of risks that are continually evaluated. Related policies and procedures are reviewed and stress tested to adapt to changing circumstances. Risks inherent to existing activities are maintained within the approved risk tolerance levels, thereby optimising the risk-return parameters for the creation of sustainable growth and value for all stakeholders.

In any economy, there are sectors that are more vulnerable to cyclical downturns than others. Changing economic variables are monitored to assist in managing exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a balanced portfolio. However, the Bank acknowledges the potential for concentration risk; this is carefully monitored and, where appropriate, corrective action is taken. Our business development efforts are focused on the stronger companies and individuals within established policy criteria, which policy serves to eliminate weaker credit from the portfolio. The Bank remains well positioned to effectively manage identified threats in a way that minimises risks to the Bank. Continuous risk management and control reviews are undertaken by senior staff members to identify material control weaknesses and action is taken as required to address any areas of weakness.

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

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

- Enhancements to the risk tolerance framework as approved by the Board and incorporated into the Company's ICAAP;
- Further progress was made with the alignment of processes to the requirements set out in the Principles for Effective Risk Data Aggregation and Risk Reporting (RDARR) as published by the Bank for International Settlements (publication BCBS239);
- Completion of comprehensive new impairment models, which are aligned to the requirements stipulated in IFRS 9 (effective 1 January 2018). Further enhancements to these models are planned for 2019;
- Business continuity management continues to be an area of focus;
- Enhancements to risk reporting, automation of selected regulatory reporting and the introduction of additional stress testing;
- Continual enhancement and expansion of the prudential management schedule, wherein risk-related ratios are monitored and reported monthly to the ALCO and Board;
- Review of the application of the Principles for Sound Liquidity Risk Management and Supervision and applying conservative liquidity buffers;
- Enhanced liquidity evaluation, monitoring and management – specifically during MBHL's sale process;
- Review of the application of the Principles for the Sound Management of Operational Risk;
- Various projects were undertaken during the current year by the Operational Risk team to improve efficiencies and mitigate risk; and
- Continuous improvement regarding cyber security and the implementation of artificial intelligence/machine learning technologies in the threat intelligence space. Completion of associated action plans is monitored by the Information Security Steering Committee.

ENTERPRISE-WIDE RISK MANAGEMENT

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

Risk management is performed on a Bank-wide basis, involving the Board and its various committees, Credit, Senior Management, Risk, business line management, Finance and Control, Legal/Compliance, Treasury and Operations with support from IT. Independent oversight and validation by Internal Audit ensures a high standard of assurance across methodology, operational and process components of the Bank's risk and capital management processes.

RISK MANAGEMENT LIFE CYCLE AND 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 pre-defined risk management policies and tolerance levels. Major risks are managed, controlled and reviewed by an independent risk function.

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

A process is in place whereby the top risks faced by the Bank are identified. These risks are assessed and evaluated in terms of a risk score attached to inherent risk and residual risk. Action plans are put in place to reduce the identified inherent risks to within acceptable residual risk parameters. The top 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 and will remain a focus area during 2019.

CREDIT RISK

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

The Company offers a spread of banking products common to the banking industry. The core market focus is established small to medium-sized businesses and commercial companies across a wide variety of industries, as well as private banking to the respective entrepreneurs.

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

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

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

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

At year-end, the Company did not have any significant concentration of risk that had not been adequately provided for. There were no material exposures in advances made to foreign entities at year-end. The Company does not lend to foreign-registered companies but does provide banking to several locally-registered companies that have foreign shareholding.

Monthly reporting to ALCO includes reporting on large exposures. A portfolio analysis report is also prepared monthly or quarterly and presented to the RMC analysing the performance and composure of the portfolio including client, geographic, segment and product concentration.

The Company continues to adopt a conservative approach to credit granting, within a specifically defined and structured approval process. The granting of credit is managed via a mandated approval process automated on the Bank's workflow system. Levels of credit approval mandates are determined by the experience of the mandated individual, with dual or multiple sign-off on all material values. Mandates have also been accorded to frontline management within predetermined rules and parameters as approved by RMC, which approvals are evaluated and monitored by Credit on an ongoing basis.

An ongoing weekly review is undertaken by the CREDCOM of all new and renewal proposals for lending in excess of R2 million (in aggregate). This meeting covers a wide variety of topics, including reporting on excess and arrear positions, security-related matters, possible changes in risk grades, the Bank's advances portfolio composure and performance and any other relevant credit-related matters requiring specific mention or discussion. Adverse behavioural patterns, such as continual excesses above approved limits and arrears on loan facilities, are monitored closely by the Credit Department and are discussed at the weekly CREDCOM meeting with appropriate actions being taken.

Identified accounts with continued behavioural concerns and/or financial underperformance are monitored by way of monthly 'Watch List' reporting. Fortnightly collection meetings are held and non-performing exposures are interrogated and monitored. To protect the Company, prompt action is taken by senior internal stakeholders, including the CEO, on large defaults. This action has seen a good measure of historical success given our flat structure that drives agility.

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

The following is highlighted for the year under review:

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

CREDIT RISK MEASUREMENT

Loans and advances (including loan commitments and guarantees)

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

CREDIT RISK GRADING

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

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

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

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

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

SICR

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

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

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

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

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

DEFINITION OF DEFAULT AND CREDIT-IMPAIRMENT ASSETS

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

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

QUANTITATIVE CRITERIA

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

QUALITATIVE CRITERIA

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

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

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

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

ECL STAGE DETERMINATION

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

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

MEASURING ECL – EXPLANATION OF INPUTS, ASSUMPTIONS AND ESTIMATION TECHNIQUES

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

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

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

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

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

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

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

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

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

FORWARD-LOOKING INFORMATION INCORPORATED IN THE ECL MODELS

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

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

CREDIT RISK EXPOSURE

MAXIMUM EXPOSURE TO CREDIT RISK – FINANCIAL INSTRUMENTS SUBJECT TO IMPAIRMENT

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

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2018				
Current accounts	**2 236 794**	**–**	**–**	**2 236 794**
Credit cards	**44 022**	**94 475**	**–**	**138 497**
Mortgage loans	**4 991 393**	**185 407**	**–**	**5 176 800**
Instalment sales and leases	**913 193**	**–**	**–**	**913 193**
Structured loans	**134 126**	**–**	**–**	**134 126**
Medium-term loans	**1 179 997**	**–**	**–**	**1 179 997**
Negotiable securities	**–**	**–**	**790 810**	**790 810**
Cash and cash equivalents	**–**	**–**	**3 123 604**	**3 123 604**
Guarantees	**–**	**–**	**1 003 723**	**1 003 723**
Letters of credit	**–**	**–**	**8 213**	**8 213**
	9 499 525	**279 882**	**4 926 350**	**14 705 757**
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

COLLATERAL AND OTHER CREDIT ENHANCEMENTS

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

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

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

A portion of the Company's financial assets originated by the mortgage business has sufficiently low loan-to-value ratios, which results in no loss allowance being recognised in accordance with the Company's ECL model. The Company closely monitors collateral held for financial assets considered to be credit-impaired, as it becomes more likely that the Company will take possession of collateral to mitigate potential credit losses. Financial assets that are credit-impaired and related collateral held to mitigate potential losses are detailed in note 6.11 of the notes to the annual financial statements.

LOSS ALLOWANCE

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

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

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

MODIFICATION OF FINANCIAL ASSETS

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

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

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

WRITE-OFF POLICY

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

PRESENTATION OF ALLOWANCE FOR ECL IN THE STATEMENT OF FINANCIAL POSITION

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

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

OPERATIONAL RISK

Operational risk is defined as the risk of loss from inadequate or failed internal processes, people and systems or from external events. Operational risks faced by the 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 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;
- Review and amendment of appropriate risk mitigation actions in line with the Company's risk appetite and tolerances as approved by the Board;
- Ongoing improvements to the Disaster Recovery and Business Continuity plans, including conducting a variety of simulation exercises in critical operational environments;
- Conducting monitoring and reviews by both the Compliance and Internal Audit functions, in line with annual plans approved by the Board;
- Comprehensive data security and protection programme;
- Ongoing review of the Company-wide risk and control self-assessment process, rolled out to job functional level in high-risk operational processing areas;
- Ongoing review of key risk indicators as a tool to further assist with risk identification and assessment;
- Embarking on a programme to comply with the requirements of BCBS 239 to ensure accurate, complete, consistent and timely risk information. The Board is fully supportive of this project and has committed human and financial resources;
- Limiting access to systems and enforcing strong password controls; and
- Managing a comprehensive insurance programme to safeguard the Company'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 Information Security Management are therefore, key components in technology-related projects and in business-as-usual activities. An ITGRC risk framework was integrated into the Enterprise-wide Risk Management Framework thereby ensuring an integrated risk model whereby risk assessment, management and reporting are consistent across all operations. This enables quick and transparent reporting to all stakeholders and the Board.

The following key milestones were achieved during the year:

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

MARKET RISK

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

The 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.

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 59 to 63).

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 R18.2 million (2017: R14 million). An adverse movement in the exchange rate of 10% would reduce the Bank's income by R1.8 million (2017: R1.4 million).

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

	US Dollar R'000	Euro R'000	Pound sterling R'000	Other R'000	Total R'000
2018					
Total foreign exchange assets	**606 246**	**110 126**	**69 526**	**26 055**	**811 953**
Total foreign exchange liabilities	**(483 600)**	**(91 035)**	**(51 018)**	**(24 983)**	**(650 636)**
Commitments to purchase foreign currency	**582 286**	**156 522**	**29 283**	**28 987**	**797 078**
Commitments to sell foreign currency	**(696 194)**	**(173 122)**	**(46 328)**	**(28 417)**	**(944 061)**
Year-end effective net open foreign currency positions	**8 738**	**2 491**	**1 463**	**1 642**	**14 334**
2017					
Total foreign exchange assets	593 835	98 612	33 270	41 059	766 776
Total foreign exchange liabilities	(843 272)	(78 921)	(32 396)	(8 861)	(963 450)
Commitments to purchase foreign currency	1 002 639	254 785	41 075	23 631	1 322 130
Commitments to sell foreign currency	(750 004)	(271 860)	(42 183)	(54 679)	(1 118 726)
Year-end effective net open foreign currency positions	3 198	2 616	(234)	1 150	6 730

INTEREST RATE RISK

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

The 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 or receive the difference between the fixed and floating interest rate, on a net basis.

Sources of interest rate risk include volatility and changes in interest rate levels, yield curves and spreads. These affect the interest rate margin realised between lending income and borrowing costs when applied to rate-sensitive assets and liabilities. The 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 R11.5 million or decrease by R18.4 million, respectively (2017: increase/decrease by R10.7 million/R16.5 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 %
2018							
ASSETS							
Cash and cash equivalents	2 029 505	–	–	–	1 094 099	3 123 604	5.6
Derivative financial instruments	–	–	–	–	17 903	17 903	–
Negotiable securities	149 668	341 074	274 279	25 801	(12)	790 810	9.4
Loans and advances	9 499 497	–	–	–	(176 800)	9 322 697	10.7
Other accounts receivable	–	–	–	–	492 078	492 078	–
Non-current assets held-for-sale	–	–	–	–	22 500	22 500	–
Other investments	–	–	–	–	8 016	8 016	–
Interest in subsidiaries	2 077		–	–	107 194	109 271	–
Investment in debt securities	–	151 629	–	–	–	151 629	16.6
Property and equipment	–	–	–	–	47 847	47 847	–
Intangible assets	–	–	–	–	128 394	128 394	–
Deferred tax assets	–	–	–	–	42 961	42 961	–
Total assets	11 680 747	492 703	274 279	25 801	1 784 180	14 257 710	
EQUITY AND LIABILITIES							
Other accounts payable	–	–	–	–	419 125	419 125	–
Derivative financial instruments	–	–	–	–	15 437	15 437	–
Current tax payable	–	–	–	–	5 726	5 726	–
Provisions and other liabilities	–	–	–	–	136 381	136 381	–
Deposits	7 666 331	237 036	519 699	62 268	2 005 953	10 491 287	5.7
Long-term funding	–	742 880	–	–	–	742 880	10.6
Total equity	–	–	–	–	2 446 874	2 446 874	–
Total equity and liabilities	7 666 331	979 916	519 699	62 268	5 029 496	14 257 710	
Financial position interest sensitivity gap	4 014 416	(487 213)	(245 420)	(36 467)		3 245 316	
Derivative financial instruments	–	–	–	–		–	
Total net interest sensitivity gap	4 014 416	(487 213)	(245 420)	(36 467)		3 245 316	

	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	9 913 984	301 894	650 829	25 762	1 932 543	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
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	2 942 269	(103 507)	195 102	(119 209)		2 914 655	
Derivative financial instruments	–	–	–	–		–	
Total net interest sensitivity gap	2 942 269	(103 507)	195 102	(119 209)		2 914 655	

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.

There were no significant changes in the way in which the Bank manages and measures liquidity 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	Mismatch R'000
2018			
Maturing up to one month	**6 062 632**	**8 040 900**	**(1 978 268)**
Maturing between one and three months	**370 555**	**1 192 592**	**(822 037)**
Maturing between three and six months	**375 281**	**202 478**	**172 803**
Maturing between six months and one year	**106 887**	**328 467**	**(221 580)**
Maturing after one year	**7 160 220**	**2 046 399**	**5 113 821**
Non-contractual	**182 135**	**–**	**182 135**
	14 257 710	**11 810 836**	**2 446 874**
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

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
2018					
Deposits	**7 473 522**	**1 196 187**	**206 128**	**348 715**	**1 419 241**
Long-term funding	**–**	**–**	**–**	**–**	**1 020 382**
Derivative financial instruments	**6 860**	**6 265**	**2 236**	**76**	**–**
Other accounts payable	**419 125**	**–**	**–**	**–**	**–**
Guarantees, letters of credit and committed undrawn facilities	**1 291 818**	**–**	**–**	**–**	**–**
Operating lease commitments	**2 639**	**5 234**	**7 750**	**15 152**	**60 230**
	9 193 964	**1 207 686**	**216 114**	**363 943**	**2 499 853**
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

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 2018 R'000	Audited 2017 R'000
Risk-weighted assets – banking book		
Credit risk	**9 917 993**	9 036 287
Operational risk	**1 648 930**	1 455 297
Market risk	**14 338**	55 863
Equity	**8 016**	6 923
Other assets	**1 024 274**	1 106 649
	12 613 551	11 661 019
Net qualifying capital and reserves		
Tier 1 capital	**2 254 121**	2 099 366
Share capital and share premium	**1 483 300**	1 483 300
Retained earnings	**883 415**	747 079
Other reserves	**127**	(982)
Less: Deductions	**(112 721)**	(130 031)
Tier 2 capital	**87 499**	24 946
General allowance for ECL	**87 499**	24 946
	2 341 620	2 124 312
Capital adequacy ratio (%)	**18.6**	18.2
Tier 1 capital (%)	**17.9**	18.0
Tier 2 capital (%)	**0.7**	0.2

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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

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