Mercantile Bank
Holdings Limited
Member of CGD Group

Integrated Annual Report **2011**

your bank, your partner, our focus

Mercantile Bank Holdings Limited

Reg No: 1989/000164/06

Member of CGD Group

This is Mercantile's first Integrated Annual Report, prepared in accordance with the provisions of the JSE Listings Requirements and King III. The aim of this report is to provide effective and transparent communication with all stakeholders in a useful, accessible and informative format.

Table of contents

Glossary of terms

Abbreviation:	Definition/Description:
AGM	Annual General Meeting
ALCO	Asset and Liability Committee
ALM	Asset and Liability Management
Banks Act	Banks Act, No. 94 of 1990, as amended
Bank Regulations	Regulations relating to banks issued under section 90 of the Banks Act, No. 94 of 1990, as amended
BEE	Black Economic Empowerment
CEO	Chief Executive Officer
CGD	Caixa Geral de Depósitos S.A., a company registered in Portugal
Companies Act	Companies Act, No.71 of 2008
CPA	Consumer Protection Act, No. 68 of 2008
CREDCOM	Credit Committee
Custom Capital	Custom Capital (Pty) Ltd
DAC	Directors' Affairs Committee
EXCO	Executive Committee
FAIS	The Financial Advisory and Intermediary Services Act, No. 37 of 2002
FICA	The Financial Intelligence Centre Act, No. 38 of 2001
GAC	Group Audit Committee
IFRS	International Financial Reporting Standards and Interpretations
JSE	JSE Limited
King III	King Report on Corporate Governance for South Africa 2009
Mercantile	Mercantile Bank Holdings Limited and its subsidiaries
Multi Risk	Multi Risk Investment Holdings (Pty) Ltd
NCA	The National Credit Act, No. 34 of 2005
RMC	Risk and Capital Management Committee
ROA	Return on average assets
ROE	Return on average equity
SARB	South African Reserve Bank
the Bank	Mercantile Bank Limited
the Board	Where applicable, the Board of Directors of Mercantile Bank Holdings Limited or collectively the Board of Directors of Mercantile Bank Holdings Limited and Mercantile Bank Limited
the Company	Mercantile Bank Holdings Limited
the Code	Code of Banking Practice
the Group	Mercantile Bank Holdings Limited and its subsidiaries

Group structure

Mercantile Bank Holdings Limited is a registered bank controlling and investment holding company and its holding company is CGD. Its principal operating subsidiaries comprise:

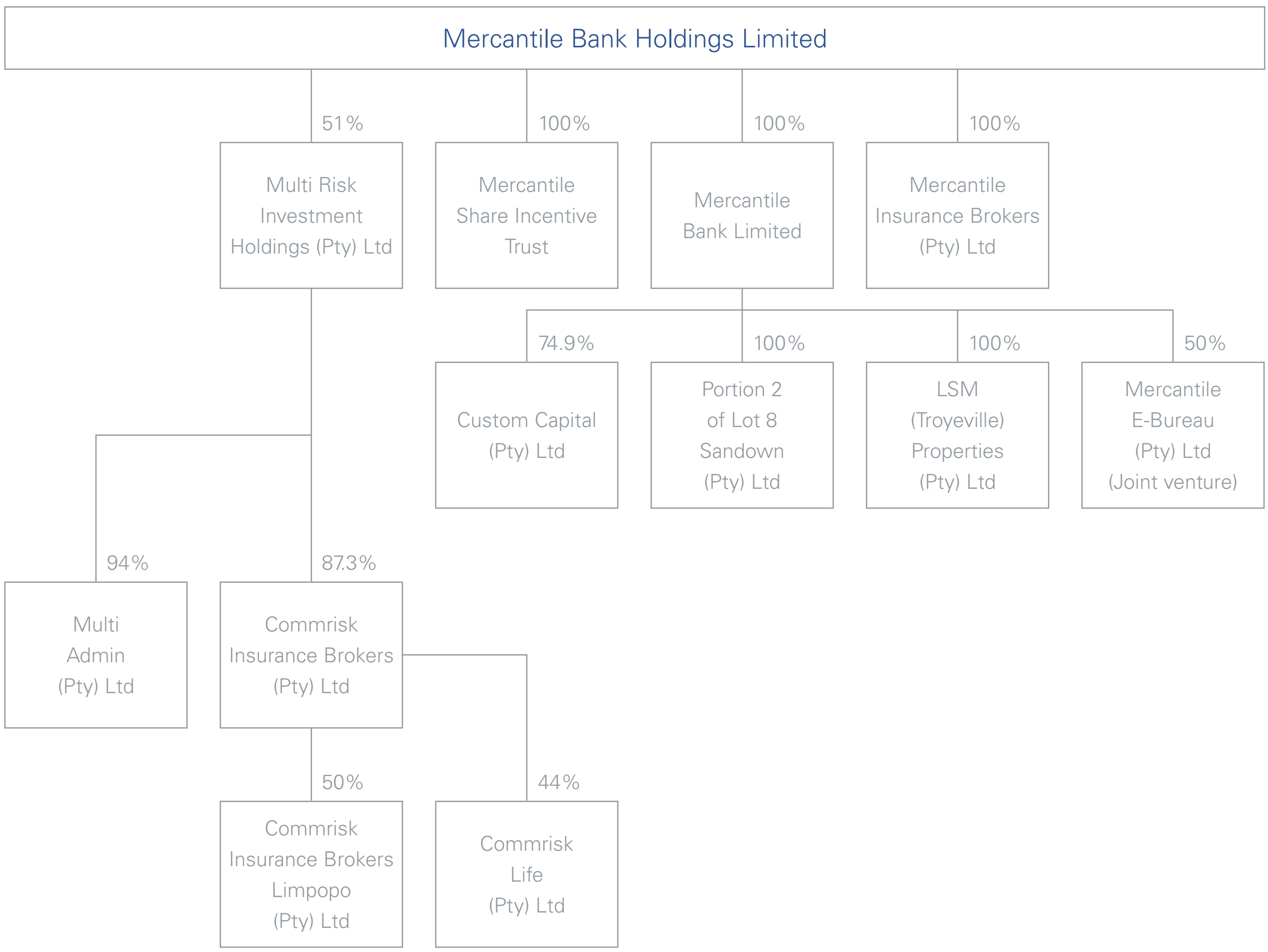
Mercantile Bank Limited which provides a full range of international and domestic banking services. It operates in selected business, commercial and alliance banking niches in which it offers banking, financial and investment services.

Custom Capital (Pty) Ltd which is a rental finance business acquired 1 April 2011. It offers financing of office automation and allied equipment through operating rentals.

Multi Risk Investment Holdings (Pty) Ltd, which is a holding company with various principal operating subsidiaries (see group structure below), was acquired 1 July 2011 and offers a full suite of insurance and assurance broking products for both business and personal customers.

Mercantile Insurance Brokers (Pty) Ltd which offers life assurance and short-term broking services to the Group and external parties through third party agreements. Its products encompass the full range available in the market including short-term insurance, pension, health benefits and life assurance. Subsequent to 1 July 2011 all new business for short-term insurance and life assurance is passed on to Multi Risk. Mercantile Insurance Brokers' only source of revenue at present is the collection of trail commission for insurance written in the past.

Group structure (excluding dormant/non-trading companies) as at 31 December 2011



Board of Directors and administration

at 23 February 2012

Board of Directors

J A S de Andrade Campos (Chairman, Non-Executive Director, Portuguese)

Joaquim holds a degree in Law from Coimbra University in Portugal. Having started his career as a public prosecutor, he later held senior positions in various banks and other companies in Europe and Africa, including Chairman of Banque Franco Portugaise in Paris (part of CGD Group).

D J Brown (CEO)

Dave holds a BComm degree from the University of South Africa and an MBA from the University of Cape Town. In addition, he attended the Management Development Programme at the School of Business Leadership and the Advanced Management Programme at Harvard Business School in the USA. He spent 30 years with the Standard Bank group where he held various senior positions including Managing Director of Stanbic Bank Botswana, Managing Director of Stanbic Bank Zambia, Managing Director of Stannic Asset Finance and Managing Director of Standard Bank Commercial Banking Division. He was appointed CEO of Mercantile in 2004.

G P de Kock (Independent Non-Executive Director)

Deon attended executive programmes at the Business Schools of the Universities of Cape Town and Stanford, California (SEP). He retired in 2004 as Managing Director of Woolworths Financial Services (Pty) Limited and as an executive director of Woolworths Holdings Limited. Before that he was the General Manager of the Credit Card Division of Edgars Stores Limited. He is currently operating as an independent consultant in the retail and financial services industries.

L Hyne (Independent Non-Executive Director)

Louis is a Chartered Accountant (SA). He attended executive programmes at Witwatersrand Graduate School of Business and Stanford University in the USA. He was admitted as a partner with Deloitte & Touche in 1970 and later became Chief Operating Officer and Deputy Chairman, from which position he retired in May 2003. He holds directorships with various companies.

A T Ikalafeng (Independent Non-Executive Director)

Thebe holds BSc (Business Administration) and MBA degrees from Marquette University in the USA, and has completed executive development courses in Finance at Wits and Harvard Business School. A chartered marketer (CM(SA)), he has held various marketing positions in the USA and Africa. He is founder and Managing Director of Brand Leadership Group and a member of the Vega School of Brand Communications advisory council.

K R Kumbier (Executive Director: Business and Finance)

Karl holds a B. Compt degree from the University of South Africa and PGDA from the University of Cape Town. He is a Chartered Accountant (SA) and a Chartered Financial Analyst (CFA Institute). Before joining Mercantile, he worked for the Standard Bank group for nine years in various positions, most recently as Provincial Director, Western Cape and Chief Operating Officer of Stanbic Bank Ghana Limited. He joined Mercantile in 2010.

J P M Lopes (Executive Director, Portuguese)

Julio holds a Degree in Law from the Lusiada University of Lisbon and a Certificate in Corporate Finance from the London School of Business. He has been employed by CGD since 1991 and spent a number of years in London where he successfully managed Derivative Products and Structured Products. His most recent appointment was Managing Director of Banco Interatlântico, which is an affiliated bank of CGD operating in the Republic of Cap Verde, focusing on Corporate Banking, Trade Financing and Private Banking. He was appointed as Executive Director of Mercantile in 2005.

T H Njikizana (Independent Non-Executive Director, Zimbabwean)

Tapiwa has over 16 years experience in public practice as a qualified Chartered Accountant (SA) and Registered Auditor. He trained with Coopers & Lybrand and after qualifying as a Chartered Accountant also had experience with Ernst & Young and Andersen internationally. Tapiwa's professional career includes international experience in Africa (Zimbabwe, Botswana and South Africa), the United Kingdom and the Republic of Ireland. He is a director of W.Consulting which offers professional training and consulting services across Africa, the United Kingdom and Australia. Tapiwa is involved in many aspects affecting the accounting profession and is a member of the Association for the Advancement of Black Accountants in Southern Africa, as well as sitting on various SAICA committees including the Accounting Practices Committee since 2007. In 2007 T H Njikizana served as a member of the GAAP Monitoring Panel of the Johannesburg Securities Exchange.

Administration

Group Secretary	A de Villiers	
Registered office	1st Floor Mercantile Bank 142 West Street Sandown 2196	**Postal address** PO Box 782699 Sandton 2146
Transfer secretaries	Computershare Investor Services (Pty) Ltd 70 Marshall Street Johannesburg 2001 South Africa	**Postal address** P O Box 61051 Marshalltown 2107 South Africa

Five-year Group salient features

years ended 31 December

	2011 R'000	2010 R'000	2009 R'000	2008 R'000	2007 R'000
Statement of financial position					
Total assets	**6 215 275**	6 254 311	5 818 734	5 916 775	4 705 784
Loans and advances	**4 489 863**	3 720 907	3 629 574	3 403 789	2 814 743
Cash and cash equivalents	**952 621**	1 759 897	1 400 937	1 464 959	1 252 376
Total equity attributable to equity holders of the parent	**1 678 774**	1 539 394	1 437 671	1 269 030	839 914
Deposits	**4 251 543**	4 563 988	4 246 598	4 389 347	3 768 183
Statement of comprehensive income					
Profit before tax	**177 272**	144 071	217 069	257 798	165 302
Profit after tax	**129 111**	101 026	162 202	419 973	165 273
Profit after tax attributable to equity holders of the parent	**123 598**	101 026	162 202	419 973	165 273
Headline earnings attributable to equity holders of the parent	**123 598**	100 269	160 851	410 107	159 684
Financial performance ratios (%)					
(No tax was raised in 2007 as the Group deemed it appropriate to recognise deferred tax for the first time in 2008, mainly in respect of tax losses incurred in the financial years prior to 2005.)					
ROE	**7.7**	6.8	12.0	39.8	21.9
ROA	**2.1**	1.7	2.8	7.9	3.6
Cost to income	**64.7**	65.5	52.7	49.0	56.4
Share statistics (cents)					
Earnings per ordinary share	**3.2**	2.6	4.1	10.7	4.2
Headline earnings per ordinary share	**3.2**	2.6	4.1	10.5	4.1
Net asset value per share	**42.9**	39.4	36.8	32.4	21.4
Tangible net asset value per share	**36.1**	33.6	32.4	30.5	20.8

Group review

Holding company

CGD, which is wholly owned by the Portuguese state, is the Group's holding company with a shareholding of 91.75%.

Business focus

The Group's business focus is unchanged, namely:

- to grow enterprise banking business by offering products and services to small and mid-sized businesses across the South African spectrum while retaining a key segment focus on Portuguese customers; and
- to grow existing and seek out new opportunities in the alliance banking arena, primarily in the areas of card, mobile and payment products.

Trading conditions

The general trading conditions in South Africa remained subdued during 2011. The emergence of the Euro Zone debt crisis dominated the global economic environment for most of the year. This had a negative effect on business confidence levels where business customers became very cautious about investing in new projects. Interest rates remained at their lowest levels in 40 years. The low interest rate environment impacts the Group's net interest income negatively as a result of the endowment effect caused by the large levels of capital and the significant credit balances on non-interest bearing customer current accounts.

Financial overview

Despite the tough trading environment, the Group has experienced strong results. Headline earnings and earnings for the year under review increased 23.2% and 22.3%, respectively, mainly due to:

- 3.9% growth in net interest income despite the negative endowment effect of the low interest rate environment. The effects of the negative endowment were countered by the strong growth in loans and advances which increased 20.7%. Approximately R400 million of the growth came through in the last quarter, the majority being new to bank customers;
- growth in net foreign currency income of 14.6% year-on-year, mainly as a result of a focus on margin management as well as broadening the product offering;
- strong growth in revenue from electronic services. This is mainly due to increased volumes on the new internet banking platform and a very strong performance from the E-bureau business; and
- a gain of R39.8 million as a result of positive fair value adjustments from equity investments in the structured loan portfolio. These gains, together with fees earned in Multi Risk, largely accounted for the overall strong growth in net non-interest income which increased by 59.0%.

The charge for credit losses increased from R3.4 million in 2010 to R11.6 million in 2011. Despite the increase, the quality of the Group's lending portfolio remained sound with a net charge for credit losses as a percentage of average loans and advances of 0.28% (2010: 0.09%) being well below industry averages.

Cost to income ratio of 64.7% improved slightly when compared to 65.5% for the year ended 31 December 2010. Both ROE at 7.7% (December 2010: 6.8%) and ROA at 2.1% (December 2010: 1.7%) improved as a result of the growth in operating income.

Business acquisitions and corporate activity

During 2011 the Group completed two acquisitions:

- effective 1 April 2011, the Group acquired 74.9% of Custom Capital, a rental finance business headquartered in Durban which offers financing of office automation and allied equipment through operating rentals. Custom Capital invested in infrastructure and people by setting up an office in Johannesburg and increasing its presence in Cape Town. The business performed very well in 2011 and exceeded expectations for new business written. The prospects for 2012 look promising. The Group is currently exploring securitisation options to fund the rapid growth in the rental book; and
- effective 1 July 2011, the Group acquired 51% of Multi Risk, an investment holding company with subsidiaries that offer insurance brokerage across a range of insurance products for both the commercial and personal markets. The company has an experienced management team and a strategic shareholder in the Hollard Group, which holds 20% of the shares. Multi Risk exceeded their targets for the 2011 financial year. The ongoing changes in the regulatory environment have created opportunities for consolidation in the insurance industry. The Group is currently exploring various opportunities to grow the business through the acquisition of small and medium-sized brokerages.

The Group will continue to explore acquisitions that enhance shareholder value by increasing the customer base, growing the balance sheet and increasing both funded and non-funded revenue. During the past 18 months numerous acquisition opportunities were explored. After thorough analysis of these opportunities, the Group is of the view that the current scope to do a large acquisition is very limited. However, there are some opportunities available for smaller acquisitions that could complement the banking, insurance and rental finance businesses.

To fund future growth in lending and partly align the structure of the balance sheet towards meeting the requirements of Basel III, the Group concluded a R491 million, seven-year term facility with the International Finance Corporation in June 2011. The full amount of the facility is still available for drawdown.

During the year under review, Bidvest Bank made an offer to CGD to acquire Mercantile Bank Holdings Limited. This offer was rejected by CGD on the basis that Mercantile is not for sale.

In a Stock Exchange News Services announcement dated 15 February 2012, the shareholders were advised that the Board had decided that the Company would make an offer to minority shareholders by way of a scheme of arrangement to acquire all of their shares at a consideration of 52 cents per share, subject to all the required approvals being obtained. This process is currently underway.

Group review

(continued)

Financial Sector Charter

The Group remains committed to achieving the targets we set ourselves with regard to employment equity, procurement, loans to Black SMEs and Corporate Social Investment. Employment equity remains a challenge, particularly at middle management level, however, good progress has been made at junior level. We are close to finalising the appointment of a black female at Board level.

From an ownership and control perspective, Mercantile announced in October 2010 that as a result of the economic crisis playing itself out in Europe and the USA, negotiations with the Group's shortlisted BEE candidates were terminated. The Group remains committed to empowerment at shareholder level and will continue to explore opportunities in this regard.

Directorate and Company Secretary

There were no changes to the Board of Directors during the year under review.

Ratings

Moody's confirmed the following RSA national scale issuer ratings for the Bank on 11 October 2011:

Short-term	P-2.za
Long-term	Baa1.za
Outlook	Stable

Outlook

The past few years have seen the Group concentrate on growing a quality loans and advances book, significantly increase its capital base, implement a new core banking platform, finalise a term loan from the International Finance Corporation and conclude certain key strategic investments. The Board is of the opinion that a strong foundation has been laid to ensure the sustainability of the business.

In November 2011 the Board approved a plan outlining a growth strategy whereby the Group will invest in increasing its distribution capability and building its brand awareness over the coming years. In order to align the culture of the organisation to the identified growth strategy, the Group embarked on a specific culture project in 2011. The benefits of this project are expected to manifest in 2012 and beyond.

Linking to the culture project, a new brand promise and updated organisation purpose were launched to staff in December 2011.

2012 will continue to pose economic challenges as a result of domestic and international developments. Despite these challenges the Group is confident that a strong platform has been built that will assist in achieving the strategic objectives and the goals set for the year ahead.

We thank all our staff for their commitment and dedication during the year under review and we convey our appreciation to our clients and shareholders for their trust and support. We also thank the SARB, the JSE and our professional advisors for their sound guidance. We will ensure that we deliver on our new Brand Promise of "Private Banking for Business" and we remain committed to our purpose of "Growing Entrepreneurs".

J A S de Andrade Campos
Chairman

23 February 2012

D J Brown
Chief Executive Officer

23 February 2012

Sustainability

The Group accepts conscious responsibility for a sustainable future and to this end aims to ensure sustainable practices across the entire scope of its business activities concerning the full spectrum of its stakeholders, both external and internal. The Sustainability Policy identifies and documents the themes, principles, strategy, objectives, management, performance and reporting of sustainability with the aim of integrating sustainability into the culture of Mercantile and aligning our sustainability strategy with our business strategy.

The Sustainability themes are based on the recommendations set out in King III, read with the JSE Sustainability Reporting Index criteria and taking into account the size of our business and the community and industry that the Group operates in. The broad categories are:

- environment - materials, energy, water, emissions, effluent and waste, products and services;
- society - education, employment practices, occupational health and safety, training and development; and
- governance and related sustainability concerns - good corporate practices.

The Board is responsible for ensuring that the Group operates as a responsible corporate citizen and has set strategic guidelines for meeting Sustainability requirements recognised by the Group, with the aim of translating its corporate values into sustainable business practices and interaction with all its stakeholders, with key focus areas for the short-, medium- and long-term as follows:

Environmental principles

The Group acknowledges that the sound management of natural resources is a cornerstone of sustainable development. As a financial institution, the Group recognises that its direct environmental impacts are associated primarily with the operation of the Group's office infrastructure. Systems aimed at reducing resource consumption over time are in place. The Group continuously explores ways in which to reduce paper, energy and water usage. The Group is cognisant that our business, through its lending practices, also impacts indirectly on the environment. Assessment and management of environmental risks associated with a particular client or credit application is integral to the credit decision-making process. In order to apply those environmental standards the Group is adhering to its Environmental Risk Management Policy.

The Group is therefore committed to complying with relevant environmental legislation and regulations applicable to all its operations, as well as incorporating best practice where appropriate.

Ethical standards

The Group is committed to high moral, ethical and legal standards and expects all representatives of the Group to act in accordance with the highest standards of personal and professional integrity and honesty in all aspects of their activities, to be accountable for their actions and to comply with all applicable laws, regulations and the Group's policies in the performance of its banking activities with all its stakeholders, i.e. shareholders, customers, colleagues, alliance partners, service providers, joint venture partners, the community, government and society at large.

The Group's commitment is clearly stated in its Code of Conduct (Ethics) which contains a set of standards that the Group believes will contribute to its commercial success, as adherence thereto is a strategic business imperative and a source of competitive advantage. The Code is a constantly evolving document that is intended to be a permanent fixture in the daily activities of the Group and its employees. It is reviewed and benchmarked on an annual basis to ensure compliance with legislative requirements/good governance and best practices.

The standards in the Code are designed to preserve the highest standards of professional confidentiality in terms of access management and processing all information and, in general, in the performance of our banking activity as a whole, and ensuring the adoption of best banking and financial practice and transparent, responsible and prudent business and risk management. It contributes to the promotion of an organisational culture of compliance with legislation and conformity with the values and principles adopted, in addition to the development of best corporate governance and ethical conduct practices.

The Board is confident that the Group has adhered to Mercantile's ethical standards during the year under review.

Safety and health

The Group is striving to improve its facilities on an ongoing basis to ensure the safety and wellbeing of its employees during the execution of their duties and of persons who may enter any of its premises. Regular inspections of the workplace are carried out to identify potential hazards and the Group does not hesitate to take and enforce such measures that may be reasonably practicable to eliminate or mitigate any hazard or potential hazard to the safety of its employees or other persons.

Talent management

In 2009 the second graduate programme (Mercantile Trainee Programme) was implemented. Of the six graduate trainees who completed the programme in 2011, five were permanently employed within the Company. An Employee Value Proposition ("EVP") relating to Personal Growth and Career Development was also launched in 2009. The EVP allows for the creation of opportunities for employees to improve their knowledge and to become multi-skilled. Those employees who embrace this opportunity are encouraged to apply for vacant positions that may arise within the organisation or explore other career opportunities within the Group in pursuit of their career goals. The incorporation of this initiative in our recruitment process, retention strategies for talent and performance management processes has assisted our recruitment process, motivated employees and improved performance and retention of employees.

The Alumni programme implemented in 2010 has added value in terms of ex-employees acting as ambassadors by referring candidates and re-applying for vacant positions within the Group after gaining new skills and experiences.

Sustainability
(continued)

Talent management (continued)

Management development plays a vital role in preparing a company for the next generation of leadership. By taking the time to invest in good management development, employees will gain the required skills and knowledge and have an economic benefit for the organisation. Three employees participated in the 2011 Bankseta Certificate Management Development Programme. Two employees also received funding for their MBA studies from the Bankseta.

To address the potential concern of employees being appointed in managerial positions without the necessary skill to lead and manage employees, we implemented a Supervisory Training course for middle and junior management level employees, which included modules on self development, team development and organisational development.

Employee satisfaction and commitment

Following the employee satisfaction and commitment survey which was conducted in 2008, we implemented a flexible work arrangement policy in 2009. With the implementation of flexible work schedules, employees have the flexibility to meet family needs, personal obligations, avoid traffic and the stress of commuting during peak hours, thereby increasing personal control over their work schedule, reducing potential burnout and allowing employees to work when they accomplish the most. For the Company it increases morale, engagement and commitment, while absenteeism and turnover of valued employees are reduced.

The attrition rate is monitored on a quarterly basis. There has been a consistent decline in the attrition rate since 2007 from 19.6% to 16.8% in 2011.

In April 2011 we introduced a reward and recognition programme where employees have the opportunity to nominate their colleagues for exceptional performance in terms of:

- teamwork;
- customer service;
- competence; and
- extraordinary effort to achieve a specific outcome.

Culture transformation process

During 2011 the Company embarked on a process to align the culture of the Company to the identified growth strategy. The process included an analysis of the current culture of the Company through a survey and focus group discussions that were held with existing employees, ex-employees and customers of the Company. Three distinct sub-cultures were identified and the strengths of these sub-cultures are being incorporated into the new culture to be aligned to the growth strategy of the Company. A number of themes emerged from the focus group discussions, encapsulating the key elements requiring attention. Several work streams will drive projects to address the identified themes. A Steering Committee has been appointed to oversee the culture process for the Company. The new brand promise and updated organisational purpose were launched to employees as follows:

- Brand promise: Private Banking for Business
- Purpose: We grow Entrepreneurs

Four pillars were identified to deliver on our brand promise and achieve our purpose, namely:

- Passionate about service
- Customers do not wait
- Tailored Solutions
- Dedicated Relationships

These four pillars will be used to assess behaviours as part of an internal culture index aimed at shaping and measuring progress in transforming the culture. The existing Mercantile Brand Values incorporated in the Code of Conduct also underpin and drive the culture transformation process and customer experience and satisfaction.

Customer satisfaction is a key strategic initiative aligned to our customer centric operating model and a survey is conducted annually to gauge the levels of customer satisfaction. The Customer Satisfaction Index has been tracked for the past seven years and new targets and action plans are implemented every year. 2011 showed a positive improvement in the customer satisfaction results.

Employee wellness

The overall wellbeing and productivity of our employees are regarded as very important and the Group offers a comprehensive Employee Assistance Programme, provided by an external company, to all employees. This programme contributes to reduction in health care costs and absenteeism thus potentially increasing productivity. The 24-hour telephone counselling service is supplemented by face-to-face counselling (if required). Issues raised by employees are monitored by the service provider and quarterly reports are provided, indicating trends and frequency of usage. Employees receive health and wellness information on a monthly basis via email. A Health and Awareness Day was also implemented where employees had the opportunity to benefit from services such as health screening, eye testing and various health presentations.

The absenteeism management programme implemented in 2009 aims to assist management and employees in understanding the impact of absenteeism, actively monitoring trends and engages employees to potentially reduce the impact. This programme also supports a sustainable and value-adding approach to the way the Company manages its absenteeism and employee wellness. A basis for measurable outcomes in the form of absenteeism rates and the associated direct costs assists management and employees to understand the impact of unplanned absenteeism, as well as why it is important for them to take a more pro-active stance. It supports the effective utilisation of the Employee Assistance Programme to address potential external drivers causing absenteeism, timeous identification of incapacity cases, reducing direct and indirect costs of absenteeism and working towards creating a wellness-culture.

Sustainability
(continued)

Transformation

The Group is fully committed to social and economic transformation and regards it as a key business imperative. Initiatives are driven and directed by the Board and integrated into the Group's strategic business plans. The Social, Ethics and Transformation Committee monitors the progress of transformation in the Group. The committee's charter stipulates how transformation will be implemented, monitored and integrated across the Group.

Employment Equity

Transformation in the workplace is an important aspect of employment equity and the Group strives to provide an environment that values and fosters diversity and equality. This includes developing a culture that supports mutual trust, respect and dignity for all employees.

Adherence to the Employment Equity Act and associated Skills Development, Basic Conditions of Employment and Labour Relations legislation is regarded as essential. The desired results of the implementation of the employment equity plan are to improve the representation of black people, women and people with disabilities towards reflecting the demographic profile of the country and prioritising the development and career advancement of the designated groups.

As employment equity is regarded as a key business imperative, targets were set for 2009 to 2012 and progress is monitored on a quarterly basis. Good progress has been made in the employment of black people in the skilled/junior management and semi-skilled categories and the overall level of representation of black people in the Bank has increased from 35% in 2004 to 50% in 2011. Although some progress has been made on the senior and middle management levels, the challenge remains the attraction, employment and retention of suitably experienced and skilled employment equity candidates for middle management, professional, specialist banking positions and senior management level positions – see tables on page 19. Employment Equity targets and performance for Multi Risk and Custom Capital have not yet been incorporated into the Group's reporting structures. This will take place in 2012.

Procurement

A targeted procurement strategy to enhance Broad-Based Black Economic Empowerment ("BBBEE") has been adopted. The principles are detailed in the Group's Procurement Charter and Procurement Policy. The objective is to actively promote the effective support of suppliers and contractors from BEE-accredited enterprises as set out in the Financial Sector Charter ("FSC") and the Department of Trade and Industry's ("DTI") Broad-Based Black Economic Empowerment Codes of Good Practice, Notice 112 of 2007. The Group has successfully met the DTI and FSC procurement targets since 2008, and is confident that we will achieve the 2014 target of 70% of procurement spend with BEE enterprises.

Loan approval to black SMEs

For purposes of the target setting, the following definition of a BEE SME has been used:

- Black SME means a small or medium enterprise (with a turnover ranging from R500 000 per annum to R20 million per annum) which is a black company or a black empowered company;
- Black companies mean companies that are more than 50% owned and are controlled by black people;
- Black empowered companies mean companies that are more than 25% owned by black people and where substantial participation in control is vested in black people; and
- Black influenced companies mean companies that are between 5% and 25% owned by black people and with participation in control by black people.

The draft Financial Sector Code was published on 10 December 2010 for comment but has not yet been finalised. Based on previous objectives, growth targets and actual performance, the Group has projected a target of R480 million in loans to black SMEs for 2012.

Corporate Social Investment

The Group accepts conscious responsibility for making a meaningful contribution to the society in which it operates and the communities that are in essence key stakeholders of the Group. The Group aims to ensure that its Corporate Social Investment ("CSI") Policy is closely linked to its market positioning so that the various initiatives it supports are aligned to all its stakeholders, both external and internal. The purpose of the CSI Policy is to identify and document the themes, principles, strategy, objectives, management, performance and reporting of the Group's CSI to ensure that the maximum amount of value is extracted for all stakeholders from the spend made by the Group. To this end the following CSI objectives have been identified:

- adoption, implementation and ongoing refinement of a CSI strategy;
- compliance with the Financial Sector Charter and the associated outlined contributions to CSI;
- ensuring we continue to behave and continue to be viewed as a good corporate citizen in the eyes of our various stakeholders;
- to make a meaningful contribution to the society in which we operate and to the market which we serve;
- to create a targeted and focused outlet point for staff-led community outreach projects;
- to optimise the value of our Group CSI spend in our core focus areas; and
- to ensure close alignment to the agreed strategy of the Bank.

Sustainability
(continued)

Corporate Social Investment (continued)

During the year under review Mercantile participated in a number of projects initiated by the employees and/or the Bank. The initiatives that employees contributed to include the Sunshine Association, which supports children with disabilities, and the Heart & Stroke Foundation of SA's annual fundraising and awareness campaign. The employees also supported two other projects during November and December, namely the Azuriah Foundation and the Abraham Kriel Children's Home. Staff used their team building funds and collected money to buy stationery, gifts and hosted a party for the underprivileged children. A total of 101 children benefitted from this initiative. The Group's Corporate Social Investment spend is aligned to our core business objectives in the form of sponsorships and/or donations to community initiatives identified by the Group.

Ownership and control

The Group remains committed to empowerment at shareholder level and will continue to explore opportunities in this regard.

Fraud

Payment card fraud:

The Bank is an issuer of MasterCard and Visa debit cards and has, in line with the card associations' regulations, adopted pro-active measures to prevent fraudulent use of these products.

Monitoring fraud reports are based on a set of parameters prescribed by the card associations and are reviewed on a daily basis with the aim of identifying suspicious transactional behaviour.

In addition to standard monitoring measures, the Bank offers an SMS notification service on both its credit and debit card products which service has contributed to the early detection and prevention of fraudulent transactions since its introduction in December 2010 (credit card) and September 2011 (debit card), respectively.

If fraudulent activity is confirmed, further action is taken to prevent future use of the card/card number. Confirmed fraudulent transactions are reported to the relevant card association which determines common trends and alerts the industry accordingly.

The Bank has recently engaged in the merchant acquiring environment and the necessary fraud prevention systems and merchant account monitoring tools were put in place to assist the Bank in complying with the card associations' requirements in respect thereof.

Fraud awareness training presentations are conducted throughout the Group. These presentations are conducted at least once a year. In addition to the presentations, newsletters are compiled and disseminated to all staff. The newsletters address a wide range of topics and are not limited to payment card fraud only.

Fraud staff attend workshops presented by the card associations, meetings of industry role players and utilise internet-based sources to stay abreast of fraud trends and the prevention thereof. The Bank also works closely with the South African Banking Risk Information Centre.

Fraud other than payment card fraud:

The Group has adopted a zero tolerance towards all types of fraud and theft.

The Forensic Investigator within Compliance investigates all incidents relating to fraud.

An incident is investigated when reported and all related evidence and statements are taken. If the incident was perpetrated externally, criminal charges are laid. If the incident was perpetrated internally, disciplinary action is instituted in addition to criminal charges being laid. All incidents are reported to the South African Banking Risk Information Centre and the South African Police Service.

The Group continuously arranges or participates in the training of relevant staff members to keep abreast of developments of the fraud trends and the prevention thereof.

Whistle-blowing

The Group has a comprehensive Protected Disclosures Policy based on the Act bearing the same name. The policy addresses the reporting of corruption and corrupt activities in particular, as well as any improper conduct in general under the Whistle-blowing section of the policy. All employees are encouraged to make disclosures in good faith and on reasonable grounds.

All business centre employees and affected head office employees receive training on what to report on and how to do the reporting. Training is repeated annually. The policy caters for anonymous reporting should the employee wish not to disclose his/her name.

An enhanced anonymous reporting system is in place. This allows all employees to report directly to Compliance and Internal Audit through electronic means. This system is deemed to simplify the anonymous reporting procedure and encourage employees to make use of the process in an efficient manner.

Corporate governance

The Boards of Directors of the Company and the Bank (collectively referred to as "the Board") hold joint Board meetings. The Board aims to entrench the collective behaviours and practices in the Group that will ensure delivery on our obligation to sound governance. The Board subscribes to and is committed to ensuring that the Group complies with the corporate governance principles of fairness, accountability, responsibility and transparency as set out in King III.

In accordance with the provisions of the JSE Listings Requirements and the Companies Act, the Board, acting in the best interests of the Company and the Bank, has followed the "apply or explain" approach with regard to the implementation of the King III principles and statements.

The Group has made good progress with regard to the implementation of the provisions of the Companies Act and Regulations to ensure compliance in accordance with the Transitional Arrangements set out in Schedule 5 of the Companies Act.

The following is a summary of the corporate governance processes of the Group for the year ended 31 December 2011:

Board of Directors

The Board exercises effective control over the Group and gives strategic direction to the Bank's management.

Key responsibilities of the Board assisted by its Board Committees are to:

- approve the Group's strategy, vision and objectives and monitor/review the implementation thereof;
- approve and annually review the Group's limits of authorities;
- annually review corporate governance processes and assess the achievement of these against objectives set;
- annually review its charter and approve changes to the charters of the Board Committees;
- annually review and approve the Non-Executive Directors' remuneration and submit such for approval and ratification by shareholders at the AGM;
- annually review and approve Executive Directors' remuneration and/or increases thereto and agree the remuneration of executive management;
- consider, approve, govern and review long-term incentive remuneration structures for the Group;
- annually approve the Group's financial budget (including capital expenditure);
- be accountable for financial, operational and internal systems of control and overall risk management;
- approve changes to the Group's financial and accounting policies;
- review and approve the audited financial statements and interim results;
- be responsible for ensuring that the Group complies with all relevant laws, regulations, codes of business practice and ethics;
- appoint appropriate Board Committees and determine the composition thereof; and
- annually approve the Board and Board Committees' self-evaluations conducted on their effectiveness.

The Board comprises Non-Executive and Executive Directors with different skills, professional knowledge and experience, with independent Non-Executive Directors comprising the majority on the Board, ensuring that no individual director has unfettered powers of decision-making. For detail on the composition of the Board, the frequency of meetings and attendance thereof, refer to page 20. The roles of the Chairman of the Board and CEO, who are appointed by the Board, are separated, thereby ensuring a clear division of responsibilities at the head of the Group. The Chairman of the Board is a Non-Executive Director.

Non-Executive Directors offer independent and objective judgement and, apart from their fees, there are no extraneous factors that could materially affect their judgement. If there is an actual or potential conflict of interest, the Director (Executive or Non-Executive) concerned, after declaring his/her interest in terms of the Companies Act, is excluded from the related decision-making process.

The process of identification of suitable candidates to fill vacancies on the Board and to re-appoint Directors upon termination of their term of office is conducted by the DAC. This committee's nominations are submitted to the Board for approval, subject to the SARB having no objections to the nominations of new appointments. Any person appointed to fill a casual vacancy or as an addition to the Board, will retain office only until the next AGM unless the appointment is confirmed at that meeting.

All Directors, except the CEO, retire on a three-year rotational basis. The service contract of the CEO was extended during the year to expire in March 2014. The service contract of Mr Lopes, an Executive Director seconded by the major shareholder, was extended to terminate on 31 July 2014. Directors are required to retire from the Board at age 70, subject to the Board's discretion to allow a Director to continue in office beyond this age. Such Director is still subject to retirement by the rotation provisions as explained above.

The Board operates in terms of a charter which defines its duties, responsibilities and powers. The charter is reviewed annually. The evaluation of the performance of the Board as a whole is conducted annually by means of a self-evaluation process. An evaluation of the Chairman is conducted by the other Directors. The evaluation of individual Non-Executive Directors' performance is conducted on a bilateral basis between the Chairman and each Director. At 31 December 2011, the Board, which has a unitary board structure, comprised eight Directors, of which three were executives.

Corporate governance

(continued)

Board of Directors (continued)

In accordance with King III an annual formal evaluation of the independence of Non-Executive Directors was approved by the Board and implemented during the year. The evaluation consists of a comprehensive questionnaire which is independently assessed via an online software tool and includes a personal declaration by each Director. With the exception of the Chairman, all the Non-Executive Directors are classified as independent. In accordance with the provisions of King III and the JSE Listings Requirements, the Board will consider the appointment of a Lead Independent Director at its first meeting in 2012. Two of the Non-Executive Directors are classified as black in terms of the relevant legislation. The Board is satisfied that its composition currently reflects an appropriate balance in this respect and has identified a suitable black female to complement the Board, who is expected to be appointed in 2012.

The Board has unrestricted access to all Company information, records, documents, property and management. If required, Directors are entitled to obtain independent professional advice at the Group's expense.

Group Secretary

The appointment and removal of the Group Secretary is a matter for consideration by the Board as a whole. The Group Secretary ensures that statutory and regulatory procedures are complied with and acts as custodian of good governance. The Group Secretary attends all Board and Board Committee meetings and has unfettered access to the Chairman. The Group Secretary provides a central source of advice and guidance on business ethics, compliance with good corporate governance and changes in legislation, assisting the Board as a whole and its members individually with guidance as to how their duties, responsibilities and powers should be adequately discharged and exercised in the best interests of the Group.

The Group Secretary also maintains and regularly updates a corporate governance manual, copies of which are distributed to all Directors, and organises and conducts a Board-approved induction programme to familiarise new Directors with the Group's operations, their fiduciary duties and responsibilities, and the Group's corporate governance processes. The Group Secretary assists the Board in developing a training framework annually to assist the Non-Executive Directors with continuous development as Directors and in particular in a banking environment. The Group Secretary is not a Director of Mercantile.

Board Committees

The Board has appointed a number of Board Committees to assist the Board in carrying out its duties and responsibilities. This does not relieve the Board of any of its responsibilities and the Board critically evaluates the recommendations and reports of these committees before approving such recommendations or accepting such reports. These committees all operate in terms of Board-approved charters which define their roles. All Board Committees' charters are reviewed annually by the Board.

The performance of Board Committees, based on the duties and responsibilities as set out in the respective charters, are evaluated annually by means of a self-evaluation process, which results are discussed at the Board Committee concerned and then reviewed and approved by the Board.

For detail on the composition of the Board Committees, frequency of meetings and attendance thereof, refer to page 20.

All Directors who are not members of the Board Committees may attend Board Committee meetings, but will not be able to participate in the proceedings without the consent of the relevant chairman and will not have a vote.

All Directors who are not Board Committee members receive copies of all documentation sent to the Board Committees from time to time.

Further details on the Board Committees are provided below.

GAC

The GAC comprises three independent Non-Executive Directors, one of whom acts as chairman, who is not the Chairman of the Board. The CEO and the Executive Director: Business and Finance attend GAC meetings as permanent invitees. The Board is satisfied that the collective skills of the members of the GAC are appropriate relative to the size and circumstances of the Company.

GAC meetings are held at least four times per annum. The meetings of the GAC are attended by the head of Internal Audit, the External Auditors, the head of Risk, the Compliance Officer, the head of Finance, the head of Alliance Banking and Support Services and the head of Treasury. If a special meeting is called, the attendance of non-members is at the discretion of the chairman of the GAC. The head of Internal Audit, the Compliance Officer, the head of Finance, the head of Risk, the CEO, the Executive Director: Business and Finance and the External Auditors have unrestricted access to the Chairman of the GAC. As defined in its charter, the primary objective of the GAC is to assist the Board to fulfil its responsibilities relative to:

- financial control and integrated reporting;
- compliance with statutory and regulatory legislation which includes but is not limited to the Banks Act, Companies Act, the JSE Listings Requirements, common law, IFRS and tax legislation;
- corporate governance;
- risk management; and
- shareholder reporting.

Corporate governance

(continued)

Board Committees (continued)

GAC (continued)

The GAC reviews, inter alia, accounting policies, the audited annual financial statements, interim results, internal and external auditors' reports, regulatory public disclosures required in terms of the Regulations to the Banks Act, the adequacy and efficiency of internal control systems, the effectiveness of management information systems, the internal audit process, the Bank's continuing viability as a going concern and its complaints handling duties in terms of the Companies Act. The Compliance Officer also gives feedback to the GAC on compliance issues and updates on changes to legislation which could have an impact on the Group.

The external auditors' appointment is recommended by the GAC and approved at the AGM. The GAC reviews the external auditors' terms of engagement and fees and also pre-approves an engagement letter on the principles of what non-audit services the external auditors could provide. The GAC meets with the external auditors separate from management at least annually.

The GAC carried out its function during the year by considering all information provided by management for discussion, decision and/or recommendation to the Board for approval at its meetings (refer to page 20). The GAC has fulfilled its statutory duties and responsibilities in terms of its charter during the year under review.

The report of the GAC (included in the annual financial statements section on page 27) provides comprehensive details of its terms of reference, composition, meetings, statutory duties and delegated duties with respect to internal financial controls and internal audit, regulatory compliance, external audit, the financial function and financial statements.

RMC

The RMC comprises five members, three of whom are Non-Executive Directors, the CEO and an Executive Director. The Chairman of the Board chairs the RMC. The Board has considered the position of the chair of the RMC in view of King III and is satisfied that the Chairman of the Board is the most appropriate Board member to act as Chairman of the RMC given his experience and individual skills set. This position will be reviewed on an annual basis.

RMC meetings are held at least four times per annum. The RMC meetings are attended by the head of Risk, the head of Treasury Middle Office and Asset and Liability Management, the head of Finance, the head of Alliance Banking and Support Services, the Compliance Officer, the head of Treasury and the head of Internal Audit.

As defined in its charter, the RMC's objectives are to:

- assist the Board to fulfil its risk management and control responsibilities in the discharge of its duties relating to risk and control management, assurance, monitoring and reporting of all risks identified and managed through the Enterprise Wide Risk Management Framework;
- monitor and oversee of the risk management process;
- facilitate communication between the Board, the GAC, Internal Auditors, Compliance and other parties engaged in the risk management activities;
- ensure the quality, integrity and reliability of the Group's risk management and control;
- review the Group's process and allocation of capital and capital management; and
- provide an independent and objective oversight and review of the information presented by management on risk management generally and specifically taking into account reports by management and the GAC to the Board on financial, operational and strategic risks.

The RMC has fulfilled its responsibilities in terms of its charter during the year under review.

For more detailed information relating to the Risk Management of the Group refer to pages 78 to 89.

DAC

The DAC comprises all the Non-Executive Directors on the Board. The Chairman of the Board chairs the DAC and the CEO attends the meetings by invitation. Meetings are held at least four times per annum.

As defined in its charter, the primary objectives of the DAC are to:

- assist the Board in its determination, evaluation and monitoring of the appropriateness and effectiveness of the corporate governance structures, processes, practices and instruments of the Group;
- establish and maintain a continuity plan for the Board;
- be responsible for the process of Board nominations and appointments for recommendation to the Board and in doing so, review the skills, experience and other qualities required for the effectiveness of the Board;
- ensure that a management succession plan is in place; and
- assist the Board in determining whether the employment/appointment of any Directors should be terminated (excludes resignations).

The DAC has fulfilled its responsibilities in terms of its charter during the year under review.

Remuneration Committee

This committee comprises all the Independent Non-Executive Directors of the Board. An Independent Non-Executive Director chairs this committee and the CEO attends the meetings by invitation. The Remuneration Committee must meet at least twice per annum.

As defined in its charter, this committee's primary objectives are to:

- assist the Board in determining the broad policy for executive and senior management remuneration and the Bank's remuneration philosophy;
- ensure alignment of the remuneration strategy/philosophy and policy with Mercantile's business strategy, desired culture, shareholders' interests and commercial wellbeing;

Corporate governance
(continued)

Board Committees (continued)

Remuneration Committee (continued)

- assist the Board in the consideration of performance-related incentive schemes, performance criteria and measurements, including allocations in terms of the Conditional Phantom Share Plan ("CPSP")/other long-term awards;
- assist the Board in reviewing CEO performance against set management and performance criteria and approve:
  - guaranteed and performance-based individual remuneration including CPSP/other long-term award allocations of the Executive Directors, Company Secretary and senior management;
  - ensure full disclosure of Director remuneration in the Integrated Annual Report on an individual basis, giving details of earnings, long-term awards, restraint payments and other benefits. Given the size and business activities of Mercantile, disclosure of the remuneration of the three most highly paid employees who are not Directors is not considered relevant and is therefore not applied, as no such employee is remunerated at a level higher than any Executive Director; and
- assist the Board in reviewing the Non-Executive Directors' fees.

The Remuneration Committee has fulfilled its responsibilities in terms of its charter during the year under review.

Social, Ethics and Transformation Committee ("SETCom")

This committee comprises two Non-Executive Directors, one of whom is independent and acts as Chairman, and the CEO. This committee must meet at least four times per annum.

As defined in its charter, the SETCom's primary objectives are to monitor Mercantile's activities with regard to:

- social and economic development, including the goals and purposes of:
  - the United Nations Global Compact principles;
  - the OECD recommendations regarding corruption;
  - the Employment Equity Act; and
  - the Broad-Based Black Economic Empowerment Act.
- good Corporate Citizenship, including:
  - the promotion of equality, prevention of unfair discrimination and reduction of corruption;
  - contribution to development of the communities in which its products and services are predominantly marketed; and
  - sponsorship, donations and charitable giving.
- the environment, health and public safety, including the impact of Mercantile's products or services;
- consumer relationships, including advertising, public relations and compliance with consumer protection laws; and;
- labour and employment, including:
  - Mercantile's standing in terms of the International Labour Organisation Protocol on decent work and working conditions; and
  - Mercantile's employment relationships and its contribution toward the educational development of its employees.

The SETCom has fulfilled its responsibilities in terms of its charter during the year under review.

Technology Committee

This committee is mandated to assist the Board in its duties with regard to the governance of Information Technology in accordance with the provisions of King III. The Technology Committee comprises two independent Non-Executive Directors and two Executive Directors. An Independent Non-Executive Director chairs this committee. The Executive Director: Business and Finance, the head of Information Technology ("IT"), the IT Governance manager and the head of Internal Audit are permanent invitees.

As defined in its charter, the Technology Committee's primary objectives are to:

- strategically align IT with the performance and sustainability objectives of the Bank;
- ensure that prudent and reasonable steps have been taken in regard to IT governance by developing and implementing an IT governance framework;
- concentrate on optimising expenditure and proving the business value of IT;
- ensure appropriate IT risk assessment and management;
- address the safeguarding and security of IT assets, continuity of operations and disaster recovery; and
- adequately protect and manage information.

The Technology Committee has fulfilled its responsibilities in terms of its charter during the year under review.

Management Committees

A number of Management Committees have been formed to assist executive management and the Board in carrying out its duties and responsibilities. These are:

- Group EXCO;
- ALCO;
- CREDCOM;
- Employment Equity Committee;
- Business and Commercial Management Committee;
- Treasury Management Committee;
- Alliance Banking Management Committee;
- Human Resources Committee;
- IT Steering Committee;
- New Product Committee; and
- Procurement Committee.

All these committees operate in terms of their charters which define their duties and responsibilities. Directors may attend any Management Committee meetings.

Subsidiaries (Multi Risk and Custom Capital)

Subsidiaries are governed by their respective boards of directors in accordance with their own governance structures and the provisions of the Companies Act. Reports from these boards are received and considered by the GAC, RMC and the Board. The Group governance policies and procedures apply to all Group companies and the subsidiaries are subject to monitoring and review by the Risk, Compliance and Internal Audit functions. Remuneration policies for subsidiaries have not at this stage been aligned to the Company's policies.

Corporate governance
(continued)

Remuneration philosophy and governance principles

The main purpose of the remuneration philosophy adopted in the Group is to promote performance-based and equitable remuneration practices, to ensure compliance with respective legislation and contractual obligations contained in the letters of appointment and conditions of service and to play a vital role in the Group achieving its strategic objectives. It encapsulates five elements which include compensation, benefits, work-life balance, performance-based recognition and development of career opportunities to help attract, motivate and retain the talent needed to achieve the Group's objectives and optimise management of employees, i.e. involved employees who are enthusiastic about work and hence further the Group's interest. Bonus pools and long-term incentives are reviewed and monitored on a regular basis to align with the Company's risk management strategy.

To attract, motivate and retain employees, the Group ensures that remuneration practices are fair, equitable and competitive. The three main components of remuneration are described below:

The total guaranteed package concept gives all employees a certain degree of flexibility as they can structure their packages to include a 13th cheque, select the appropriate level of travel allowance (in accordance with SARS' regulations) and have the option of two medical aid schemes to choose from. It also includes retirement contribution, i.e. the employer contributes 11% to the Pension Fund and the employee contributes 7.5%. External equity is ensured by comparing packages to market levels through salary surveys. This is done at least once a year prior to annual salary review processes. Market benchmarking information compiled by Remchannel is used to compare the appropriateness and competitiveness of guaranteed packages.

Increases and movements in individual pay levels are based on performance, levels of competence and current position/pay level within the market. The market median pay level for the comparative position is used as a guideline.

Short-term incentives (bonus pools) form an important component of variable pay. The objective of the short-term incentive scheme is to reward performance and to motivate employees to perform beyond expectations and drive the Company results. It is also an important element of establishing a performance culture and retaining the service of key contributors. Payouts occur in April each year and for employees with payouts in excess of R250 000, payment is split into two tranches (April and October). Measurement criteria are aligned to Company strategic objectives and financial growth and performance targets as well as customer service satisfaction targets. The rules include a range of payouts as a percentage of the guaranteed package according to job level.

Whereas Company performance determines the size of the bonus pool and the range of incentive percentages per broadband (job grade) that may be awarded, individual performance determines the actual incentive percentage within the range that is awarded. Individual performance is measured by way of a Performance Management process incorporating an aligned Balanced Scorecard framework through which Key Result Areas are agreed and documented in a Personal Performance Contract. Financial performance is measured by reference to the annual budget cycle. No deferral of short-term incentive payments takes place (except as outlined above) unless the Board was of the view that revenues recognised during the budget year may be reversed in future years. Periodic reviews of the short-term incentive scheme take place at the discretion of the Board Remuneration Committee and/or Executive Directors to ensure market competitiveness and alignment to regulatory requirements/good governance.

The third element of the remuneration mix is long-term incentives. The purpose of this element is to attract and reward key staff members whose contribution within the next three to five years is viewed as critical and whose retention is regarded as a priority. A long-term incentive scheme, the Conditional Share Plan ("CSP"), was introduced in 2008 in place of the previous share option scheme and was amended in 2009. Due to ongoing lack of liquidity of the Company shares in the market and the consequential impact on the share price, the Board decided during November 2011 to discontinue new awards under the CSP scheme for an indefinite period and to convert existing unvested awards to a new performance-based Conditional Phantom Share Plan ("CPSP") – a deferred bonus scheme settled in cash. Conditional awards are made annually to participants on the basis of their job grade as a percentage of their cost to company packages. Participants are selected from eligible employees (earning > R300k per annum) who can have an impact on the future strategic growth of the Company. Awards will normally vest three years after the grant date and will be settled in cash. The number of Phantom shares vesting to determine the cash settlement will be subject to performance criteria set by the Remuneration Committee and approved by the Board. Vesting of awards will occur within a range of 25% to 175% of the original conditional awards made, depending on whether performance conditions are achieved. Performance conditions are based on the achievement of specified targets for growth in Company HEPS and Company ROE. The key drivers of HEPS and ROE measured over a three-year period would allow for the longer term impact of short-term decisions to manifest itself. PWC Remchannel provided expert input to the Remuneration Committee as part of the design of the CSP and the CPSP schemes.

Corporate governance
(continued)

Remuneration philosophy and governance principles (continued)

The CSP scheme and/or the share option scheme may be reinstituted by the Board at their discretion at a future date. All of the long-term incentive schemes include protection of participants in the event of a change of control or similar corporate action.

The remuneration of Non-Executive Directors takes into account the responsibilities of the role and the skills and experience of the individual whilst not losing sight of the requirement for market related, fair and defendable compensation from a regulatory and stakeholder viewpoint. King III requires fair and responsible remuneration policies in relation to Non-Executive Director remuneration and hence our Remuneration Committee advises the Board on appropriate remuneration for Non-Executive Directors. Incentives such as share options/plans or rewards geared to the Company's share price or performance does not form part of the remuneration of Non-Executive directors. Shareholders annually approve all Directors' fees.

Remuneration governance principles

The Remuneration Committee has assumed the responsibilities for remuneration in respect of Mercantile, but the Board has ultimate authority to approve the proposals considered and recommended by the Remuneration Committee. In addition there is cross-representation of non-executive members of the RMC on the Remuneration Committee.

Risk measures are part of determining the bonus pool value and also part of individual Key Result Areas measures. Risk decision-making is separated from sales – there is a clear separation between the management and approval of risk and the sale of risk products. Credit risk is the main risk that the Group faces (as there is no proprietary trading activity) and is managed through different levels of governance ranging from the mandates of Credit Managers and the head of Risk to the mandates of the Credit Committee and the approval by the RMC of the Board. All of these risk mandates are informed by the risk appetite defined by the Company.

Due to the nature of the Bank's business, material risk-taking is confined to the three Executive Directors and the head of Risk. The basis of the difference in the case of the Executive Directors is informed by their discretion in terms of managing the business, individual mandates and executive capacity, particularly as it pertains to execution on strategy. In the case of the head of Risk, the risk-taking revolves primarily around the relevant mandate in the area of credit risk.

Management and staff of the Risk and Compliance functions are effectively independent and compensated appropriately. These functions operate in accordance with the provisions of the Banks Act and Regulations as well as industry best practices and King III requirements. Performance measurements for these functions are principally based on the achievement of the objectives of their function. The overall size of the bonus pool in which they participate is a function of the overall performance of the Bank, hence if there is no bonus pool for the Bank there can be no bonus participation for these functions.

Business Units are allocated capital on an annual basis as part of the budget process. This capital is charged out to the respective units at the Bank's deemed cost of capital, therefore the Business Units' performance targets take this cost into consideration. In turn, the overall capital position of the Bank is taken into consideration as part of the structure of targets and performance measures set for the Bank. The cost of capital takes credit and operational risk into account.

Internal Audit activity

The Internal Audit activity is an integral component of the Group's overall risk management and governance processes. The head of Internal Audit reports functionally to the Chairman of the GAC and administratively to the CEO and has direct and unrestricted access to the CEO and the Chairmen of the GAC, the RMC and the Board. The GAC must concur with any decision to appoint or dismiss the head of Internal Audit.

The Internal Audit Charter, which governs Internal Audit activities in the Group, was reviewed and revised by the Board during the year. The charter defines the purpose, authority and responsibility of the Internal Audit activity in line with the requirements of the International Professional Practices Framework of the Institute of Internal Auditors Inc. as well as the requirements of Regulation 48 of the Banks Act.

All operations, business activities and support functions are subject to Internal Audit review. The annual internal audit plan is risk-based and is approved by the GAC. Audits are conducted according to a risk-based approach and the audit plan is updated quarterly or as needed to reflect any changes in the risk profile of the Group. Updated plans are then presented to the GAC for review and approval.

The Internal Audit activity is responsible for reviewing the adequacy and effectiveness of control and governance processes throughout the Group. Any significant or material control weaknesses are reported to management, the GAC and/or the RMC for consideration and remedial action, if necessary.

The activity also works closely with the Risk and Compliance Management departments to ensure that audit issues of an ethical, compliance or governance nature are made known and are appropriately resolved. The Risk and Compliance Management processes are also reviewed by the Internal Audit activity in accordance with the annual internal audit plan.

To complement the Internal Audit activity the Bank has entered into a co-sourcing arrangement with KPMG to provide specialist internal audit skills in the IT environment.

Corporate governance
(continued)

External Auditors' services: outsourcing policy

The Group will not contract its external auditors on an outsourcing basis where such an engagement compromises their independence and, in particular, the following areas are specifically excluded from the services that are procured from the external auditors:

- 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;
- as staff-recruitment agent;
- broker-dealer, investment advisor or investment banking services; and
- legal services.

The following is a summary of the policy adopted by the GAC to ensure proper governance and approval of the use of external auditors to provide non-audit services:

The GAC approved a "Blanket" engagement letter for non-audit services ("the Engagement Letter") on the basis that the external auditors confirm in writing, prior to providing a service contained in the Engagement Letter, that such service does not impair their independence and that they may provide such service. The GAC has approved that non-audit services, which the external auditors may provide in terms of the Engagement Letter, with a value of R250 000 or less may be provided subject to the CEO's approval. A report on these services provided is submitted to the GAC meetings for notification. The GAC requires that all non-audit services which the External Auditors may provide in terms of the Engagement Letter with a value of more than R250 000 must be submitted to the GAC for approval prior to the External Auditors providing the service.

Dealing in securities of the Group

The Group's dealings in securities policy ("the policy") complies with the JSE Listings Requirements regarding dealings in the Group's securities by Directors and the Group Secretary. Should any Director and the Group Secretary or their associates wish to trade in the Group's securities, held either directly or indirectly, beneficially or non-beneficially, written clearance must be obtained in advance from the Chairman of the Board or the designated Director for this purpose. The policy also restricts trading by all employees of the Bank.

All individuals bound by the policy may not trade during the following periods:

- when the Company is trading under a cautionary announcement;
- the period between the end of either the financial year or half-year and release of results pertaining to that period; and
- any period when there exists any matter which constitutes unpublished price sensitive information.

In addition, the policy emphasises that each individual (whether a Director or an employee) is obliged to comply with the provisions of the Securities Services Act, No. 36 of 2004, in regard to insider trading and inside information. The policy is implemented by the Group Secretary who is required to keep a written record of all written clearances given and, as soon as the trade has been executed, to ensure that the appropriate disclosure, where relevant, is made on SENS in terms of the JSE Listings Requirements.

The Code

As a member of the Banking Association of South Africa the Group subscribes to the Code that promotes good banking practices by setting standards for disclosure and conduct, thereby providing valuable safeguards for its clients. The Group aims to conduct its business with uncompromising integrity and fairness so as to promote complete trust and confidence. In meeting this fundamental objective, the Group conducts its relationships with the regulatory authorities, clients, competitors, employees, shareholders, suppliers and the community at large by striving for high service levels with veracity, and encourages its employees to acquaint themselves with the Code and honour its precepts.

Corporate governance
(continued)

Employment Equity

The table below illustrates the number of staff per race category (as defined by the Department of Labour) as at 31 December 2011.

Occupational levels	Male				Female				Foreign nationals		Total
	A	C	I	W	A	C	I	W	Male	Female	
Top management	0	0	0	2	0	0	0	0	1	0	3
Senior management	0	2	0	18	0	1	0	4	0	0	25
Middle management	3	4	5	42	6	1	3	41	0	0	105
Junior management	22	6	9	19	23	23	14	97	3	2	218
Semi-skilled	17	12	5	2	60	29	7	16	0	0	148
Unskilled	6	0	0	0	2	0	0	0	0	0	8
Total permanent	48	24	19	83	91	54	24	158	4	2	507
Temporary employees	1	1	0	2	1	3	0	6	0	0	14
Grand total	49	25	19	85	92	57	24	164	4	2	521

A = African, C = Coloured, I = Indian, W = White

The identification of potential leaders and development of leadership and management skills is another strategic initiative that was identified. In addition to the existing management training, more interventions for the senior managers as well as other managers will be implemented in 2012.

Skills Development

Various training components were presented in-house over the last year as reflected in the schedule below:

Training programme attendance

Training intervention	Number of staff trained
Functional/Technical/Legislative	
• FAIS (Fit and Proper)	36
• Regulatory exams workshops	140
• Regulatory exams	121
• Information Technology – ITIL V3 Foundation	10
• FAIS Code of Conduct/Conflict of interest	31
Management training	
• Supervisory training	12
• BOP (Balance of Payments) training	15
• Performance management	10
• Management principles	61
BaNCS system – In-house classroom training	
• Manage instruments (VPI module)	6
• Manage instructions (stop payments, standing orders, balance order)	9
• Create and maintain customer accounts	9
• Enquiries	9
• Statements and certificates	9
Other	
• Product training	189
• Safety/First Aid	26
• Induction	32
• Client service training	35
• Time management	15
• Liability training	65
Various external programmes attended	39
18 study loans were granted to employees during this period to the value of R149 996	

Corporate governance

(continued)

Skills Development (continued)

Participation in the Bankseta Learnership programme commenced in 2004 and another three learners – one graduate and two matriculants with disabilities – were upskilled within the various business/support service units in the Company during 2011. The employment and retention of the learners from previous programmes continue to be very successful.

Annual financial statements

Accounting policies and the basis of accounting on which the annual financial statements are prepared are set out on pages 31 to 38 of this report.

Regulation

The Bank Supervision Division of the SARB is the lead regulator for the Group. The Financial Services Board, the National Credit Regulator, the Registrar of Companies and the JSE regulate the various activities of the Group. The Group strives to establish and maintain open and active dialogue with regulators and supervisors. Processes are in place to respond proactively and pragmatically to emerging issues and the Group regularly reports to regulators and supervisory bodies. Where appropriate, the Group participates in industry associations and discussion groups to maintain and enhance the regulatory environment in which the Group operates.

Communication with stakeholders

The Board communicates with its shareholders in accordance with the Companies Act and JSE Listings Requirements. Appropriate communication is also sent to the employees of the Bank from time to time. The Board has delegated authority to the CEO to speak to the press and investment analysts from time to time. Communication with the SARB, the Registrar of Companies and the JSE is done in compliance with the respective laws/guidelines.

Attendance of meetings by Directors

			Board Committees					
Name	**Date of first appointment**	**Board (joint meetings)**	**GAC**	**RMC**	**DAC**	**Remuneration**	**Social, Ethics and Transformation**	**Technology**
Number of meetings held during the year under review		5#	5	4	4	3	4	4
Director								
J A S de Andrade Campos	26.07.2002	4 C	▲	3 C	3 C	▲	3	▲
D J Brown	29.03.2004	5	▲	4	▲	▲	4	4
G P de Kock	23.11.2000	5	5	4	4	3 C	▲	4
L Hyne	01.06.2003	5	5 C	4	4	3	▲	▲
A T Ikalafeng	16.11.2004	5	▲	▲	4	3	4 C	▲
K R Kumbier	01.06.2010	5	▲	4	▲	▲	▲	▲
J P M Lopes	09.11.2005	5	▲	4	▲	▲	▲	4
T H Njikizana	06.11.2008	5	5	▲	4	3	▲	4 C

▲ Non-member of committee/permanent invitee. The ad hoc attendance by a Director at a meeting that he/she is not a member of is not disclosed.

C Chairman of meeting

One of which was a one-day Strategy Board meeting. Excludes ad hoc meetings conducted via teleconference.

Compliance Officer's report

Compliance risk is the risk to earnings, capital and reputation arising from violations of, or non-compliance with laws, rules, regulations, supervisory requirements, prescribed practices or ethical standards. The role of the Compliance function is to identify, assess and monitor the statutory and regulatory risks faced by the Group and advise and report to senior management and the Board on these risks.

The objective of the Compliance function is to ensure that the Group continuously manages and complies with existing and emerging regulations impacting on our business activities.

To ensure the independence of the Compliance function from the business activities of the Group, in accordance with the requirements stipulated in section 60A of the Banks Act, read with the provisions of regulation 49, the Board authorised the Compliance function to:

- carry out its responsibilities on its own initiative in all areas of the Group in which regulatory risk may or may not exist;
- ensure it is provided with sufficient resources to enable it to carry out its responsibilities effectively; and
- not have direct business line responsibilities.

The head of Compliance reports to the head of Risk and has unrestricted and unfettered access to the CEO, the Chairmen of the Board, the GAC and the RMC. The head of Compliance is supported by two Compliance Officers, a Money Laundering Control Officer, a Compliance Monitoring Specialist and a Money Laundering Control/ Compliance Analyst. The compliance function at Mercantile follows a centralised structure co-ordinating activities across the Group and business units.

A Compliance Charter has been approved and is annually reviewed by the Board to assess the extent to which the Group is managing its regulatory risks effectively.

The GAC annually reviews and approves a compliance plan. The GAC monitors the progress against the compliance plan which sets out training, monitoring and review of compliance with the regulatory requirements in the Group. The compliance plan was revised in July 2011 to integrate the regulatory requirements pertaining to the two subsidiaries acquired by the Group. An independent compliance officer has been dedicated to Multi Risk.

The Compliance function keeps senior management and the Board informed about significant regulatory issues and any trends exhibited, and identifies where urgent intervention is needed. The Group's Compliance Officers are charged with developing and maintaining constructive working relationships with Regulators, Supervisors and Compliance staff work closely with business and operational units to ensure consistent management of compliance risk.

Compliance risk is managed within the Group through the following key activities:

- creating awareness by training employees in respect of the impact and responsibilities related to legislative requirements;
- monitoring and reporting on the level of compliance with regulatory requirements, including reporting specific incidents of non-compliance to senior management and the Board;
- providing assurance that the risks relating to regulatory requirements are identified, understood and effectively managed; and
- consulting with the business units and providing compliance opinions with regard to new business ventures and processes.

The Compliance risk management tools provided to management include a comprehensive and consolidated Compliance Manual, Compliance Risk Management Plans, Compliance Opinions and Compliance Monitoring Reports.

Reporting to the Board is in the form of a Level of Compliance Report to both the RMC and the GAC (the same report is also submitted to the SARB, once considered by the GAC).

The challenge of the increasing pace and organisational impact of regulatory change continued in 2011, with a veritable raft of new regulation and regulatory changes, which has placed additional pressure on banks, and arguably, this increased workload has had a disproportionate impact on smaller banks.

The key Acts that the Compliance function focused on during the year under review were:

- The National Credit Act, No. 34 of 2005;
- The Financial Intelligence Centre Act, No. 38 of 2001;
- The Financial Advisory and Intermediary Services Act, No. 37 of 2002;
- The Consumer Protection Act, No. 68 of 2008;
- The National Payment System Act, No. 78 of 1998: and
- The Occupational Health and Safety Act, No. 85 of 1993.

Compliance with FICA, as amended, and the Protection of Constitutional Democracy against Terrorist and Related Activities Act, No. 12 of 2004 is ongoing. The requirements provided by this regulation are set out in the group anti-money laundering and anti-terror financing policy which incorporates Mercantile's client acceptance policy. The electronic Anti-Money Laundering system focuses on transaction monitoring and the detection of potential money laundering activity. This system includes cross-referencing clients against international databases of adverse client information (including persons named on the United Nations' lists). The Anti-Money Laundering system was enhanced to address suspicious activity reporting and to determine potentially suspicious activities. Such activities are further investigated to determine whether they need to be reported to the Financial Intelligence Centre as required by legislation. The initiative to implement these enhancements in the system is ongoing. A further enhancement to the system has been to automate cash threshold reporting, a FICA requirement from December 2010. In accordance with the amended FICA requirements, all Mercantile divisions that are 'accountable institutions' have been registered with the Financial Intelligence Centre. All cash threshold reports and suspicious transaction reports are submitted to the Financial Intelligence Centre centrally by the Money Laundering Control Officer. Training of staff on anti-money laundering and related topics remains a key focus area and the training material is constantly updated to provide for any changes in legislation, international best practice and industry trends.

Compliance Officer's report
(continued)

Consumer protection regulation continued to be a key focus in 2011 with ongoing monitoring and reporting of compliance with the requirements of FAIS, the NCA and, as of 1 April 2011, the CPA. The NCA and the CPA have imposed strict requirements on credit and service providers including affordability assessments, disclosures to consumers, advertising and marketing practices, complaints, pricing and reporting to the respective regulators. Business processes have been reformulated and undergo ongoing enhancements to ensure compliance with these pieces of legislation. Compliance carried out extensive training and monitoring reviews throughout the year.

The ongoing implementation of the FAIS Fit and Proper requirements and especially the requirement for all Key Individuals and Representatives to undertake regulatory examinations was the other major imperative for Business and the Compliance function during the year. Compliance, Business and Human Resources have developed a system to monitor and ensure compliance with the requirements of the 'Fit and Proper' status of Representatives and Key Individuals. In-house training is provided to all affected staff and comprehensive monitoring reviews are carried out on a regular basis. Amendments to the FAIS General Code of Conduct highlighted and detailed the conflict of interest management requirements of Financial Services Providers. These include enhanced disclosures of existing conflicts, a Board-approved policy on how the Financial Services Provider identifies, avoids and (where avoidance is not possible) manages conflicts and stringent provisions on what financial interests representatives may receive.

Through the Banking Association of South Africa, a Code of Banking Practice has been endorsed by its members to provide safeguards for consumers. A revised Code came into operation on 1 January 2012 and this will constitute a further major area of focus for Business and Compliance in the coming year.

Compliance risk is managed through internal policies and processes which include legal, regulatory and business-specific requirements. A compliance tool was developed to assist management in reporting compliance breaches electronically and thereby supporting Compliance in fulfilling its obligations. Regular training and advice is provided to ensure that all employees are familiar with their compliance obligations. Compliance staff independently monitors the business units to ensure adherence to policies and procedures and business-specific requirements.

No material incidents of non-compliance were reported during the year under review.

H Stoffberg
Head: Compliance

23 February 2012

Bank Regulations public disclosure

The December 2011 bi-annual disclosure required in terms of Regulation 43 of the Bank Regulations is published on the Group's website.

Home Loan and Mortgage disclosure

The Home Loan and Mortgage Disclosure Act, No. 63 of 2000 aims to:

- promote fair lending practices;
- ensure disclosure of information by Financial Institutions regarding the provision of home loans; and
- establish an Office of Disclosure to oversee compliance with legislation.

The following tables summarise the home loan statistics for 2011 per province and per race group:

Statistics per province

	Gauteng		KwaZulu-Natal		Western Cape		Total	
	R'000	Count	R'000	Count	R'000	Count	R'000	Count
Received	791 525	286	50 972	19	23 416	9	865 913	314
Approved and taken up	772 235	274	50 972	19	22 091	8	845 298	301
Approved and not taken up	–	–	–	–	–	–	–	–
Declined	19 290	12	–	–	1 325	1	20 615	13
Pending, taken up but not disbursed	295 813	94	33 900	5	11 073	3	340 786	102
Disbursed	476 422	180	17 072	14	11 017	5	504 511	199

Statistics per race group

	African		Coloured		Indian		White		Other		Total	
	R'000	Count	R'000	Count	R'000	Count	R'000	Count	R'000	Count	R'000	Count
Received	16 898	12	40 622	18	6 985	6	662 387	260	139 021	18	865 913	314
Approved and taken up	16 898	12	40 622	18	5 135	5	643 611	248	139 021	18	845 298	301
Approved and not taken up	–	–	–	–	–	–	–	–	–	–	–	–
Declined	–	–	–	–	1 850	1	18 765	12	–	–	20 615	13
Pending, taken up but not disbursed	2 999	4	22 281	7	2 165	2	278 550	81	34 791	8	340 786	102
Disbursed	13 899	8	18 341	11	2 969	3	365 072	167	104 230	10	504 511	199

Annual financial statements

Contents

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 Mr K R Kumbier (CA)SA, Executive Director: Finance and Business.

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

Directors' responsibility statement

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

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 GAC and other risk monitoring committees and functions.

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

The external auditors are responsible for reporting on the fair presentation of the Company and Group annual financial statements.

The Company and Group annual financial statements are prepared in accordance with IFRS issued by the International Accounting Standards Board, AC 500 issued by the Accounting Practices Board and incorporate responsible disclosures in line with the accounting policies of the Group. The Company and Group annual financial statements are based on appropriate accounting policies consistently applied except as otherwise stated and are supported by reasonable and prudent judgements and estimates. The Board believes that the Group will be a going concern in the year ahead. For this reason they continue to adopt the going concern basis in preparing the annual financial statements.

These annual financial statements, set out on pages 27 to 89, have been approved by the Board of Mercantile Bank Holdings Limited and are signed on their behalf by:

J A S de Andrade Campos
Chairman

D J Brown
Chief Executive Officer

23 February 2012

Certificate from the Company Secretary

In terms of the provisions of the Companies Act, I certify that, to the best of my knowledge and belief, the Company has lodged with the Registrar of Companies for the financial year ended 31 December 2011 all such returns as are required of a public company in terms of the Companies Act, and that all such returns are true, correct and up to date.

A de Villiers
Company Secretary

23 February 2012

Independent auditor's report

to the shareholders of Mercantile Bank Holdings Limited

Report on the financial statements

We have audited the Group annual financial statements and annual financial statements of the Company, which comprise, the statements of financial position at 31 December 2011, the statements of comprehensive income, the statements of changes in equity and the statements of cash flows for the year then ended, a summary of significant accounting policies and other explanatory information, and the Directors' report as set out on pages 29 to 89.

Directors' responsibility for the financial statements

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

Auditor's responsibility

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

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

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

Opinion

In our opinion, these financial statements present fairly, in all material respects, the consolidated and separate financial position of the Company as at 31 December 2011, and its consolidated and separate financial performance its cash flows for the year then ended in accordance with IFRS and the requirements of the Companies Act of South Africa.

Deloitte & Touche
Registered Auditors
Per Riaan Eksteen
Partner

23 February 2012

Building 8, Deloitte Place, The Woodlands, 20 Woodlands Drive, Sandton, 2196

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

A full list of partners and directors is available on request
BBBEE rating: Level 2 contributor in terms of the Charter Accountancy Profession Sector Code
Member of Deloitte Touche Tohmatsu Limited

Audit Committee report

for the year ended 31 December 2011

The GAC is a committee of the Board and has assumed the responsibilities of an audit committee in respect of all subsidiaries of Mercantile, and therefore a separate GAC has not been formed for the Bank or any other subsidiaries. The GAC assists the Board in fulfilling its monitoring and controlling responsibilities in terms of applicable legislation.

Terms of reference

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

Composition

The GAC comprises three independent Non-Executive Directors. At 31 December 2011 and throughout the year in review, the members were:

- L Hyne (Chairman) CA(SA)
- G P de Kock
- T H Njikizana CA(SA)

The CEO, Executive Director: Finance and Business, head of Finance, representatives from the external and internal auditors and the head of Compliance attend the committee meetings by invitation. The external and internal auditors have unrestricted access to the GAC Chairman or any other member of the committee as required.

Meetings

The GAC held five meetings during the period under review. All members of the committee attended each of these meetings.

Statutory duties

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

- nominated for appointment as auditor, Deloitte & Touche, who, in its opinion, is independent of the Company;
- determined the fees to be paid to Deloitte & Touche as disclosed in note 24 to the annual financial statements;
- determined Deloitte & Touche's terms of engagement;
- believes the appointment of Deloitte & Touche complies with the relevant provisions of the Companies Act and King III;
- pre-approved all non-audit service contracts with Deloitte & Touche in accordance with its policy;
- received no complaints with regard to accounting practices and the internal audit of the Company, the content or auditing of its financial statements, the internal financial controls of the Company and any other related matters; and
- advised the Board that regarding matters concerning the Company's accounting policies, financial control, records and reporting, it concurs that the adoption of the going concern premise in the preparation of the financial statements is appropriate.

Internal financial control and internal audit

In the execution of its delegated duties in this area, the GAC 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;
- obtained assurance from the external auditors that adequate accounting records were maintained; and
- reviewed policies and procedures for preventing and detecting fraud.

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

Regulatory compliance

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

External audit

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

Based on our satisfaction with the results of the activities outlined above, the GAC has recommended to the Board that Deloitte & Touche should be reappointed for 2012.

Audit Committee report

for the year ended 31 December 2011 (continued)

Finance function

The GAC believes that Mr K R Kumbier, the Executive Director: Finance and Business for the duration of 2011 up to the date of this report, possessed the appropriate expertise and experience to meet his responsibilities in that position. We are also satisfied with the expertise and adequacy of resources within the finance function.

In making these assessments, we have obtained feedback from both external and internal audit.

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

Financial statements

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

On behalf of the GAC

L Hyne
Chairman of the GAC

23 February 2012

Directors' report

for the year ended 31 December 2011

The Directors have pleasure in presenting their report which forms part of the audited annual financial statements of the Company and the Group for the year ended 31 December 2011.

1. Nature of business

The Company is a registered bank controlling and investment holding company incorporated in the Republic of South Africa. Through its subsidiaries, the Company is involved in the full spectrum of domestic and international banking and financial services to niche markets in business, commercial and alliance banking.

2. Holding company

The majority shareholder of the Company is CGD (91.75%).

3. Financial results

An overview of the financial results is set out in the Group Review commencing on page 6. Details of the Company and Group financial results are set out on pages 31 to 89 and in the opinion of the Directors require no further comment.

4. Share capital

There were no changes to the authorised and issued share capital of the Company during the year (2010: nil). The authorised and issued share capital of the Company and Group is detailed in note 14 to the annual financial statements.

5. Directors, Company Secretary and registered addresses

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

J A S de Andrade Campos*+ (Chairman)
D J Brown# (CEO)
G P de Kock°
L Hyne°
A T Ikalafeng°
K R Kumbier#
J P M Lopes*#
T H Njikizana^°

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

The Directors of the Company as at 23 February 2012 are shown on page 4.

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

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

6. Dividends

No dividend was declared during the year under review (2010: nil).

7. Subsidiary companies and companies not consolidated

All subsidiary companies are incorporated in the Republic of South Africa. A register containing details of all non-trading companies is available for inspection at the registered office of the Company.

Aggregate income after tax earned by subsidiaries amounted to R138.0 million (2010: R110.0 million) and aggregate losses amounted to R2.4 million (2010: R7.9 million).

Directors' report

for the year ended 31 December 2011 (continued)

7. Subsidiary companies and companies not consolidated (continued)

The principal consolidated subsidiary companies are as follows:

	Issued share capital	Effective holding	Nature of business	Shares at cost		Owing to subsidiaries	
				2011	2010	**2011**	2010
	R'000	**%**		**R'000**	R'000	**R'000**	R'000
Company name							
Custom Capital (Pty) Ltd		74.9	Rental finance	**–**	–	**–**	–
LSM (Troyeville) Properties (Pty) Ltd	–	100	Property holding	**140**	140	**–**	–
Mercantile Bank Limited	124 969	100	Banking	**1 485 448**	1 485 448	**–**	12 757
Mercantile Insurance Brokers (Pty) Ltd	250	100	Insurance broking	**294**	294	**–**	–
Multi Risk Investment Holdings (Pty) Ltd		51	Insurance and assurance broking	**39 658**	–	**–**	–
Portion 2 of Lot 8 Sandown (Pty) Ltd	–	100	Property holding	**8 832**	8 832	**–**	–

Mercantile E-Bureau (Pty) Ltd has not been consolidated into the Group's results, the impact being immaterial.

8. Going concern

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

9. Special resolutions

Four special resolutions were adopted at the AGM held on 1 June 2011 to amend the Company's Memorandum of Incorporation (previously the Articles of Association) in relation to the office of directors, directors' rotation and communication to shareholders by electronic means.

10. Events after the reporting period

In a Stock Exchange News Services announcement dated 15 February 2012, the shareholders were advised that the Board had decided the Company would make an offer to minority shareholders by way of a scheme of arrangement to acquire all of their shares at a consideration of 52 cents per share, subject to all the required approvals being obtained. This process is currently underway.

Accounting policies

for the year ended 31 December 2011

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

1. Basis of presentation

The Company and Group annual financial statements have been prepared in accordance with IFRS issued by the International Accounting Standards Board and AC 500 issued by the Accounting Practices Board, using the historical cost convention as modified by the revaluation of certain financial assets, liabilities and properties.

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

2. Basis of consolidation

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between Group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

3. Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are generally recognised in profit or loss as incurred. At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value.

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed.

The interest of the non-controlling interest in the acquiree is initially measured at the non-controlling interest's proportion of the net realisable assets of the acquiree.

4. Goodwill

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business (see note 3 above) less accumulated impairment losses, if any.

Goodwill is tested for impairment annually. Any impairment loss for goodwill is recognised directly in profit or loss in the consolidated statement of comprehensive income. An impairment loss recognised for goodwill is not reversed in subsequent periods. On disposal of the relevant business, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

5. Recognition of assets and liabilities

5.1 Assets

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

5.2 Liabilities

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

5.3 Provisions

Provisions are recognised when the Group has a present legal or constructive 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 and a reliable estimate of the amount of the obligation can be made.

5.4 Contingent liabilities

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

6. Financial instruments

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

Accounting policies

for the year ended 31 December 2011 (continued)

6. Financial instruments (continued)

The Group derecognises a financial asset when:

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

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

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

6.1 Derivative financial instruments

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

The Group 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 options.

Derivative financial instruments ("derivatives") are not entered into for trading or speculative purposes. All derivatives are recognised in the statement of financial position. Derivative financial instruments are initially recorded at cost and are remeasured to fair value, excluding transactions costs, at each subsequent reporting date. Changes in the fair value of derivatives are recognised in profit and loss.

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

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

6.2 Financial assets

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

Financial assets at fair value through profit and loss

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

Available-for-sale

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

Cash and cash equivalents

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

Bank term deposits

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

Other investments

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

Negotiable securities

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

Accounting policies

for the year ended 31 December 2011 (continued)

6. Financial instruments (continued)

6.2 Financial assets (continued)

Negotiable securities (continued)

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

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

Loans and advances

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

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

Other account receivables

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

6.4 Financial liabilities

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

6.5 Fair value estimation

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

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

6.6 Amortised cost

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

6.7 Impairments

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

Advances which are deemed uncollectible are written off against the specific impairments. A direct reduction of an impaired financial asset occurs when the Group writes off an impaired account. The Group's policies set out the criteria for write-offs which involve an assessment of the likelihood of commercially viable recovery of the carrying amount of impaired financial assets. Both the specific and portfolio impairments raised during the year less the recoveries of advances previously written off, are charged to profit and loss. The recoverable amount is the sum of the estimated future cash flows, discounted to their present value using a pre-tax discount rate that reflects the portfolio of advances' effective interest rate.

If the recoverable amount of the advance is estimated to be less than the carrying amount, the carrying amount of the advance is reduced to its recoverable amount by raising a specific impairment which is recognised as an expense. Where the impairment loss subsequently reverses, the carrying amount of the advance is increased to the revised estimate of its recoverable amount, subject to the increased carrying amount not exceeding the carrying amount that would have been determined had no impairment loss been recognised for the advance in prior years. A reversal of an impairment loss is recognised through profit and loss immediately.

Accounting policies

for the year ended 31 December 2011 (continued)

7. Foreign currency transactions

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

8. Subsidiaries

Investments in subsidiaries in the Company's annual financial statements are designated as available-for-sale assets and are recognised at fair value. All gains and losses on the sale of subsidiaries are recognised in profit and loss.

9. Associated companies

Associated companies are those companies in which the Group exercises significant influence, but has no control or joint control over their financial and operating policies and holds between 20% and 50% interest therein.

The carrying values of investments in associated companies represent the aggregate of the cost of the investments plus post-acquisition equity-accounted income and reserves. These investments are accounted for using the equity method in the Group's annual financial statements. This method is applied from the effective date on which the enterprise became an associated company up to the date on which it ceases to be an associated company.

The results and assets and liabilities of associated companies are incorporated in the financial statements using the equity method of accounting.

10. Investment properties

Investment properties are held to earn rentals and/or for capital appreciation. The Group carries investment properties in the statement of financial position at open-market fair value based on valuations by independent registered professional valuators at each reporting date. The open-market fair value is based on capitalisation rates for open-market net rentals for each property. Fair value movements are included in profit and loss in the year in which they arise.

11. Property and equipment

Owner-occupied properties are held for use in the supply of services or for administrative purposes and are stated in the statement of financial position at open-market fair value on the basis of their existing use at the date of revaluation, less any subsequent accumulated depreciation calculated using the straight-line method and subsequent accumulated impairment losses. The open-market fair value is based on capitalisation rates for open-market net rentals for each property. Revaluations are performed annually by independent registered professional valuators.

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

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

Depreciation on equipment is calculated using the straight-line method to allocate cost to residual values over estimated useful lives. Leasehold improvements are depreciated over the period of the lease or over such lesser period as is considered appropriate. Equipment residual values and useful lives are reviewed for impairment where there are indicators of impairment and adjusted, if appropriate, at each reporting date.

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

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

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

Accounting policies

for the year ended 31 December 2011 (continued)

11. Property and equipment (continued)

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

12. Intangible assets

12.1 Computer software

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

Computer software and licenses that are recognised as intangible assets are amortised on the straight-line basis at rates appropriate to the expected useful lives of the assets which is usually between three and five years, but where appropriate over a maximum of 10 years and are carried at cost less any accumulated amortisation and any accumulated impairment losses.

12.2 Intangible assets acquired in a business combination

Intangible assets acquired in a business combination and recognised separately from goodwill are initially recognised at their fair value at the acquisition date (which is regarded as their cost). Such assets are amortised on the straight-line basis at rates appropriate to the expected useful lives of the assets, which is usually between one and five years.

Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and accumulated impairment losses on the same basis as intangible assets that are acquired separately.

12.3 Derecognition of intangible assets

An intangible asset is derecognised on disposal or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in profit or loss when the asset is derecognised.

12.4 Impairment of intangible assets

At the end of each reporting period, the Group reviews the carrying amounts of intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss.

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

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

13. 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.

14. Tax

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

14.1 Current tax

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

14.2 Deferred tax

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Accounting policies

for the year ended 31 December 2011 (continued)

14. Tax (continued)

14.2 Deferred tax (continued)

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

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

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

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

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

14.3 Current and deferred tax for the year

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

15. Instalment sales and leases

15.1 Group as the lessee

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

15.2 The Group 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.

16. Interest income and interest expense

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

17. 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.

18. Retirement funds

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

19. Post-retirement medical benefits

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

Accounting policies

for the year ended 31 December 2011 (continued)

20. Share-based payment arrangements

Equity-settled share-based payments to employees are measured at the fair value of the equity instruments at the grant date.

The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of equity instruments that will eventually vest, with a corresponding increase in equity. At the end of each reporting period, the Group revises its estimate of the number of equity instruments expected to vest. The impact of the revision of the original estimates, if any, is recognised in profit or loss such that the cumulative expense reflects the revised estimate, with a corresponding adjustment to the share-based payments reserve.

A Share Incentive Trust is used for share option awards and its financial position and results are consolidated.

For cash-settled share-based payments, a liability is recognised for the goods or services acquired, measured initially at the fair value of the liability. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured with any changes in fair value recognised in profit or loss for the year.

21. Key assumptions and estimates applied by management

The Group 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.

21.1 Impairment losses on loans and advances

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

21.2 Fair value of financial instruments

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

21.3 Impairment of available-for-sale equity investments

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

21.4 Income taxes

There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group 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.

Accounting policies

for the year ended 31 December 2011 (continued)

22. Recent accounting developments

There are new and revised standards and interpretations in issue that are not yet effective and there are no plans to early adopt. These include the following standards and interpretations that could be applicable to the business of the Group and may have an impact on future financial statements. The impact of initial application of the following standards has not been assessed as at the date of authorisation of the annual financial statements and will be applied for years ending after 31 December 2011:

	Standard	**Effective date**
IFRS 7	Financial Instruments: Disclosures: Amendments enhancing disclosures about transfers of financial assets	Annual periods beginning on or after 1 July 2011
IFRS 7	Financial Instruments: Amendments enhancing disclosures about offsetting of financial assets and financial liabilities	Annual periods beginning 1 January 2013 and interim periods within those periods
IFRS 7	Financial Instruments: Amendments requiring disclosures about the initial application of IFRS 9	Annual periods beginning on or after 1 January 2015 (or otherwise when IFRS 9 is first applied)
IFRS 9	Financial Instruments: Classification and measurement	Annual periods beginning on or after 1 January 2015
IFRS 10	Consolidated financial statements	Annual periods beginning on or after 1 January 2013
IFRS 11	Joint arrangements	Annual periods beginning on or after 1 January 2013
IFRS 12	Disclosure of interest in other entities	Annual periods beginning on or after 1 January 2013
IFRS 13	Fair value measurement	Annual periods beginning on or after 1 January 2013
IAS 1	Presentation of financial statements – Amendments to revise the way other comprehensive income is presented	Annual periods beginning on or after 1 July 2012
IAS 12	Income taxes: Limited scope amendment (recovery of underlying assets)	Annual periods beginning on or after 1 January 2012
IAS 19	Employee benefits – Amended standard resulting from the post-employment benefits and termination benefits projects	Annual periods beginning on or after 1 January 2013
IAS 27	Consolidated and separate financial statements – Reissued as IAS 27 Separate financial statements	Annual periods beginning on or after 1 January 2013
IAS 28	Investments in associates – Reissued as IAS 28 Investments in associated and joint ventures	Annual periods beginning on or after 1 July 2013
IAS 32	Financial instruments: Presentation – Application guidance amendments relating to the offsetting of financial assets and financial liabilities	Annual periods beginning on or after 1 January 2014

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

	Standard/Interpretation	**Effective date**
IFRS 1	First-time Adoption of IFRS: Replacement of 'fixed dates' for certain exceptions with 'the date of transition to IFRSs'	Annual periods beginning on or after 1 July 2011
IFRS 1	First-time Adoption of IFRS: Additional exemption for entities ceasing to suffer from severe hyperinflation	Annual periods beginning on or after 1 July 2011
IFRIC 20	Stripping costs in the production phase of a surface mine	Annual periods beginning on or after 1 January 2013

Statements of financial position

at 31 December 2011

		Group		Company	
		2011	2010	**2011**	2010
	Note	**R'000**	R'000	**R'000**	R'000
ASSETS					
Intangible assets	2	**216 086**	224 402	**–**	–
Property and equipment	3	**129 568**	126 887	**–**	–
Goodwill	4	**49 932**	–	**–**	–
Tax	5	**–**	101	**–**	–
Other accounts receivable	6	**87 434**	49 021	**7**	7
Interest in subsidiaries	7	**–**	–	**1 697 522**	1 555 647
Other investments	8	**63 789**	10 969	**62**	29
Deferred tax assets	9	**17 737**	62 382	**–**	–
Loans and advances	10	**4 489 863**	3 720 907	**–**	–
Derivative financial instruments	11	**15 657**	34 717	**–**	–
Negotiable securities	12	**192 588**	265 028	**–**	–
Cash and cash equivalents	13	**952 621**	1 759 897	**223**	223
Total assets		**6 215 275**	6 254 311	**1 697 814**	1 555 906
EQUITY AND LIABILITIES					
Total equity attributable to equity holders of the parent		**1 678 774**	1 539 394	**1 697 781**	1 555 892
Share capital and share premium	14	**1 202 948**	1 202 760	**1 210 143**	1 210 143
Capital redemption reserve fund		**3 788**	3 788	**3 788**	3 788
Share-based payments reserve		**–**	3 190	**–**	–
General reserve		**7 478**	7 478	**–**	–
Property revaluation reserve		**62 433**	54 547	**–**	–
Available-for-sale reserve		**21 291**	10 502	**1 074 490**	991 239
Retained earnings/(Accumulated loss)		**380 836**	257 129	**(590 640)**	(649 278)
Non-controlling interests		**(3 185)**	–	**–**	–
Total equity		**1 675 589**	1 539 394	**1 697 781**	1 555 892
Liabilities		**4 539 686**	4 714 917	**33**	14
Deferred tax liabilities	9	**27 066**	21 038	**–**	–
Deposits	15	**4 251 543**	4 563 988	**–**	–
Derivative financial instruments	11	**17 130**	28 122	**–**	–
Provisions and other liabilities	16	**50 191**	29 920	**–**	–
Other accounts payable	18	**192 836**	71 849	**33**	14
Tax	5	**920**	–	**–**	–
Total equity and liabilities		**6 215 275**	6 254 311	**1 697 814**	1 555 906

Statements of comprehensive income

for the year ended 31 December 2011

		Group		Company	
		2011	2010	**2011**	2010
	Note	**R'000**	R'000	**R'000**	R'000
Interest income	20	**447 835**	450 918	**–**	–
Interest expense	21	**(181 408)**	(194 558)	**–**	–
Net interest income		**266 427**	256 360	**–**	–
Net charge for credit losses	10.4	**(11 618)**	(3 422)	**–**	–
Net interest income after credit losses		**254 809**	252 938	**–**	–
Net gain on disposal of available-for-sale investments		**–**	885	**–**	–
Net non-interest income		**267 936**	168 485	**59 929**	–
Non-interest income	22	**356 255**	271 587	**59 929**	–
Fee and commission expenditure	23	**(128 168)**	(103 102)	**–**	–
Gains on remeasurement to fair value on unlisted investments	8	**39 849**	–	**–**	–
Net interest and non-interest income		**522 745**	422 308	**59 929**	–
Operating expenditure	24	**(345 473)**	(278 804)	**(1 291)**	(1 064)
Operating profit		**177 272**	143 504	**58 638**	(1 064)
Share of income from associated company		**–**	567	**–**	–
Profit/(Loss) before tax		**177 272**	144 071	**58 638**	(1 064)
Tax	25	**(48 161)**	(43 045)	**–**	–
Profit/(Loss) after tax		**129 111**	101 026	**58 638**	(1 064)
Other comprehensive income/(loss)					
Revaluation of owner-occupied properties		**11 456**	2 554	**–**	–
Gains/(Losses) on remeasurement to fair value on other investments and negotiable securities		**12 545**	(3 331)	**83 251**	102 145
Release to profit and loss on disposal of available-for-sale financial assets		**–**	(885)	**–**	–
Tax relating to other comprehensive income/loss		**(5 326)**	120	**–**	–
Other comprehensive income/(loss) net of tax		**18 675**	(1 542)	**83 251**	102 145
Total comprehensive income		**147 786**	99 484	**141 889**	101 081
Profit/(Loss) after tax attributable to:					
Equity holders of the parent		**123 598**	101 026	**58 638**	(1 064)
Non-controlling interests		**5 513**	–	**–**	–
		129 111	101 026	**58 638**	(1 064)
Total comprehensive income attributable to:					
Equity holders of the parent		**142 273**	99 484	**141 889**	101 081
Non-controlling interests		**5 513**	–	**–**	–
		147 786	99 484	**141 889**	101 081
Earnings per ordinary share (cents)	26.1	**3.2**	2.6		
Diluted earnings per ordinary share (cents)	26.2	**3.2**	2.6		

Statements of changes in equity

for the year ended 31 December 2011

	Share capital and share premium R'000	Capital redemption reserve fund R'000	Share-based payments reserve R'000	General reserve R'000	Property revaluation reserve R'000	Available-for-sale reserve R'000	Retained earnings R'000	Attributable to equity holders of the parent R'000	Non-controlling interests R'000	Total R'000
Group										
Balance at 1 January 2010	1 202 571	3 788	1 894	7 478	52 708	13 883	155 349	1 437 671	–	1 437 671
Net movement for the year	189	–	1 296	–	1 839	(3 381)	101 780	101 723	–	101 723
Total comprehensive income for the year	–	–	–	–	1 839	(3 381)	101 026	99 484	–	99 484
Profit after tax	–	–	–	–	–	–	101 026	101 026	–	101 026
Other comprehensive income/(loss)	–	–	–	–	2 554	(4 216)	–	(1 662)	–	(1 662)
Tax relating to other comprehensive income	–	–	–	–	(715)	835	–	120	–	120
Decrease of treasury shares held within the Group	189	–	–	–	–	–	–	189	–	189
Vesting of conditional share plan awards	–	–	(104)	–	–	–	–	(104)	–	(104)
Share-based payments expense	–	–	1 400	–	–	–	754	2 154	–	2 154
Balance at 31 December 2010	**1 202 760**	**3 788**	**3 190**	**7 478**	**54 547**	**10 502**	**257 129**	**1 539 394**	**–**	**1 539 394**
Net movement for the year	**188**	**–**	**(3 190)**	**–**	**7 886**	**10 789**	**123 707**	**139 380**	**(3 185)**	**136 195**
Total comprehensive income for the year	**–**	**–**	**–**	**–**	**7 886**	**10 789**	**123 598**	**142 273**	**5 513**	**147 786**
Profit after tax	**–**	**–**	**–**	**–**	**–**	**–**	**123 598**	**123 598**	**5 513**	**129 111**
Other comprehensive income	**–**	**–**	**–**	**–**	**11 456**	**12 545**	**–**	**24 001**	**–**	**24 001**
Tax relating to other comprehensive income	**–**	**–**	**–**	**–**	**(3 570)**	**(1 756)**	**–**	**(5 326)**	**–**	**(5 326)**
Non-controlling interest arising from the acquisition of Multi Risk Investment Holdings (Pty) Ltd	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**(8 698)**	**(8 698)**
Decrease of treasury shares held within the Group	**188**	**–**	**–**	**–**	**–**	**–**	**–**	**188**	**–**	**188**
Vesting of conditional share plan awards	**–**	**–**	**(1 544)**	**–**	**–**	**–**	**–**	**(1 544)**	**–**	**(1 544)**
Conversion of conditional share plan	**–**	**–**	**(1 646)**	**–**	**–**	**–**	**–**	**(1 646)**	**–**	**(1 646)**
Share-based payments expense	**–**	**–**	**–**	**–**	**–**	**–**	**109**	**109**	**–**	**109**
Balance at 31 December 2011	**1 202 948**	**3 788**	**–**	**7 478**	**62 433**	**21 291**	**380 836**	**1 678 774**	**(3 185)**	**1 675 589**

Statements of changes in equity

for the year ended 31 December 2011 (continued)

	Share capital and share premium R'000	Capital redemption reserve fund R'000	Available-for-sale reserve R'000	Accumulated loss R'000	Total R'000
Company					
Balance at 1 January 2010	1 210 143	3 788	889 094	(648 214)	1 454 811
Net movement for the year/Total comprehensive income for the year	–	–	102 145	(1 064)	101 081
Loss after tax	–	–	-	(1 064)	(1 064)
Other comprehensive income	–	–	102 145	-	102 145
Balance at 31 December 2010	**1 210 143**	**3 788**	**991 239**	**(649 278)**	**1 555 892**
Net movement for the year/Total comprehensive income for the year	–	–	**83 251**	**58 638**	**141 889**
Profit after tax	–	–	–	**58 638**	**58 638**
Other comprehensive income	–	–	**83 251**	–	**83 251**
Balance at 31 December 2011	**1 210 143**	**3 788**	**1 074 490**	**(590 640)**	**1 697 781**

Statements of cash flows

for the year ended 31 December 2011

		Group		Company	
		2011	2010	**2011**	2010
	Note	**R'000**	R'000	**R'000**	R'000
Cash flows from operating activities					
Cash receipts from customers	27.1	**810 568**	716 255	**–**	–
Cash paid to customers, suppliers and employees	27.2	**(598 890)**	(551 098)	**(1 291)**	(1 064)
Cash generated from/(utilised in) operations	27.3	**211 678**	165 157	**(1 291)**	(1 064)
Dividends received		**364**	348	**59 929**	–
Tax (paid)/recovered	27.4	**(7 389)**	(118)	**–**	256
Net (increase) in income earning assets	27.5	**(706 760)**	(53 431)	**–**	–
Net (decrease)/increase in deposits and other accounts	27.6	**(263 325)**	308 793	**(18 980)**	807
Net cash (outflow)/inflow from operating activities		**(765 432)**	420 749	**39 658**	(1)
Cash flows from investing activities					
Purchase of intangible assets	2.1	**(8 583)**	(74 896)	**–**	–
Purchase of property and equipment	3	**(1 970)**	(3 569)	**–**	–
Acquisition of subsidiaries	30.3	**–**	–	**(39 658)**	–
Net cash outflow from acquisition of subsidiaries	30.8	**(31 353)**	–	**–**	–
Proceeds on disposal of property and equipment		**62**	–	**–**	–
Proceeds on disposal of investments		**–**	12 875	**–**	–
Dividends received and capital repayment from associated company		**–**	3 801	**–**	–
Net cash (outflow) from investing activities		**(41 844)**	(61 789)	**(39 658)**	–
Net cash (outflow)/inflow for the year		**(807 276)**	358 960	**–**	(1)
Cash and cash equivalents at the beginning of the year		**1 759 897**	1 400 937	**223**	224
Cash and cash equivalents at the end of the year	13	**952 621**	1 759 897	**223**	223

Notes to the annual financial statements

for the year ended 31 December 2011

	Group 2011 Fair value R'000	Group 2011 Carrying amount R'000	Group 2010 Fair value R'000	Group 2010 Carrying amount R'000
1. Categories and fair values of financial instruments				
1.1 Category analysis of financial instruments				
Assets				
Available-for-sale	**42 814**	**42 814**	30 201	30 201
Other investments	**23 940**	**23 940**	10 969	10 969
Negotiable securities – Government stock	**18 874**	**18 874**	19 232	19 232
Loans and receivables	**5 646 345**	**5 647 847**	5 698 203	5 699 526
Loans and advances				
Current accounts	**911 714**	**911 714**	617 914	617 914
Credit card	**15 352**	**15 352**	14 249	14 249
Mortgage loans	**2 006 772**	**2 006 772**	1 813 965	1 813 965
Instalment sales and leases	**481 275**	**481 275**	263 906	263 906
Structured loans	**94 037**	**94 037**	211 045	211 045
Other advances	**924 928**	**924 928**	723 632	723 632
Negotiable securities				
Treasury bills	**172 212**	**173 714**	214 435	215 758
Land Bank promissory notes	–	–	30 038	30 038
Cash and cash equivalents	**952 621**	**952 621**	1 759 897	1 759 897
Tax	–	–	101	101
Other accounts receivable	**87 434**	**87 434**	49 021	49 021
Designated at fair value through profit and loss	**95 634**	**95 634**	76 196	76 196
Loans and advances				
Mortgage loans	**34 749**	**34 749**	38 641	38 641
Instalment sales and leases	–	–	66	66
Other advances	**21 036**	**21 036**	37 489	37 489
Other investments	**39 849**	**39 849**	–	–
Held-for-trading				
Derivative financial instruments	**15 657**	**15 657**	34 717	34 717
	5 800 450	**5 801 952**	5 839 317	5 840 640

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 Fair value R'000	Group 2011 Carrying amount R'000	Group 2010 Fair value R'000	Group 2010 Carrying amount R'000
1. Categories and fair values of financial instruments (continued)				
1.1 Category analysis of financial instruments (continued)				
Liabilities				
Held-for-trading				
Derivative financial instruments	**17 130**	**17 130**	28 122	28 122
Amortised cost	**4 445 299**	**4 445 299**	4 635 837	4 635 837
Deposits	**4 251 543**	**4 251 543**	4 563 988	4 563 988
Tax	**920**	**920**	–	–
Other accounts payable	**192 836**	**192 836**	71 849	71 849
	4 462 429	**4 462 429**	4 663 959	4 663 959

	Company 2011 Fair value R'000	Company 2011 Carrying amount R'000	Company 2010 Fair value R'000	Company 2010 Carrying amount R'000
Assets				
Available-for-sale	**1 697 584**	**1 697 584**	1 555 676	1 555 676
Other investments	**62**	**62**	29	29
Interest in subsidiaries	**1 697 522**	**1 697 522**	1 555 647	1 555 647
Loans and receivables	**230**	**230**	230	230
Cash and cash equivalents	**223**	**223**	223	223
Other accounts receivable	**7**	**7**	7	7
	1 697 814	**1 697 814**	1 555 906	1 555 906
Liabilities				
Amortised cost				
Other accounts payable	**33**	**33**	14	14
	33	**33**	14	14

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

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

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

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

1.3 Fair value measurements recognised in the statement of financial position

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

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

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group			
	Level 1	Level 2	Level 3	Total
	R'000	R'000	R'000	R'000
1. Categories and fair values of financial instruments (continued)				
1.3 Fair value measurements recognised in the statement of financial position (continued)				
2011				
Assets				
Available-for-sale				
Other investments*	**18 912**	**–**	**5 028**	**23 940**
Negotiable securities – Government stock	**18 874**	**–**	**–**	**18 874**
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	**–**	**34 749**	**–**	**34 749**
Other advances	**–**	**21 036**	**–**	**21 036**
Other investments	**–**	**–**	**39 849**	**39 849**
Held-for-trading				
Derivative financial instruments	**15 657**	**–**	**–**	**15 657**
	53 443	**55 785**	**44 877**	**154 105**
Liabilities				
Held-for-trading				
Derivative financial instruments	**17 130**	**–**	**–**	**17 130**
	17 130	**–**	**–**	**17 130**
2010				
Assets				
Available-for-sale				
Other investments*	10 724	245	–	10 969
Negotiable securities – Government stock	19 232	–	–	19 232
Designated at fair value through profit and loss				
Loans and advances				
Mortgage loans	–	38 641	–	38 641
Instalment sales and leases	–	66	–	66
Other advances	–	37 489	–	37 489
Other investments	–	–	–	–
Held-for-trading				
Derivative financial instruments	34 717	–	–	34 717
	64 673	76 441	–	141 114
Liabilities				
Held-for-trading				
Derivative financial instruments	28 122	–	–	28 122
	28 122	–	–	28 122

* Based on further analysis, available-for-sale other investments previously categorised as Level 2 have been transferred to Level 3 in 2011 (refer to note 1.4).

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

A Level 3 investment was disposed of during 2010.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Company			
	Level 1	**Level 2**	**Level 3**	**Total**
	R'000	**R'000**	**R'000**	**R'000**
1. Categories and fair values of financial instruments (continued)				
1.3 Fair value measurements recognised in the statement of financial position (continued)				
2011				
Assets				
Available-for-sale				
Other investments*	**–**	**–**	**62**	**62**
2010				
Assets				
Available-for-sale				
Other investments*	–	29	–	29

* Based on further analysis, available-for-sale other investments previously categorised as Level 2 have been transferred to Level 3 in 2011 (refer to note 1.4).

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

	Group	
	2011	2010
	R'000	R'000
1.4 Reconciliation of Level 3 fair value measurements of financial assets		
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning of the year	**–**	–
Transfer from Level 2 (refer to note 1.3)	**245**	–
Gains on remeasurement to fair value in comprehensive income	**4 783**	–
Balance at the end of the year	**5 028**	–
Designated at fair value through profit and loss		
Other investments – unlisted equities		
Balance at the beginning of the year	**–**	7 682
Gains on remeasurement to fair value in comprehensive income	**39 849**	2 032
Realisation	**–**	(9 714)
Balance at the end of the year	**39 849**	–

	Company	
	2011	2010
	R'000	R'000
Available-for-sale		
Other investments – unlisted equities		
Balance at the beginning of the year	**–**	–
Transfer from Level 2 (refer to note 1.3)	**29**	–
Gains on remeasurement to fair value in comprehensive income	**33**	–
Balance at the end of the year	**62**	–

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group	
	2011	2010
	R'000	R'000
2. Intangible assets		
2.1 Computer software		
Cost at the beginning of the year	**296 928**	221 805
Additions	**8 583**	74 896
Acquisitions through business combinations (refer to note 30.4)	**291**	–
Net transfer from property and equipment*	**487**	227
Write-off of obsolete computer software	**(3 741)**	–
Cost at the end of the year	**302 548**	296 928
Accumulated amortisation and impairment losses at the beginning of the year	**(72 526)**	(51 480)
Amortisation	**(25 791)**	(20 819)
Acquisitions through business combinations (refer to note 30.4)	**(229)**	–
Net transfer (from) property and equipment*	**–**	(227)
Write-off of obsolete computer software	**2 908**	–
Accumulated amortisation and impairment losses at the end of the year	**(95 638)**	(72 526)
Net carrying amount at the end of the year	**206 910**	224 402

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

2.2 Intangible asset acquired in a business combination		
Contractual and customer relationships		
Balance at the beginning of the year	**–**	–
Acquisitions through business combinations	**10 598**	–
Balance at the end of the year	**10 598**	–
Accumulated amortisation and impairment losses at the beginning of the year	**–**	–
Amortisation	**(1 422)**	–
Accumulated amortisation and impairment losses at the end of the year	**(1 422)**	–
Net carrying amount at the end of the year	**9 176**	–
Total net carrying amount at the end of the year	**216 086**	224 402

During 2010 and 2011 the Group identified no events or circumstances that would indicate that the Group's intangible assets may need to be impaired.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Owner-occupied properties R'000	Leasehold improvements R'000	Computer equipment R'000	Furniture and fittings R'000	Office equipment R'000	Motor vehicles R'000	Total R'000
3. Property and equipment							
Group							
2011							
Open market value/cost at the beginning of the year	**97 164**	**19 663**	**94 078**	**9 967**	**31 685**	**492**	**253 049**
Revaluations	**9 400**	**–**	**–**	**–**	**–**	**–**	**9 400**
Additions	**–**	**–**	**497**	**175**	**910**	**388**	**1 970**
Acquisitions through business combinations (refer to note 30.4)	**–**	**–**	**1 025**	**1 795**	**323**	**305**	**3 448**
Transfer*	**–**	**–**	**(2 926)**	**10**	**2 429**	**–**	**(487)**
Write-off of obsolete assets	**–**	**–**	**(3 704)**	**(120)**	**(9)**	**(179)**	**(4 012)**
Disposals	**–**	**–**	**–**	**–**	**–**	**(75)**	**(75)**
Open market value/cost at the end of the year	**106 564**	**19 663**	**88 970**	**11 827**	**35 338**	**931**	**263 293**
Accumulated depreciation and impairment losses at the beginning of the year	**–**	**(16 154)**	**(75 640)**	**(9 403)**	**(24 527)**	**(438)**	**(126 162)**
Depreciation	**(2 056)**	**(692)**	**(5 881)**	**(283)**	**(2 508)**	**(98)**	**(11 518)**
Revaluation	**2 056**	**–**	**–**	**–**	**–**	**–**	**2 056**
Acquisitions through business combinations (refer to note 30.4)	**–**	**–**	**(802)**	**(936)**	**(158)**	**(230)**	**(2 126)**
Transfer*	**–**	**–**	**–**	**(10)**	**10**	**–**	**–**
Write-off of obsolete assets	**–**	**–**	**3 704**	**120**	**9**	**179**	**4 012**
Disposals	**–**	**–**	**–**	**–**	**–**	**13**	**13**
Accumulated depreciation and impairment losses at the end of the year	**–**	**(16 846)**	**(78 619)**	**(10 512)**	**(27 174)**	**(574)**	**(133 725)**
Net carrying amount at the end of the year	**106 564**	**2 817**	**10 351**	**1 315**	**8 164**	**357**	**129 568**
2010							
Open market value/cost at the beginning of the year	96 464	19 591	91 915	9 967	30 631	492	249 060
Revaluations	700	–	–	–	–	–	700
Additions	–	72	2 417	3	1 077	–	3 569
Transfer*	–	–	(227)	–	–	–	(227)
Write-off of obsolete assets	–	–	(27)	–	(23)	–	(50)
Disposals	–	–	–	(3)	–	–	(3)
Open market value/cost at the end of the year	97 164	19 663	94 078	9 967	31 685	492	253 049
Accumulated depreciation and impairment losses at the beginning of the year	–	(15 410)	(70 358)	(9 227)	(22 192)	(390)	(117 577)
Depreciation	(1 854)	(744)	(5 530)	(179)	(2 358)	(48)	(10 713)
Revaluation	1 854	–	–	–	–	–	1 854
Transfer*	–	–	227	–	–	–	227
Write-off of obsolete assets	–	–	21	–	23	–	44
Disposals	–	–	–	3	–	–	3
Accumulated depreciation and impairment losses at the end of the year	–	(16 154)	(75 640)	(9 403)	(24 527)	(438)	(126 162)
Net carrying amount at the end of the year	97 164	3 509	18 438	564	7 158	54	126 887

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

G J Van Zyl, a valuator with Van Zyl Valuers and a Member of The Institute of Valuers of South Africa, independently valued the properties at 31 December 2011.

A register containing details of owner-occupied properties and the revaluation thereof is available for inspection at the registered office of the Company.

	Group	
	2011 R'000	2010 R'000
Historical cost of properties that have been revalued	**36 910**	36 910

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 R'000	Group 2010 R'000
4. Goodwill		
Carrying value at the beginning of the year	–	–
Amounts recognised from business combinations occurring during the year (refer to note 30.6)	**49 932**	–
	49 932	–

Goodwill represents the excess of fair value of certain assets and liabilities acquired by the Group.

Impairment testing of goodwill is done annually, or more frequently if required, by comparing the net carrying value to the estimated value in use. No impairment losses on goodwill were recognised during 2011.

	Group 2011 R'000	Group 2010 R'000
5. Tax		
South African Revenue Services		
Tax overpaid	–	101
Tax owing	**920**	–

	Group 2011 R'000	Group 2010 R'000	Company 2011 R'000	Company 2010 R'000
6. Other accounts receivable				
Items in transit	**20 757**	21 254	–	–
Prepayments and deposits	**8 670**	3 887	**7**	7
Other receivables	**58 007**	23 880	–	–
	87 434	49 021	**7**	7

	Company 2011 R'000	Company 2010 R'000
7. Interest in subsidiaries		
Unlisted		
Shares at fair value	**1 691 280**	1 568 404
Mercantile Bank Limited	**1 649 693**	1 566 781
Mercantile Insurance Brokers (Pty) Ltd	**1 929**	1 623
Multi Risk Investment Holdings (Pty) Ltd	**39 658**	–
Loan – amount owing from Multi Risk Investment Holdings (Pty) Ltd	**6 242**	–
Loan – amount owing to Mercantile Bank Limited	–	(12 757)
	1 697 522	1 555 647

A list of principal subsidiary companies is contained in note 7 of the Directors' report. The loans are interest-free and have no fixed terms of maturity.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group		Company	
	2011	2010	**2011**	2010
	R'000	R'000	**R'000**	R'000
8. Other investments				
Available-for-sale				
Unlisted equities	**5 028**	245	**62**	29
Listed equities – Visa Inc.	**18 912**	10 724	**–**	–
Designated at fair value through profit and loss				
Unlisted equities*	**39 849**	–	**–**	–
	63 789	10 969	**62**	29

* Certain zero cost equity options which were acquired in prior years as part of the structured loan portfolio were converted into equity in 2011 resulting in the recognition of fair value adjustments of R39.849 million (2010: nil).

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

	Group	
	2011	2010
	R'000	R'000
9. Deferred tax		
Balance at the beginning of the year	**41 344**	84 066
Acquisitions through business combinations (refer to note 30.4)	**(2 996)**	–
Current year charge		
Per the statement of comprehensive income	**(42 351)**	(42 842)
Per the statement of changes in equity/other comprehensive income	**(5 326)**	120
	(9 329)	41 344
Comprising		
Deferred tax assets	**17 737**	62 382
Deferred tax liabilities	**(27 066)**	(21 038)
	(9 329)	41 344
Deferred tax is attributable to the following temporary differences		
Assets		
Intangible assets	**(37 223)**	(28 944)
Property and equipment	**(123)**	(157)
Provisions and other liabilities	**(10 523)**	(10 661)
Calculated tax losses	**45 514**	83 087
Other	**20 092**	19 057
	17 737	62 382
Liabilities		
Revaluations	**28 224**	27 060
Other	**(1 158)**	(6 022)
	27 066	21 038

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

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 R'000	Group 2010 R'000
10. Loans and advances		
10.1 Product analysis		
Amortised cost	**4 510 591**	3 712 206
Current accounts	**931 610**	633 290
Credit card	**19 777**	18 968
Mortgage loans	**2 018 908**	1 824 348
Instalment sales and leases	**490 805**	268 408
Structured loans	**103 081**	230 036
Other advances	**946 410**	737 156
Designated at fair value through profit and loss	**55 822**	76 285
Mortgage loans	**34 754**	38 665
Instalment sales and leases	**–**	66
Other advances	**21 068**	37 554
Gross loans and advances	**4 566 413**	3 788 491
Less: Portfolio impairments for credit losses	**(4 399)**	(5 513)
Specific impairments for credit losses	**(72 151)**	(62 071)
	4 489 863	3 720 907

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

	Group 2011 R'000	Group 2010 R'000
10.2 Maturity analysis		
Repayable on demand and maturing within one month	**1 114 304**	703 519
Maturing after one month but within six months	**20 442**	151 228
Maturing after six months but within 12 months	**72 608**	38 919
Maturing after 12 months	**3 359 059**	2 894 825
	4 566 413	3 788 491

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

	Gross amount R'000	Portfolio impairments R'000	Specific impairments R'000	Net balance R'000
10.3 Detailed product analysis of loans and advances				
Group				
2011				
Current accounts	**931 610**	**1 144**	**18 752**	**911 714**
Credit card	**19 777**	**811**	**3 614**	**15 352**
Mortgage loans	**2 053 662**	**309**	**11 832**	**2 041 521**
Instalment sales and leases	**490 805**	**592**	**8 938**	**481 275**
Structured loans	**103 081**	**62**	**8 982**	**94 037**
Other advances	**967 478**	**1 481**	**20 033**	**945 964**
	4 566 413	**4 399**	**72 151**	**4 489 863**
2010				
Current accounts	633 290	1 633	13 743	617 914
Credit card	18 968	658	4 061	14 249
Mortgage loans	1 863 013	1 145	9 262	1 852 606
Instalment sales and leases	268 474	650	3 852	263 972
Structured loans	230 036	88	18 903	211 045
Other advances	774 710	1 339	12 250	761 121
	3 788 491	5 513	62 071	3 720 907

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Total R'000	Current accounts R'000	Credit card R'000	Mortgage loans R'000	Instalment sales and leases R'000	Structured loans R'000	Other advances R'000
10. Loans and advances (continued)							
10.4 Impairments for credit losses							
Group							
2011							
Balance at the beginning of the year	**67 584**	**15 376**	**4 719**	**10 407**	**4 502**	**18 991**	**13 589**
Movements for the year:							
Credit losses written-off	**(1 982)**	**(705)**	**(412)**	**–**	**(308)**	**–**	**(557)**
Net impairments raised/(released)	**10 948**	**5 225**	**118**	**1 734**	**5 336**	**(9 947)**	**8 482**
Balance at the end of the year	**76 550**	**19 896**	**4 425**	**12 141**	**9 530**	**9 044**	**21 514**
2010							
Balance at the beginning of the year	64 828	5 273	4 757	3 684	3 469	18 874	28 771
Movements for the year:							
Credit losses written-off	(2 542)	(4)	(694)	(230)	(442)	–	(1 172)
Net impairments raised/(released)	5 298	10 107	656	6 953	1 475	117	(14 010)
Balance at the end of the year	67 584	15 376	4 719	10 407	4 502	18 991	13 589

	Group 2011 R'000	Group 2010 R'000
Net charge for credit losses in the statement of comprehensive income		
Net impairments raised	**(10 948)**	(5 298)
Amounts directly written off to other comprehensive income	**(1 448)**	–
Recoveries in respect of amounts previously written off	**778**	1 876
	(11 618)	(3 422)

	Gross amount R'000	Portfolio impairment R'000	Net balance R'000
10.5 Product analysis of performing loans and advances			
Group			
2011			
Current accounts	**894 578**	**1 144**	**893 434**
Credit card	**16 163**	**811**	**15 352**
Mortgage loans	**1 954 391**	**309**	**1 954 082**
Instalment sales and leases	**476 133**	**592**	**475 541**
Structured loans	**87 457**	**62**	**87 395**
Other advances	**924 863**	**1 481**	**923 382**
	4 353 585	**4 399**	**4 349 186**
2010			
Current accounts	608 089	1 633	606 456
Credit cards	14 884	658	14 226
Mortgage loans	1 761 523	1 145	1 760 378
Instalment sales and leases	257 594	650	256 944
Structured loans	181 207	88	181 119
Other advances	736 184	1 339	734 845
	3 559 481	5 513	3 553 968

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 R'000	Group 2010 R'000
10. Loans and advances (continued)		
10.6 Product analysis of performing loans and advances excluding loans and advances with renegotiated terms		
Current accounts	**894 578**	608 089
Credit card	**16 154**	14 884
Mortgage loans	**1 942 801**	1 749 528
Instalment sales and leases	**476 133**	256 885
Structured loans	**87 457**	181 207
Other advances	**913 704**	726 588
	4 330 827	3 537 181
10.7 Product analysis of loans and advances with renegotiated terms that would otherwise be past due or impaired		
Current accounts	**–**	–
Credit card	**9**	–
Mortgage loans	**11 590**	11 995
Instalment sales and leases	**–**	709
Structured loans	**–**	–
Other advances	**11 159**	9 596
	22 758	22 300

	Past due for: 1 – 30 days R'000	31 – 60 days R'000	61 – 90 days R'000	Total gross amount R'000	Fair value of collateral and other credit enhancements R'000
10.8 Product age analysis of loans and advances that are past due but not individually impaired					
Group					
2011					
Current accounts	**–**	**–**	**–**	**–**	**–**
Credit card	**–**	**–**	**–**	**–**	**–**
Mortgage loans	**23 430**	**13 012**	**25 527**	**61 969**	**58 645**
Instalment sales and leases	**95**	**23**	**906**	**1 024**	**871**
Structured loans	**–**	**–**	**–**	**–**	**–**
Other advances	**5 707**	**107**	**9 407**	**15 221**	**6 172**
	29 232	**13 142**	**35 840**	**78 214**	**65 688**
2010					
Current accounts	–	–	–	–	–
Credit cards	–	–	–	–	–
Mortgage loans	10 214	6 295	16 490	32 999	31 241
Instalment sales and leases	299	–	–	299	203
Structured loans	–	–	20 446	20 446	13 195
Other advances	1 536	4 346	3 562	9 444	6 032
	12 049	10 641	40 498	63 188	50 671

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

10. Loans and advances (continued)

10.9 Product analysis of loans and advances that are individually impaired

	Gross amount R'000	Specific impairment R'000	Net balance R'000	Fair value of collateral and other credit enhancements R'000
Group				
2011				
Current accounts	**37 032**	**18 752**	**18 280**	**9 507**
Credit card	**3 614**	**3 614**	**–**	**–**
Mortgage loans	**99 271**	**11 832**	**87 439**	**94 359**
Instalment sales and leases	**14 672**	**8 938**	**5 734**	**5 210**
Structured loans	**15 624**	**8 982**	**6 642**	**7 782**
Other advances	**42 615**	**20 033**	**22 582**	**18 730**
	212 828	**72 151**	**140 677**	**135 588**
2010				
Current accounts	25 201	13 743	11 458	8 076
Credit cards	4 084	4 061	23	–
Mortgage loans	101 490	9 262	92 228	97 716
Instalment sales and leases	10 880	3 852	7 028	7 128
Structured loans	48 829	18 903	29 926	36 233
Other advances	38 526	12 250	26 276	28 749
	229 010	62 071	166 939	177 902

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

10. Loans and advances (continued)

10.10 Collateral held as security and other credit enhancements

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

All customers of the Bank are accorded a client risk grading. The risk grading of a client is dependent upon the client's creditworthiness and standing with the Bank and is subjected to ongoing assessment of the client's financial standing and the acceptability of their dealings with the Bank including adherence to repayment terms and compliance with other 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	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	75% of professional valuation
Commercial and industrial properties	70% of professional valuation
Catering, industrial and office equipment	variable depending on asset type and depreciated value
Trucks	variable depending on asset type and depreciated value
Earthmoving equipment	variable depending on asset type and depreciated value
Motor vehicles	variable depending on asset type and depreciated value
General notarial bond	variable depending on asset type and depreciated value
Special notarial bond	variable depending on asset type and depreciated value

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

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

10.11 Structured loans

The Group has acquired zero-cost equity options attached to certain structured loans which have been recognised at cost in accordance with accounting policy 6.1.

	Notional principal of assets R'000	Fair value of assets R'000	Notional principal of liabilities R'000	Fair value of liabilities R'000
11. Derivative financial instruments				
Group				
2011				
Held-for-trading				
Foreign exchange contracts	**979 843**	**15 657**	**784 018**	**14 750**
Interest rate swaps	**–**	**–**	**50 573**	**2 380**
	979 843	**15 657**	**834 591**	**17 130**
2010				
Held-for-trading				
Foreign exchange contracts	1 319 956	34 658	363 419	23 525
Interest rate swaps	7 000	59	67 159	4 597
	1 326 956	34 717	430 578	28 122

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 R'000	Group 2010 R'000
12. Negotiable securities		
Loans and receivables		
Treasury bills	**173 714**	**215 758**
Promissory notes – Land Bank	–	**30 038**
Available-for-sale		
Government stock	**18 874**	**19 232**
	192 588	**265 028**
Maturity analysis		
Maturing within one month	**74 643**	49 782
Maturing after one month but within six months	**99 071**	191 188
Maturing after six months but within 12 months	–	4 826
Maturing after one year but within five years	**18 874**	–
Maturing after five years	–	19 232
	192 588	265 028

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

	Group 2011 R'000	Group 2010 R'000	Company 2011 R'000	Company 2010 R'000
13. Cash and cash equivalents				
Cash on hand	**38 128**	20 504	–	–
Central Bank balances	**125 632**	103 248	–	–
Money Market funds	**51 455**	305 787	–	–
Rand denominated domestic bank balances	**102 789**	185 378	**223**	223
Foreign currency denominated bank balances*	**634 617**	1 144 980	–	–
	952 621	1 759 897	**223**	223

* Refer to note 28.2 for balances with CGD included in this amount.

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
14. Share capital and share premium				
14.1 Issued – Group				
Shares in issue net of treasury shares at 1 January 2010	3 911 114 124	31 817	1 170 754	1 202 571
Decrease of treasury shares held within the Group	844 501	189	–	189
At 31 December 2010	3 911 958 625	32 006	1 170 754	1 202 760
Decrease of treasury shares held within the Group	**576 027**	**188**	–	**188**
At 31 December 2011	**3 912 534 652**	**32 194**	**1 170 754**	**1 202 948**

In total, 26 383 872 (December 2010: 26 959 899) Treasury shares have been eliminated from share capital and premium.

	Number of issued ordinary shares	Share capital R'000	Share premium R'000	Total R'000
14.2 Issued – Company				
At 31 December 2010 and 31 December 2011	**3 938 918 524**	**39 389**	**1 170 754**	**1 210 143**

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

14. Share capital and share premium (continued)

14.3. Authorised

The total authorised number of ordinary shares is 4 465 955 440 shares (2010: 4 465 955 440 shares) with a par value of 1 cent each. The total authorised number of preference shares is 15 150 486 shares (2009: 15 150 486 shares) with a par value of 25 cents each.

14.4 Unissued

The unissued ordinary and preference shares are under the control of the directors until the next AGM.

14.5. Share-based payments

The number of shares which could be utilised for the purposes of the share incentive schemes is 393 891 852 (2010: 393 891 852), which is 10% (2010: 10%) of the issued share capital of the Company at year-end. At the reporting date, 32 960 000 (2010: 34 254 400) share options and nil (2010: 74 940 000) conditional share plan awards were outstanding under these schemes. The balance available to be utilised under these schemes is 296 258 685 (2010: 286 197 452). The number of scheme shares that may be issued to a single participant is 59 083 778 (2010: 59 083 778) or 1.5% (2010: 1.5%) of the total number of issued shares.

The Group recognised an expense of R4.257 million (2010: R2.154 million) relating to equity and cash-settled share-based payment transactions and the conversion of the conditional share plan to the new cash-settled conditional phantom share plan (deferred bonus scheme) – refer to notes 16 and 24.

Share option scheme

In terms of the Trust Deed, as amended in 2007, options can be exercised in respect of 33% of the option shares after the expiration of three years from the offer date, a further 33% after the expiration of four years from the offer date and the remaining option shares after the expiration of five years from the offer date. Prior to 2008, should the options not have been exercised by the fifth anniversary date of the offer, the option holder was obliged to exercise the option in respect of at least 20% of the options in question by the sixth anniversary date of the offer or else the said 20% of the options would lapse. The same rule applied for the seventh, eighth, ninth and tenth anniversary of the offer date until the options in question either lapsed or were exercised.

The scheme was modified in 2008 to remove the expiry condition from the sixth anniversary date and all unexpired options now lapse after 10 years from the date of issue. The scheme was replaced by the conditional share plan and no further options were granted after implementation of the conditional share plan. As at 31 December 2011 all options issued under the scheme have vested.

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

Conditional share plan

The conditional share plan incentive scheme, implemented in 2008, aimed to attract, retain and reward selected employees who are able to contribute to the growth of the Group and provide for an incentive to encourage their continued employment relationship with the Group. By providing them with the opportunity to receive shares in the Company, participants are incentivised to advance the Group's interests and to ensure that the Group attracts and retains the core competencies required for formulating and implementing the Group's business strategies. The awards, other than a guaranteed 25% of all awards, were subject to performance conditions measured over a period of three years. Due to the ongoing lack of liquidity of the Company's shares in the market, the Board decided to discontinue new awards under the scheme for an indefinite period which may be reinstituted at a future date. All existing unvested awards were converted to a new cash-settled conditional phantom share plan, explained in note 16, which is a deferred bonus scheme.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

14. Share capital and share premium (continued)

14.5 Share-based payments (continued)

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

	Exercise price (cents)	Options at the beginning of the year	Forfeited/ Lapsed during the year	Exercised during the year	Options at the end of the year	Exercisable options at the end of the year	Relating to directors*
Share option scheme							
Grant date							
2011							
20 November 2001	**32**	**394 400**	**(394 400)**	–	–	–	–
11 February 2002	**32**	**160 000**	–	–	**160 000**	**160 000**	–
5 October 2004	**18**	**5 000 000**	–	–	**5 000 000**	**5 000 000**	**5 000 000**
7 October 2004	**17**	**250 000**	–	–	**250 000**	**250 000**	–
11 February 2005	**20**	**500 000**	–	–	**500 000**	**500 000**	–
27 July 2005	**32**	**750 000**	–	–	**750 000**	**750 000**	–
9 February 2006	**41**	**750 000**	–	–	**750 000**	**750 000**	–
22 March 2006	**40**	**9 800 000**	–	–	**9 800 000**	**9 800 000**	**7 000 000**
26 February 2007	**34**	**16 150 000**	**(400 000)**	–	**15 750 000**	**15 750 000**	**8 000 000**
1 June 2007	**36**	**500 000**	**(500 000)**	–	–	–	–
		34 254 400	**(1 294 400)**	–	**32 960 000**	**32 960 000**	**20 000 000**
2010							
20 November 2001	32	394 400	–	–	394 400	394 400	–
11 February 2002	32	160 000	–	–	160 000	160 000	–
5 October 2004	18	5 000 000	–	–	5 000 000	5 000 000	5 000 000
7 October 2004	17	750 000	–	(500 000)	250 000	250 000	–
11 February 2005	20	500 000	–	–	500 000	500 000	–
27 July 2005	32	750 000	–	–	750 000	750 000	–
9 February 2006	41	750 000	–	–	750 000	750 000	–
22 March 2006	40	10 600 000	(800 000)	–	9 800 000	9 800 000	7 000 000
26 February 2007	34	17 600 000	(1 450 000)	–	16 150 000	10 659 000	8 000 000
1 June 2007	36	500 000	–	–	500 000	330 000	–
		37 004 400	(2 250 000)	(500 000)	34 254 400	28 593 400	20 000 000

* Refer to note 28.3.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

14. Share capital and share premium (continued)

14.5 Share-based payments (continued)

	Market price at date of grant (cents)	Conditional awards at the beginning of the year	Granted during the year	Forfeited/ Lapsed during the year	Settled during the year	Conversion of the scheme during the year	Conditional awards at the end of the year	Relating to directors*
Conditional share plan								
Grant date								
2011								
22 February 2008	**32**	**21 515 000**	**–**	**(16 406 250)**	**(5 108 750)**	**–**	**–**	**–**
26 March 2008	**31**	**4 000 000**	**–**	**(3 000 000)**	**(1 000 000)**	**–**	**–**	**–**
24 July 2008	**26**	**375 000**	**–**	**(281 250)**	**(93 750)**	**–**	**–**	**–**
1 November 2008	**28**	**2 000 000**	**–**	**(1 500 000)**	**(500 000)**	**–**	**–**	**–**
18 March 2009	**26**	**14 500 000**	**–**	**(11 500 171)**	**(212 329)**	**(2 787 500)**	**–**	**–**
1 July 2009	**25**	**1 000 000**	**–**	**(819 178)**	**(180 822)**	**–**	**–**	**–**
25 February 2010	**20**	**20 050 000**	**–**	**(4 917 124)**	**(182 876)**	**(14 950 000)**	**–**	**–**
1 June 2010	**24**	**10 000 000**	**–**	**–**	**–**	**(10 000 000)**	**–**	**–**
1 December 2010	**20**	**1 500 000**	**–**	**–**	**–**	**(1 500 000)**	**–**	**–**
25 March 2011	**21**	**–**	**24 050 000**	**(200 000)**	**–**	**(23 850 000)**	**–**	**–**
		74 940 000	**24 050 000**	**(38 623 973)**	**(7 278 527)**	**(53 087 500)**	**–**	**–**
2010								
22 February 2008	32	22 749 000	–	(974 522)	(259 478)	–	21 515 000	7 600 000
26 March 2008	31	4 000 000	–	–	–	–	4 000 000	–
24 July 2008	26	375 000	–	–	–	–	375 000	–
1 November 2008	28	2 200 000	–	(200 000)	–	–	2 000 000	–
18 March 2009	26	15 800 000	–	(1 214 977)	(85 023)	–	14 500 000	5 000 000
1 July 2009	25	1 000 000	–	–	–	–	1 000 000	–
25 February 2010	20	–	20 050 000	–	–	–	20 050 000	5 000 000
1 June 2010	24	–	10 000 000	–	–	–	10 000 000	10 000 000
1 December 2010	20	–	1 500 000	–	–	–	1 500 000	–
		46 124 000	31 550 000	(2 389 499)	(344 501)	–	74 940 000	27 600 000

* Refer to note 28.3.

	Group 2011 R'000	Group 2010 R'000
15. Deposits		
Call deposits and current accounts	**2 160 128**	2 364 767
Savings accounts	**179 708**	175 595
Term and notice deposits	**1 750 731**	1 719 410
Negotiable certificates of deposit	**55 480**	103 867
Foreign deposits	**105 496**	200 349
	4 251 543	4 563 988
Maturity analysis		
Repayable on demand and maturing within one month	**2 903 750**	3 051 177
Maturing after one month but within six months	**891 924**	817 335
Maturing after six months but within 12 months	**422 541**	622 906
Maturing after 12 months but within five years	**33 328**	72 570
	4 251 543	4 563 988

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

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	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
16. Provisions and other liabilities							
Group							
At 1 January 2010	–	10 189	3 700	13 863	9 522	868	38 142
Provision raised	–	–	7 520	1 286	2 087	778	11 671
Reversal of provision	–	(1 270)	–	–	–	–	(1 270)
Charged to provision	–	(8 919)	(6 610)	–	(2 168)	(926)	(18 623)
At 31 December 2010	**–**	**–**	**4 610**	**15 149**	**9 441**	**720**	**29 920**
Acquisitions through business combinations (refer to note 30.4)	**–**	**–**	**357**	**–**	**–**	**240**	**597**
Provision raised	**5 793**	**12 000**	**6 766**	**900**	**2 169**	**1 800**	**29 428**
Reversal of provision	**–**	**–**	**–**	**–**	**–**	**(331)**	**(331)**
Charged to provision	**–**	**–**	**(7 383)**	**–**	**(2 002)**	**(38)**	**(9 423)**
At 31 December 2011	**5 793**	**12 000**	**4 350**	**16 049**	**9 608**	**2 391**	**50 191**

Deferred bonus scheme

A cash-settled, conditional phantom share plan was approved by the Board in 2011 in place of the conditional share plan. Awards in terms of the conditional share plan that had not vested as at 30 November 2011 were converted into awards under the conditional phantom share plan (refer to note 14.5). This plan will be subject to similar terms and conditions as the conditional share plan, notably performance conditions and a performance period and will be governed by the Board.

Post-retirement medical benefits

Refer to note 17 for detailed disclosure of this provision.

Leave pay

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

Other risks

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

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

17. Post-retirement medical benefits

The Bank operates a partly funded post-retirement medical scheme. The assets of the funded plans are held independently of the Group's assets in a separate trustee-administered fund. Independent actuaries value this scheme annually and the last valuation was carried out at 31 December 2011. The actuary's opinion is that the plan is in a sound financial position.

			Group		
	2011	2010	2009	2008	2007
	R'000	R'000	R'000	R'000	R'000
The amounts recognised in the statement of financial position are as follows (refer to note 16):					
Present value of total service liabilities	**18 577**	20 648	19 370	19 664	20 223
Fair value of plan assets	**(2 528)**	(5 499)	(5 507)	(5 133)	(5 880)
Provident fund	**(1 800)**	(1 832)	(1 674)	(922)	(838)
Endowment bond	**(728)**	(2 530)	(2 718)	(3 118)	(3 446)
Annuities	**–**	(1 137)	(1 115)	(1 093)	(1 596)
Liability in the statement of financial position	**16 049**	15 149	13 863	14 531	14 343
The amounts recognised in the statement of comprehensive income are as follows (refer to note 24):					
Current service cost	**53**	50	92	89	116
Interest costs	**1 636**	1 767	1 785	1 568	1 539
Expected return on plan assets	**(509)**	(578)	(526)	(529)	(549)
Discharge of liability and related plan asset	**486**	–	–	–	–
Actuarial loss/(gain)	**767**	1 488	(660)	368	936
Employer benefit payments	**(1 533)**	(1 441)	(1 359)	(1 308)	(1 202)
Payments from plan assets	**–**	–	–	–	650
Total included in staff costs	**900**	1 286	(668)	188	1 490
Reconciliation of the movement in the present value of total service liabilities:					
At the beginning of the year	**20 648**	19 370	19 664	20 223	18 989
Current service cost	**53**	50	92	89	116
Interest costs	**1 636**	1 767	1 785	1 568	1 539
Discharge of liability	**(1 891)**	–	–	–	–
Actuarial (gain)/loss	**(336)**	902	(812)	(908)	781
Employer benefit payments	**(1 533)**	(1 441)	(1 359)	(1 308)	(1 202)
At the end of the year	**18 577**	20 648	19 370	19 664	20 223
Reconciliation of the movement in the fair value of plan assets:					
At the beginning of the year	**5 499**	5 507	5 133	5 880	6 136
Expected return on plan assets	**509**	578	526	529	549
Non-qualifying plan asset as a result of discharge of liability	**(2 377)**	–	–	–	–
Actuarial (loss)	**(1 103)**	(586)	(152)	(1 276)	(155)
Payments from plan assets	**–**	–	–	–	(650)
At the end of the year	**2 528**	5 499	5 507	5 133	5 880

The principal actuarial assumptions used were as follows:

Discount rate	**8.25%** (2010: 8.25%) compounded annually
Investment return	**9.25%** (2010: 9.25%) compounded annually
Rate of medical inflation	**7.25%** (2010: 7.00%) compounded annually
Salary inflation	**6.75%** (2010: 6.50%) compounded annually

The effect of a 1% increase/decrease on the assumed rate of medical inflation would be an increase in the liability in an amount of R1.613 million (2010: R1.973 million) and a decrease of R1.361 million (2010: R1.680 million), respectively.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 R'000	Group 2010 R'000	Company 2011 R'000	Company 2010 R'000
18. Other accounts payable				
Accruals	**15 911**	20 058	**33**	14
Product-related credits	**73 819**	31 190	**–**	–
Sundry creditors	**103 106**	20 601	**–**	–
	192 836	71 849	**33**	14

	Group 2011 R'000	Group 2010 R'000
19. Contingent liabilities and commitments		
19.1 Guarantees, letters of credit and committed undrawn facilities		
Guarantees	**294 263**	305 669
Lending related	**8 431**	8 850
Mortgage	**97 694**	65 113
Performance	**188 138**	231 706
Letters of credit	**24 883**	10 260
Committed undrawn facilities	**82 050**	129 903
	401 196	445 832
19.2 Commitments under operating leases		
The total minimum future lease payments under operating leases are as follows:		
Property rentals:		
Due within one year	**5 490**	5 264
Due between one and five years	**7 369**	11 352
	12 859	16 616
After tax effect on operating leases	**9 258**	11 964

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.

	Group 2011 R'000	Group 2010 R'000
19.3 Capital commitments		
Contracted for consulting services for the core banking system	**–**	5 360
	–	5 360
20. Interest income		
Loans and receivables	**440 354**	438 991
Cash and cash equivalents	**61 480**	64 515
Negotiable securities	**14 287**	18 791
Loans and advances	**364 587**	355 685
Loans and receivables designated at fair value through profit and loss		
Loans and advances	**7 444**	11 867
Held-for-trading		
Interest rate swaps	**37**	60
	447 835	450 918

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 R'000	Group 2010 R'000
21. Interest expense		
Deposits	**176 745**	190 768
Long-term funding*	**1 832**	-
Held-for-trading		
Interest rate swaps	**2 831**	3 790
	181 408	194 558

* Charges relate to arrangement and commitment fees on unutilised long-term funding at year-end.

	Group 2011 R'000	Group 2010 R'000	Company 2011 R'000	Company 2010 R'000
22. Non-interest income				
Fee and commission income	**286 930**	208 396	–	–
Loans and receivables	**242 441**	206 725	–	–
Insurance-related products	**44 489**	1 671	–	–
Trading income	**68 961**	62 836	–	–
Held-for-trading	**66 229**	61 622	–	–
Foreign currency	**66 237**	60 261	–	–
Derivative assets	**(59)**	2	–	–
Derivative liabilities	**51**	1 359	–	–
Designated at fair value through profit and loss	**2 732**	1 214	–	–
Loans and advances	**(79)**	(818)	–	–
Other investments	**2 811**	2 032	–	–
Investment income	**364**	355	**59 929**	–
Dividends	**364**	348	**59 929**	–
Rental income	–	7	–	–
	356 255	271 587	**59 929**	–

	Group 2011 R'000	Group 2010 R'000
23. Fee and commission expenditure		
Foreign currency	**22 491**	22 089
Commissions and transactions	**105 677**	81 013
	128 168	103 102

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group		Company	
	2011	2010	**2011**	2010
	R'000	R'000	**R'000**	R'000
24. Operating expenditure				
Amortisation (refer to note 2)	**27 213**	20 819	**–**	–
Auditors' remuneration				
Audit fees – Current year	**6 938**	7 500	**–**	–
Fees for other services – Tax advisory fees	**185**	160	**–**	–
– IT due diligence	**62**	–	**–**	–
– Secondment of staff	**–**	51	**–**	–
– Administrative and IT staff	**–**	309	**–**	–
– *Less:* Amounts capitalised to intangible assets	**–**	(258)	**–**	–
– Other	**47**	23	**–**	–
	7 232	7 734	**–**	–
Depreciation (refer to note 3)	**11 518**	10 713	**–**	–
Directors' emoluments (refer to note 28.3)				
Executive directors	**12 785**	7 904	**–**	–
Non-executive directors' fees	**3 859**	3 848	**–**	–
	16 644	11 752	**–**	–
Indirect tax				
Non-claimable Value-Added Tax	**9 170**	8 705	**–**	–
Secondary tax on companies	**(418)**	–	**–**	–
Skills development levy	**1 242**	1 086	**–**	–
	9 994	9 791	**–**	–
Lease charges – equipment	**–**	56	**–**	–
Loss on sale of property and equipment	**–**	6	**–**	–
Marketing and communication	**7 508**	7 193	**540**	579
Operating leases for premises and related costs	**14 954**	10 626	**–**	–
Other operating costs	**35 184**	29 135	**639**	485
Professional fees				
Consulting	**2 877**	3 101	**–**	–
Legal and collection	**1 695**	252	**112**	–
Computer consulting and services	**43 407**	37 586	**–**	–
	47 979	40 939	**112**	–
Staff costs				
Salaries, wages and incentives	**147 628**	123 219	**–**	–
Post-retirement medical benefits (refer to note 17)	**900**	1 286	**–**	–
Share-based payments and deferred bonus scheme expense including directors	**4 257**	2 154	**–**	–
Other	**14 462**	3 381	**–**	–
	167 247	130 040	**–**	–
Total operating expenditure	**345 473**	278 804	**1 291**	1 064
Number of persons employed by the Group at year-end	**521**	439		

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group 2011 R'000	Group 2010 R'000	Company 2011 R'000	Company 2010 R'000
25. Tax				
South African normal tax	**5 810**	203	**–**	–
Current year	**5 810**	203	**–**	–
Deferred tax	**42 351**	42 842	**–**	–
Current year	**39 148**	38 924	**–**	–
Prior year	**3 203**	3 918	**–**	–
	48 161	43 045	**–**	–
Direct tax				
South African normal tax	**5 810**	203	**–**	–
South African tax rate reconciliation				
South African standard tax rate (%)	**28.00**	28.00	**28.00**	28.00
Exempt income (%)	**(0.04)**	(0.66)	**(29.00)**	0.00
Expenses not deductible for tax purposes (%)	**0.00**	0.41	**0.00**	0.00
Additional allowances for tax purposes (%)	**(3.56)**	(0.14)	**0.00**	0.00
Capital gain – 50% portion not taxable (%)	**(1.44)**	(0.09)	**0.00**	0.00
Under provision prior years (%)	**1.81**	2.57	**0.00**	0.00
Tax losses (%)	**2.40**	(0.21)	**1.00**	(28.00)
Effective tax rate (%)	**27.17**	29.88	**0.00**	0.00
Estimated tax losses available for offset against future taxable income	**168 973**	301 867	**6 421**	5 128

	Group 2011 R'000	Group 2010 R'000
26. Earnings, diluted earnings, headline earnings and diluted headline earnings per ordinary share		
26.1 Earnings per ordinary share		
Profit after tax attributable to equity holders of the parent	**123 598**	101 026
Weighted number of ordinary shares in issue ('000)	**3 912 234**	3 911 255
Earnings per ordinary share (cents)	**3.2**	2.6
26.2 Diluted earnings per ordinary share		
Profit after tax attributable to equity holders of the parent	**123 598**	101 026
Weighted diluted number of ordinary shares in issue ('000)	**3 917 984**	3 935 365
Diluted earnings per ordinary share (cents)	**3.2**	2.6
26.3 Headline and diluted headline earnings per ordinary share		
Profit after tax attributable to equity holders of the parent	**123 598**	101 026
Adjustment for non-headline items:		
Realisation of available-for-sale reserve on disposal of investments	**–**	(885)
Loss on disposal of property and equipment	**–**	6
Tax on non-headline items	**–**	122
Headline earnings	**123 598**	100 269
Headline earnings per ordinary share (cents)	**3.2**	2.6
Diluted headline earnings per ordinary share (cents)	**3.2**	2.5

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group		Company	
	2011	2010	**2011**	2010
	R'000	R'000	**R'000**	R'000
27. Notes to statements of cash flows				
27.1 Cash receipts from customers				
Interest income	**447 835**	450 918	**–**	–
Non-interest income and gain on disposal of available-for-sale investments	**396 104**	272 472	**59 929**	–
Adjusted for: Dividends received	**(364)**	(348)	**(59 929)**	–
Net (gain) on disposal of available-for-sale investments	**–**	(885)	**–**	–
Revaluation of fair value financial instruments	**(33 785)**	(7 778)	**–**	–
Recoveries in respect of amounts previously written off	**778**	1 876	**–**	–
	810 568	716 255	**–**	–
27.2 Cash paid to customers, suppliers and employees				
Interest expense	**(181 408)**	(194 558)	**–**	–
Operating expenditure and fee and commission expenditure	**(473 641)**	(381 906)	**(1 291)**	(1 064)
Adjusted for: Amortisation	**27 213**	20 819	**–**	–
Depreciation	**11 518**	10 713	**–**	–
Write-off of obsolete computer software	**833**	–	**–**	–
Loss on sale of property and equipment	**–**	6	**–**	–
Vesting of shares in the conditional share plan	**(1 544)**	(104)	**–**	–
Share-based payments expense	**4 257**	2 154	**–**	–
Increase/(Decrease) in provisions excluding cash-settled share-based payments provision	**13 882**	(8 222)	**–**	–
	(598 890)	(551 098)	**(1 291)**	(1 064)
27.3 Reconciliation of profit before tax to cash generated from operations				
Profit/(Loss) before tax	**177 272**	144 071	**58 638**	(1 064)
Profit/(Loss) before tax adjusted for:				
Dividends received	**(364)**	(348)	**(59 929)**	–
Net (gain) on disposal of available-for-sale investments	**–**	(885)	**–**	–
Revaluation of fair value financial instruments	**(33 785)**	(7 778)	**–**	–
Net impairments raised	**12 396**	5 298	**–**	–
Amortisation	**27 213**	20 819	**–**	–
Depreciation	**11 518**	10 713	**–**	–
Write-off of obsolete computer software	**833**	–	**–**	–
Loss on sale of property and equipment	**–**	6	**–**	–
Share-based payments expense	**4 257**	2 154	**–**	–
Vesting of shares in the conditional share plan	**(1 544)**	(104)	**–**	–
Increase/(Decrease) in provisions excluding cash-settled share-based payments provision	**13 882**	(8 222)	**–**	–
Share of income from associated company	**–**	(567)	**–**	–
Cash generated from operations	**211 678**	165 157	**(1 291)**	(1 064)

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	Group		Company	
	2011	2010	**2011**	2010
	R'000	R'000	**R'000**	R'000
27. Notes to statements of cash flows (continued)				
27.4 Tax				
Amounts paid at the beginning of the year	**101**	186	**–**	256
Acquisitions through business combinations (refer to note 30.4)	**(2 600)**	–	**–**	–
Statement of comprehensive income (charge)	**(5 810)**	(203)	**–**	–
Less: Amounts unpaid/(overpaid) at the end of the year	**920**	(101)	**–**	–
Total tax (paid)/recovered	**(7 389)**	(118)	**–**	256
27.5 Net movement in income earning assets				
Decrease in negotiable securities	**72 588**	3 597	**–**	–
(Increase) in loans and advances	**(779 348)**	(92 304)	**–**	–
Decrease in bank term deposits	**–**	35 276	**–**	–
Net (increase) in income earning assets	**(706 760)**	(53 431)	**–**	–
27.6 Net movement in deposits and other accounts				
(Decrease)/Increase in deposits	**(312 445)**	317 390	**–**	–
Decrease of treasury shares held within the Group	**188**	189	**–**	–
(Decrease)/Increase in subsidiary loans	**–**	–	**(18 999)**	810
(Increase) in other accounts receivable	**(35 929)**	(19 482)	**–**	(3)
Increase in other accounts payable	**84 861**	10 696	**19**	–
Net (decrease)/increase in deposits and other accounts	**(263 325)**	308 793	**(18 980)**	807

28. Related-party information

28.1 Identity of related parties with whom transactions have occurred

The holding Company and material subsidiaries of the Group are identified on page 3 and page 30 in the Directors' report. All of these entities and the directors are related parties. There are no other related parties with whom transactions have taken place, other than as listed below.

28.2 Related-party balances and transactions

The Company, its subsidiaries and associated company (voluntarily liquidated during 2010), in the ordinary course of business, enter into various financial services transactions with the ultimate holding company and its subsidiaries and other entities within the Group. Except for the interest-free loan from the Bank to the Company which was settled in December 2011, and the interest-free shareholder loan from the Company to Multi Risk, transactions are governed by commercial terms.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

	2011 R'000	2010 R'000
28. Related party information (continued)		
28.2 Related-party balances and transactions (continued)		
Balances between the ultimate holding company (CGD) and the Bank:		
CGD – Lisbon (Branch of CGD)	**7 299**	1 084 225
Nostro accounts*	**7 869**	2 530
Vostro accounts	**(570)**	(1 912)
Deposit accounts*	**–**	1 083 607
CGD – Paris (Branch of CGD)	**(2 124)**	225
Nostro accounts*	**148**	261
Vostro accounts	**(2 272)**	(36)
CGD – London (Branch of CGD)		
Vostro accounts	**(15)**	(16)
Total CGD branches	**5 160**	1 084 434
Banco Comercial e de Investimentos – Mozambique (BCI) (Subsidiary of CGD)	**(134 801)**	(107 659)
Vostro accounts	**(4 543)**	(3 326)
Fixed deposits	**(102 800)**	(103 800)
Call and notice deposits	**(27 458)**	(533)
Total CGD	**(129 641)**	976 775

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

	2011 R'000	2010 R'000
Transactions between the ultimate holding company (CGD) and the Bank:		
Interest paid by CGD to the Bank	**1 973**	1 353
Interest paid by the Bank to BCI	**7 883**	2 294

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

28. Related-party information (continued)

28.2 Related-party balances and transactions (continued)

		2011 R'000	2010 R'000
Balances with the Company, its subsidiaries and associated company:			
Loan to:	**Loan from:**		
Mercantile Bank Holdings Limited	Mercantile Bank Limited	–	12 757
Portion 2 of Lot 8 Sandown (Pty) Limited	Mercantile Bank Limited	87 205	34 126
LSM (Troyeville) Properties (Pty) Limited	Mercantile Bank Limited	7 352	6 784
Mercantile Insurance Brokers (Pty) Limited	Mercantile Bank Limited	48	828
Multi Risk Investment Holdings (Pty) Limited	Mercantile Bank Holdings Limited	6 242	–
Custom Capital (Pty) Limited	Mercantile Bank Limited	158 889	–
Deposit with:	**Deposit by:**		
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Limited	2 111	2 794
Mercantile Bank Limited	Mercantile Bank Holdings Limited	223	223
Mercantile Bank Limited	Multi Risk Investment Holdings (Pty) Limited	20 020	–
Transactions with the Company, its subsidiaries and associated company:			
Interest received by:	**Interest paid by:**		
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown (Pty) Limited	3 373	4 409
Mercantile Bank Limited	LSM (Troyeville) Properties (Pty) Limited	761	787
Mercantile Insurance Brokers (Pty) Limited	Mercantile Bank Limited	83	86
Custom Capital (Pty) Limited	Mercantile Bank Limited	1 608	–
Mercantile Bank Limited	Custom Capital (Pty) Limited	4 681	–
Mercantile Bank Limited	Multi Risk Investment Holdings (Pty) Limited	127	–
Statman Investments (Pty) Limited *	Mercantile Bank Limited	–	707
Non-interest income earned by:	**Operating expenditure paid by:**		
Portion 2 of Lot 8 Sandown (Pty) Limited	Mercantile Bank Limited	14 961	13 921
LSM (Troyeville) Properties (Pty) Limited	Mercantile Bank Limited	628	1 052
Mercantile Bank Limited	Mercantile Insurance Brokers (Pty) Limited	98	158
Portion 2 of Lot 8 Sandown (Pty) Limited	Mercantile Insurance Brokers (Pty) Limited	61	73
Mercantile Bank Limited	Custom Capital (Pty) Limited	74	–
Dividends earned by:	**Dividends paid by:**		
Mercantile Bank Holdings Limited	Mercantile Bank Limited	59 929	–
Mercantile Bank Limited	Portion 2 of Lot 8 Sandown (Pty) Limited	60 000	–
Mercantile Bank Limited	Statman Investments (Pty) Limited *	–	3 126

* Statman Investments (Pty) Ltd was an associated company, which was voluntarily liquidated in 2010.

Other

Post-retirement medical plan

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

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

28. Related-party information (continued)

28.3 Director and Director-related activities

No loans were made to directors during the year under review. There were no material transactions with Directors, other than the following fees and salary related costs:

	Directors' fees R'000	Salary R'000	Fringe benefits R'000	Retirement funds and medical aid contributions R'000	Performance bonus R'000	Total R'000
Group						
2011						
Non-Executive Directors						
J A S de Andrade Campos	**1 547**	–	–	–	–	**1 547**
G P de Kock	**635**	–	–	–	–	**635**
L Hyne	**599**	–	–	–	–	**599**
A T Ikalafeng	**507**	–	–	–	–	**507**
T H Njikizana	**571**	–	–	–	–	**571**
Executive Directors						
D J Brown	–	**3 028**	–	**323**	**2 800**	**6 151**
K R Kumbier	–	**2 342**	–	**252**	**1 400**	**3 994**
J P M Lopes	–	**1 835**	**312**	**43**	**450**	**2 640**
	3 859	**7 205**	**312**	**618**	**4 650**	**16 644**
2010						
Non-Executive Directors						
J A S de Andrade Campos	1 413	–	–	–	–	1 413
G P de Kock	602	–	–	–	–	602
L Hyne	567	–	–	–	–	567
A T Ikalafeng	480	–	–	–	–	480
T H Njikizana	475	–	–	–	–	475
S Rapeti (resigned 29 July 2010)	311	–	–	–	–	311
Executive Directors						
D J Brown	–	2 837	–	301	–	3 138
K R Kumbier (appointed 1 June 2010)*	–	2 227	–	156	–	2 383
J P M Lopes	–	1 771	568	44	–	2 383
	3 848	6 835	568	501	–	11 752

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

	2011 R'000	2010 R'000
Share-based payments and deferred bonus scheme expense relating to Executive Directors		
D J Brown	**1 213**	656
K R Kumbier (appointed 1 June 2010)	**1 209**	135
Amounts paid by CGD to Executive Directors		
J P M Lopes	**681**	552

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

28. Related-party information (continued)

28.3 Director and Director-related activities (continued)

Service agreements

D J Brown, CEO

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

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

J P M Lopes, Executive Director

Mr Lopes has been seconded to Mercantile by CGD.

Mr Lopes' employment contract was extended by the Board to July 2014. In terms of his service agreement, Mr Lopes agreed to perform such duties, functions and services as are assigned to him from time to time by the Board of Directors and which are consistent and commensurate with his position as Executive Director.

K R Kumbier, Executive Director

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

Share options

In terms of the share option scheme, the following share options in the Company have been granted to D J Brown which have not yet been exercised (refer to note 14.5):

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

Conditional share and deferred bonus scheme awards

7 600 000 conditional share awards in the Company, with a market value on date of grant of 32 cents each, were granted to D J Brown on 22 February 2008 (refer to note 14.5). 1 900 000 of these awards vested and were cash settled in 2011 at a market price of 21 cents per award. The balance of awards (5 700 000) were forfeited as the performance conditions in terms of the plan were not achieved.

In terms of the conditional share plan, conditional share awards in the Company were granted to D J Brown and K R Kumbier. During 2011 these unvested awards were converted into a deferred bonus scheme as follows:

D J Brown:

- 1 250 000 at an estimated proxy price as at 31 December 2011 of 58 cents each;
- 5 000 000 at an estimated proxy price as at 31 December 2011 of 64 cents each; and
- 7 500 000 at an estimated proxy price as at 31 December 2011 of 69 cents each.

K R Kumbier:

- 10 000 000 at an estimated proxy price as at 31 December 2011 of 64 cents each; and
- 5 000 000 at an estimated proxy price as at 31 December 2011 of 69 cents each.

Directors' interests

Except for K R Kumbier, who holds 2 016 851 (2010: 2 016 851) shares directly, no other Director held beneficial and/or non-beneficial interests, directly or indirectly, in shares issued by the Company.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

29. Segment information

The reportable segments of the Group are as follows:

Segment	Scope of products and services
Business and Commercial Banking*	Banking, investment and other financial services offered to banking customers
Treasury*	Managing internal liquidity, foreign exchange services as well as serving wholesale and alliance banking customers
Alliance banking*	Card processing services and electronic services offered to banking customers
Support and other services	Support services and tax for the above segments, surplus capital and inter-group eliminations
Rental finance	Rental finance business conducted under the subsidiary Custom Capital (Pty) Ltd
Insurance and assurance brokers	Insurance and assurance broking business conducted under the subsidiaries Mercantile Insurance Brokers (Pty) Ltd and Multi Risk Investment Holdings (Pty) Ltd

* Excludes the allocation of attributable support costs and tax for Bank segments. Rental finance and insurance brokers segments operate under different legal entities and are measured on a post tax basis. This is the measure reported to the chief operating decision-maker for the purposes of resource allocation and assessment of segment performance.

All operations are located in South Africa.

Revenue is earned from external customers.

During 2011, profit resulting from fair value adjustments of a structured investment contributed significantly to the year-on-year increase of the Business and Commercial Banking segment.

During 2011, several credit card related products were allocated from the Alliance banking segment to the Business and Commercial banking segment and therefore the 2010 comparatives have been accordingly adjusted.

	Business and Commercial Banking R'000	Treasury R'000	Alliance banking R'000	Support and other services R'000	Rental finance R'000	Insurance and assurance brokers R'000	Total R'000
2011							
Statement of comprehensive income							
Interest income	367 638	26 834	2 904	37 987	11 654	818	447 835
Interest expense	(152 700)	(21 125)	(1 223)	(50)	(6 148)	(162)	(181 408)
Net interest income	214 938	5 709	1 681	37 937	5 506	656	266 427
Net charge for credit losses	(11 460)	–	–	1 238	(1 396)	–	(11 618)
Net interest income after credit losses	203 478	5 709	1 681	39 175	4 110	656	254 809
Net gain on disposal of available-for-sale investments	–	–	–	–	–	–	–
Net non-interest income	125 140	61 419	37 102	(773)	1 200	43 848	267 936
Net interest and non-interest income	328 618	67 128	38 783	38 402	5 310	44 504	522 745
Operating expenditure	(124 756)	(30 434)	(9 797)	(142 010)	(8 516)	(29 960)	(345 473)
Operating profit	203 862	36 694	28 986	(103 608)	(3 206)	14 544	177 272
Share of income from associated company	–	–	–	–	–	–	–
Profit/(Loss) before tax	203 862	36 694	28 986	(103 608)	(3 206)	14 544	177 272
Tax	–	–	–	(44 466)	–	(3 695)	(48 161)
Profit/(Loss) after tax	203 862	36 694	28 986	(148 074)	(3 206)	10 849	129 111
Included in non-interest income:							
Fair value profit/(loss)	39 781	(19)	–	79	–	–	39 841
Included in operating expenditure:							
Depreciation	6 152	136	38	3 390	103	1 699	11 518
Amortisation	17 259	7 771	39	671	–	1 473	27 213
Statement of financial position:							
Segment assets	4 578 316	576 599	114 086	618 972	200 239	127 063	6 215 275
Segment liabilities	3 943 523	467 481	84 184	(212 612)	203 445	53 665	4 539 686

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

29. Segment information (continued)

	Business and Commercial Banking R'000	Treasury R'000	Alliance banking R'000	Support and other services R'000	Rental finance R'000	Insurance and assurance brokers R'000	Total R'000
2010							
Statement of comprehensive income							
Interest income	359 645	38 024	704	52 459	–	86	450 918
Interest expense	(160 892)	(30 050)	(1 010)	(2 606)	–	–	(194 558)
Net interest income	198 753	7 974	(306)	49 853	–	86	256 360
Net charge for credit losses	(5 383)	–	–	1 961	–	–	(3 422)
Net interest income after credit losses	193 370	7 974	(306)	51 814	–	86	252 938
Net gain on disposal of available-for-sale investments	–	–	–	885	–	–	885
Net non-interest income	85 324	52 366	29 217	561	–	1 017	168 485
Net interest and non-interest income	278 694	60 340	28 911	53 260	–	1 103	422 308
Operating expenditure	(112 251)	(25 795)	(11 879)	(128 613)	–	(266)	(278 804)
Operating profit	166 443	34 545	17 032	(75 353)	–	837	143 504
Share of income from associated company	–	–	–	567	–	–	567
Profit/(Loss) before tax	166 443	34 545	17 032	(74 786)	–	837	144 071
Tax	–	–	–	(42 806)	–	(239)	(43 045)
Profit/(Loss) after tax	166 443	34 545	17 032	(117 592)	–	598	101 026
Included in non-interest income:							
Fair value profit/(loss)	2 603	(28)	–	818	–	–	3 393
Included in operating expenditure:							
Depreciation	5 945	147	171	4 449	–	1	10 713
Amortisation	14 083	6 188	30	518	–	–	20 819
Statement of financial position:							
Segment assets	4 307 961	904 306	36 975	1 002 124	–	2 945	6 254 311
Segment liabilities	3 769 281	860 328	14 344	69 642	–	1 322	4 714 917

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

30. Business combinations

30.1 Subsidiaries acquired

	Principal activity	Date of acquisition	% acquired	Total investment R'000
2011				
Custom Capital	Rental finance	1 April 2011	74.9	–
Multi Risk	Insurance and assurance brokers	1 July 2011	51	45 900

30.2 Purpose of acquisitions

Custom Capital: to grow rental assets and transactional banking in the SME sector.

Multi Risk: enhance product offering, diversify revenue streams and increase the potential to cross-sell banking products to the customer bases of the Group.

30.3 Acquisition considerations

Custom Capital

The acquisition was structured by way of the vendors transferring rental finance assets from their existing businesses to Custom Capital to the value of R34 million on loan account in exchange for their equity holding. Mercantile invested R102 million on loan account in respect of its proportionate shareholding. Legal and consulting costs of R199k relating to the acquisition of Custom Capital are included in operating expenditure.

Multi Risk	R'000
The acquisition price consists of the following components:	
Shares	39 658
Shareholder loan	6 242
	45 900

Legal and consulting costs of R257k relating to the acquisition of Multi Risk are included in operating expenditure.

30.4 Assets acquired and liabilities recognised at the date of acquisition

	Custom Capital R'000	Multi Risk R'000
Net liabilities acquired		
Property and equipment	–	1 322
Intangible asset: computer software	–	62
Intangible asset: contractual and customer relationship	–	10 598
Other investments	–	576
Tax receivable	–	23
Other accounts receivable	–	2 484
Cash and cash equivalents	–	14 547
Loans from shareholders	–	(12 155)
Deferred tax	–	(2 996)
Tax payable	–	(2 623)
Other accounts payable	–	(25 036)
Provisions	–	(597)
Dividend payable	–	(5 177)
	–	(18 972)

30.5 Non-controlling interests

At acquisition date	–	(8 698)

The non-controlling interest at acquisition in Multi Risk was measured with reference to the net liabilities acquired of R18.972 million.

Notes to the annual financial statements

for the year ended 31 December 2011 (continued)

30. Business combinations (continued)

30.6 Goodwill arising on consolidation

	Custom Capital R'000	Multi Risk R'000
Acquisition consideration of shares	–	39 658
Non-controlling interests	–	(8 698)
Fair value of net liabilities acquired	–	18 972
Goodwill arising on acquisition	–	49 932

Goodwill arose in the acquisition of Multi Risk based on the value associated with the expected future earnings from the business. Projected earnings have been determined on a discounted cash flow basis at a discount rate of 20% which has been warranted by the sellers. If the warranted profits are not achieved over a period of five and a half years from the effective date, then Mercantile will either be refunded the shortfall in value by the sellers or Mercantile's shareholding will be increased to a maximum of 66%.

30.7 Impact of acquisitions on the results of the Group

	Custom Capital R'000	Multi Risk R'000
Interest income	11 654	735
Interest expense	(6 148)	(162)
Net interest income	5 506	573
Net charge for credit losses	(1 396)	–
Net interest income after credit losses	4 110	573
Net non-interest income	1 200	42 763
Net interest and non-interest income	5 310	43 336
Operating expenditure	(8 516)	(29 216)
Profit/(Loss) before tax	(3 206)	14 120
Tax	–	(3 576)
Profit/(Loss) after tax	(3 206)	10 544
Profit/(Loss) after tax attributable to:		
Equity holders of the parent	(2 401)	4 226
Non-controlling interests	(805)	6 318
	(3 206)	10 544

Had these business acquisitions been effected at 1 January 2011, the estimated profit/(loss) after tax for the year would have been R21.1 million for Multi Risk and (R3.6) million for Custom Capital, respectively. The Directors consider the pro forma number for Multi Risk to represent an approximate measure of the performance on an annualised basis. Due to the nature of the business of Custom Capital and the start-up of this operation from a low base, this loss cannot provide a reference point for comparison in future periods and it is anticipated that this company will be profitable in 2012.

30.8 Net cash outflow on acquisition of subsidiaries

	R'000
Consideration paid in cash	45 900
Less: Cash and cash equivalents acquired	(14 547)
	31 353

Risk management and control

Group risk management philosophy

The Group recognises that the business of banking and financial services is conducted within an environment of complex inter-related risks that have become all too evident during the ongoing global financial crisis. The Group operates in a dynamic environment where the past is not necessarily an acceptable guide to the future. Risk management is a key focus of the Group and addresses a wide spectrum of risks that are continually evaluated and policies and procedures reviewed and stress tested to adapt to changing circumstances. In any economy there are sectors that are more vulnerable to cyclical downturns than others. Economic variables are monitored to assist in managing exposure to such sectors. The concentration of risk in our target market sectors is managed to achieve a balanced portfolio. However, the Group acknowledges the potential of concentration risk in being a niche bank and this is carefully monitored and, where appropriate, corrective action is taken. Our business development efforts are focused on the stronger companies and individuals within established policy criteria, which policy serves to eliminate weaker credit from the portfolio. The Group remains well positioned to effectively manage identified threats in a way that minimises risks to the Group. An independent review of risk management and controls was undertaken during 2011 identifying no material weaknesses and our risk environment was rated as mature.

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

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

- a revamp of the Risk Control Self-Assessment process across all key areas of the Bank that involved active participation of middle management in all areas;
- the establishment of Treasury Middle Office was finalised and an audit undertaken confirming that all requisite back and front office functions had indeed been migrated;
- further enhancements to the Asset Liability Management monitoring and reporting process were implemented;
- the development of a Risk Tolerance Framework that has been approved by the Board; and
- enhancement and expansion to the prudential management schedule wherein all risk-related ratios are monitored and reported to the ALCO and Board on a monthly basis.

Risk management and subsidiaries

The Group made two acquisitions during the year and the Risk Division is currently developing and rolling out risk requirements for each of the subsidiaries in line with the requirements of the Enterprise-wide Risk Management Requirements applied within the Group. The risk reporting for the two acquired entities will be included within the overall Group reporting and will follow, as appropriate, the current reporting structure for the Group.

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

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

Risk management life cycle/process

All of the Group's policies and procedures manuals are subject to ongoing review and are signed off by the relevant business unit heads. These standards are an integral part of the Group's governance structure and risk management profile, reflecting the expectations and requirements of the Board in respect of key areas of control. The standards and effective maintenance of the Risk Control Self-Assessment process ensures alignment and consistency in the way that prevalent risk types are identified, managed and form part of the four phases of the risk management life cycle, defined as:

Risk identification (and comprehension)

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

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

Once risks have been identified, they need to be measured. Certain risks will obviously lend themselves more easily to determination and measurability than others, but it is necessary to ascertain the magnitude of each risk whether quantifiable or not and whether direct or indirect.

Risk management (as an independent function)

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

Risk management and control

(continued)

Risk management life cycle/process (continued)

Risk monitoring (and compliance with documented policies)
Open, two-way communication between the Group and the SARB is fundamental to the entire risk monitoring and supervisory process. To achieve this, responsible line heads are required to document conclusions and communicate findings to the ALCO, RMC and CREDCOM and to the SARB via the Finance Division through BA returns and periodic meetings.

Risk control (stress and back-testing)
The Group follows a policy of ongoing stress testing. Critical variables are sensitive to market changes both domestic and international. These are identified and modelled to determine the possible impact of any deterioration of such identified variables on the Group'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 was implemented during the first quarter of 2011.

Management of risk

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

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

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

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

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

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

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

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

The Group subscribes to the 11 Principles of Sound Practices for the Effective Management and Supervision of Operational Risk as defined by the Basel Committee on Banking Supervision.

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

The Capital Management Committee, under the auspices of the RMC, proactively evaluates and manages the capital requirements of the Group as determined by Basel requirements. A comprehensive re-evaluation of the capital requirements under the Internal Capital Adequacy Assessment Process is regularly undertaken with consideration being given to all risks impacting on the need for capital reserves within the Group. The outcome of these assessments resulted in the Group 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 half-yearly and adjusted where appropriate.

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

Credit risk

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

Risk management and control

(continued)

Credit risk (continued)

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

Counterparties to derivatives expose the Group to credit-related losses in the event of non-performance. The counterparties to these contracts are financial institutions. The Group 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 Group did not have any significant concentration of risk which had not been adequately provided for. There were no material exposures in advances made to foreign entities at year-end.

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

The Group has adopted a conservative approach to credit granting within a specifically defined and structured approval process. The granting of credit is managed via a mandated approval process whereby levels of credit approval are determined by the experience of the mandated individual with dual or multiple sign-off on all material values. An ongoing weekly review is also undertaken by the CREDCOM of all new and renewal proposals for lending in excess of R2 million. In addition, an early warning system is applied to actively manage all accounts within the risk structure. The system identifies a number of characteristics relating to the performance of the accounts and based on various predefined algorithms, flags issues of concern. Monitoring is done by the Portfolio Management Department and any concerns are raised with the Credit Department and Business or Commercial banking units.

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

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

	Loans and advances R'000	Committed undrawn facilities R'000	Other R'000	Total R'000
2011				
Current accounts	**931 610**	–	–	**931 610**
Credit card	**19 777**	**14 049**	–	**33 826**
Mortgage loans	**2 053 662**	**68 001**	–	**2 121 663**
Instalment sales and leases	**490 805**	–	–	**490 805**
Structured loans	**103 081**	–	–	**103 081**
Other advances	**967 478**	–	–	**967 478**
Negotiable securities	–	–	**192 588**	**192 588**
Cash and cash equivalents	–	–	**952 621**	**952 621**
Guarantees	–	–	**294 263**	**294 263**
Letters of credit	–	–	**24 883**	**24 883**
	4 566 413	**82 050**	**1 464 355**	**6 112 818**
2010				
Current accounts	633 290	–	–	633 290
Credit card	18 968	14 848	–	33 816
Mortgage loan	1 863 013	115 055	–	1 978 068
Instalment sales and leases	268 474	–	–	268 474
Structured loans	230 036	–	–	230 036
Other advances	774 710	–	–	774 710
Negotiable securities	–	–	265 028	265 028
Cash and cash equivalents	–	–	1 759 897	1 759 897
Guarantees	–	–	305 669	305 669
Letters of credit	–	–	10 260	10 260
	3 788 491	129 903	2 340 854	6 259 248

Risk management and control

(continued)

Operational risk

The Group subscribes to the 11 Principles of Sound Practices for the Effective Management and Supervision of Operational Risk.

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

- documented operational policies, processes and procedures with segregation of duties;
- ongoing training and upskilling of staff on operational procedures and legislative compliance;
- an operational event logger wherein all losses associated with operational issues including theft and robbery are recorded and evaluated to facilitate corrective action;
- ongoing improvements to the Disaster Recovery and Business Continuity plans including conducting a variety of simulation exercises in critical operations environments;
- conducting a variety of internal audits and reviews by both the Compliance and Internal Audit Departments in line with annual plans approved by the Board;
- comprehensive data security and protection;
- ongoing review of the Bank-wide Risk Control Self-Assessment Process rolled out to job functional level in high-risk operational processing areas; and
- limiting access to systems and enforcing strong password controls.

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

Technology risk

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

Market risk

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

The Group does not currently take proprietary trading positions and therefore has minimal exposure to market risk. Before the Group considers entering into a proprietary trading position, the Trading Committee will evaluate and approve such positions. This committee will ensure that the Group is prudently positioned, taking into account agreed limits, policies, prevailing markets, available liquidity and the relationship between risk and reward primarily to the financial risks of changes in foreign currency exchange rates and interest rates.

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

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

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

The Group does not perform a detailed sensitivity analysis on the potential impact of a change in exchange rates on a daily basis due to the fact that the Group does not currently have any proprietary trading positions. The impact of changes in open foreign currency client positions is modelled to take cognisance of credit risks associated with volatility in foreign currency exchange rates with the purpose of covering adverse positions through calling for initial and variation margins. A detailed sensitivity analysis is performed for liquidity and interest rate risk (described on pages 82 to 87).

There has been no significant change to the Group's exposure to market risks or the manner in which it manages and measures the risk. Various conservative prudential risk limits are in place. Exposures under prudential risk limits and various sensitivities relating thereto are reported to the ALCO, RMC and Board on a regular basis.

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

Foreign currency risk

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

The Group has conservative limits in terms of net open foreign currency positions that are well below the limits allowed by the SARB. For the year under review, the highest net open position recorded for any single day was R5.45 million (2010: R4.75 million). An adverse movement in the exchange rate of 10% would reduce the Group's income by R0.5 million (2010: R0.5 million).

Risk management and control

(continued)

Foreign currency risk (continued)

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

	US Dollar R'000	Euro R'000	Pound Sterling R'000	Other R'000	Total R'000
2011					
Total foreign exchange assets	**596 992**	**16 673**	**4 780**	**16 490**	**634 935**
Total foreign exchange liabilities	**(96 000)**	**(8 534)**	**(1 061)**	**(12)**	**(105 607)**
Commitments to purchase foreign currency	**262 255**	**89 071**	**4 790**	**7 893**	**364 009**
Commitments to sell foreign currency	**(763 088)**	**(96 877)**	**(9 020)**	**(22 700)**	**(891 685)**
Year-end effective net open foreign currency positions	**159**	**333**	**(511)**	**1 671**	**1 652**
2010					
Total foreign exchange assets	1 104 488	25 697	6 856	8 145	1 145 186
Total foreign exchange liabilities	(172 412)	(19 874)	(7 910)	(337)	(200 533)
Commitments to purchase foreign currency	179 019	121 800	26 828	10 156	337 803
Commitments to sell foreign currency	(1 110 368)	(128 435)	(25 831)	(16 800)	(1 281 434)
Year-end effective net open foreign currency positions	727	(812)	(57)	1 164	1 022

Interest rate risk

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

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

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

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

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

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

The yield on assets remained under pressure during 2011 as a result of the relatively low interest rate environment in South Africa. South Africa was not immune to the global credit and liquidity crisis as well as market uncertainty in respect of the longer-term interest rate trends. Net interest income was adversely impacted by the negative endowment effect due to the current high levels of excess capital of the Group and the high level of non-interest bearing deposits. Pressure on margins is likely to continue during 2012.

Risk management and control

(continued)

Interest rate risk (continued)

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

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

At the reporting date, a 50 basis point change in prevailing interest rates was applied as a sensitivity analysis to determine the impact on earnings as a result of a change in interest rates. If interest rates increased/decreased by 50 basis points and all other variables remained constant, the Group's net profit and equity at year-end would increase by R8.7 million and decrease by R7.9 million (2010: increase/decrease by R10.6 million). This is mainly attributable to the Group's exposure to interest rates on its surplus capital and lending and borrowings in the banking book.

The tables on pages 84 and 85 summarise the Group'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 Group remains asset-sensitive as interest-earning assets reprice sooner than interest-paying liabilities, before and after derivative hedging activities. Thus, future net interest income remains vulnerable to a decrease in market interest rates.

Risk management and control
(continued)

Interest rate risk (continued)

	Up to 1 month R '000	1 – 3 months R'000	4 – 12 months R'000	1 – 5 years R'000	Over five years R'000	Non-interest sensitive R'000	Total R'000	Effective interest rate %
2011								
Assets								
Intangible assets	–	–	–	–	–	216 086	216 086	–
Property and equipment	–	–	–	–	–	129 568	129 568	–
Goodwill	–	–	–	–	–	49 932	49 932	–
Other accounts receivable	–	–	–	–	–	87 434	87 434	–
Other investments	–	–	–	–	–	63 789	63 789	–
Deferred tax assets	–	–	–	–	–	17 737	17 737	–
Loans and advances	4 533 168	–	19 320	9 639	24 540	(96 804)	4 489 863	9.16
Derivative financial instruments	–	–	–	–	–	15 657	15 657	–
Negotiable securities	74 643	99 071	–	18 874	–	–	192 588	6.03
Cash and cash equivalents	467 880	266 927	–	–	–	217 814	952 621	4.66
Total assets	5 075 691	365 998	19 320	28 513	24 540	701 213	6 215 275	
Equity and liabilities								
Total equity	–	–	–	–	–	1 675 589	1 675 589	–
Deferred tax liabilities	–	–	–	–	–	27 066	27 066	–
Deposits	3 136 359	322 780	665 110	3 708	–	123 586	4 251 543	4.12
Derivative financial instruments	793	1 587	–	–	–	14 750	17 130	–
Provisions and other liabilities	–	–	–	–	–	50 191	50 191	–
Other accounts payable	–	–	–	–	–	192 836	192 836	–
Tax	–	–	–	–	–	920	920	–
Total equity and liabilities	3 137 152	324 367	665 110	3 708	–	2 084 938	6 215 275	
Financial position interest sensitivity gap	1 938 539	41 631	(645 790)	24 805	24 540	–	1 383 725	
Derivative financial instruments	17 594	31 529	(17 594)	(31 529)	–	–	–	
Total net interest sensitivity gap	1 956 133	73 160	(663 384)	(6 724)	24 540	–	1 383 725	

Risk management and control
(continued)

Interest rate risk (continued)

	Up to 1 month R'000	1 – 3 months R'000	4 – 12 months R'000	1 – 5 years R'000	Over five years R'000	Non-interest sensitive R'000	Total R'000	Effective interest rate %
2010								
Assets								
Intangible assets	–	–	–	–	–	224 402	224 402	–
Property and equipment	–	–	–	–	–	126 887	126 887	–
Tax	–	–	–	–	–	101	101	–
Other accounts receivable	–	–	–	–	–	49 021	49 021	–
Other investments	–	–	–	–	–	10 969	10 969	–
Deferred tax assets	–	–	-	–	–	62 382	62 382	–
Loans and advances	3 749 310	–	–	45 499	30 786	(104 688)	3 720 907	8.62
Derivative financial instruments	59	–	–	–	–	34 658	34 717	–
Negotiable securities	49 782	63 161	132 853	19 232	–	–	265 028	6.72
Cash and cash equivalents	1 574 773	–	–	–	–	185 124	1 759 897	5.26
Total assets	5 373 924	63 161	132 853	64 731	30 786	588 856	6 254 311	
Equity and liabilities								
Total equity	–	–	–	–	–	1 539 394	1 539 394	–
Deferred tax liabilities	–	–	–	–	–	21 038	21 038	–
Deposits	2 845 361	340 102	679 748	30 643	–	668 134	4 563 988	4.17
Derivative financial instruments	2 860	1 736	–	–	–	23 526	28 122	–
Provisions and other liabilities	–	–	–	–	–	29 920	29 920	–
Other accounts payable	–	–	–	–	–	71 849	71 849	–
Total equity and liabilities	2 848 221	341 838	679 748	30 643	–	2 353 861	6 254 311	
Financial position interest sensitivity gap	2 525 703	(278 677)	(546 895)	34 088	30 786	–	1 765 005	
Derivative financial instruments	17 630	35 604	7 000	(33 975)	(26 259)	–	–	
Total net interest sensitivity gap	2 543 333	(243 073)	(539 895)	113	4 527	–	1 765 005	

Risk management and control
(continued)

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

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

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

Through active liquidity management, the Group 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 Group performs, amongst others, the following:

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

Overall, the Group's key liquidity risk metrics, which have been formulated to achieve a prudent liquidity profile, were maintained at acceptable levels. Through increased stress testing, scenario analysis and contingency planning, the Group continues to actively manage its stress funding sources and liquidity buffers to ensure that it exceeds the estimated stress funding requirements which could emanate from moderate to high-stressed liquidity events. The Group complies with the BIS Principles for Sound Liquidity Risk Management and Supervision. Overall the Group's liquidity position remains strong.

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

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

	Up to 1 month R'000	1 – 3 months R'000	4 – 6 months R'000	7 – 12 months R'000	Over 1 year R'000
2011					
Deposits	**2 904 640**	**612 370**	**290 107**	**442 203**	**36 954**
Derivative financial instruments	**6 505**	**4 862**	**2 737**	**1 439**	**1 587**
Other accounts payable	**192 836**	**–**	**–**	**–**	**–**
Tax	**920**	**–**	**–**	**–**	**–**
Guarantees, letters of credit and committed undrawn facilities	**401 196**	**–**	**–**	**–**	**–**
Operating lease commitments	**472**	**944**	**1 438**	**2 636**	**7 369**
	3 506 569	**618 176**	**294 282**	**446 278**	**45 910**
2010					
Deposits	3 051 846	574 149	253 830	658 218	80 601
Derivative financial instruments	1 316	19 985	2 077	147	4 597
Other accounts payable	71 849	–	–	–	–
Guarantees, letters of credit and committed undrawn facilities	445 832	–	–	–	–
Operating lease commitments	434	869	1 323	2 638	11 352
Capital commitments	4 106	1 254	–	–	–
	3 575 383	596 257	257 230	661 003	96 550

Risk management and control

(continued)

Liquidity risk (continued)

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

	Assets R'000	Liabilities R'000	Total mismatch R'000
2011			
Maturing up to one month	**1 972 944**	**3 118 764**	**(1 145 820)**
Maturing between one and three months	**377 610**	**612 864**	**(235 254)**
Maturing between three and six months	**13 428**	**286 658**	**(273 230)**
Maturing between six months and one year	**72 800**	**423 980**	**(351 180)**
Maturing after one year	**3 377 932**	**34 915**	**3 343 017**
Non-contractual	**400 561**	**62 505**	**338 056**
	6 215 275	**4 539 686**	**1 675 589**
2010			
Maturing up to one month	2 579 700	3 154 262	(574 562)
Maturing between one and three months	83 572	589 407	(505 835)
Maturing between three and six months	281 223	249 990	31 233
Maturing between six months and one year	47 455	623 053	(575 598)
Maturing after one year	2 942 409	77 167	2 865 242
Non-contractual	319 952	21 038	298 914
	6 254 311	4 714 917	1 539 394

Basel III – influencing risk management developments at the Bank

In today's complex environment, combining effective bank-level management with market discipline and regulatory supervision best attains systemic safety and soundness. Building on these principles, the implementation of Basel III is expected to have far-reaching implications for banks in terms of minimum capital standards and liquidity requirements. In addition to this, it is anticipated that the reforms will be accompanied by enhancements in supervision, risk management and governance requirements including added transparency and disclosure requirements. The Bank is monitoring developments and will ensure that it is well positioned to meet the added requirements of Basel III as approved for implementation by the SARB.

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

The Basel III package was proposed to ensure that the financial system cannot suffer the type of collapse and resultant economic slowdown that occurred between 2007 and 2009. It encompasses:

- an unweighted leverage ratio;
- two new capital buffers – a conservation buffer and a countercyclical buffer;
- new and substantial capital charges for non-cleared derivative and other financial market transactions; and
- significant revisions to the rules on the types of instrument that count as bank capital.

One of the most significant impacts of Basel III on the world's banking industry is the liquidity coverage ratio ("LCR"). This ratio is designed to promote short-term resilience of a one-month liquidity profile, by ensuring that banks have sufficient high-quality liquid assets to meet potential outflows in a stressed environment. The regulations are yet to be finalised in South Africa by the SARB which recently released certain guidelines that are currently under review.

The potential impact of the LCR is already being monitored on a high level and included the preliminary results of the proposed requirements into the prudential ratios report on a monthly basis. The various ALM-related assumptions (specifically the Business as Usual assumptions) are in the process of being reviewed to include the various Basel III requirements and the beneficial impact of the IFC funding on the proposed changes.

A substantial number of changes are proposed in Basel III relating to the minimum required capital. It focuses mainly on the various qualifying forms of core tier 1 capital and further deductions against capital. Mercantile is largely unaffected by these changes due to the current high levels of tier 1 capital. The majority of current qualifying capital will still qualify as tier 1 capital when Basel III comes into effect.

Risk management and control

(continued)

Basel III – influencing risk management developments at the Bank (continued)

Key time lines for the implementation of Basel III include:

Leverage ratio parallel run:	2013
Credit value adjustment (#):	2013
Pubic disclosure of Leverage Ratio:	2015
Implementation of Liquidity Coverage Ratio:	2015
Implementation of Net Stable Funding Ratio:	2018
Implementation of Leverage Ratio within Pillar 1:	2018

(#) not a concern to Mercantile, but calculations still need to be performed

A substantial number of changes are proposed in Basel III relating to the minimum required capital. It focuses mainly on the various qualifying forms of core tier 1 capital and further deductions against capital.

Capital management

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

Capital adequacy and the use of regulatory capital are monitored by employing techniques based on the guidelines documented in the Regulations to the Banks Act and implemented by the SARB for supervisory purposes. The SARB uses the capital adequacy ratio of banks as a key supervisory tool. In terms of regulation, the Group is able to consider different tiers of capital. The capital of the Bank consists almost entirely of tier 1 capital. Following the recapitalisation of the Group in 2004, it has remained capitalised well beyond regulatory and internal requirements.

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

Capital to support the Group's needs is currently generated by retained earnings and the surplus capital held.

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

Risk management and control

(continued)

Capital management (continued)

The level of capital for the Bank is as follows:

	2011 R'000	2010 R'000
Risk-weighted assets – Banking book		
Credit risk	**4 371 738**	4 335 032
Operational risk	**801 859**	808 095
Market risk	**170 063**	2 350
Equity	**63 152**	10 940
Other assets	**125 315**	234 963
	5 532 127	5 391 380
Net qualifying capital and reserves		
Primary capital	**1 410 686**	1 276 395
Share capital and share premium	**1 483 299**	1 483 299
Retained earnings	**127 984**	10 659
General reserves	**12 231**	12 231
Less: Deductions	**(212 828)**	(229 794)
Secondary capital	**3 509**	5 161
General allowance for credit impairment	**3 475**	5 127
Surplus resulting from a revaluation of specified assets	**34**	34
	1 414 195	1 281 556
Capital adequacy ratio (%)	**25.6**	23.8
Primary capital (%)	**25.5**	23.7
Secondary capital (%)	**0.1**	0.1

Analysis of shareholders

at 31 December 2011

Shareholders' spread

	2011	2010
Number of public shareholders	**6 109**	6 246

Percentage of shares held by:

	2011 Number	2011 %	2010 Number	2010 %
Public	**296 489 106**	**7.53**	295 812 979	7.51
Non-public	**3 642 429 418**	**92.47**	3 643 105 545	92.49
Directors	**2 016 851**	**0.051**	2 016 851	0.051
Employees	**10 500**	**0.000**	110 600	0.003
Trustees of share incentive scheme	**26 383 872**	**0.670**	26 959 899	0.684
Holders of 10% or more of shares	**3 614 018 195**	**91.75**	3 614 018 195	91.75
	3 938 918 524	**100**	3 938 918 524	100

Major shareholders holding in excess of 5% of the Company's share capital

	Number of shares	%
2011		
Caixa Geral de Depósitos SA	**3 614 018 195**	**91.75**
2010		
Caixa Geral de Depósitos SA	3 614 018 195	91.75

Performance on the JSE during the year

	2011	2010
Number of shares issued	**3 938 918 524**	3 938 918 524
Share price (cents)		
Year-end	**23**	20
Highest	**32**	30
Lowest	**19**	19
Number of shares traded	**34 850 198**	53 711 509
Value of shares traded (R'000)	**8 139**	11 379
Average price (cents)	**23**	21
Market capitalisation (R'000)	**905 951**	787 784
Market capitalisation net of treasury shares (R'000)	**899 882**	782 392

Group addresses

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

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

Custom Capital
Head Office
18 Bute Street, Morningside, Durban, 4001
PO Box 47290, Greyville, 4023
Tel: +27 31 303 2292
Fax: +27 31 303 2612

Multi Risk
Head Office
Fourways View Office Park Block A, 1210
Sunset Boulevard, Lonehill Ext 44, Fourways
PO Box 254, Pinegowrie, 2123
Tel: +27 11 840 7000
Fax: +27 11 465 6456

Mercantile Bank Business Centres

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

Bruma Business Centre
11 Ernest Oppenheimer Boulevard,
Bruma, 2198
PO Box 31558, Braamfontein, 2017
Tel: +27 11 622 0916
Fax: +27 11 622 8833

Cape Town City Business Centre
Ground Floor, M&B House, Pier Place,
Foreshore, Cape Town, 8001
PO Box 51, Cape Town, 8000
Tel: +27 21 419 9402
Fax: +27 21 419 5929

Cape Town Tygerberg Business Centre
Ground Floor, Tygerpoort Building,
7 Mispel Street, Belville, 7530
PO Box 5436, Tygervalley, 7536
Tel: +27 21 910 0161
Fax: +27 21 910 0163

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

Durban Business Centre
Cowey Centre, 123 Cowey Road,
Morningside, Durban, 4001
PO Box 519, Durban, 4000
Tel: +27 31 209 9048
Fax: +27 31 209 9446

Germiston Business Centre
The Lake Shopping Centre, cnr William Hill
and Lake Street, Germiston, 1401
PO Box 31558, Braamfontein, 2017
Tel: +27 11 824 5813
Fax: +27 11 824 5823

Horizon Business Centre
153 Ontdekkers Road, Horizon, 1730
PO Box 31558, Braamfontein, 2017
Tel: +27 11 763 6000
Fax: +27 11 763 8742

Pretoria Hatfield Business Centre
Pro-Equity Court, cnr Pretorius and
Gordon Streets, Hatfield, Pretoria, 0083
PO Box 31558, Braamfontein, 2017
Tel: +27 12 342 1151
Fax: +27 12 342 1191

Pretoria West Business Centre
477 Mitchell Street,
Pretoria West, 0183
PO Box 31558, Braamfontein, 2017
Tel: +27 12 327 4671
Fax: +27 12 327 4645

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

Strijdompark 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

Troyeville Business Centre
77 Bezuidenhout Street, Bertrams, 2094
PO Box 31558, Braamfontein, 2017
Tel: +27 11 624 1450
Fax: +27 11 614 9611

Vanderbijlpark Business Centre
Shop 1 & 2, Russell's Building,
54 President Kruger Street,
Vanderbijlpark, 1911
PO Box 31558, Braamfontein, 2017
Tel: +27 16 981 4132
Fax: +27 16 981 0767

Welkom Business Centre
Tulbagh House, 11 Tulbagh Street,
Welkom, 9459
PO Box 2207, Welkom, 9460
Tel: +27 57 357 3143
Fax: +27 57 352 7879

Notice of Annual General Meeting

Mercantile Bank Holdings Limited
Member of CGD Group

Registration number: 1989/000164/06
(Incorporated in the Republic of South Africa)
Share code: MTL ISIN: ZAE000064721
("Mercantile" or "the Company")

Notice is hereby given that an Annual General Meeting ("the meeting") of the shareholders of the Company will be held at 12h30 on Monday, 23 April 2012 with a record date for voting purposes being Friday, 13 April 2012, and the last day to trade for voting purposes being Wednesday, 4 April 2012, in the Boardroom, First Floor, Mercantile Bank, 142 West Street, Sandown, Sandton for the following purposes:

Special resolutions

1. Amendment to the Memorandum of Incorporation of the Company:

"**RESOLVED** as a special resolution that the Memorandum of Incorporation (previously the Articles of Association) of the Company be and are hereby amended, with or without modification, by inserting a new article 23A:

23A Acquisition by the Company of its own shares

23A1 subject to the Listings Requirements of the JSE Limited, if applicable, the provisions of section 48 of the Companies Act, 2008 and subject to the further provisions of this clause 23A –

23A1.1 the Directors may determine that the Company should acquire a number of its own shares; and the directors of any subsidiary of the Company may determine that such subsidiary should acquire shares of the Company, but –

23A1.1.1 not more than 10% (ten percent), in aggregate, of the number of issued shares of any class may be held by, or for the benefit of, all of the subsidiaries of the Company, taken together; and

23A1.1.2 no voting rights attached to those shares may be exercised while the shares are held by that subsidiary and it remains a subsidiary of the Company.

23A2 Any decision by the Company to acquire its own shares must satisfy the requirements of section 46 of the Companies Act, 2008 and the Listings Requirements of the JSE Limited (for as long as the Company remains listed on the JSE Limited) and, accordingly, the Company may not acquire its own shares unless –

23A2.1 for as long as it is required in terms of the Listings Requirements, the acquisition has been approved by a special resolution of the shareholders, whether in respect of a particular repurchase or generally approved by shareholders and unless such acquisition otherwise complies with sections 5.67 to 5.69 of the Listings Requirements (or such other sections as may be applicable from time to time);

23A2.2 the acquisition is pursuant to an existing legal obligation of the Company, or a court order; or the Directors, by resolution, have authorised the acquisition;

23A2.3 it reasonably appears that the Company will satisfy the Solvency and Liquidity Test as set out in the Companies Act, 2008, immediately after completing the proposed acquisition; and

23A2.4 the Directors, by resolution, have acknowledged that it has applied the Solvency and Liquidity Test and reasonably concluded that the Company will satisfy the Solvency and Liquidity Test immediately after completing the proposed acquisition.

23A3 a decision of the Directors referred to in 23A1.1 above –

23A3.1 must be approved by a special resolution of the shareholders if any shares are to be acquired by the Company from a Director or prescribed officer of the Company, or a person related to a Director or prescribed officer of the Company; and

23A3.2 is subject to the requirements of sections 114 and 115 of the Companies Act, if considered alone, or together with other transactions in an integrated series of transactions, it involves the acquisition by the Company of more than 5% (five percent) of the issued shares of any particular class of shares.

23A4 notwithstanding any other provision of this Memorandum of Incorporation (Articles of Association), the Company may not acquire its own shares, and no subsidiary of the Company may acquire shares of the Company if, as a result of that acquisition, there would no longer be any shares of the Company in issue other than –

23A4.1 shares held by one or more subsidiaries of the Company; or

23A4.2 convertible or redeemable shares."

The reason for the amendment is to allow for the Company to acquire its own shares or for subsidiaries of the Company to acquire shares in the Company. The effect of the amendment is to allow the Company to acquire its own shares or for subsidiaries of the Company to acquire shares in the Company, subject to the regulatory and statutory requirements.

Notice of Annual General Meeting

(continued)

Special resolutions (continued)

1. Amendment to the Memorandum of Incorporation of the Company: (continued)

The quorum for the consideration of special resolutions is the presence or representation of members holding not less than 25% of the total votes and approval by a 75% majority of the votes cast by shareholders present or represented by proxy at this meeting is required for these resolutions to be passed.

2. Directors' remuneration

"**RESOLVED** as a special resolution to approve and ratify the proposed fees payable on a monthly basis to the Non-Executive Directors of the Mercantile Group from time to time for the period 1 April 2012 to 31 March 2013 for serving as a Director on the Board and Board Committees and to approve the remuneration paid on a monthly basis to the Executive Directors."

2.1 Executive Directors:

2.1.1 CEO:	R3 570 000 per annum
2.1.2 Executive Director: Business and Finance:	R2 756 250 per annum
2.1.3 Executive Director:	R1 987 256 per annum

2.2 Chairman of the Mercantile Board: R1 645 000 per annum

2.3 Director of the Mercantile Board: R226 000 per annum

2.4 Director of Mercantile Bank Limited, the major subsidiary of the Company: R49 000 per annum

2.5 Chairman of the Group Audit Committee: R90 000 per annum

2.6 Member of the Group Audit Committee: R68 000 per annum

2.7 Chairman of the Remuneration Committee: R60 000 per annum

2.8 Member of the Remuneration Committee: R68 000 per annum

2.9 Member of the Risk and Capital Management Committee: R68 000 per annum

2.10 Chairman of the Transformation Committee: R60 000 per annum

2.11 Member of the Transformation Committee: R68 000 per annum

2.12 Member of the Directors' Affairs Committee: R68 000 per annum

2.13 Chairman of the Technology Committee: R60 000 per annum

2.14 Member of the Technology Committee: R68 000 per annum"

The reason for the resolution is to request Shareholders' approval of the remuneration payable to Executive Directors and to Non-Executive Directors for serving on the Boards and Board Committees of the Company and the Bank in accordance with section 66(9) of the Companies Act, 2008. The Chairman of the Mercantile Board's fee includes remuneration for the Chairman's participation on other Boards and Board Committees. The Board members' total fees are dependent on their participation on Board Committees – refer to page 20 for the Board and Board Composition as at 31 December 2011.

The effect of the resolution will be the approval of the remuneration to be paid to Executive and Non-Executive Directors for the period 1 April 2012 to 31 March 2013.

Ordinary resolutions

1. Adoption of annual financial statements

To receive and adopt the annual financial statements of the Company and of the Mercantile Group for the year ended 31 December 2011.

Explanatory note:
At the Annual General Meeting the Directors must present the audited annual financial statements for the year ended 31 December 2011 to shareholders together with the reports of the Directors and auditors as contained in the 2011 Integrated Annual Report.

Notice of Annual General Meeting

(continued)

Ordinary resolutions (continued)

2. Re-election of Directors retiring by rotation

To re-elect, by way of separate resolutions, Directors in the place of those retiring in accordance with the Company's Memorandum of Incorporation. The Directors retiring are:

J A S de Andrade Campos (appointed 26/07/2002)
T H Njikizana (appointed 06/11/2008)

and being eligible offer themselves for re-election.

An abbreviated curriculum vitae of each Director offering themselves for re-election is contained on page 4.

Explanatory note:
In accordance with the Memorandum of Incorporation of the Company, one-third of the Directors is required to retire at each meeting and may offer themselves for re-election. In terms of the Memorandum of Incorporation of the Company the Executive Directors, during the period of their service contracts, are not taken into account when determining which Directors are to retire by rotation.

3. Auditors

To recommend the re-appointment of Deloitte & Touche as independent auditors of the Company and to appoint D Crowther as the designated auditor to hold office for the ensuing year.

Explanatory note:
Deloitte & Touche has indicated their willingness to continue as the Company's auditors until the next Annual General Meeting. The Group Audit Committee has satisfied itself as to the independence of Deloitte & Touche. The Group Audit Committee has the power in terms of the Companies Act, 2008 to approve the remuneration of the external auditors. The remuneration and non-audit fees paid to the auditors during the year ended 31 December 2011 are contained on page 66.

As special business and requiring shareholder approval, shareholders are requested to consider and if deemed fit, pass, with or without modification, the resolution numbers 4, 5 and 6.

4. Control of authorised but unissued shares

"RESOLVED as an ordinary resolution that all the unissued shares in the authorised share capital of the Company be and are hereby placed under the control of the Directors of the Company, who are authorised to allot and issue the same to such persons and on such terms and conditions as they may determine in their sole and absolute discretion, subject to the provisions of the Companies Act, 2008 (as amended), the provisions of the Banks Act, No. 94 of 1990 (as amended) and the Listings Requirements of the JSE Limited."

The approval is given in the form of a general authority and accordingly:
- is only valid until the next Annual General Meeting of the Company; and
- may be varied or revoked by any General Meeting of the Company prior to such Annual General Meeting.

5. General authority to issue shares for cash

"RESOLVED that the Directors be given the general authority to issue unissued shares of a class already in issue held under their control, for cash, when the Directors consider it appropriate in the circumstances, subject to the provisions of the Companies Act, 2008 (as amended), the provisions of the Banks Act, No. 94 of 1990 (as amended), the Listings Requirements of the JSE Limited and to the following limitations, that:
- the authority shall be valid until the next Annual General Meeting of the Company (provided it shall not extend beyond 15 months from the date of this resolution);
- a paid press announcement giving full details, including the impact on net asset value, net tangible asset value, earnings and headline earnings per share, will be published at the time of any issue representing, on a cumulative basis within one financial year, 5% or more of the number of shares in issue prior to such issue;
- issues for cash in any one financial year may not exceed 15% of the Company's issued share capital;
- the issues must be made to public shareholders as defined by the Listings Requirements of the JSE Limited; and
- in determining the price at which an issue of shares may be made in terms of this authority, the maximum discount permitted will be 10% of the volume weighted average traded price as determined over the 30 business days prior to the date that the price of the issue is determined or agreed by the Directors of the Company."

The approval of a 75% majority of the votes cast by shareholders present or represented by proxy at this meeting is required for this resolution to become effective.

Notice of Annual General Meeting

(continued)

Ordinary resolutions (continued)

6. Signature of documents

"RESOLVED that any one Director or the Company Secretary of the Company be and is hereby authorised to do all such things and sign all documents and take all such action as they consider necessary to implement the resolutions set out in the notice convening this Annual General Meeting at which this ordinary resolution will be considered."

Voting and proxies

A member entitled to attend, speak and vote at this meeting is entitled to appoint a proxy (who need not be a member of the Company) to attend, vote and speak in his/her stead.

Members, which are companies or other body corporates, may, in terms of section 58 of the Companies Act, 2008 (as amended), by resolution of their Directors or other governing body, authorise any person to act as its representative at the meeting.

Certificated shareholders and own-name dematerialised shareholders, who are unable to attend this meeting but wish to be represented thereat, must complete and return the attached form of proxy in accordance with the instructions contained therein. A form of proxy is attached for this purpose and must be lodged at the Company's transfer secretaries or the Company's registered address by no later than 12h30 on Thursday, 19 April 2012. The detail of these addresses are on page 4.

Dematerialised shareholders, excluding own-name dematerialised shareholders, who wish to attend this meeting, must request their Central Securities Depository Participant ("CSDP") or broker to provide them with a Letter of Representation or must instruct their CSDP or broker to vote by proxy on their behalf in terms of the agreement entered into between the shareholder and their CSDP or broker.

By order of the Board

A de Villiers
Company Secretary
Sandton

22 March 2012

Registered office
First Floor
Mercantile Bank
142 West Street
Sandown, 2196
PO Box 782699, Sandton, 2146

Transfer Secretaries
Computershare Investor Services (Pty) Ltd
Ground Floor
70 Marshall Street
Johannesburg 2001
PO Box 61051, Marshalltown, 2107

Notes

Form of proxy

Mercantile Bank Holdings Limited
Member of CGD Group

Registration number: 1989/000164/06
(Incorporated in the Republic of South Africa)
Share code: MTL ISIN: ZAE000064721
("Mercantile" or "the Company")

for use by certificated and own-name dematerialised ordinary shareholders at the Annual General Meeting of the Company to be held at 12h30 on Monday, 23 April 2012 ("the meeting") in the Boardroom, First Floor, Mercantile Bank, 142 West Street, Sandown, Sandton.

I/We (please print) full name(s)

of (please print) address(es)

being (a) member(s) of the Company, holding ordinary shares in the Company, hereby appoint:

1. or failing him/her,

2. or failing him/her,

3. the Chairman of the meeting

as my/our proxy to attend, speak and vote on my/our behalf at the Annual General Meeting to be held at the registered office of the Company, in Sandton, on Monday, 23 April 2012 at 12h30 and at any adjournment thereof, and to vote or abstain from voting on the ordinary resolutions to be proposed at the meeting, as follows:

Resolutions	For	Against	Abstain
1. Special resolutions:			
1.1 Special resolution 1: Amendment to the Memorandum of Incorporation			
1.2 Special resolution 2: Directors' remuneration			
2. Ordinary resolutions			
2.1 Ordinary resolution number 1: Adoption of annual financial statements			
2.2 Re-election of Directors			
2.2.1 Ordinary resolution number 2: Re-election of J A S de Andrade Campos			
2.2.2 Ordinary resolution number 2: Re-election of T H Njikizana			
2.3 Ordinary resolution number 3: Re-appointment of auditors			
2.4 Ordinary resolution number 4: Control of authorised but unissued shares			
2.5 Ordinary resolution number 5: General authority to issue shares for cash			
2.6 Ordinary resolution number 6: Signature of documents			

Signed this day of 2012

Signature of member(s)

Assisted by me (where applicable)

Please read the notes and instructions on the reverse hereof.

Notes to form of proxy

1. A member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend, speak and vote in his/her stead. A proxy need not be a member of the Company.
2. Every person present and entitled to vote at the meeting as a member or as a proxy or as a representative of a body corporate shall, on a show of hands, have one vote only, irrespective of the number of shares such person holds or represents, but in the event of a poll, a member shall be entitled to that proportion of the total votes in the Company which the aggregate amount of the nominal value of the shares held by him/her/it bears to the aggregate amount of the nominal value of all the shares issued by the Company. It is the intention of the Company to request for a vote on a poll.
3. Please insert the relevant number of shares/votes in the appropriate spaces on the face hereof and how you wish your votes to be cast. If you return this form of proxy duly signed without any specific directions, the proxy will vote or abstain from voting at his/her/its discretion.

Instructions on signing and lodging this form of proxy:

1. A deletion of any printed matter and the completion of any blank spaces need not be signed or initialled. Any alteration or correction must be initialled by the authorised signatory(ies).
2. The Chairman shall be entitled to decline or accept the authority of a person signing this form of proxy:
   (a) under a power of attorney; or
   (b) on behalf of a company,

   unless that person's power of attorney or authority is deposited at the registered office of the Company not later than 12h30 on Thursday, 19 April 2012.
3. You may insert the name of any person(s) whom you wish to appoint as your proxy in the blank space(s) provided for that purpose.
4. When there are joint holders of shares, all joint shareholders must sign this form of proxy.
5. The completion and lodging of this form of proxy will not preclude the member who grants this proxy from attending the meeting and speaking and voting in person thereat to the exclusion of any proxy appointed in terms hereof should such member wish to do so.
6. Documentary evidence establishing the authority of a person signing this form of proxy in a representative capacity must be attached to this form of proxy, unless previously recorded by the transfer secretaries of the Company or waived by the Chairman of the meeting. The Chairman of the meeting may reject any form of proxy not completed and/or received in accordance with these notes and/or instructions, or with the Memorandum of Incorporation of the Company.
7. Completed forms of proxy should be returned to the registered office, First Floor, Mercantile Bank, 142 West Street, Sandown, 2196 (PO Box 782699, Sandton, 2146) or faxed to the Company Secretary (fax number +27 11 883 7765) or faxed to the transfer secretaries (fax number +27 11 688 5238) by no later than 12h30 on Thursday, 19 April 2012.

Mercantile Bank
Holdings Limited
Member of CGD Group

142 West Street, Sandown, 2196, South Africa
Tel +27 (0)11 302 0300, Fax +27 (0)11 302 0729
www.mercantile.co.za