# people, passionately delivering on clients' needs

Capitec Bank Limited Annual Report **2019**

# people, passionately delivering on clients' needs

In 2019, we have a bank with 13 774 employees, 840 branches and 11.4 million clients. Our fundamentals make banking simple, accessible, affordable and personal for everyone. We value relationships and increasingly engage on social platforms with our stakeholders. We believe in doing business responsibly. This is reflected in how we deliver our Global One solution and who we employ. We focus on building a strong talent pipeline and appoint people for their potential. We take responsibility for their training and development.

We are developing fun, digital and educational ways to increase financial literacy for clients and employees. We won the latest awards for the top South African bank, the most loved bank and the most innovative brand, among others. Our Global One solution remains simple and transparent: transact, save, insure and credit.

Our operating environment continues to be shaped by a challenging economic landscape. The unsecured credit market remains active and well regulated. We implemented the new IFRS 9 Accounting Standard. In terms of risk management, we have clearly defined roles, responsibilities and policies. Our motivation remains to create sustainable value for all our stakeholders.

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Noteholders are advised that the King IV application register of the Company ("King IV Register"), is incorporated by reference into this annual report. The King IV Register can be accessed on the Company's website as set out below and is available for inspection at the registered office of the Company at no charge.

| Disclosure | Document | Website link |
| --- | --- | --- |
| King IV disclosure and application | King IV Register | https://resources.capitecbank.co.za/capitec_kingiv.pdf |

# CFO report

## Headline earnings growth of 19%

The growth in headline earnings was driven by strong client acquisition which led to higher transactional volumes combined with enhanced credit management in a very competitive market. This complemented our focus to stay true to our fundamentals of a personal experience that is simple, affordable and accessible to all clients.

A total dividend of 1 750 cents (2018: 1 470 cents) was declared for the year. The dividend cover was maintained at 2.6 times to provide us with the opportunity to grow, improve and innovate in the future.

The compound annual growth rates (CAGR) are as follows:

| % | Since listing in 2002 % | Last 10 years % | Last 5 years % | Last 3 years % | Last year % |
|---|---|---|---|---|---|
| Headline earnings | 32 | 33 | 21 | 18 | **19** |
| Headline earnings per share | 27 | 29 | 21 | 18 | **19** |
| Dividend per share | 27 | 29 | 21 | 18 | **19** |
| Share price | 51 | 46 | 48 | 40 | **57** |

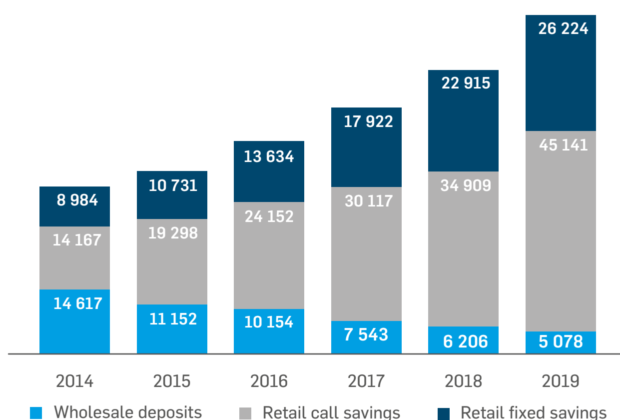
## The year under review

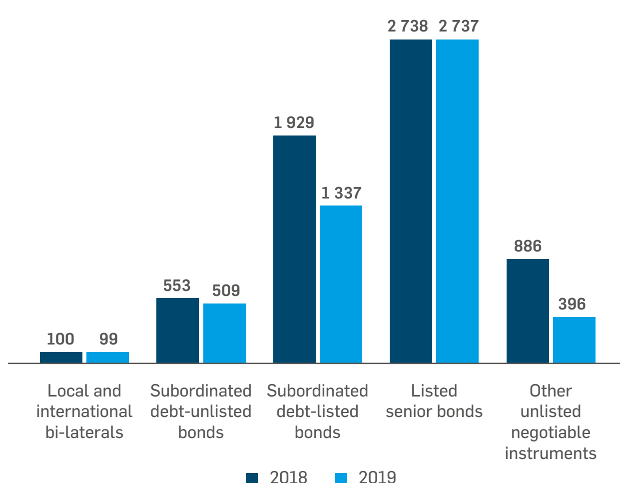
Our ability to serve millions of clients and address their financial needs through our Global One solution remained one of the key underlying factors in delivering the results.

Highlights of the 2019 financial year:

- The trust in our brand was tested in January 2018 with the allegations published by a short seller. This impacted our share price and deposit book at the time and both recovered and grew due to us remaining transparent in everything we do and addressing all allegations timeously and effectively in the market.
- On 1 March 2018, we successfully implemented International Financial Reporting Standard (IFRS) 9: *Financial Instruments*. For a detailed overview of our transition to IFRS 9, please refer to our transitional report, which is available on our website at https://resources.capitecbank.co.za/Capitec_-_IFRS9_transitional_report.pdf.
- The Capitec funeral cover product was launched on 21 May 2018 and we are pleased with the market acceptance to date.
- During the financial year we invested a further R180 million and increased our shareholding in Cream Finance Holdings Limited (Creamfinance) to 40.25%. The investment provides Capitec with the opportunity to learn more about the behavioural trends, regulators and legislation in the foreign market and gain insight into the development of foreign online consumer credit markets.
- On 22 November 2018, we announced that our bid to acquire Mercantile Bank Holdings Limited was successful. The acquisition price is R3.2 billion and will be adjusted by any change in the net asset value from 30 April 2019 to the completion date of the transaction, when all conditions have been met.
- For the month of January 2019 we experienced the largest uptake of clients in our history and our active client base now exceeds 11 million. For us, this is a confirmation that we are delivering a client-centric solution.

We strongly believe that the commitment to our clients, the Capitec team and the delivery of our simple solutions have cemented a foundation for us to improve, grow and diversify further with the vision of remaining relevant and sustainable.




# Save

## Funding

The debt-to-equity ratio increased slightly from 3.5:1 to 3.6:1 in 2019 due to continued strong growth in retail deposits. Total deposit funding increased by R12 billion to R76 billion.

Total retail deposits increased by 23% to R71 billion (2018: R58 billion). Retail call deposits and retail fixed deposits grew by 29% and 14% respectively. The strong growth in retail deposits was driven by the 15% growth in clients and is a true reflection of our clients' trust in our brand. The average maturity of retail fixed deposits was 16.9 months at February 2019 (2018: 18.1 months).

Wholesale funding (institutional bond and other funding) declined by 18% to R5 billion in 2019. Wholesale funding was deliberately managed lower due to the loan book growth, compared to strong retail fixed deposits and earnings growth.

To retain our presence in the debt capital market, we auctioned R500 million in bonds in May 2018 that were 3.6 times over-subscribed. Due to the strong investor appetite for wholesale funding, we will consider a further issuance during the 2020 financial year.

The weighted average maturity of wholesale funding was 14.9 months at February 2019. (2018: 19.7 months).

## Liquidity

The approach to liquidity risk remains conservative. The management of liquidity takes preference over the optimisation of profits. This conservative approach results in the inherent compliance with the Basel 3 liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR).

Compliance with the LCR was required from 1 January 2015, with a minimum required ratio of 60%, increasing to 100% by 2019. Our LCR exceeded these minimums with a ratio of 1 450% (2018: 1 878%). Compliance with a NSFR of 100% was required from 2018 onwards. Our NSFR is 196% (2018: 206%).

To reduce liquidity risk, call deposits are only allowed to fund cash flows shorter than 6 months. The surplus funds compared to operational requirements are R44.3 billion (2018: R34.7 billion) and are invested in low risk, liquid, interest-bearing instruments.

The weighted average remaining maturity of the investment portfolio at 28 February 2019 was 77 days (28 February 2018: 76 days). None of the longer-term investments have an original contractual maturity of longer than one year which assists in the management of interest rate risk.

## Credit ratings

Capitec Bank is rated by S&P Global Ratings (S&P). The ratings were affirmed on 22 November 2018:

Global – "BB" long-term rating
– "B" short-term rating

National – "zaAA" long-term rating
– "zaA-1+" short-term rating

The global scale long-term ratings carry a stable outlook.

## Capital

Capitec remains well capitalised with a capital adequacy ratio (CAR) of 33.9% (2018: 35.7%) and a core equity ratio (CET1) of 32.8% (2018: 33.9%). The bank continues to meet all prudential requirements.

Preference shares and subordinated debt instruments are subject to the applicable phase-out rules in terms of Basel 3. Non-qualifying perpetual preference shares amounting to R31 million and subordinated debt amounting to R619 million were redeemed during the financial year.

The IFRS 9 transition after applying the phase-in resulted in 0.5% decrease in the CAR ratio based on the current year's capital and risk weighted assets.

The implementation of IFRS 16 from 1 March 2019 will have an estimated impact of between 1.3% and 1.5% on the CAR ratio, which is not subject to phase-in.

# Insure

We are pleased with the market uptake of the Capitec funeral cover plan. The cover plan is a simple contract, and one that Capitec can leverage through branches or the app using existing infrastructure and systems. At financial year end more than 360 000 policies were active.

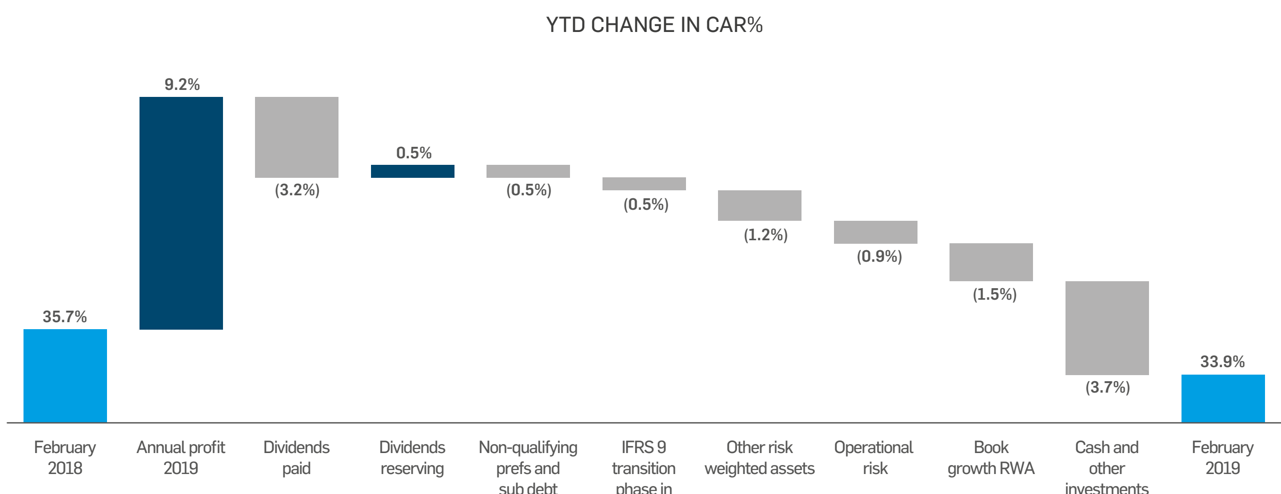
The funeral income recognised on the income statement is received from the cell captive as a dividend after tax, subject to our profit share agreement. Funeral income includes the tax expense, commission fee earned from the cell captive as well as planned and experienced profits after claims paid.

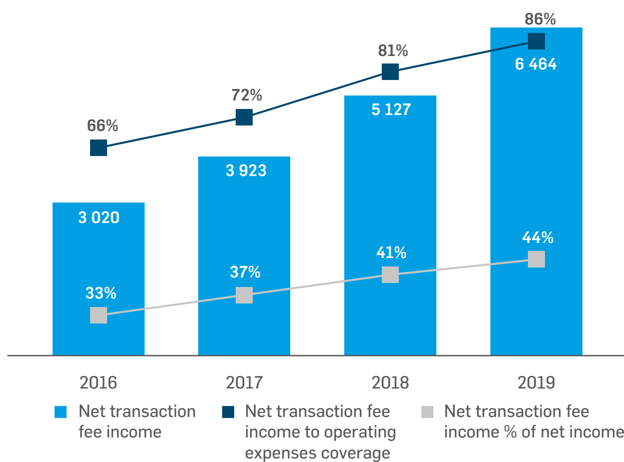
Similar to all other solutions we offer, the funeral product is priced to achieve a desired return on equity while at the same time delivering real value to clients.

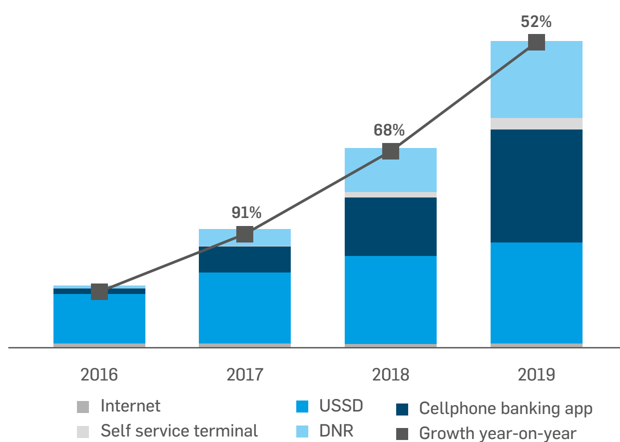
Our mobile app functionality for buying and maintaining a funeral plan was an industry first when it launched. Clients who purchase cover via our remote app experience further savings on their premiums.

We are excited about the value the Capitec funeral cover plan creates, as we seek to diversify our income stream.

YTD CHANGE IN CAR%






## Transact

Net transaction fee income grew by 26% to R6 464 billion in the 2019 financial year. The net transaction fee income to net income ratio increased to 44% (2018: 41%), while the net transaction fee income to operating expenses ratio increased to 86% (2018: 81%).

By 2022 we want to cover 100% of our operating expenses through our transactional income.

We continue to focus on growing our quality banking clients, whom we define as those clients who have a stable inflow into their account and stable product usage over a consecutive 3-month period. Quality banking clients have increased by 16% in 2019.

Over 2.2 million clients actively use the banking app. In addition to the mobile app, we still offer Unstructured Supplementary Service Data ("USSD") services which enables us to make our financial solutions available to wider group of clients.

Our net transaction fee income from our digital channels (banking app and USSD) have increased by 47% from R494 million to R723 million.

We do however, acknowledge that not every client has the ability or the desire to access their financial services via digital channels. To ensure we remain accessible to all, we value our branch network that increased to 840 this year (2018: 826). The net transaction fee income from branch related transactions have increased by 15% to R1 387 million and contributes to 21% of the total net transaction fee income.

Investment in self-service banking innovation remains an integral part of our strategy to help our clients to effectively manage their own financial lives and remain in control of their money.

Our self-service banking (mobile app, internet banking, self-service terminals, Dual Note Recycler ("DNR") and USSD) channels have continued to improve in line with our current strategic objective. The net transaction fee income relating to these channels have increased by 52%.

Self-service terminals and DNRs at the branches save clients' time and money and creates capacity for consultants to better serve clients. Self-service terminal transactions increased by 111% to 17.5 million (2018: 8.3 million) and DNR transactions increased by 55% to 29.0 million (2018: 18.7 million).

## Credit

The fierce competition and economic conditions impacted the unsecured market during 2019. However, our ability to continuously enhance our granting strategy resulted in an improved credit book and client composition.

We analyse the financial health of our clients and monitor and identify trends within the market to continuously enhance our granting strategy. Our strong growth of Global One clients further aids our analyses and gives us a competitive edge.

### Loan granting strategy

The reason why clients approach credit providers for credit is that they have specific requirements. These requirements include the need for emergency cash, education, second-hand vehicles, and housing.

In order to execute on this solution, we incorporate a comprehensive assessment of the client's behaviour, affordability and source of income. For the assessment, we use information from the credit bureau, bank statements and payslips. We apply 2 parallel disposable income calculations i.e. the NCA affordability assessment regulations calculation, and our own disposable income calculation that maintains conservative buffers. We then apply the most stringent of the 2. Branch staff have no credit granting discretion and all exceptions are managed and monitored by a centralised specialist team.

During the loan application process, we present the maximum loan amount, maximum term and maximum instalment to the client. Within these constraints, the client may select any combination that best suits him or her. We encourage clients to take up credit for shorter periods of time and for smaller amounts. This is done through a pricing model that discounts the interest rate in instances where clients select a term that is shorter than the maximum for which they qualify. This is due to the manner in which the pricing for risk model reacts to the lower default rates for such clients.

When existing clients apply for further credit, we conduct a full credit assessment. If a client qualifies for further credit, it can be extended as a further agreement in addition to the current credit; or the client can have the existing credit consolidated into a new credit agreement. This is only available to clients if instalments are up-to-date on all Capitec loans and to clients who have a satisfactory credit risk.

Our scoring models react to instances where a client repeatedly takes up credit, and when their debt-to-income ratio becomes too high. In such instances we limit the term and amount of credit offered to clients or we decline the application for credit.

Acquisition and retention strategies are built on the principles of the client's credit behaviour (willingness to pay), affordability and source of income. Rehabilitation strategies are need-driven to assist clients based on their unique circumstances.

Unforeseen circumstances may lead to reduced income or increased expenditure for the client. These circumstances may include:

- employers that reduce overtime and bonuses or place staff on short pay due to difficult economic conditions;
- strikes;
- clients may be forced to change employment at reduced salaries due to poor performance or health problems; or
- financial problems faced by employers.

These instances may result in a client missing an instalment on a loan and being in arrears.

If the client is in arrears due to challenges regarding the client's inability to repay the debt, we either negotiate with the client to immediately bring the arrears instalments up to date, or we attempt to help and manage the situation through agreeing a course of action with the client by amending the loan agreement (loan reschedule).

The first solution is preferable, as it:

- reduces arrears if the client pays on the same date;
- improves our cash flow;
- helps restore the client to a creditworthy position; and
- limits the overall cost of credit for clients.

We have extensive history that measures the yields we can receive by handing clients over to external debt collectors. We monitor the cash flow yields that we receive from this process against internal collection processes, including rescheduling. We optimise the strategy for different client groups and use handover samples for each strategy to monitor the relative performance and validate the strategy for each client group.

Factors that we consider in delivering the optimal strategy for a client include:

- the risk profile and payment history of the client;
- the arrears status of the client;
- whether the client was rescheduled previously;
- the credit exposure amount;
- free cash flow estimates derived from clients' bank accounts or credit bureau records (salary less debit orders); and
- any information we have about the client's employer.

Depending on a combination of factors, the optimal strategy is to encourage clients with some free cash flow or limited credit exposure to bring arrear instalments up to date; or assist clients that have cash flow difficulty but have good behaviour history, to reduce their instalments and extend the term of the credit agreement (i.e. reschedule). When there is a clear temporary interruption of income such as a strike or a client is on maternity leave, we may allow a reduced instalment for a short period (typically 3 months) with subsequent increased instalments, in order to assist the client through this period (i.e. variable reschedule).

We use system-based rules to limit instances where we allow rescheduling. The rules engine determines whether clients are eligible for rescheduling as well as the maximum term for which the loan can be extended. We do not reschedule all loans that meet our criteria, as this depends on the individual circumstances of each client applying to reschedule.

We monitor the performance and cure rate of reschedules using a segmented approach to ensure that it remains within the bank's risk appetite. This process allows us to optimise collections and reduce clients' debt levels. Our aim is always to partner with our clients through both good and tough times and act in their best interest.

## Loan sales

### Term loan

We achieved loan sales (new credit granted) of R24.8 billion this year (2018: R24.3 billion) although the number of loans granted during the year decreased to 1.8 million from 2.2 million.

Loan sales do not include any rescheduled loans. Rescheduling is an amendment to an existing loan contract with no credit granted. No initiation fees are charged on rescheduled loans.

Loan sales in the 61 to 84 months category increased by 11% in 2019, driven by the strategic focus on higher income earning clients, improving the performance of the credit book.

The average credit granted of total term loans granted increased from R10 934 to R14 145.

In the 13 to 36 month category we experienced a 20% increase of R1.3 billion in 2019. The increase was due to the increase in loans where clients decided to take shorter term loans at lower interest rates than the full loan for which they qualify. These results align with our strategy to support clients to take credit for the right reasons and periods.

The average credit granted greater than 6 months increased from R32 133 to R35 332.

We report the net amount of credit issued and we exclude the consolidation loans from loan sales in this analysis.

### Credit card

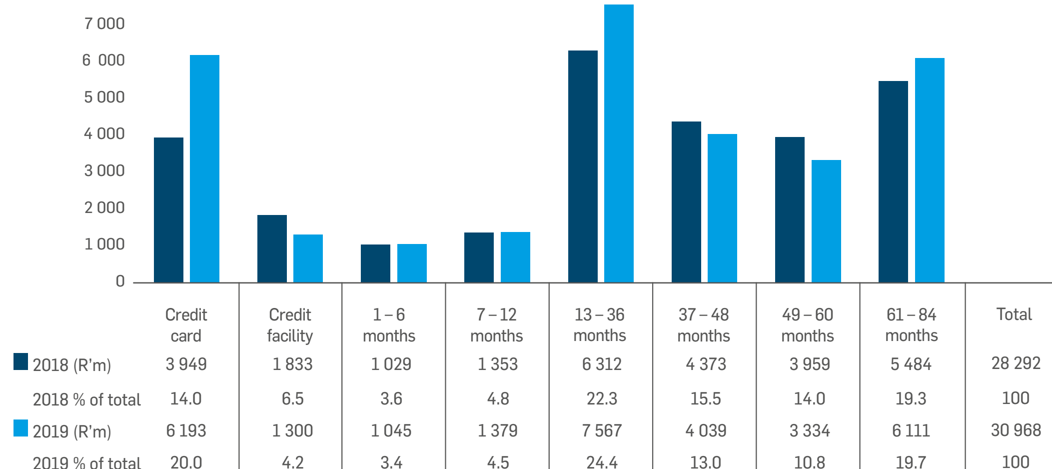
The 2019 financial year is the second full year that our credit card has been in operation. By 28 February 2019, approximately 445 000 cards were in issue, with disbursements increasing by 57% to R6.2 billion (28 February 2018: R3.9 billion).

In each month that a credit card is utilised, 1 loan is counted towards the number of loans and advances granted.

The average disbursement amount granted decreased from R2 296 to R1 974 due to a increased number of loans granted at a lower value during the 2019 financial year.

At 28 February 2019, the gross credit card book was R3.6 billion and comprises approximately 3.0% of total South African retail credit card market.

LOAN SALES BY PRODUCT (R'm)




## Total lending and insurance income (excluding investment income)

| Total lending and insurance income reconciliation (R'm) | 2019 | 2018 | Change % |
|---|---|---|---|
| Interest income on loans and advances to clients[(1)] | **11 935** | 12 440 | (4%) |
| Loan origination fees | **787** | 776 | 1% |
| Monthly service fee | **931** | 919 | 1% |
| Net insurance income[(2)(3)] | **795** | 873 | (9%) |
| **Total lending and insurance income** | **14 448** | 15 008 | (4%) |
| Loan fee expense[(4)] | **( 219)** | (412) | (47%) |
| **Total net lending and insurance income** | **14 229** | 14 596 | (3%) |

(1) *In the current year, under IFRS 9, interest income and credit impairment charge are recognised on a net basis for all loans classified as Stage 3 (R1 073 million netting reversal for the year ended February 2019)*

(2) *Insurance and funeral profit is received from the related cell captives as a dividend after tax. The tax expense on insurance profit is included in net insurance and funeral income for the financial year ended 28 February 2019.*

(3) *Third-party cell captive net insurance income from 6 May 2016.*

(4) *First-party cell captive insurance expense on loans granted before 6 May 2016 that are still on the credit book.*

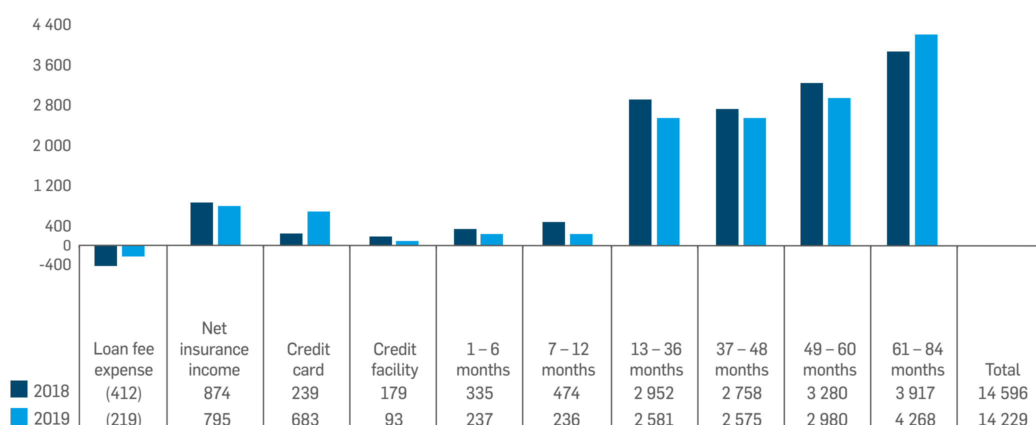
Total net lending and insurance income decreased by 3% from R14 596 million to R14 229 million. The main drivers behind the decrease in total lending and insurance income are the transition to International Financial Reporting Standard (IFRS) 9: *Financial Instruments* and the tax effect on insurance income, presented in the table above.

Interest income on loans and advances, initiation fees and monthly services fees decreased by 4% to R11 935 million (2018: R12 440 million). Under IFRS 9, both interest income and credit impairment charge are recognised on a net basis for loans in stage 3 resulting in a zero profit impact. In addition to the net interest recognition our enhanced granting strategy of shorter term loans at lower interest rates (13 to 36 months) and the increase in longer term lower interest rate loans also resulted in lower interest yields which further contributed to the decrease.

Insurance income is received from the related cell captives as a dividend after tax. In the current period, the tax attributable to the profits from the cell captives of R309 million was deducted from the net insurance income. This has resulted in the 9% decrease to R795 million.

The loan fee expense due to our first-party cell captive structure has decreased by 47% (2018: 36%) in the 2019 financial year. The first-party insurance expense relates to loans issued prior to National Credit Act ("NCA") amendments on 6 May 2016 and third-party net insurance relates to loans issued after this date. The first-party loan book rolls off over time as amounts are repaid and credit is extended under the third-party cell captive.

TOTAL NET LENDING AND INSURANCE INCOME
(EXCLUDING INVESTMENT INCOME) (R'm)




## Application of Expected Credit Losses (ECL) model

From 1 March 2018, we transitioned and applied the ECL model in terms of IFRS 9.

ECL is calculated as an unbiased, probability weighted amount which is determined by evaluating the range of reasonably possible outcomes, the time value of money and considering all reasonable and supportable information including that which is forward-looking.

The most significant class of financial asset subject to an ECL is loans and advances. Loans and advances comprise a large number of small, homogeneous assets. We use an ECL provisioning model based on historical roll rates using the Markov chain method.

We stratify the Markov roll rate results into similar groups to ensure results are stable and appropriate to predict future cash flows for clients with similar characteristics. We stratify on the group's aspects such as client risk groups, time on book, product term, payment frequency (monthly, fortnightly or weekly), default statuses, employment, industry and rescheduling status, and the behaviour score of the client.

Furthermore, the model combines the roll rate matrices with a loan amortisation model on a loan-by-loan basis. The specific features of each loan such as balance, interest rate, fees, remaining term, instalments and arrears status, combined with the roll rates applicable to loans with the same characteristics, estimate the expected cash flow and balance amortisation of the loan. The rolled up results enable us to analyse portfolio and segmented views.

Forward-looking economic assumptions are incorporated into the model where relevant and where they influence credit risk. These assumptions are incorporated using the group's most likely forecast for a range of macro-economic assumptions. Three forward-looking scenarios are incorporated into the range of reasonably possible outcomes (base case, negative and positive scenarios).

The period over which the ECL is calculated is limited to the maximum contractual period.

The resultant ECL calculation amounts to the excess of the balance of a loan above the present value of its expected cash flows, discounted using the effective interest rate on the financial instrument as calculated at initial recognition (initiation fee plus interest).

The key inputs used for measuring ECL are:

- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

PD is an estimate of the likelihood of default over a given time horizon. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates. The estimation is based on current conditions, adjusted to take into account estimates of future conditions that will impact the PD.

The calculation is based on a statistical model that predicts the future repayment performance of clients based on their arrears status, model segment and tenure.

Future cash flows and arrears status probabilities are generated from which an expected ECL provision is calculated. The prediction of future repayment is based on observed roll rates over the last 12 months. Roll rates refer to the rates at which clients transition or roll from a repayment status in a given month to a repayment status in the following month.

LGD is an estimate of the loss arising on default. LGD models for unsecured assets consider time of recovery and recovery rates. The calculation is on a discounted cash flow basis.

EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.

The EAD is calculated by creating an amortisation structure for each account. This structure includes the expected monthly repayment, as well as the projected monthly cumulative repayment status probabilities and the cash flows associated with every repayment status.

Our modelling approach for EAD reflects expected changes in the balance outstanding over the lifetime of the loan exposure that are permitted by the current contractual terms, such as amortisation profiles, early repayment or overpayment, changes in utilisation of undrawn commitments and credit mitigation actions taken before default. We use EAD models that reflect the characteristics of the portfolios.

The developing and measuring of the group's processes for measuring ECL, including the monitoring of Significant Increases in Credit Risk (SICR), the incorporation of economic forward-looking information and the methods used to calculate ECL and ensuring that polices and procedures are in place to appropriately maintain and validate models used to measure ECL, are overseen by the group's credit committee. The internal audit function performs regular audits to ensure that established controls and procedures are both adequately designed and implemented.

IFRS 9's ECL model requires the classification and measurement of ECL using the general model for loans and advances measured at amortised cost. In essence, the general model is a three stage model. Capitec has interpreted the three stages as being up-to-date (stage 1), up-to-date loans with SICR and loans up to 1 month in arrears (stage 2) and credit impaired (stage 3). Loans and advances within stage 1 are measured based on a 12 month ECL and a lifetime ECL is determined for loans and advances within stage 2 and stage 3.

*Stage 1:*

The ECL model is applied in terms of IFRS 9 stages as follows:

An ECL is recognised at the time of initial recognition of the financial debt instruments and represents the lifetime cash shortfall arising from possible default events up to 12 months into the future from the balance sheet date.

An ECL continues to be determined on this basis until there is a SICR event or the financial debt instrument becomes credit impaired.

A cash shortfall is the difference between the cash flows that are due in accordance with the contractual terms of the loan and the cash flows that the group expects to receive over the contractual life of the loan.

Loans and advances, up-to-date loans and clients that applied for debt review more than 12 months ago that are currently performing are included in stage 1.

*Stage 2:*

We monitor loans and advances subject to impairment requirements at each reporting date to determine whether evidence exists that there has been a SICR since initial recognition of the loan and advance.

We identify SICR for clients that are up-to-date on their loans, but who have reached certain behaviour risk thresholds or specific events have occurred that raise a SICR flag in the model. The ECL is extended to a lifetime ECL for these clients.

We consider the following to be a SICR for all loans and advances extended to the client:

- A client who has been reported as being unemployed;
- A client with a term loan that is up-to-date, but with a Capitec credit card which is in arrears;
- A client with a behaviour score that has decreased below the internal SICR threshold set by the group; and
- A client with an updated granting score below the internal SICR threshold set by the group.

We consider reasonable and supportable information based on our historical experience, credit risk assessment and forward-looking information (including macro-economic factors) when determining whether the credit risk (i.e. the risk of default) of loans and advances has increased significantly since initial recognition. The ECL framework aligns with our credit granting strategy.

We have set certain behaviour and granting score thresholds which are used to identify SICR.

The purpose of the behaviour score in the ECL model is to provide a measure of an existing client's propensity to default on a loan within 12 months. The score was built on a client level, utilising Capitec loans and savings account information, as well as the credit exposure and repayment behaviour at external credit providers. The behaviour score is updated monthly on all existing loan clients to ensure that Capitec has a consistently updated view of the client.

The updated granting score in the ECL model aims to provide an assessment of SICR on a collective basis for groups of exposure that share similar credit characteristics in order to account for forward-looking information that may not be identified at an individual loan level.

The updated granting view is simply a reinterpretation of the information available at granting date and is not an updated view on the client. Updated client information is incorporated in the behaviour score.

The SICR thresholds are reviewed on an annual basis to ensure that they are able to identify SICR throughout the lifetime of the loan.

The following loans and advances are included in stage 2:

- up-to-date loans with a SICR;
- loans up to 1 month in arrears; and
- clients that applied for debt review between 6 and 12 months ago which are currently performing.

*Stage 3 – Credit impaired:*

Loans and advances are considered impaired if there is objective evidence of impairment as a result of events that occurred after initial asset recognition (known as loss events). These loss events have an adverse impact on the asset's estimated future cash flows that can be measured reliably.

We define loans and advances as being 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset has occurred. Loans and advances are considered to be credit impaired upon the occurrence of any of the following events:

- the client is currently under debt review;
- the client is handed over for collection or has a legal status;
- the client is in default. We define default as the point at which the client is past due on 2 contractual payments, i.e. more than 1 month in arrears;
- clients that applied for debt review less than 6 months ago and are currently performing;
- up-to-date loans rescheduled from up-to-date (not yet rehabilitated); and
- up-to-date loans rescheduled from arrears (not yet rehabilitated).

Interest on loans and advances categorised as stage 3 is recognised in the income statement and balance sheet, net of ECL impairments.

It is a fundamental principle of IFRS 9 that the ECL impairment provision that the group holds against potential future credit losses should not only depend on the health of the economy presently, but should take into account changes to the economic environment in the future.

To capture the effects of changes to the economic environment in the future, the forward-looking model considers economic variables specific to South Africa that directly impact the group's clients. We utilise the Bureau of Economic Research (BER) macro-economic outlook for the country over a planning horizon of at least 3 years. The outlook is provided to the asset and liability committee (ALCO) for review and approval.

*Write-off is a derecognition event:*

Following the implementation of IFRS 9, loans and advances are written off when it is has been determined that the reasonable expectation of recovery is less than 5% of gross balance before write-off.

On 1 March 2018, when we transitioned to IFRS 9, we informed the market that we would apply a partial write-off policy. The policy was to immediately write off 20% of all loans rolling into debt review and 70% for accounts handed over or in legal status. The partial write-off was supported by statistical evidence. The write-off point of the remaining balance was then determined by the time since last payment (TSLP) received on a loan. For loans in debt review, the remaining 80% of the loans were written off 16 months TSLP and for loans handed over 6 months TSLP.

Subsequent to transition, we refined and simplified the method to estimate the point of write-off by applying a more scientific method aligned to handover scores. This is now defined as follows:

- Loans in debt review: 4 consecutive missed payments after termination of debt review.
- Loans handed over: handover score less than the predetermined threshold or handover score more than predetermined threshold and 4 consecutive missed payments.

The change in methodology aligns with operations and collections strategies.

## Credit book

The following terminology is used when referring to the credit quality of loans and advances to clients:

| Loans status | 2019 – Description (IFRS 9) |
| --- | --- |
| Up-to-date | Clients that are fully up to date with their original contractual obligations or amended contractual obligations and rehabilitated post rescheduling, are classified as up-to-date. |
| Arrears | Arrears reflect the outstanding balances, where 1 or more instalments (or part of an instalment on any of the client's loans and advances) remain unpaid after the contractual payment date, that is 1 day past the contractual payment date. The arrears balance therefore includes rescheduled loans when the amended instalment was not paid in full. |
| Rescheduling | Rescheduling refers to an amendment of the original terms of the loan contract, as formally agreed between the bank and the client. Rescheduling is used as a rehabilitation mechanism for clients in arrears who are contacted successfully by centralised collections. It is also used as a proactive mechanism to assist up-to-date clients who contact the bank when wanting to reschedule their loans due to changes in their circumstances. No initiation fee is charged on a rescheduled loan as no new credit is granted. Rescheduled loans do not form part of loan sales. |
| Rehabilitated | Clients with rescheduled loans are deemed to be rehabilitated once they have made contractual payments for 6 months post rescheduling and are up-to-date with their amended contractual obligations. This is supported by statistical analysis. |
| Rescheduled from up-to-date not rehabilitated | These are loans and advances relating to clients that were fully up to date with their original contractual obligations, have contacted the bank to reschedule the original terms of their loan due to a change in their circumstances and have made payment under the rescheduled terms. These loans are up-to-date with their amended contractual obligations post rescheduling but have not yet made payments for 6 consecutive months under the amended contract. |
| Rescheduled from arrears not rehabilitated | These are loans and advances relating to clients that were in arrears and were subsequently rescheduled and have made payment under the rescheduled terms. These clients are up-to- date with their amended contractual obligations but have not yet made payments for six consecutive months under the amended contract. |
| Application for debt review | Clients that apply for debt review are identified as credit impaired, and the related loan is classified as stage 3 for the first 6 months following application.<br><br>Clients that applied for debt review more than 6 months ago that are up-to-date are identified as SICR and the related loan is classified as stage 2 between 6 to 12 months following application.<br><br>Clients that applied for debt review more than 12 months ago and remained up-to-date and the related loan is classified as stage 1 subject to the SICR assessment. |
| Expected recoveries receivable | The expected recoveries receivable under IAS 39 that existed at transition date were transferred to stage 3. |
| Stage 1 | These are loans and advances which are up-to-date with no indication of SICR, clients that applied for debt review more than 12 months ago and remained up to date, as well as loans that have been rescheduled from up-to-date or arrears and have been rehabilitated. |

| Loans status | 2019 – Description (IFRS 9) |
|---|---|
| Stage 2 | These are loans and advances that have raised a SICR flag due to:<br>• unemployment;<br>• behaviour score below the threshold;<br>• granting score below the threshold; or<br>• a client that has a term loan that is up-to-date but has a credit card in arrears<br><br>Stage 2 also includes loans that are up to 1 month in arrears, as well as clients that applied for debt review between 6 to 12 months ago, but who are performing. |
| Stage 3 | These are loans and advances that are more than 1 month in arrears or:<br>• have been rescheduled but not yet rehabilitated;<br>• where the client has applied for debt review less than 6 months ago and are currently performing;<br>• is currently under debt review; or<br>• has another legal status (among others, under administration). |
| Write-off | Loans are written off when there is no reasonable expectation of recovery. This point is defined as a loan with a present value future recovery of less than 5% of the gross balance before write-off. |

**Analysis of net loans and advances by status – 28 February 2019 (IFRS 9)**

| | Stage 1 | Stage 2 | | Stage 3 | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| R'm | Up-to-date | Up-to-date loans and advances with SICR and applied for debt review >6 months | Up to 1 month in arrears | 2 and 3 months in arrears | Re-scheduled from up-to-date (not yet re-habilitated) | Re-scheduled from arrears (not yet re-habilitated) | More than 3 months in arrears, legal statuses and applied for debt review <6 months[1][2] | Expected recoveries receivable | Total |
| **Balance at 28 February 2019** | | | | | | | | | |
| Gross loans and advances | 41 587 | 3 765 | 1 087 | 1 389 | 856 | 1 272 | 4 923 | – | 54 879 |
| Cumulative provision | (2 671) | (771) | (582) | (1 097) | (345) | (534) | (4 364) | – | (10 364) |
| Net loans and advances | 38 916 | 2 994 | 505 | 292 | 511 | 738 | 559 | – | 44 515 |
| ECL coverage % | 6.4 | 20.5 | 53.5 | 79.0 | 40.3 | 42.0 | 88.6 | – | 18.9 |
| % of total gross loans and advances | 75.8 | 6.9 | 2.0 | 2.5 | 1.6 | 2.3 | 8.9 | – | |

[1] *Includes loans that are currently up to 1 month in arrears that were previously rescheduled but have not been rehabilitated.*
[2] *In the transition report application for debt review within 6 months and arrears – 2 and 3 months in arrears were aggregated.*

**Analysis of net loans and advances by status – 1 March 2018 (IFRS 9)**

| | Stage 1 | Stage 2 | | Stage 3 | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| R'm | Up-to-date | Up-to-date loans and advances with SICR and applied for debt review >6 months | Up to 1 month in arrears | 2 and 3 months in arrears | Re-scheduled from up-to-date (not yet re-habilitated) | Re-scheduled from arrears (not yet re-habilitated) | More than 3 months in arrears, legal statuses and applied for debt review <6 months[1][2] | Expected recoveries receivable | Total |
| **Balance at 1 March 2018** | | | | | | | | | |
| Gross loans and advances | 37 165 | 4 401 | 1 003 | 1 697 | 1 085 | 1 277 | 108 | 906 | 47 642 |
| Cumulative provision | (2 675) | (1 033) | (558) | (1 311) | (462) | (609) | (67) | – | (6 715) |
| Net loans and advances | 34 490 | 3 368 | 445 | 386 | 623 | 668 | 41 | 906 | 40 927 |
| ECL coverage % | 7.2 | 23.5 | 55.6 | 77.3 | 42.6 | 47.7 | 62.0 | – | 14.1 |
| % of total gross loans and advances | 78.0 | 9.2 | 2.1 | 3.6 | 2.3 | 2.7 | 0.1 | 2.0 | |

[1] *Includes loans that are currently up to 1 month in arrears that were previously rescheduled but have not been rehabilitated.*
[2] *In the transition report application for debt review within 6 months and arrears – 2 and 3 months in arrears were aggregated.*

The most significant impact of IFRS 9 is the change in write-off policy, which changed the composition of the loan book and provision. Previously, loan balances were written off at the earlier of having a legal status, e.g. debt review, deceased or handed over, or being 3 months or more in arrears. An expected recovery receivable was raised on the loans written off.

Under IFRS 9, loans and advances are written off when it has been determined that no reasonable expectation of recovery exists. We consider this point to be when a loan has a present value future recovery less than 5% of the gross balance before write-off.

The consequence of the new write-off policy is that loan balances that were previously written off under the old write-off policy are now kept on book longer.

The stage 1 up-to-date book increased by 12% compared to 1 March 2018 while up-to-date loans with SICR decreased by 14% from R4.4 billion to R3.8 billion.

Loans up to 3 months in arrears can be compared to the prior year under IAS 39. At year end, loans up to 3 months in arrears decreased by 8%.

Loans more than 3 months in arrears increased to R4.9 billion with a related credit impairment of R4.4 billion (89% provision coverage) being on book as at 28 February 2019.

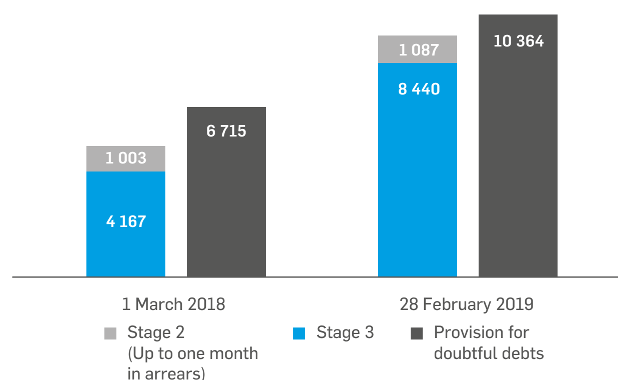
The total up-to-date loans rescheduled from up-to-date and arrears (not yet rehabilitated) decreased by 10%. The decrease is a direct result of enhancements made on rescheduling strategies.

Clients that have applied for debt review within the last 6 months decreased by 35% from 1 March 2018. Clients under debt review, clients more than 3 months in arrears and legal status are included in stage 3.

The net loans and advances in stage 1 as a percentage of total net loans and advances improved to 87% (1 March 2018: 84% ). The quality and performance of the book is well aligned with our enhanced credit strategy.

The expected recoveries receivable (R906 million) on 1 March 2018 represent the net present value of expected future recoveries on loans that were written off in full previously under IAS 39 (the receivable). Under IFRS 9, no future expected receivable is recognised post write-off. The receivable was settled in the current period and bad debts recovered reduced by R906 million.

Our provisioning methodology remains conservative. The coverage ratio for all stage 3 loans (excluding expected recoveries receivable) and stage 2 (up to 1 month in arrears) is 109% (1 March 2018: 130%).




The table below illustrates the appropriate change in write-off, related movement in credit impairment and bad debts recovered under IFRS 9 compared to the prior period under IAS 39.

| Net provision for credit impairment charge (R'm) | 2019 | 2018 | Change % |
|---|---|---|---|
| Bad debts written off | **1 268** | 6 662 | (81) |
| Movement in credit impairment | **3 649** | (102) | |
| Gross provision of credit impairment charge | **4 917** | 6 560 | (25) |
| Bad debts recovered | **(467)** | (1 280) | (64) |
| Net provision for credit impairment charge | **4 450** | 5 280 | (16) |

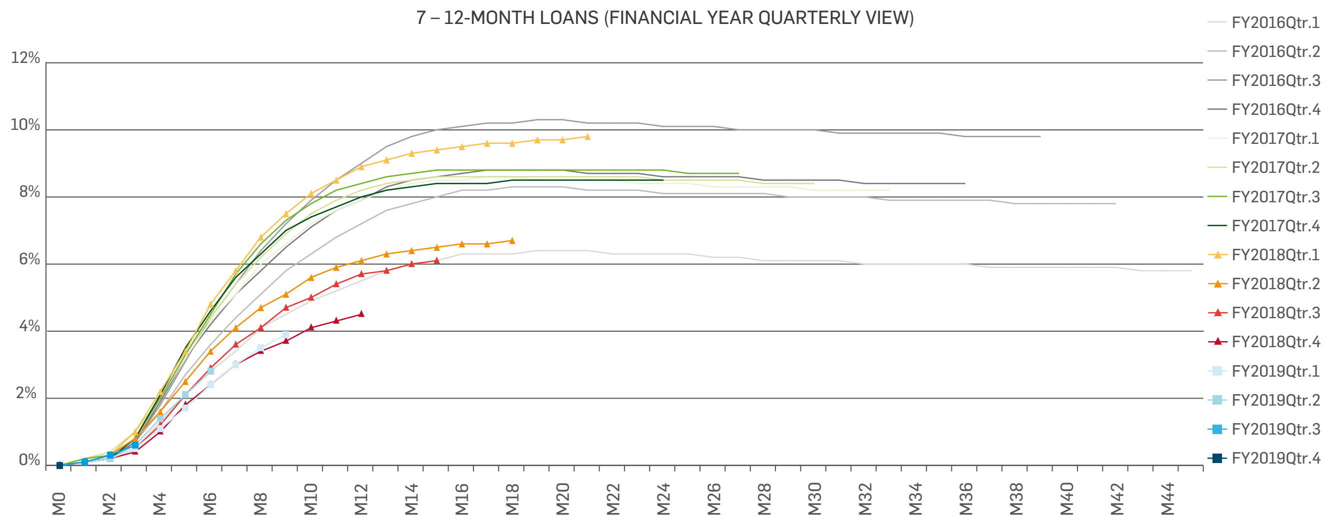
Under IFRS 9, the credit impairment charge is recognised on a net basis for all loans in stage 3.

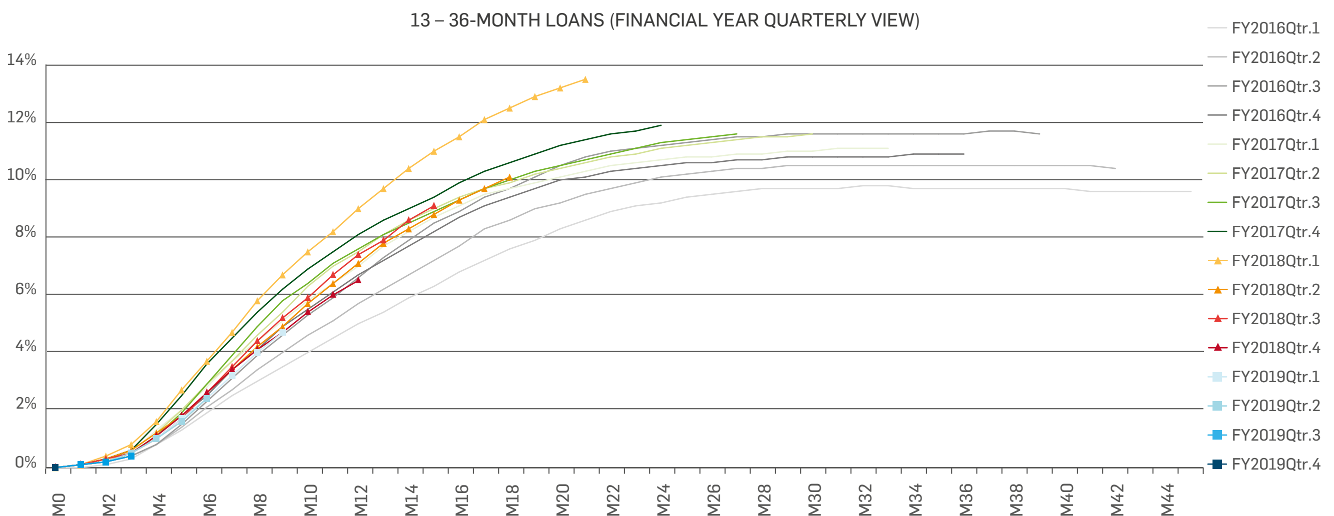
## Vintage graphs

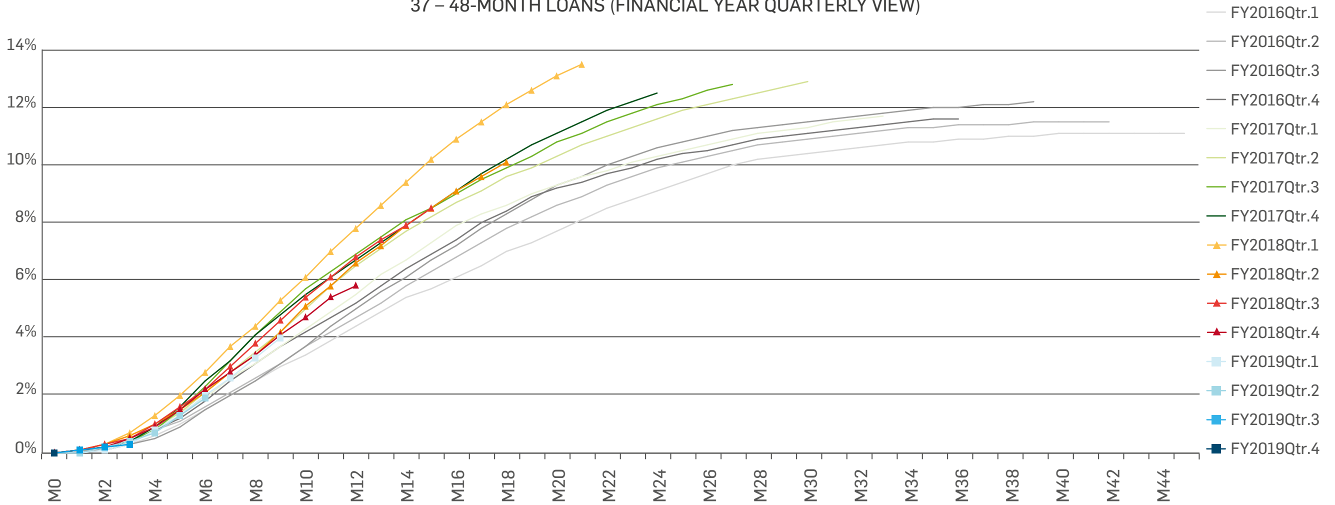
We grant credit on risk-based pricing that includes the probability that a client may default on payments. Default in the graphs below, is defined as the client being more than 90 days in arrears, legally handed over to external debt collectors or under debt review.

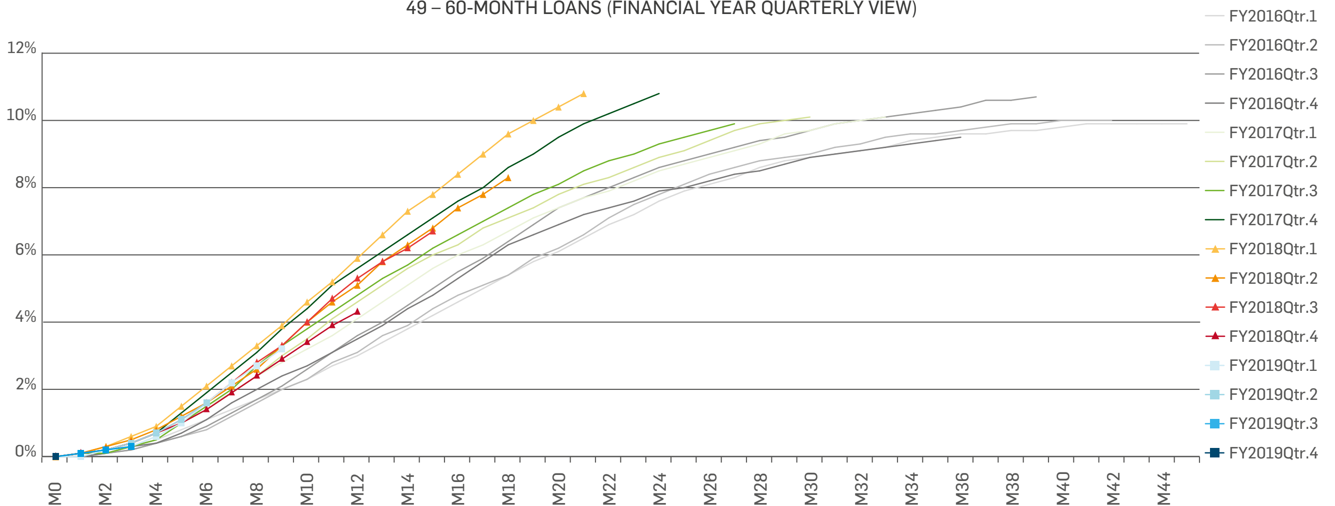
The vintage graphs below express the balance at risk at the time a loan goes into arrears as a percentage of the total original instalments (capital, interest, initiation fees, monthly fees and insurance) expected for loans granted in a given quarter. The vintage graphs reflect our expectation of clients defaulting on payments and our ability to appropriately adapt pricing in specific loan categories to match our granting strategy and risk appetite.

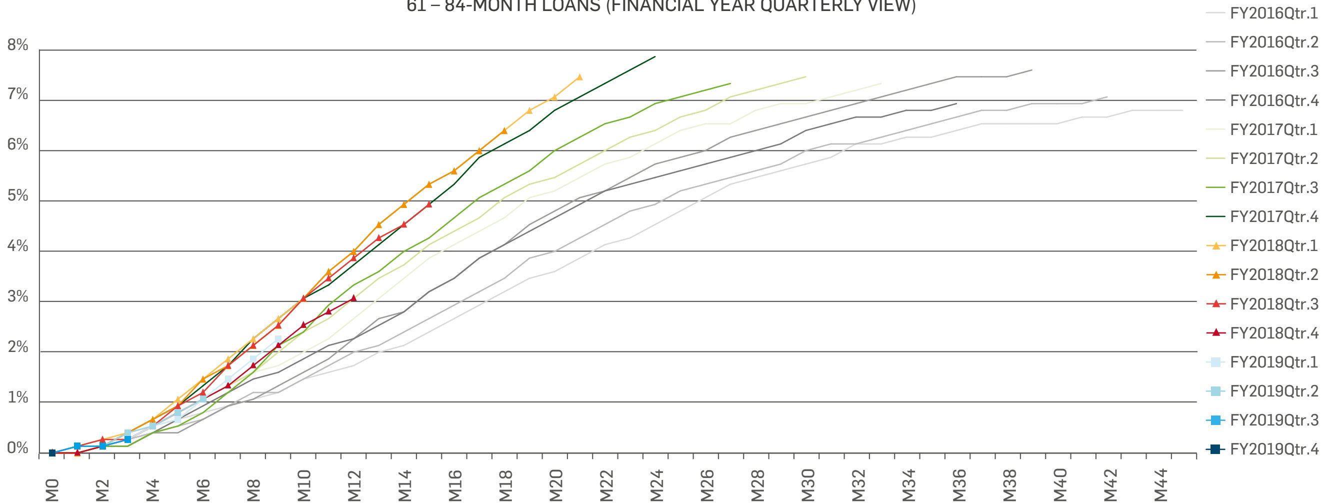
Vintage graphs are tracked monthly against price risk targets which ensures that our risk appetite is not exceeded.




37 – 48-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)
14%
12%
10%
8%
6%
4%
2%
0%
M0
M2
M4
M6
M8
M10
M12
M14
M16
M18
M20
M22
M24
M26
M28
M30
M32
M34
M36
M38
M40
M42
M44
FY2016Qtr.1
FY2016Qtr.2
FY2016Qtr.3
FY2016Qtr.4
FY2017Qtr.1
FY2017Qtr.2
FY2017Qtr.3
FY2017Qtr.4
FY2018Qtr.1
FY2018Qtr.2
FY2018Qtr.3
FY2018Qtr.4
FY2019Qtr.1
FY2019Qtr.2
FY2019Qtr.3
FY2019Qtr.4


49 – 60-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)
12%
10%
8%
6%
4%
2%
0%
M0
M2
M4
M6
M8
M10
M12
M14
M16
M18
M20
M22
M24
M26
M28
M30
M32
M34
M36
M38
M40
M42
M44
FY2016Qtr.1
FY2016Qtr.2
FY2016Qtr.3
FY2016Qtr.4
FY2017Qtr.1
FY2017Qtr.2
FY2017Qtr.3
FY2017Qtr.4
FY2018Qtr.1
FY2018Qtr.2
FY2018Qtr.3
FY2018Qtr.4
FY2019Qtr.1
FY2019Qtr.2
FY2019Qtr.3
FY2019Qtr.4


61 – 84-MONTH LOANS (FINANCIAL YEAR QUARTERLY VIEW)
8%
7%
6%
5%
4%
3%
2%
1%
0%
M0
M2
M4
M6
M8
M10
M12
M14
M16
M18
M20
M22
M24
M26
M28
M30
M32
M34
M36
M38
M40
M42
M44
FY2016Qtr.1
FY2016Qtr.2
FY2016Qtr.3
FY2016Qtr.4
FY2017Qtr.1
FY2017Qtr.2
FY2017Qtr.3
FY2017Qtr.4
FY2018Qtr.1
FY2018Qtr.2
FY2018Qtr.3
FY2018Qtr.4
FY2019Qtr.1
FY2019Qtr.2
FY2019Qtr.3
FY2019Qtr.4

## Investing in growth and efficiencies

Due to IFRS 9 and the interest recognition on a net basis, the cost-to-income ratio increased to 39% (2018: 36%). By adjusting the income to a gross basis to compare year-on-year, the cost-to-income ratio would have increased by only 1% from last year. Operating expenses have increased by 18% from R6.4 billion to R7.5 billion in line with earnings growth.

The increase in operating cost and capital commitments is an investment in our future growth and ability to unlock efficiency. A majority of the increased cost in salaries is due to the focus on further developing and enhancing our digital and credit offerings.

In August 2018, we broke ground to build our own head office that will allow all staff to collaborate under one roof. We are excited about the increased productivity, strategic alignment and culture growth that will be unlocked.

September 2018 saw us embark on a project to implement a new SAP general ledger, procurement and human resource system to support the increase in growth, drive processing efficiency and enhance decision-making capacity. We plan to implement the first phase of the project with respect to a new general ledger system by September 2019.

## Forward looking

### Mercantile Bank Holdings Limited

Mercantile Bank will provide many opportunities in the market to better serve small-to-medium enterprises and owner-managed businesses. The acquisition of Mercantile Bank Holdings Limited will obviate the need to reinvent and create new systems and processes anew and thus fast track Capitec's objective to expand its focus to a broader bank strategy.

The transaction is subject to regulatory approvals. All regulatory applications have been prepared and submitted to the Prudential Authority, the Minister of Finance and the Competition Commission. The acquisition is now pending the outcome from the regulatory authorities.

### IFRS 16

IFRS 16: *Leases*, will become effective from 1 March 2019.

The group will apply IFRS 16 using the modified retrospective approach and therefore the comparative information for the financial year ending 28 February 2020 will not be restated.

The group will recognise lease liabilities in relation to all leases which had previously been classified as 'operating leases' under the principles of IAS 17 *Leases*. These liabilities will be measured at the present value of the remaining lease payments, discounted using the group's incremental borrowing rate as of 1 March 2019.

The associated right-of-use assets will be measured at the amount equal to the lease liability, adjusted by the amount of any prepaid of accrued lease payments relating to the lease recognised in the balance sheet as at 28 February 2019.

On 1 March 2019, we will recognise lease liabilities estimated at R2.6 billion and right-of-use assets of approximately R2.5 billion.

**Regulation**

The regulatory environment constantly changes. We continue to proactively contribute to and manage our regulatory environment by taking care of the interests of all our stakeholders and clients.

The table below summarises the status of these developments and their impact:

| Regulator | Status |
|---|---|
| South African Reserve Bank (SARB) | The Authenticated Collections/DebiCheck system, which aims to provide a more secure debit order collection system to replace the existing AEDO and NAEDO systems, pilot was implemented on 1 August 2018. The banks and users are in a system stabilisation phase to repair the remaining technical challenges while gradually increasing the volumes on the new system. The Reserve Bank Directive stated that the system must be fully implemented by 31 October 2019. The impact of changes will be addressed in our processes. |
| | Review of various methods used for calculating the capital requirements for credit risk (which includes counterparty credit risk exposures and the large exposures framework) and the introduction of a method for holding capital on interest rate risk positions. Capitec is involved in the working groups that are part of assessing these developments. |
| | The Deposit Insurance Scheme (DIS), a wholly owned subsidiary of the SARB, which will require banks to contribute to the fund was introduced. Contributions will be based on the level of covered deposits, which covers up to R100 000 per client deposit. |
| Department of Trade and Industry (DTI) and National Credit Regulator (NCR) | The National Credit Amendment Bill [B 30 – 2018], which provides for the establishment of a debt intervention solution for consumers who, on average, earn no more than R7 500 per month and who have unsecured debt of no more than R50 000, is in the finalisation stage. Despite many objections from industry, little has been changed to the proposed Bill. The draft Bill still makes provision for repayment suspension of up to 24 months and the expungement of debt. It furthermore places an obligation on the credit provider to ensure that the consumer enters into and maintains credit life insurance for the duration of the term of the credit agreements.<br><br>The Bill may also adversely affect the supply of credit to borrowers in certain income thresholds, which could have negative implications for financial inclusion. There may also be an increase in moral hazard on the part of some borrowers who may enter into further credit arrangements in anticipation of debt being expunged. |
| *NCA Section 103 In Duplum*: University of Stellenbosch Law Clinic versus BASA (as well as most of the banks, including Capitec) | The law clinic argues that all collection fees, including attorneys' and advocates' fees, form part of the *in duplum* calculation in order to determine whether the *in duplum* amount is reached. The clinic also argues that the calculation of the *in duplum* amount applies even after judgment is granted and that the *in duplum* calculation does not start once again after judgment is granted.<br><br>The banks, represented by the Banking Association of South Africa, argues that the legal fees of attorneys and advocates do not form part of collection costs and should therefore not be taken into consideration when calculating the NCA *in duplum* amount. BASA also argues that judgment creates a new debt and after judgment is granted the calculation of the *in duplum* amount starts to run again on the new judgment debt. The view of Capitec and the other banks was taken into consideration when BASA filed the opposing affidavit. |

| Regulator | Status |
|---|---|
| Financial Sector Conduct Authority (FSCA) | The Financial Sector Conduct Authority (FSCA) was established in April 2018 as a dedicated market conduct regulator, with full jurisdiction over all financial institutions in South Africa. Historically, the SARB focused on the prudential oversight of banks while the FSB regulated banks' intermediation only in respect of the FAIS Act. Market conduct of banks will now be directly regulated by the FSCA, with the National Credit Regulator (NCR) continuing to regulate consumer credit extension.<br><br>In 2017, Treasury commissioned the World Bank to undertake a study to provide independent research on the extent to which banks in South Africa treat their retail customers fairly in relation to transactional and fixed-deposit accounts. The study's analysis and recommendations as well as public comments on the study will help shape the FSCA's approach to regulating the way banks treat their customers, including the development of conduct standards for banks.<br><br>The draft Conduct of Financial Institutions Bill (COFI) has also been published. The COFI Bill is the next phase of the legislative reforms aimed at strengthening the regulation of how the financial services sector treats its customers. The banking industry, through BASA, is commenting on the Bill. |

We are well prepared for the challenges in 2020 with the focus remaining on our clients, the Capitec team and the delivery of market-leading solutions.

**André du Plessis**
*Chief financial officer*

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to
one
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# risk management

*We manage risks to ensure that we can continue creating sustainable value for stakeholders. We do this in a responsible way and have a culture of risk management. This directs behaviour to best align with the Capitec risk appetite.*

*The outcomes of effective risk management are higher levels of certainty about potential risks and ways to mitigate these, and an improved ability to achieve our strategic objectives.*

## Enterprise risk management framework

* Our enterprise risk management framework governs risk management and aims to continuously improve our risk culture. This requires an integrated approach in all business areas.

There is evidence of more awareness and an increase in the reporting of risks from employees. Collaboration with internal audit is an effective mechanism to identify new or emerging risks. Our risk culture was tested this year by unanticipated events such as the Viceroy reports. In all cases our crisis management plans proved to be effective and agile. The enterprise risk management framework defines Capitec's risk management universe, structure, policies and processes. No changes were made to the framework this year: the focus was on the maturity of implementation.

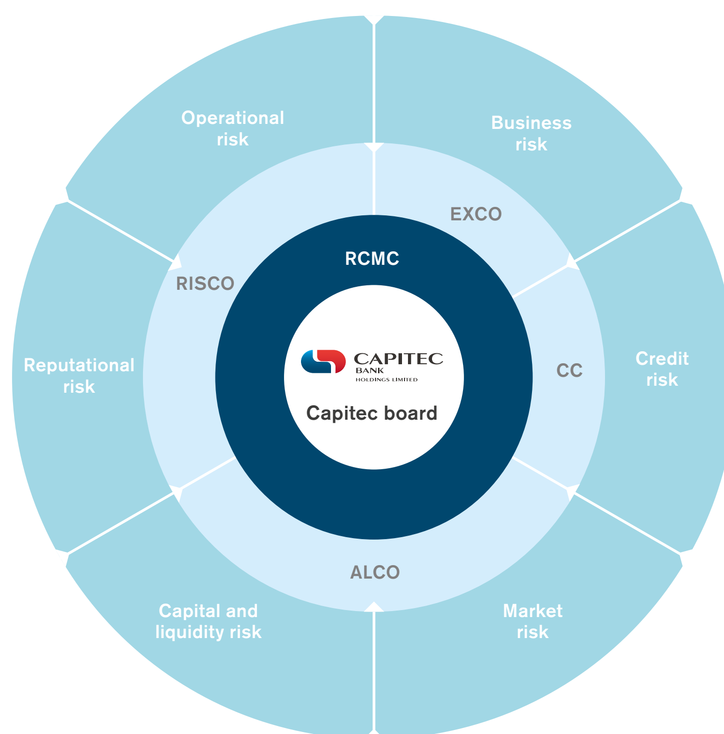
## The governance of risk

* The board remains ultimately responsible for ensuring that risks are adequately identified, measured, managed and monitored and that good governance is maintained. The board monitors the implementation of the risk strategy, approves the risk appetite and ensures that risks are managed within tolerance levels.

Capitec's risk universe consists of 6 risk categories that are managed by EXCO and 3 risk management committees: the risk committee (RISCO), the credit committee (CC) and the asset and liability committee (ALCO). These committees report to the RCMC, which has been mandated by the board to oversee risk management.

## Enterprise risk management governance

* The RCMC, which is composed of executive, non-executive and independent non-executive directors, oversees risk management according to a board-approved charter. The committee meets quarterly and includes senior management attendees with representation from risk, credit, compliance and internal audit. This ensures that a consistent risk appetite is shared by management and the board. We believe the composition of the RCMC is important to ensure that proper governance is maintained and that healthy risk discussions are encouraged from a forward-looking perspective while also taking past risk events into account.




* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

## 5 levels of risk management

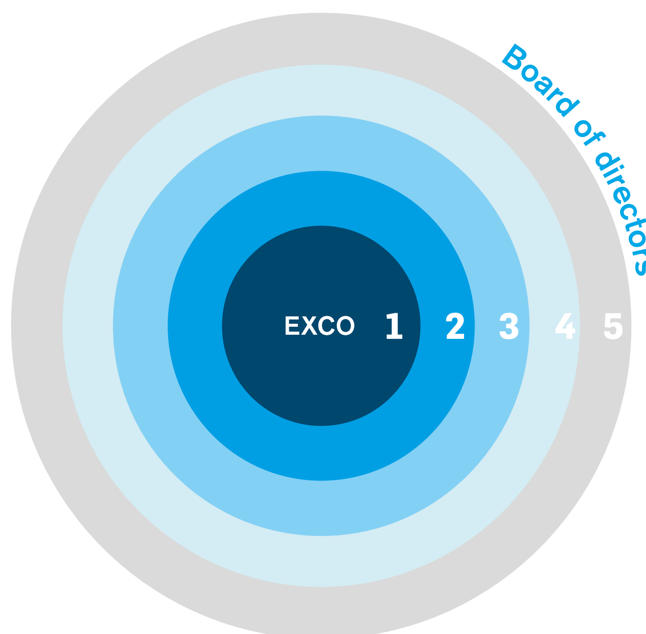
We use 5 levels of risk management to ensure integrated, objective and effective identification, monitoring, response and evaluation of risk. The EXCO is at the core of risk management: at their weekly operational meetings, risks are reported and addressed as a first line of defence.

### Risk and compliance information flow and reporting

In a business as usual scenario, risk and compliance information flows outward from the EXCO according to structured agendas, roles and responsibilities. The board monitors that risk is governed holistically and in such a way that it supports Capitec in achieving its strategic objectives.

In the case of a material risk event, EXCO will immediately inform key representatives on the board, and inform individuals on the relevant levels of risk management.

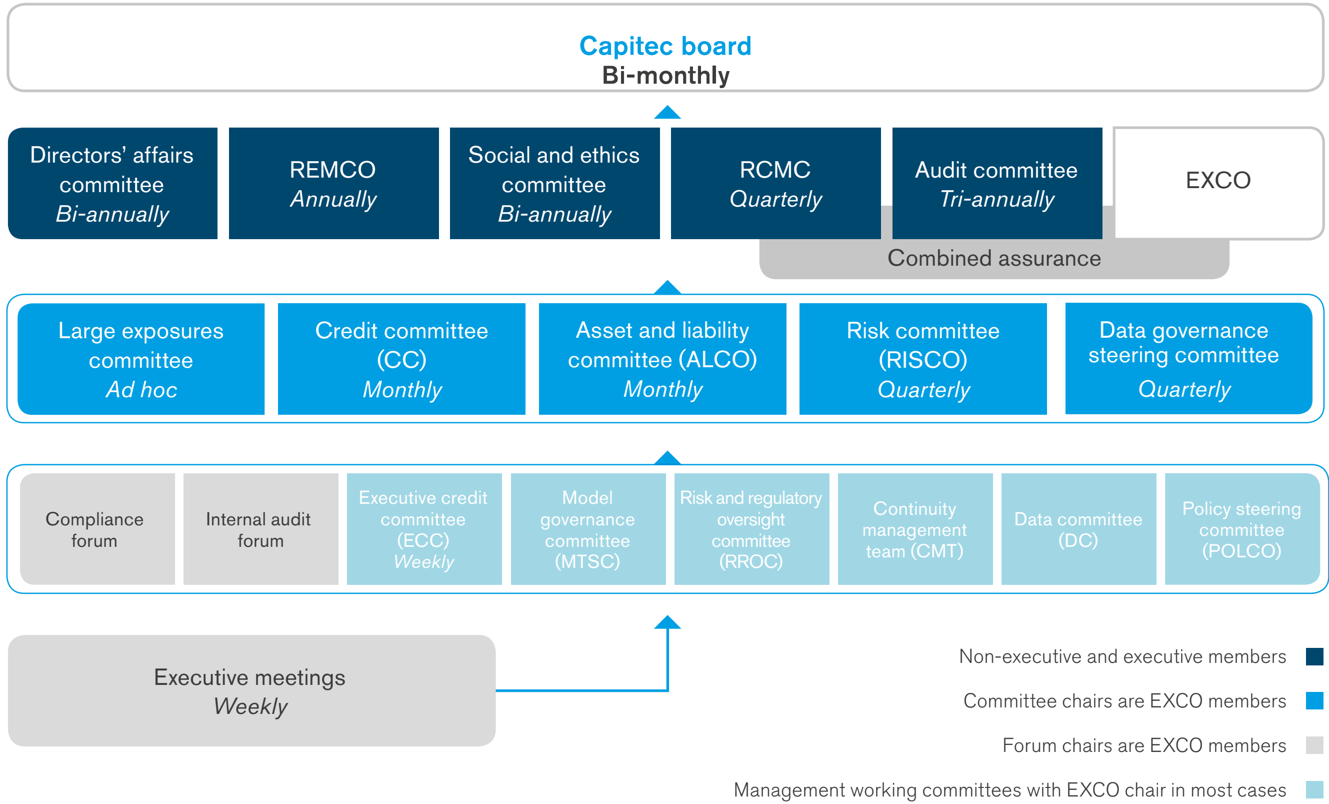
* This year we formalised risk and compliance as second-line functions with oversight roles rather than a reporting function. Internal audit remains the third line of defence. Our comprehensive and integrated risk management governance structure consists of committees with varying areas of responsibility to ensure that the full risk universe is covered.




### Risk and compliance levels of management and oversight: Roles, risk nature and frequency

| Level | Role | | Committees | | |
|---|---|---|---|---|---|
| 1 | **Executive management** considers and mitigates operational risks and compliance. | Internal | EXCO *Semi-weekly* | ECC *Weekly* | |
| 2 | **Risk functions** such as the compliance forum, audit forum and enterprise risk management services provide an integrated view and validation of risks for all levels of the business on an ongoing basis. The continuity management team (CMT), ALCO and the credit committee (CC) review risks, agree on mitigating actions and assign responsibilities. | Internal | CMT *Quarterly*<br>RISCO *Quarterly* | ALCO *Monthly* | CC *Monthly* |
| 3 | **Internal audit** provides independent validation and review of risk management and compliance processes at all levels on an ongoing basis. | Internal | Audit forum *Monthly* | Compliance forum *Quarterly* | |
| 4 | Various **external** risk audits and interventions are done by the SARB, the NCR, external audit, external assurance providers, advisory services and verification agencies. | External | External audit | | |
| 5 | **The Capitec board sub-committees** (audit, RCMC and directors' affairs) oversee all aspects of risk and compliance management. | External | Audit committee *Tri-annually* | RCMC *Quarterly* | Directors' affairs committee *Bi-annually* |

* *Denotes text in the risk management report that forms part of the group's audited annual financial statements.*



Capitec board
Bi-monthly
Directors' affairs committee
Bi-annually
REMCO
Annually
Social and ethics committee
Bi-annually
RCMC
Quarterly
Audit committee
Tri-annually
EXCO
Combined assurance
Large exposures committee
Ad hoc
Credit committee (CC)
Monthly
Asset and liability committee (ALCO)
Monthly
Risk committee (RISCO)
Quarterly
Data governance steering committee
Quarterly
Compliance forum
Internal audit forum
Executive credit committee (ECC)
Weekly
Model governance committee (MTSC)
Risk and regulatory oversight committee (RROC)
Continuity management team (CMT)
Data committee (DC)
Policy steering committee (POLCO)
Executive meetings
Weekly
Non-executive and executive members
Committee chairs are EXCO members
Forum chairs are EXCO members
Management working committees with EXCO chair in most cases

## Risk management process elements

**Risk identification**
Heads of business carry the primary responsibility for the risks in the group, particularly to identify and manage risk appropriately. The risk management department facilitates risk self-assessment workshops, where appropriate, to assist. Identified risks are formally documented on our risk registers and have designated risk owners. Mitigation plans are tracked against predetermined timelines and monitored. The necessary escalation processes are in place.

**Risk evaluation**
Risks are evaluated in terms of 2 criteria: likelihood and impact when materialising. We consider the inherent and residual side of risk. Our board-approved risk matrix allows for consistency in the evaluation of risk. The risk management department supports the business heads by providing independent oversight and monitoring across the group on behalf of the board and relevant committees. Risk management is headed by an executive risk officer who owns and maintains risk frameworks, maintains risk governance structures and manages regulatory relationships regarding risk matters.

**Risk reporting**
We believe risk reporting should be clear, concise and put management and the board in a position to make informed risk decisions. Because we believe risk should be managed as part of our daily operations, we developed key risk indicators to assess risk against predetermined tolerance levels. To ensure we report the right risks to the right people at the right time, we adopted the Basel Committee on Banking Supervision principles for effective risk data aggregation and risk – reporting practices under BCBS 239 or commonly known as RDARR.

## Embedded RDARR principles in our data management and risk management practices

We believe that adapting RDARR principles is not enough but that it has to be embedded in our business. Our risk and data management practices are well aligned at present and our data strategy will ensure we continues to improve as we grow.

**RDARR**

I. Overarching Governance and Infrastructure

- Define a strong governance framework, risk data architecture & IT infrastructure
- Ensure risk data aggregation capabilities & risk reporting practices and subject to strong governance
- Design, build & maintain data architecture and IT infrastructure

II. Risk Data Aggregation Capabilities

- Generate accurate, reliable and up to date risk data across the banking group activities in order to identify and report risk exposures, concentration and emerging risks

III. Risk Reporting Practices

- Ensure reports are accurate, convey aggregated risk data and are reconciled and validated
- Ensure reports are comprehensive, clear, useful and set on a frequency which meets recipients' requirements

IV. Supervisory Review, tools and coordination

- Supervisors should periodically review and evaluate compliance to these principles
- Ensure reports are comprehensive, clear, useful and set on a frequency which meets recipients' requirements

The board and senior management promote and monitor the efforts of embedding these principles throughout the business. We strive to continuously mature our data governance and risk management practices.

## Our risk appetite and tolerance

Our risk appetite is the level of risk we are willing to accept while pursuing our objectives.

* As expected from a bank, Capitec's highest exposure is in the credit risk environment, where we define the appetite level through our pricing model. We aim to achieve a targeted return on equity (ROE) on all credit products. The pricing model combines the revenue and operational costs for a specific loan product and derives the total credit losses that can be absorbed over the term of the product to achieve our targeted ROE.

We adopted a zero appetite towards any risk events related to discrimination. For other operational risk events we have a low appetite, which means that the bank will not knowingly expose itself to the risk that these events occur. To determine risk tolerances, we consider outcome measures for our key objectives, such as revenue growth, market share, client satisfaction or earnings per share. We then consider the range of outcomes above and below the targets that are acceptable. The tolerances are measured by the Capitec MOS indicators.

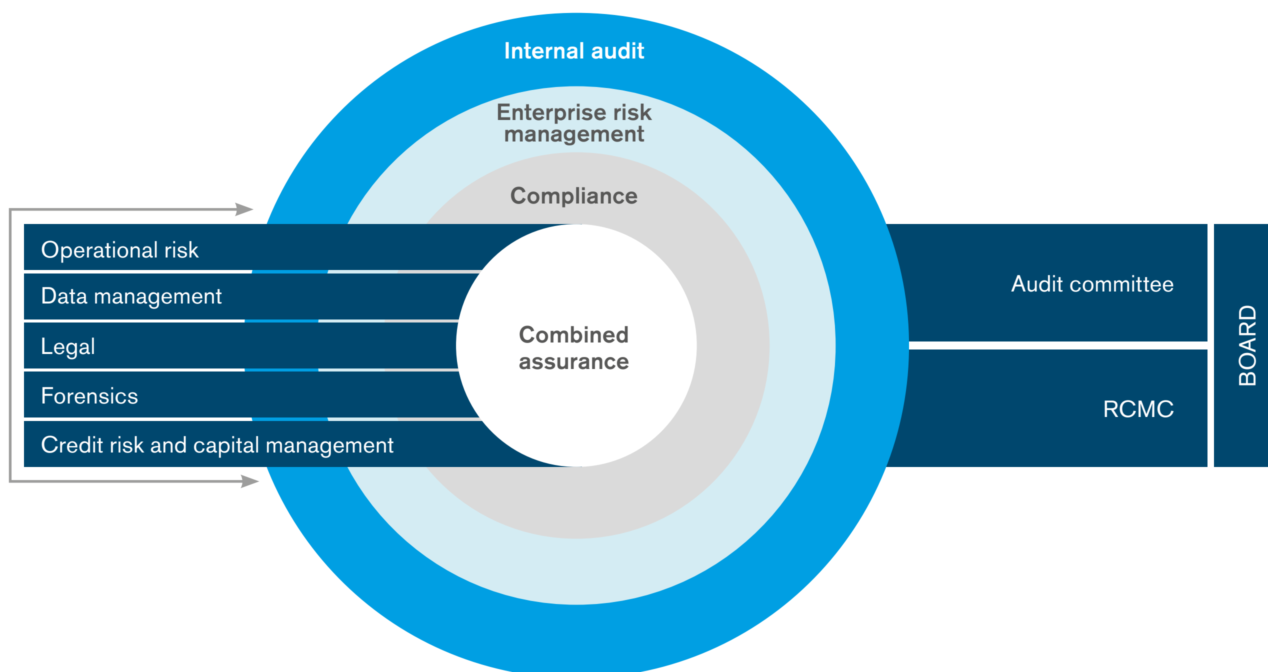
## Risk management and combined assurance

Capitec has a wide range of functions and roles that contribute to combined assurance. Collaboration between functions such as the internal audit and the risk function, for example, is entrenched in annual work plans and feedback processes.

In Capitec both the audit committee and the RCMC oversee the combined assurance model, which includes:

- establishing and analysing the risk environment;
- enabling an effective internal control environment;
- supporting the integrity of information used for internal decision-making by management, the board and its committees; and
- supporting the integrity of external reports.

The internal players in combined assurance are illustrated below:




* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

## Stress testing, contingency planning and business continuity

The bank conducts integrated scenario-based recovery planning to prepare for contingencies. In addition to the SARB's requirements, the bank conducts recovery planning to ensure that it is well prepared to withstand capital, liquidity and operational risk shocks. We have started implementing a business continuity tool that will enable us to develop our own scenarios in future, based on an analysis of drivers for the different business divisions.

A continuity management team is responsible for all aspects of business continuity. The board-approved business continuity framework and methodology are based on ISO 22301. The framework is linked to the disaster recovery plan.

The business continuity and disaster recovery plans contain procedures to be followed should an extreme event occur. The disaster recovery and evacuation plans were tested successfully during the year. The IT disaster recovery plans are tested continuously.

## Future focus areas for risk management

We are exploring options to automate risk management due to the nature and complexity of risks. This includes an automated alert system and will address any deviations from a target range. This tool will also focus on the analysis of data to improve the efficiency of risk management.

# credit risk

*The risk of loss arising from the failure of a client or counterparty to meet its financial obligations. Our credit risk primarily arises from unsecured retail credit lending.

*The RCMC has oversight through its credit subcommittee, which sets credit strategy, approves credit policy and monitors credit risk to be within appetite tolerance, provisions and changes in the operating environment. The executive credit committee (ECC) reports on the credit risk policy-monitoring decisions for each of the stages in the credit life cycle. Financial governance is applied through pricing and provisioning models, regulatory reporting and the internal capital adequacy assessment process (ICAAP). A modelling technical subcommittee (MTSC) has been established to provide a forum for the technical discussion, coordination and direction in setting modelling standards, methodologies and techniques. Integrated risk management is applied across all stages of the credit life cycle.

* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

*Credit risk management decisions are made throughout the credit life cycle with the aim of improving the financial lives of our clients. Various credit management controls such as credit policies, data, models and risk indicators are in place to guide these decisions according to agreed principles and tolerance levels. At each stage, we consider the impact on the probability of default, exposure at default, loss given default, pricing, provisions and profitability.*

## Our credit-granting approach

Our personalised credit solution achieves the best possible credit limit, over the optimal repayment term, with the best interest rate. This is offered to clients based on their past banking and credit behaviour, affordability and the stability of their source of income. We also use data from credit bureau records, bank statements and payslip information.

Our credit-granting approach evolves as we improve our understanding of client needs, behaviours and risk profiles and as we respond to changes in the economic and regulatory environment. The low-growth economic environment means we are taking a cautious approach to credit granting. We apply a sophisticated statistical model when granting credit. We continue to incorporate more machine-learning algorithms and more transactional data into our credit risk-scoring model.

In addition to the comprehensive credit risk-scoring assessment, a client also needs to pass a rigorous affordability assessment to qualify for credit.

Client affordability is assessed by considering the client's sustainable income, existing debt repayment obligations and other necessary expenses in line with regulatory requirements. We also perform a Capitec disposable income calculation in parallel and use the more conservative outcome of the 2.

The credit application process and calculations are automated and client data is captured based on standardised rules to ensure compliance. Quality is assured through loan reviews and ongoing training of service consultants.

Our credit-granting model puts clients in control of their own credit decisions by providing a range of credit offers. They can choose between offers that maximise the loan amount or credit limit to suit their funding needs, offers that minimise the monthly instalment to suit their cash flow, and offers that minimise the cost of credit.

In the coming year we will focus on enhancing client retention.

## Credit collection and rescheduling

Offering sustainable credit products and client rehabilitation strategies play a vital role in fostering long-term client relationships and achieving Capitec's financial goals. We use the regulated non-authenticated early debit order (NAEDO) system to collect instalments from clients. Early-stage arrears are managed by a centralised function that uses an arrears segmentation strategy based on a client-behaviour score as a risk migration tool. Rescheduling is offered as a rehabilitation mechanism, by amending existing credit agreements, to arrears clients who have a propensity to rehabilitate and as a proactive mechanism to non-arrears clients in order to mitigate credit losses.

Unforeseen circumstances may lead to reduced income or increased expenditure for the client. If the client is in arrears due to debt repayment challenges, we either negotiate with the client to bring the arrears instalments up to date, or we attempt to help manage the situation by amending the loan agreement (loan reschedule).

Various forms of rescheduling are available to offer suitable solutions to address the underlying cause of the arrears. A data-driven treatment model has been implemented to assist call-centre agents in offering the optimal arrangement or rescheduling option to a client, based on the client's risk profile, financial need and ability to honour the arranged treatment.

* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

* Factors that we consider in delivering the optimal strategy for a client include:

- the risk profile and payment history of the client;
- the arrears status of the client (one or 89 days in arrears, for example);
- whether the client was rescheduled previously;
- the credit exposure amount;
- free cash-flow estimates derived from the client's bank accounts or credit bureau records (salary less debit orders); and
- any information we have about the client's employer.

This process allows us to optimise collections and reduce clients' debt levels. Our aim is always to partner with our clients through both good and tough times and act in their best interest.

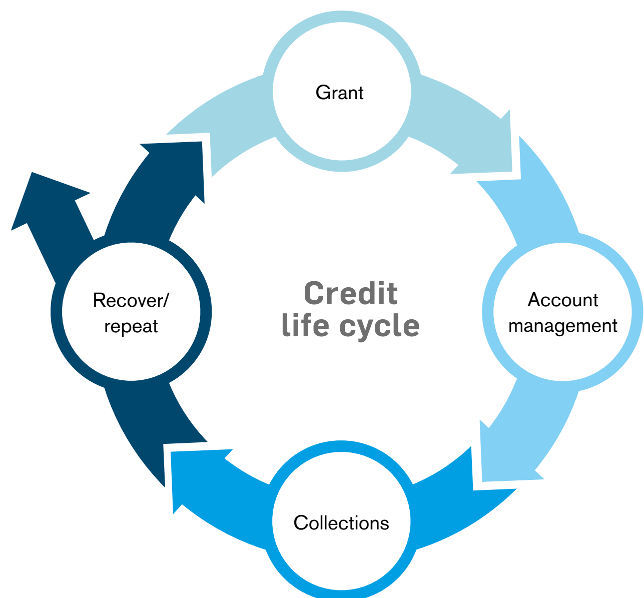
A payment propensity model is used to determine which clients are retained for in-house collection. Clients with a low propensity to cure in-house are handed over to an external debt collector (EDC) for outsourced recoveries. Outsourced recoveries are performed by a number of EDCs with different capabilities, ranging from high-volume call centres to lower-volume legal collections. Debt is sold when the expectation of future payments, as estimated by an internal valuation methodology, is considered too low.

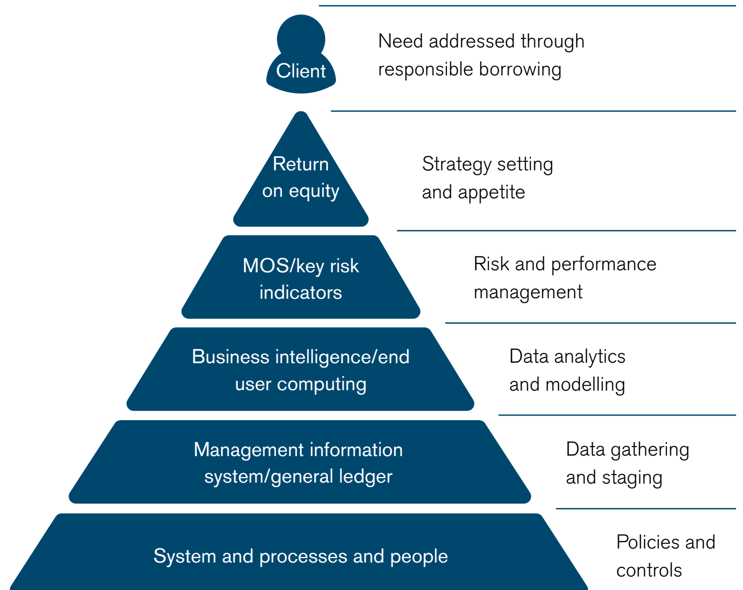
We monitor the proceeds (yield) that we receive from this outsourced process against internal collection processes, including rescheduling. We use holdout samples to evaluate the success of new collections and recoveries to further optimise yield.

Apart from the above rehabilitation options, a client also has access to statutory mechanisms, such as debt counselling. Over the last few years we have observed a rise in debt counselling, along with a reduction of the average age of the debt in debt counselling, in line with mounting economic pressures.

We also launched a credit assistance programme to help clients in instances where they have lost income or where expenses increased beyond their control. The programme offers a unique debt-relief solution and will help improve consumer financial literacy. This initiative also provides learning that will be useful for the implementation of the anticipated National Credit Amendment Bill.

## Credit management framework




* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

## Credit risk reporting

Credit risk is monitored daily, weekly and monthly by key risk indicators such as accept rates and take-up rates regarding sales. Book measurements include arrears, instalment collection success, centralised collection activities, treatments and balances rolling into a fully provided state.

With the implementation of IFRS 9, we changed our financial reporting on credit loss impairments. The change in the financial reporting standard enabled better alignment with our strategy of managing credit risk that uses the migration in behaviour and granting scores.

We expanded our efforts to reconcile the elements of probability, price and provisions. Our focus is to optimise profit for the credit portfolios, not only in total but also at various levels of segmentation. This has entailed increasing capacity allocated to the credit and finance teams, with more collaboration and technological support.

We regularly assess the levels of provisions through coverage ratios to ensure that we adequately provide for the risk profile of the loan book. For rescheduled loans, we also follow a conservative approach to provisioning based on validated rehabilitation.

## Credit risk training

All new service consultants complete intensive training in simulated environments and are required to pass stringent assessments before they can work in the live environment, initially under supervision. We continuously provide credit training to ensure that each service consultant understands and can adhere to the latest policies and procedures. The need to understand credit risk resulted in the development of a BANKSETA-accredited learnership package. This is the starting point towards a qualification in banking and unsecured lending as a prospective career.

We continue to focus on purpose-driven lending as the starting point to credit decisions and aim to offer a full device agnostic digital end-to-end solution for all credit requirements of our market.

## Counterparty credit risk

Capitec has limited counterparty credit risk in terms of the Banks Act regulations, as we do not operate a trading book. Our exposures are limited to hedges entered into to mitigate interest rate and currency risk in the banking book, and resale investment transactions concluded as part of cash management activities.

## Investment credit risk

Capitec has a low risk appetite regarding investing surplus cash and liquidity buffers. Surplus cash is invested in the wholesale money markets, at the discretion of treasury, subject to the parameters defined by the RCMC.

Treasury targets a weighted average maturity of 90 days for the cash portfolio and maintains a healthy stock of highly liquid investments. A hold-to-maturity approach is used. The yield must be commensurate with any increase in risk.

## Other credit risk

### Corporate insurers

We select corporate insurers to insure the loan book against death and retrenchment, and to cover property and casualty insurance needs based on sufficient underwriting capacity and an appropriate reinsurance strategy.

### Suppliers

The supplier and counterparty risk committee assesses and the CC approves prepayment and inventory exposure limits to suppliers as part of the procurement policy, to limit operational and financial risk. Read more about counterparty, investment and other credit risks in the audited annual financial statements from page 50.

* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

## Analysis of regulatory credit exposure

| Basel 3 exposure categories R'000 | Average gross exposure[1] | | Average gross period-end exposure[2] [4] | | Exposure post-risk mitigation[2] [3] [4] | | Risk weights[5] |
|---|---|---|---|---|---|---|---|
| | **28 Feb 2019** | **28 Feb 2018** | **28 Feb 2019** | **28 Feb 2018** | **28 Feb 2019** | **28 Feb 2018** | **%** |
| **On balance sheet** | | | | | | | |
| Corporate[6] | **6 157 970** | 4 339 309 | **6 402 202** | 3 764 555 | **6 262 852** | 3 628 931 | **100** |
| Sovereign[7] | **12 628 587** | 11 977 984 | **13 176 711** | 13 096 689 | **13 176 711** | 13 089 771 | **0** |
| Banks (claims <3 months original maturity) | **14 422 645** | 9 502 551 | **11 877 158** | 11 666 113 | **10 156 473** | 10 242 254 | **20** |
| Banks (claims >3 months original maturity) | **7 305 578** | 5 279 692 | **10 331 464** | 3 720 150 | **10 331 464** | 3 720 150 | **50/100** |
| Banks (derivatives >3 months Aaa to Aa3) | **–** | – | **–** | – | **–** | – | **20** |
| Banks (derivatives >3 months A1 to Baa3) | **20 551** | 71 551 | **8 479** | 15 184 | **8 479** | 15 184 | **50** |
| **Retail personal loans** | | | | | | | |
| With unidentified impairments | **45 837 897** | 44 083 394 | **46 345 711** | 43 628 225 | **46 345 711** | 43 628 225 | **75** |
| With identified impairments[8] | **7 638 058** | 3 862 755 | **8 440 489** | 2 133 889 | **8 440 489** | 2 133 889 | **various** |
| Subtotal | **94 011 286** | 79 117 236 | **96 582 214** | 78 024 805 | **94 722 179** | 76 458 404 | |
| **Off balance sheet** | | | | | | | |
| Corporate guarantees | **–** | – | **–** | – | **–** | – | **100** |
| Retail personal loans | | | | | | | |
| Retail guarantees | **–** | – | **–** | – | **–** | – | **75** |
| Committed undrawn facilities | **–** | – | **–** | – | **–** | – | **75** |
| Conditionally recoverable commitments[9] | **566 592** | 570 502 | **911 740** | 796 274 | **911 740** | 796 274 | **0** |
| **Total exposure** | **94 577 878** | 79 687 738 | **97 493 954** | 78 821 079 | **95 633 919** | 77 254 678 | |

As required by the Banks Act and its regulations (which incorporate the Basel requirements):

(1) *Average gross exposure is calculated using daily balances for the last 6 months.*
(2) *Items represent exposure before the deduction of qualifying impairments on advances.*
(3) *Represents exposure after taking into account any qualifying collateral. Amounts are shown gross of impairments, which are deducted to calculate risk-weighted assets.*
(4) *"Corporate" and "bank" exposures were calculated based on an average, using daily balances for month 6 of the respective reporting periods. All other items are the balances at the respective month-ends.*
(5) *The risk weightings reflected are the standard risk weightings applied to exposures, as required by the regulations. Risk weights for exposures (other than retail) are determined by mapping the exposure's Moody's international grade rating to a risk-weight percentage using the mapping table (see table below). The risk weightings for retail exposure are specified directly in the banking regulations. A standard risk weight of 75% is applied to performing retail exposures while impaired exposures attract a standard 100% risk weight, net of allowed impairments.*
(6) *95.3% (Feb 2018: 95.5%) of corporate (unrated) aggregate gross period-end exposure relates to investments in money market unit trusts.*
(7) *Sovereign comprises investments in RSA treasury bills and SARB debentures. These exposures are zero-risk-weighted.*
(8) *An ageing of impaired advances based on arrears status is shown in Note 7 to the financial statements. According to banking regulations, those retail personal loans that have been provided for in excess of 50% of the outstanding balance, are risk-weighted at 50%.*
(9) *These commitments are as a result of undrawn credit facility and undrawn credit card amounts. The bank's contractual commitment is revocable should a client not meet their contractual obligations or where the bank has determined that the client's credit risk profile has changed. 64.0% (Feb 2018: 48.1%) is expected to be drawn down within 1 month. As these commitments are revocable, there is no capital charge in terms of the standardised approach for credit risk.*

## Rating grades and related risk weights

| Long-term credit assessment | Aaa to Aa3 % | A1 to A3 % | Baa1 to Baa3 % | Ba1 to B3 % | Below B3 % | Unrated % |
|---|---|---|---|---|---|---|
| Sovereigns | 0 | 20 | 50 | 100 | 150 | 100 |
| Public sector entities | 20 | 50 | 50 | 100 | 150 | 50 |
| Banks | 20 | 50 | 50 | 100 | 150 | 50 |
| Security firms | 20 | 50 | 50 | 100 | 150 | 50 |
| Banks: Short-term claims | 20 | 20 | 20 | 50 | 150 | 20 |
| Security firms: Short-term claims | 20 | 20 | 20 | 50 | 150 | 20 |
| Corporate entities | 20 | 50 | 100 | 150 | | 100 |

| Short-term credit assessment | P-1 % | P-2 % | P-3 % | Other % |
|---|---|---|---|---|
| Banks and corporate entities | 20 | 50 | 100 | 150 |

# operational risk

The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

The RCMC and the audit committee have oversight of operational risks through the RISCO. The executive risk officer and his team are responsible for implementing and maintaining frameworks and policies. They also manage internal and external relationships of risk matters.

*We make informed decisions about operational risk, guided by the enterprise risk management framework and the risk committee. We believe in collaborative and cohesive relationships within the business to encourage transparency and trust and to ensure consistent risk management practices. This creates a risk culture, which is essential to identify, manage and mitigate operational risk that can occur anywhere in the business: from head office to our 840 branches.*

Good risk management practices suggest we should at least stand back from our daily risk registers once a year. We reconsider known issues and revisit the entire risk landscape and its potential impact on the objectives of the bank. This top-down assessment aligns our business plans and focus areas appropriately.

Our systems and processes support a centralised view of all risks in the group. This view is continuously enriched with information from our risk self-assessment workshops. In combination with near-miss and incident analysis, we create a holistic view of operational risk. Mitigation is shared in the combined risk function collaboration to give unified assurance. Key risk indicators are used to monitor assessed risks.

## Fraud risk

We use technology to prevent exposure to fraud and to ensure that we are at the forefront of fraud prevention. Our fraud policy outlines what constitutes fraud and corruption. It details the procedures to follow where fraud or corruption is suspected or discovered. We co-operate with government and industry role players to ensure the successful apprehension and conviction of the perpetrators of financial crime. These crimes include bribery and corruption charges.

## Information technology risk

The persistent pursuit to provide clients with simplified banking drives Capitec to focus on innovative methods of technology application and solutions. We aim to protect client information, to apply controls and compliance consistently, and to develop new controls.

We have a mature information security approach that consistently monitors and remediates areas of concern where our clients and company information could be at risk.

Information technology governance is implemented according to the Capitec IT governance policy. The policy is built on a strong framework that incorporates principles and controls defined in international standards, such as the Control Objectives for Information and Related Technologies (COBIT), the Information Security Forum (ISF) Standard of Good Practice, and ISO 25999 and 27001/2.

The way in which we aligned and structured the framework and the way in which strategic plans are designed, ensure that our IT strategy is created, approved, reviewed and implemented to align with the business strategy, with a focus on our clients. We work according to a 6 month planning process to align IT initiatives in each IT function with business objectives that can be tracked on a weekly and monthly basis, to achieve set targets.

The IT governance framework defines the IT organisational structure and the policies and procedures to facilitate good governance and compliance practices regarding IT. Weekly EXCO meetings and formal IT prioritisation meetings provide platforms to discuss strategic IT matters and initiatives and align priorities.

These meetings focus on IT risks and potential issues. They ensure that situations that could threaten the availability of systems, or the confidentiality and integrity of information, are identified and discussed at a senior management level. Important issues are handled with the appropriate level of urgency and focus.

Formal visits by the SARB every 2 years include a full- day assessment of our IT risk management capability. We also report any incidents or relevant information to them via the monthly Capitec reporting pack. This ensures that our regulator is kept up to speed with any emerging or developing technology risks.

### IT compliance

The information security and risk department acts as the compliance function for IT and facilitates frequent assessment of the status of legal and regulatory compliance matters. We track and report progress on all compliance matters.

### Information security management system

The Capitec information security policies and standards provide the basis on which controls are developed to protect sensitive client and business information systems. Our information security management system is based on ISO 27001/2 standards and the best-practice principles of the ISF Standard of Good Practice. The information security manager is responsible for information security management.

**Cybersecurity**

Capitec has a dedicated team focusing solely on the protection, detection and response to cybersecurity within the bank. We test our own IT controls for weaknesses to improve our security and response times. Capitec is involved in industry initiatives, such as the South African Banking Risk Information Centre (SABRIC), to establish and embed well-coordinated security response mechanisms in the event of major security threats to the banking industry or individual banks.

## Information risk

Data drives our business model and operations. Good data practices not only ensure compliance and the safeguarding of our information assets but also form the foundation of our competitive advantage as a bank.

Capitec operates in a highly regulated industry where data breaches could have a disastrous impact on an organisation's reputation and sustainability. The RDARR principles, in particular, require a clear organisational strategy for data governance, quality, infrastructure and information risk management.

In the past year, we focused on staying abreast of regulatory requirements such as the Protection of Personal Information Act, Act 4 of 2013 and RDARR and on increasing Capitec's ability to take informed risks decisions. Our current and future focus areas include:

- Data governance and ownership
- Data architecture and information management
- Data quality management
- Information security

## Compliance

We regard the interconnectedness of the banking industry and the reliance of the economy and citizens on banks as important drivers in our approach to comply with legislation.

The bank has a dedicated function, as prescribed by the Banks Act, to manage compliance risk. The function comprises 2 sections: compliance and anti-money-laundering. The head of compliance reports to the audit and RCMC committees and submits reports to the directors' affairs committee.

Our compliance policy, which forms part of the compliance framework, and our compliance manual and compliance programme, defines the ways in which the board and CEO are assisted to ensure that we operate with integrity, comply with legal and regulatory requirements and work according to ethical standards.

Our compliance universe consists of applicable laws and is reviewed annually to ensure that these remain relevant and current as we grow and launch new products.

The compliance function helps to foster a culture that creates awareness and recognises the value of compliance risk identification, assessment, management, monitoring and reporting as part of the bank's ongoing activities.

Notable regulators that play a role in compliance requirements and direct our conduct are:

- the SARB;
- the NCR;
- the JSE Limited;
- the Financial Intelligence Centre;
- the Financial Sector Conduct Authority (FSCA); and
- the Information Regulator.

We received no material regulatory penalties, sanctions or fines for contraventions of or non-compliance with statutory obligations. Read more about the regulatory environment from page 19 in the CFO report.

## Insurance

A comprehensive insurance programme covers operational risk losses such as fraud, theft, professional liability claims, damage to physical assets and the cost of business interruption. The opportunity cost of lost revenue is not covered.

# market risk

The risk of a potential decrease in stakeholders' value due to adverse changes in market prices and rates negatively impacting assets and liabilities.*

Market risk is addressed at least on a monthly basis by the ALCO.*

Read more about market risk in the CFO report from page 2.

* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

*Market risk generally has a wide impact and is often outside our control. It includes equity, bond and commodity price changes and fluctuations in exchange and interest rates. Our exposure to market risk is mainly due to inherent interest rate risk in retail banking activities, which are defined as the "banking book" by Basel.*

## Interest rate risk

Market-driven interest rates can adversely affect our profitability and the value of the Capitec balance sheet.

We have a conservative approach to liquidity. Whereas other retail banks operate floating-rate mortgage books and have to minimise the impact of rate changes on the value of their equity, we offer fixed interest rates on retail term loans. These factors result in an inherent interest rate repricing mismatch for Capitec.

We operate well within our target range and even if there is a 2% shock on interest rates in either direction, we would experience an impact of less than 1% on the bank's profit.

### Fixed interest rate retail loans

The interest charged on all unsecured retail loans is based on fixed interest rates. This protects loan clients from the effect of rising interest rates. They therefore do not have the risk of increasing instalments on their loans.

### The impact of the liquidity strategy

The Capitec approach to liquidity is to match long-term loans with long-term funding. However, the longer-term funding can initially be sourced with a floating coupon, contributing to the repricing mismatch.

Call deposits are not used to fund long-term loans. These floating-rate deposits are matched in a floating-rate investment portfolio.

### The effect of shareholders' equity

A natural mismatch position arises when there are more rate-sensitive assets than rate-sensitive liabilities. This mismatch is due primarily to ordinary shareholders' equity, a consequence of our conservative leveraging. Traditionally, equity is considered as non-rate-sensitive. Capitec targets a fixed ROE. Given that our principal asset class is unsecured retail lending at fixed rates and given the allocation of a large portion of equity to funding of these assets (in line with the philosophy of matching the funding of longer-term assets with long-term funds), part of the mismatch between assets and liabilities due to equity funding is considered matched.

### Managing interest rate risk

The asset and liability management (ALM) policy precludes taking speculative or trading positions on the banking book. In general, ALCO aims to match the fixed or floating-rate nature of funding with the fixed and floating-rate elements of the loan book and surplus cash positions. To manage mismatches, long-term floating-rate liabilities may be swapped to fixed rates.

Our appetite for interest rate risk is managed according to set limits that are applied using balance sheet and earnings measures. We assess the impact of rate changes on the net present value of the retail loan book and related funding, and the potential impact of an open position on current and future profitability.

| Regulatory sensitivity analysis of equity – 200 basis point shift | 2019 R'000 | 2019 % | 2018 R'000 | % |
|---|---|---|---|---|
| Increase | **(760 837)** | **(2.7)** | (699 604) | (3.3) |
| Decrease | **785 186** | **2.8** | 722 962 | 3.4 |

The sensitivity analysis is calculated by modelling the impact on equity of parallel shifts of 200 basis points on the yield curve on the balance sheet. The analysis is performed on a full-lifetime run-off basis, using the discounted cash-flow approach, in line with the requirements of the Banks Act. This gives an indication of how the value of shareholders' funds may change if there is a shift in interest rates.

## Insurance risk

When loan clients are granted credit for terms 7 months and longer, the group requires the loan client to have credit insurance to cover death, unemployment or inability to earn an income (other than disability), temporary and permanent disability. The loan client has the right to either provide the group with an existing policy to cover this requirement or take out an insurance policy with another insurer. As an option available to our loan clients, the group, in the normal course of business, offers them the opportunity to enter into credit insurance contracts.

The significant type of insurance contract offered by the group is the credit insurance described above. The group carries no insurance risk on the funeral product.

The credit insurance contracts offered by the group to its loan clients is through a cell captive arrangement underwritten by a cell captive insurer. The group is the

* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

owner of a cell that holds the credit insurance underwritten by the cell captive insurer. As part of its arrangement with the cell captive insurer, the group has entered into a binder agreement to manage the collection of premiums, payment of claims and the residual net cash being remitted to the provider of the cell captive arrangement.

The cell captive arrangement is considered to have transferred significant insurance risk to the group (see accounting policy 2.15 in the annual financial statements) due to the contractual requirement imposed on the group to maintain the solvency of the cell. To mitigate this insurance risk, the group, in consultation with the cell captive insurer, elected to reinsure the insurance risk contained within the cell captive, with the significant portion being placed with A- (S&P) credit-rated insurance companies. This results in the group essentially being the reinsurer of last resort should the reinsurers not honour the reinsurance contract and the group would have to recapitalise the cell should losses be incurred.

Reinsurance relates only to the death, unemployment and a portion of permanent and temporary disability components of the credit life insurance policies underwritten by the cell captive insurer.

The cell captive insurer is responsible for evaluating the retained insurance risk in terms of statistical and underwriting disciplines according to the approved mandate for the cell captive arrangement. The insurance contract liabilities for the retained insurance risk are disclosed in Note 9 – Net insurance receivables to the annual financial statements.

The main risks to which the group is exposed include:

- mortality and morbidity risks: the risk that actual experience in respect of the rates of mortality and morbidity may be higher than that assumed in pricing and valuation, depending on the terms of different products;
- contract-persistency risk: the risk that policyholders may cease or reduce their contributions or withdraw their benefits and terminate their contracts prior to the contractual maturity date of a contract;
- expense risk: the risk that the group may experience a loss due to actual expenses being higher than that assumed when pricing and valuing policies; and
- business volume risk: the risk that the group may not sell sufficient volumes of new business to meet the expenses associated with distribution and administration.

## Equity risk

Capitec does not deal in equity instruments. The bank has limited exposure to equity investments.

## Currency risk

This is the risk that profitability and shareholders' equity will be adversely affected by changes in exchange rates between the Rand and the foreign currencies in which assets and liabilities are denominated.

Currency risk has a minimal impact on Capitec's operations as all its operations are in South Africa. Imported capital equipment and technological support services result in limited exposure to currency fluctuations. However, these transactions are fully hedged by means of forward exchange contracts. There was no foreign currency funding at 28 February 2019.

## Hedging market risk

ALCO only allows derivatives to be used for hedging risk in the banking book:

- Interest rate swaps are used to convert floating-rate to fixed-rate funding, to achieve the objective of matching the fixed-rate nature of assets and funding.
- Forward foreign-exchange contracts are used to cover obligations relating to capital equipment, technology and technology support services needed for the core banking activities.

Any hedges cover the complete exposure on the underlying transaction. Read more about all aspects of market risk in the audited annual financial statements from page 108.

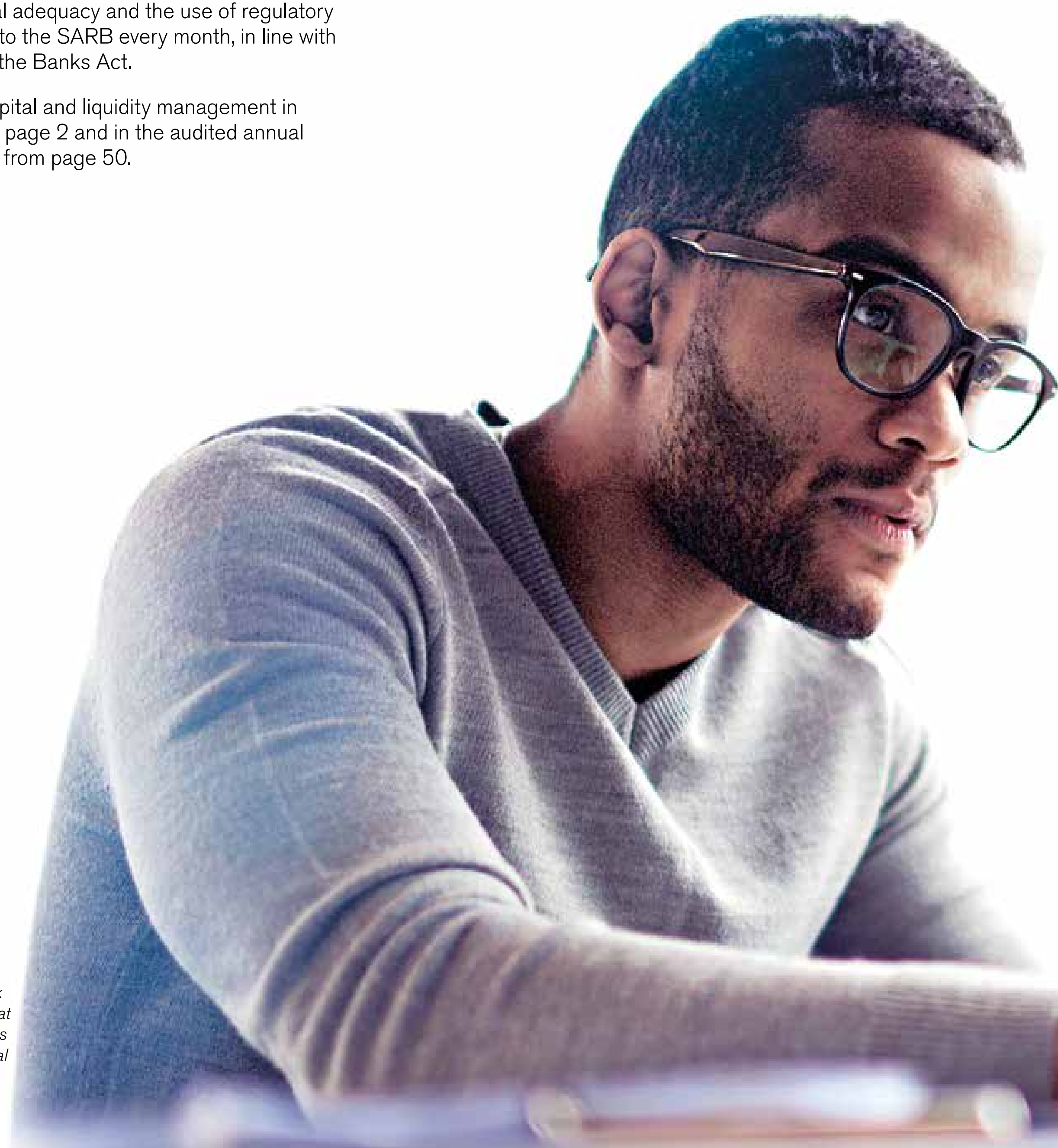
* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

# capital & liquidity

* The risk of losses from not having cash to honour commitments on time.

* ALCO oversees the activities of treasury, which operates in terms of an approved ALM policy. ALCO assesses capital adequacy on a monthly basis. This includes a historical and future capital positioning review and a quarterly report to the RCMC. Capital adequacy and the use of regulatory capital are reported to the SARB every month, in line with the requirements of the Banks Act.

Read more about capital and liquidity management in the CFO report from page 2 and in the audited annual financial statements from page 50.



* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

*Risk management and capital management are interdependent. In line with regulatory requirements, we hold risk capital as a reserve for all residual risks that remain after cost-effective risk management techniques, impairment provisioning and risk mitigation have been applied. Residual risk exists as there is potential for unexpected losses as well as volatility in the expected losses to occur in the future that are not captured in terms of IFRS.*

## Capital management

Capitec's principal objectives when managing capital are to:

- Ensure that the return on capital targets are achieved through efficient capital management, and adequate capital is available to support the growth of the business
- Ensure that there is sufficient risk capital with a capital buffer for unexpected losses to protect depositors and shareholders and to ensure sustainability through the business cycle

The 2 principles counterbalance each other by aiming to maximise returns for shareholders, but not at the expense of other stakeholders. This approach prevents the adoption of high-risk/high-reward strategies. It also safeguards long-term sustainability while maintaining satisfactory returns for all stakeholders. Implicit in this approach is compliance with the prudential requirements of the Banks Act and maintaining a strong capital base to support the development and growth of the business.

### Capital to manage risk and growth

Capitec retains capital for risk on the existing portfolio and to support risk arising from planned growth. Supply and demand factors have an impact on capital adequacy.

#### Supply-side risk

Supply-side risk relates to procuring appropriate capital resources at appropriate pricing and times, to keep ahead of any changes in the technical calculation of capital adequacy, to maintain capital buffers at the stipulated requirements of regulators and to meet the expectations of shareholders.

#### Demand-side risk

Demand-side risk involves monitoring the growth in risk-weighted assets. This in turn drives the growth in regulatory and our own internal capital requirements.

Our internal risk management function addresses the demand-side risk, which encompasses risks that have a negative impact on earnings and capital.

### Capital management

The group's principal objectives when managing capital are to:

- address the expectations of shareholders and optimise business activities to ensure return on capital targets are achieved through efficient capital management;
- ensure that the group and bank hold sufficient risk capital. (Risk capital caters for unexpected losses that may arise, protects shareholders and depositors and thereby assures the sustainability of the bank through the business cycle); and
- comply with the capital supervisory requirements of the SARB as codified in the Banks Act 1990 (as amended) and related regulations.

The group has an Internal Capital Adequacy Assessment Process (ICAAP), which on an ongoing basis drives the group's position on capital management. The ICAAP reviews the historic, current and future capital positioning of the group, both from an internal and a regulatory capital perspective.

* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*

The table below summarises the composition of regulatory capital for the group and the bank:

| R'000 | Group 2019 | Group 2018 | Bank 2019 | Bank 2018 |
|---|---|---|---|---|
| **Composition of qualifying regulatory capital** | | | | |
| Ordinary share capital | **5 649 020** | 5 649 020 | **6 105 981** | 6 105 981 |
| Foreign currency translation reserve | **4 619** | 3 158 | **–** | – |
| Accumulated profit | **15 950 142** | 13 153 434 | **14 790 738** | 12 331 048 |
| | **21 603 781** | 18 805 612 | **20 896 719** | 18 437 029 |
| **Regulatory adjustments** | | | | |
| – Intangible assets in terms of IFRS | **(316 282)** | (283 011) | **(316 282)** | (283 011) |
| – Specified advances | **480 650** | (12 035) | **481 313** | (8 511) |
| – Unappropriated profit | **(856 407)** | (1 128 678) | **856 407** | (1 128 678) |
| **Common Equity Tier 1 capital (CET1)** | **20 911 742** | 17 381 888 | **20 205 343** | 17 016 829 |
| Issued preference share capital[7] | **81 603** | 112 803 | **81 603** | 112 803 |
| Phase out – non-loss absorbent[1] | **(3 912)** | (9 216) | **(3 912)** | (9 216) |
| **Additional Tier 1 capital (AT1)** | **77 691** | 103 587 | **77 691** | 103 587 |
| **Tier 1 capital (T1)** | **20 989 433** | 17 485 475 | **20 283 034** | 17 120 416 |
| Issued subordinated debt | **1 822 000** | 2 441 000 | **1 822 000** | 2 441 000 |
| Phase out – non-loss absorbent[1] | **(1 822 000)** | (2 076 600) | **(1 822 000)** | (2 076 600) |
| Deduction for third-party capital issued by bank subsidiary[2] | **–** | (80 962) | **–** | – |
| Total subordinated debt | **–** | 283 438 | **–** | 364 400 |
| Unidentified impairments | **624 762** | 519 230 | **624 762** | 519 230 |
| **Tier 2 capital (T2)** | **624 762** | 802 668 | **624 762** | 883 630 |
| **Qualifying regulatory capital** | **21 614 195** | 18 288 143 | **20 907 796** | 18 004 046 |
| CET1 % | **32.8** | 33.9 | **32.2** | 33.3 |
| AT1% | **0.1** | 0.2 | **0.1** | 0.2 |
| T1 % | **32.9** | 34.1 | **32.3** | 33.5 |
| T2 % | **1.0** | 1.6 | **1.0** | 1.7 |
| **Total capital adequacy %[3]** | **33.9** | 35.7 | **33.3** | 35.2 |

| R'000 | Group 2019 | Group 2018 | Bank 2019 | Bank 2018 |
|---|---|---|---|---|
| **Composition of required regulatory capital** | | | | |
| On balance sheet | **5 706 267** | 4 602 965 | **5 743 468** | 4 621 702 |
| Off balance sheet | **4 739** | – | **4 739** | – |
| Credit risk | **5 711 006** | 4 602 965 | **5 748 207** | 4 621 702 |
| Operational risk | **879 306** | 683 940 | **866 622** | 683 002 |
| Equity risk in the banking book | **51 291** | 56 819 | **48 375** | 41 872 |
| Other assets | **685 946** | 355 777 | **558 647** | 345 109 |
| **Total regulatory capital requirement** [4] | **7 327 549** | 5 699 501 | **7 221 851** | 5 691 685 |
| **Composition of risk-weighted assets**[5] | | | | |
| On balance sheet | **41 619 716** | 41 374 966 | **49 943 202** | 41 543 388 |
| Off balance sheet | **41 209** | – | **41 209** | – |
| Credit risk | **49 660 925** | 41 374 966 | **49 984 411** | 41 543 388 |
| Operational risk | **7 646 139** | 6 147 776 | **7 535 845** | 6 139 346 |
| Equity risk in the banking book | **446 009** | 510 730 | **420 654** | 376 379 |
| Other assets | **5 964 751** | 3 197 993 | **4 857 796** | 3 102 106 |
| **Total risk-weighted assets** | **63 717 824** | 51 231 465 | **62 798 706** | 51 161 219 |
| Total assets based on IFRS | **100 427 749** | 84 957 233 | **100 061 284** | 84 850 405 |
| Total risk-weighted assets - adjustments[6] | **(36 709 925)** | (33 725 768) | **(37 262 578)** | (33 689 186) |
| **Total risk-weighted assets - regulatory** | **63 717 824** | 51 231 465 | **62 798 706** | 51 161 219 |

[1] *Starting 2013, the non-loss absorbent AT1 and T2 capital is subject to a 10% per annum phase-out in terms of Basel 3.*

[2] *Starting 2013, a deemed surplus attributable to T2 capital of subsidiaries issued to outside third parties is excluded from group qualifying capital in terms of the accelerated adoption of Basel 3. This deduction phases in at 20% per annum.*

[3] *The total capital adequacy ratio percentage is determined by dividing the total qualifying regulatory capital by total risk-weighted assets.*

[4] *This value is 11.500% (2018: 11.125%) of risk-weighted assets, being the Basel global minimum requirement of 8%, the South African country-specific buffer of 1.00% (2018: 1.25%) and the Capital Conservation Buffer of 2.500% (2018: 1.875%) (disclosable in terms of SARB November 2016 directive in order to standardise reporting across banks). In terms of the regulations the Individual Capital Requirement (ICR) is excluded.*

[5] *Risk-weighted assets are calculated by using regulatory percentages applied to the statement of financial position, in order to establish the base for calculating the required regulatory capital.*

[6] *The adjustments reflect mainly the impact of the regulatory percentages and the addition of a risk-weighted equivalent for operational risk.*

[7] *The base value of preference shares phasing out in terms of Basel 3 is R258 969 000. At year-end, 68.49% (2018: 56.44%) of these shares had been repurchased as they no longer contributed to qualifying regulatory capital.*

## Internal capital adequacy assessment process

We run an internal capital adequacy assessment process (ICAAP) which, on an ongoing basis, shapes the group's position on capital management. The ICAAP reviews the historic, current and future capital positioning of the group, both from an internal and a regulatory capital perspective.

The ICAAP also addresses the management of capital and solvency risk, as well as risks arising from the pro-cyclicality of business operations through the economic cycle. This involves broad-based participation from key risk owners and is subject to periodic review by internal audit and relevant external consulting specialists that benchmark our process against best practice. The ICAAP is submitted annually to the SARB for review.

This year we updated the ICAAP economic capital model to calculate expected losses and concentration risk. In addition, we calculated capital requirements using the advanced internal ratings-based (AIRB) approach.

Functions and processes of the ICAAP include:

- determining capital sufficiency through a review of the historical and future capital positioning:
  - reviewing the historical and future capital positioning from a regulatory, shareholders' and an internal capital perspective;
  - forecasting capital supply requirements, including stressing the budget and/or forecast to determine the sufficient capital requirement in a downturn of the economic cycle;
  - allowing the regulator to assess the bank's capital-planning strategy;
- managing the bank's approach to raising capital that is required to underwrite the risks of the business:
  - raising capital when conditions are conducive to doing so and the sustainability, reputation and price optimisation benefits offset any issuing cost; and
  - planning ROE as an input of investment decisions and the credit-granting model.

## Basel 3

Basel 3 sets the minimum standards required to comply with the longer-term prudential liquidity ratio. We calculate our regulatory capital requirement for credit and operational risk by using a percentage applied to the risk-weighted assets of the business. Various methods are used to calculate risk weights in terms of the Banks Act. Capitec uses the standardised approach to calculate risk-weighted assets for credit and equity risks in the banking book. Our calculation of operational risk is governed by the alternative standardised approach (ASA).

Capitec operates a mono-line banking business through a portfolio of retail banking assets. All other ancillary assets exist to support this business.

The impact of Basel 3 on capital adequacy measurement:

### Loss absorbency

Basel 3 loss-absorbency rules require additional tier 1 (AT1) and tier 2 (T2) capital instruments to have a clause in the agreement that enables the regulator to convert them to ordinary shares or write them down in the event of the resolution of the financial institution (a bailout by public institutions). The clause provides the regulator with alternate legal options in the event that a bank crisis must be resolved.

All capital that does not meet the new loss-absorbency requirements will be phased out over a period of 10 years. Subordinated debt will be phased out at the earlier of 10 years or based on actual maturity, where applicable. An overall ceiling limit that reduces by 10% per year was set on 1 January 2013, based on the outstanding capital value of non-loss absorbent AT1 and T2 instruments at the time.

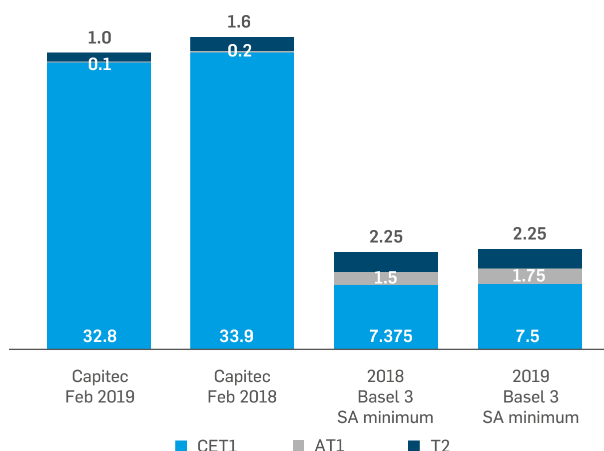
### Subsidiary third-party capital

Basel 3 limits the contribution of preference share capital and subordinated debt issued by subsidiaries, in the group capital adequacy ratio. This consolidation deduction is being phased in at 20% per year from 1 January 2013. The limitation aims to encourage the issue of capital by holding companies, rather than by subsidiaries.

### Leverage ratio

The leverage ratio acts as a capital floor to the Basel risk-adjusted capital-adequacy framework. Capitec had a calculated regulatory leverage ratio of 5 times common equity tier 1 (CET1) capital at the end of the financial year (2018: 5 times CET1). The maximum allowed leverage in South Africa is 25 times CET1 capital.

CAPITAL ADEQUACY BY TIER (%)



**CET1:** Common Equity Tier 1 capital: ordinary share capital and reserves after Basel deductions.

- **AT1:** Additional Tier 1 capital: Capitec's perpetual preference shares qualify as entry-level AT1 capital and are subject to phasing out in terms of Basel 3 as they do not meet new loss-absorbency standards.
- **T2:** Tier 2 capital: Capitec Bank's subordinated debt instruments qualify as entry-level T2 capital and are subject to phasing out in terms of Basel 3 as they do not meet new loss-absorbency standards. Subordinated debt is issued by the bank subsidiary as the interest cost is offset against revenue. This debt is regarded as third-party capital, subject to additional phasing-out rules, at a consolidated level. No subordinated debt instruments were issued by Capitec during the financial year.
- Globally, the Basel 3 minimum capital adequacy percentage is 8%.
- The 2019 Basel 3 South African minimum includes the South African country buffer of 1.000% (2018: 1.25%). The level of this buffer is at the discretion of the SARB and is subject to periodic review.
- The 2019 Basel 3 South African minimum includes the capital conservation buffer of 2.500% (2018: 1.875%), which was phased in from the beginning of 2016. All banks must maintain this buffer to avoid regulatory restrictions on the payment of dividends and bonuses.
- Excluded from the South African minimum are the Basel 3:

**Bank-specific buffers**

Bank-specific buffers include the individual capital requirement (ICR) and domestic systemically important bank (D-SIB) buffer. In terms of the Banks Act regulations, banks may not disclose their ICR requirement and D-SIB status. Any D-SIB requirement will be phased in over 4 years commencing January 2016. Current regulations state that the South African country risk buffer and the D-SIB buffers on a combined basis cannot be more than 3.5%.

**Countercyclical buffer**

This buffer can range between 0% and 2.5% at the discretion of the monetary authorities. It is not expected that this buffer will be applied on a permanent basis; it will only be applied when credit growth exceeds real economic growth. The implementation period commenced in January 2016 with the rate of 0%.

**Haircuts**

Haircuts are to be applied against a deemed surplus attributable to minority and third-party capital issued by subsidiaries. Phasing in started in 2013 at 20% per year.

### Restrictions on the transfer of regulatory capital

Given Capitec's simple structure and the fact that all the operations are in South Africa, the only restrictions on the transfer of ordinary equity reserves relate to the statutory limitations on investments in certain associates as defined in the Banks Act. Subordinated debt issued by Capitec Bank is not available for distribution to Capitec.

### Capital recovery plan

A capital recovery plan detects possible capital stress occurrences and provides guidance on appropriate actions to respond to early-warning signs. As it is difficult to obtain additional capital in times of stress, Capitec has a proactive and preventative approach to capital procurement. Management makes use of positive market conditions and positioning to obtain additional capital.

## Liquidity risk

We mitigate liquidity risk by ensuring that Capitec has access to sufficient or acceptable cash and cash equivalents to fund increases in assets and meet our obligations as they become due, without incurring unacceptable losses. We adhere to more stringent internal liquidity measurements than required by Basel 3. *

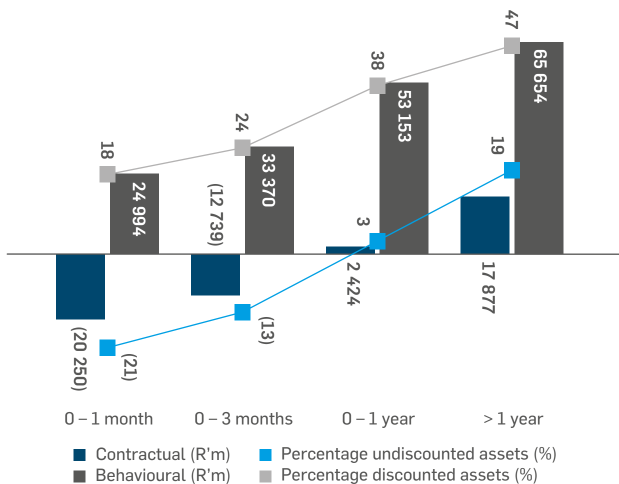
Our approach to liquidity risk remains conservative. There were no changes to the liquidity policy over the past financial year. The management of liquidity takes preference over the optimisation of profits.

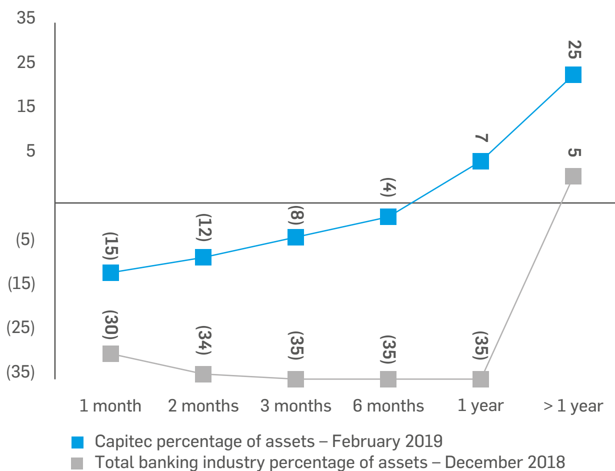
To reduce liquidity risk, call deposits are only allowed to fund cash flows shorter than 6 months. Funding that is surplus to operational requirements totalled R44.2 billion (2018: R34.7 billion). These are invested in low-risk, liquid, interest-bearing instruments. These assets provide a positive return. *

The liquid asset requirement of R2 328.0 million (R2018: R2 277.5 million) is held in order to comply with regulatory liquidity requirements and consists of treasury bills. The intention is to hold all treasury bills to full maturity.

For cash-planning purposes, we use the contractual mismatch and not the behavioural mismatch. *

* *Denotes text in the risk management report that forms part of the bank's audited annual financial statements.*




## Contractual and behavioural liquidity mismatches

Contractual and behavioural mismatches both benefit from the high component of equity funding. This creates a greater surplus of asset cash flows over liability cash flows than at banks with lower capital ratios. The main difference between the behavioural and contractual mismatches relates to the treatment of retail call deposits. 92.3% of these deposits (2018: 91%) are reflected as stable based on a standard deviation measure of volatility, which is considered reasonable for business-as-usual conditions.

Capitec complied with all regulatory liquidity capital requirements during the current and previous year.

## The liquidity coverage ratio (LCR)

The LCR is a 30-day stress test, using 90 days (actual data points for the quarter) to calculate an average for the quarter. It requires banks to hold sufficient high-quality liquid assets to cover envisaged net outflows. These outflows are calibrated using prescribed Basel factors applied to assets and liabilities in a static run-off model. Basel definitions are used to identify high-quality liquid assets.

| | **2019** | 2018 | 2017 | 2016 |
|---|---|---|---|---|
| LCR (%) | **1 450** | 1 878 | 1 152 | 1 040 |
| High-quality liquid assets (R'm) | **16 352** | 18 056 | 9 266 | 6 671 |
| Net outflow (R'm) | **1 128** | 962 | 804 | 641 |

As Capitec has a net cash inflow after applying the run-off factors, outflows for the purpose of the ratio are deemed to be 25% of gross outflows.

A ratio of 100% or more represents compliance in terms of Basel 3 requirements. The requirement to comply is being phased in from 2015 and a ratio of 100% was required from 1 January 2019.

## The net stable funding ratio (NSFR)

The NSFR is designed to ensure closer matching of long-term asset cash flows with long-term funding cash flows. It also strongly relies on retail deposit funding. A ratio of 100% or more represents compliance.

| | **2019** | 2018 | 2017 | 2016 |
|---|---|---|---|---|
| NSFR (%) | **196** | 206 | 187 | 145 |
| Required stable funding (R'm) | **46 548** | 37 205 | 35 337 | 34 406 |
| Available stable funding (R'm) | **91 044** | 76 621 | 66 187 | 49 968 |

The NSFR is calculated according to the SARB rules. Capitec's conservative approach to liquidity management has resulted in compliance with these 3 Basel ratios on a level that is consistently higher than required.

## Retail call deposit limit ratio (RCDR) percentage

The RCDR is an internal ratio, looking at the next 6 months. The purpose of the ratio is to indicate whether retail call deposits are being lent out long and if we need to change our strategy and acquire more wholesale funding. This ratio should be equal or greater than 100% on an ongoing basis. Our internal liquidity-stress early-warning indicator ratio is set at 107%.

## Retail call deposit tolerance

The retail call deposits liquidity tolerance is a treasury tool to indicate how quickly the bank can pay back deposits. This is done by applying future cash from loans, wholesale and fixed-term maturities to any current cash deficit that may arise.

Capitec's average days' tolerance for the financial year was 1 day(s) and the maximum tolerance for the year was 18 day(s).

## The liquidity recovery plan

The liquidity recovery plan requires that the bank has a liquidity monitor, a set of triggers developed to help identify the early stages of a liquidity crisis. The monitor addresses 2 phases of liquidity difficulty, namely:

### Early stage

This is the lower-risk stage that provides management with more opportunity to manage the bank out of a potential crisis.

### Late stage

This is the high-risk stage where management's opportunities for corrective action are limited by the circumstances.

After a range of stress indicators were assessed, it was evident, on an overall balanced basis, that neither early- nor late-stage liquidity stress exists.

# reputational risk

The current or prospective risk to earnings and capital arising from an adverse perception of Capitec by clients, counterparties, investors, employees or regulators.

Reputational risk is managed directly at an executive management level and escalated to the board in case of significant events.

Reputational risk is managed on an ongoing basis through a policy framework that details expected behaviour of the business and employees. It guides us on the monitoring of employee behaviour and specific client responses as well as to society in general. This includes precise and transparent reporting through our integrated annual report, annual financial statements and other public statements.

Our risk-mitigation strategy includes:

- a centralised policy on media;
- an escalation process for complaints; and
- clear relationships with stakeholders.

We actively manage the results of any reputational incident. The Viceroy incident highlighted the potential scope of reputational risk and resulted in enhanced awareness of this risk.

A security incident and event-monitoring solution is used to proactively monitor intelligence to identify and respond to incidents, including cyberattacks. Our social media monitoring tool tracks all posts related to Capitec. Various software, processes and procedures were implemented to ensure ethical and responsible use of technology and information, thereby protecting our reputation.

The risk management function is tasked with ensuring that stress testing is embedded in operational processes so that it is intuitive, relevant and part of the mainstream business activities.

# Capitec Bank Limited financial statements

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The preparation of the audited Capitec Bank Limited annual financial statements was supervised by the chief financial officer, André du Plessis, CA(SA)

# Statement of responsibility by the board of directors

*Capitec Bank Limited ('the bank' or 'Capitec Bank' or 'the company')*

The directors are responsible for the preparation, integrity and fair presentation of the annual financial statements of Capitec Bank Limited. The annual financial statements, comprising the statement of financial position at 28 February 2019, income statement, statements of comprehensive income, statement of changes in equity, statement of cash flows for the year then ended and the notes to the financial statements which include a summary of significant accounting policies and other explanatory notes, have been prepared in accordance with International Financial Reporting Standards (IFRS) and the Companies Act of South Africa, Act 71 of 2008, as amended (Companies Act) and include amounts based on judgements and estimates made by management. In addition, the directors are responsible for preparing the directors' report.

The directors consider that the most appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates have been used in the preparation of the annual financial statements and that all statements of IFRS that are considered applicable have been applied. The directors are satisfied that the information contained in the annual financial statements fairly presents the results of operations for the year and the financial position of the company at year-end. The directors also prepared the directors' report and the other information included in the integrated annual report and are responsible for both its accuracy and consistency with the annual financial statements.

The directors' responsibility includes maintaining adequate accounting records. The accounting records should disclose, with reasonable accuracy, the financial position of the company to enable the directors to ensure that the financial statements comply with relevant legislation.

Capitec Bank Limited operates in a well-established control environment, which is documented and regularly reviewed. The control environment incorporates risk management and internal control procedures, which are designed to provide reasonable, but not absolute, assurance that assets are safeguarded and that the risks facing the business are controlled.

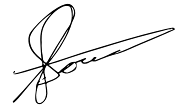
The annual financial statements were prepared on a going concern basis. Based on their assessment the directors have no reason to believe that the company will not continue as a going concern in the foreseeable future. The viability of the company is supported by the annual financial statements.

The company adhered to the Code of Corporate Practices and Conduct (Code).

The company's external auditors, PricewaterhouseCoopers Incorporated, audited the financial statements and their report is presented on page 54.

The annual financial statements set out on pages 59 to 139 were approved by the board of directors and signed on its behalf on 27 March 2019 by:

**Riaan Stassen**
*Chairman*



**Gerrie Fourie**
*Chief executive officer*

# Certificate by the company secretary

I hereby confirm, in my capacity as company secretary of Capitec Bank Limited, that for the year ended 28 February 2019, the company has filed all required returns and notices in terms of the Companies Act, 2008 and that all such returns and notices are to the best of my knowledge and belief true, correct and up to date.

**Yolande Mouton**
*Stellenbosch*

27 March 2019

# *Audit committee report*

*Capitec Bank Limited*

The Capitec Bank Limited audit committee ('the committee') is an independent statutory committee appointed by the board of directors in terms of section 64 of the Banks Act (Act 94 of 1990) and section 94 of the Companies Act (Act 71 of 2008) (Companies Act) to the extent applicable.

The committee comprises 3 independent non-executive directors. The committee met 3 times during the year with 100% attendance by members at the meetings.

The committee's responsibilities include statutory duties in terms of the Companies Act, as well as responsibilities assigned to it by the company's board of directors. The committee's terms of reference are set out in a board-approved charter and are detailed in the corporate governance review.

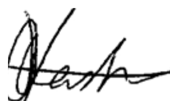
The committee conducted its affairs in compliance with, and discharged its responsibilities in terms of, its charter for the year ended 28 February 2019.

The committee performed the following statutory duties during the period under review:

- Satisfied itself that the external auditor is independent of the company, as set out in section 94(8) of the Companies Act, and suitable for reappointment by considering, inter alia, the information stated in paragraph 22.15(h) of the JSE Listings Requirements
- Ensured that the appointment of the auditor complied with the Companies Act, and any other legislation relating to the appointment of auditors
- In consultation with executive management, agreed to the engagement letter, terms, audit plan and budgeted fees for the 2019 financial year
- Approved the nature and extent of non-audit services that the external auditor may provide
- Nominated for election at the annual general meeting, PricewaterhouseCoopers Inc. as the external audit firm
- Satisfied itself, based on the information and explanations supplied by management and obtained through discussions with the independent external auditor and internal auditors, that the system of internal financial controls is effective and forms a basis for the preparation of reliable financial statements
- Reviewed the accounting policies and the company financial statements for the year ended 28 February 2019 and, based on the information provided to the committee, considers that the company complies, in all material respects, with the requirements of the Companies Act, Code of Corporate Practice and Conduct and IFRS
- Undertook the prescribed functions (in terms of section 94(7) of the Companies Act on behalf of the company.

The committee performed the following duties assigned by the board during the period under review:

- Considered the sustainability report forming part of the integrated annual report and satisfied itself that the information is reliable and consistent with the financial results. The committee, at its meeting held on 27 March 2019, recommended the integrated annual report for approval by the board of directors
- Ensured that the company's internal audit function is independent and had the necessary resources and authority to enable it to discharge its duties
- The committee approved the internal audit charter and the annual audit plan
- The committee met with the external auditors and with the head of the internal audit function without management being present
- The committee satisfied itself in terms of the JSE Listings Requirements 3.84(g)(i) that the bank financial director has appropriate expertise and experience.



**Jean Pierre Verster**
*Chairman*

27 March 2019

# *Directors' report*

*Year ended 28 February 2019*

The directors present their annual report to shareholders for the year ended 28 February 2019.

## Nature of the business

Capitec Bank Limited (Capitec Bank) or the company or the bank is a leading South African retail bank which focuses on essential banking services and provides innovative savings, transacting and unsecured lending products to individuals.

## Review of operations

The operating results and the state of affairs of the company are fully disclosed in the annual financial statements and commentary is provided in the chief financial officer's report.

## Share capital

No ordinary shares were issued during the year ended 28 February 2019. The number of shares in issue amounted to 1 300 000 (February 2018: 1 300 000).

No ordinary shares were repurchased during the year and 345 658 (February 2018: 423 137) preference shares were repurchased.

## Dividends to shareholders

The company declared the following dividends for the year under review and the previous year:

| | 2019 | 2018 |
|---|---|---|
| Ordinary dividend (R'000) | | |
| Interim | **728 450** | 607 042 |
| Final | **1 295 022** | 1 092 675 |
| Preference dividend (R'000) | | |
| Interim | **4 998** | 6 730 |
| Final | **3 786** | 5 293 |

The final ordinary dividend for 2019 was approved by the directors on Wednesday, 27 March 2019. In terms of the requirements of IFRS no accrual was made for this dividend.

The board performed a solvency and liquidity test in accordance with section 4 of the Companies Act (Act 71 of 2008) when dividends were declared.

## Directors

The directors of the company during the reporting period and as at the reporting date are as follows:

- R Stassen (Chairman)
- GM Fourie (Chief executive officer)
- LA Dlamini
- AP du Plessis (Chief financial officer)
- MS du P le Roux
- K Makwane
- NS Mashiya (Chief risk officer)
- JD McKenzie
- DP Meintjes (Appointed on 28 November 2018)
- NS Mjoli-Mncube
- PJ Mouton
- CA Otto
- JP Verster

Directors' remuneration is disclosed in the notes to the annual financial statements.

## Company secretary

The company secretary during the reporting period and as at the reporting date is as follows:

- YM Mouton

# *Independent auditor's report*

*To the Shareholders of Capitec Bank Limited*

## Report on the audit of the financial statements

### Our opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Capitec Bank Limited (the Company) as at 28 February 2019, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards and the requirements of the Companies Act of South Africa.

### What we have audited

Capitec Bank Limited's financial statements set out on pages 59 to 139 comprise:

- the statement of financial position as at 28 February 2019;
- the income statement for the year then ended;
- the statement of other comprehensive income for the year then ended;
- the statement of changes in equity for the year then ended;
- the statement of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies.

Certain required disclosures have been presented elsewhere in the *Capitec Bank Limited Annual Report 2019*, rather than in the notes to the financial statements. These are cross-referenced from the financial statements and are identified as audited.

## Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the financial statements* section of our report.

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

### Independence

We are independent of the Company in accordance with the *Independent Regulatory Board for Auditors Code of Professional Conduct for Registered Auditors (IRBA Code)* and other independence requirements applicable to performing audits of financial statements in South Africa. We have fulfilled our other ethical responsibilities in accordance with the IRBA Code and in accordance with other ethical requirements applicable to performing audits in South Africa. The IRBA Code is consistent with the International Ethics Standards Board for Accountants *Code of Ethics for Professional Accountants* (Parts A and B).

## Our audit approach

### Overview

**Overall group materiality**
- Materiality: R342.5 million, which represents 5% of profit before tax.

**Key audit matters**
- Expected credit losses (ECL) on loans and advances

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements. In particular, we considered where the directors made subjective judgements; for example, in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. As in all of our audits, we also addressed the risk of management override of internal controls, including among other matters, consideration of whether there was evidence of bias that represented a risk of material misstatement due to fraud.

### Materiality

The scope of our audit was influenced by our application of materiality. An audit is designed to obtain reasonable assurance whether the financial statements are free from material misstatement. Misstatements may arise due to fraud or error. They are considered material if individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Based on our professional judgement, we determined certain quantitative thresholds for materiality, including the overall materiality for the financial statements as a whole, as set out in the table below. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

| | |
|---|---|
| **Overall materiality** | R342.5 million |
| **How we determined it** | 5% of profit before tax |
| **Rationale for the materiality benchmark applied** | We chose profit before tax as the benchmark because, in our view, it is the benchmark against which the performance of the Company is most commonly measured by users, and is a generally accepted benchmark. We chose 5% which is consistent with quantitative materiality thresholds used for profit-oriented companies in this sector. |

## Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| Key audit matter | How our audit addressed the key audit matter |
|---|---|

*Expected credit losses (ECL) on loans and advances*

*Refer to note 3 (Critical accounting estimates and judgements in applying accounting policies – expected credit loss on loans and advances), note 7 (Net loans and advances), note 2.4 (Accounting policy – Impairment – amortised cost), note 2.18.1 (Accounting policy – IFRS 9 Financial Instruments), note 27.1 (Credit risk), for the related disclosures.*

At 28 February 2019, gross unsecured loans and advances amounted to R54.9 billion against which an ECL of R10.4 billion was raised.

The ECL was calculated by applying International Financial Reporting Standard (IFRS) 9 Financial Instruments (IFRS 9), as described in the notes to the financial statements, which was adopted for the first time on 1 March 2018.

In calculating the ECL, the key areas of significant management judgement and estimation included:

- Determining whether evidence exists that there has been a significant increase in credit risk (SICR) since initial recognition of the financial instrument, by considering shifts in calculated behavioural and granting scores, beyond determined thresholds.
- Determination of the write-off point. The Company considers the point at which there is no reasonable expectation of further recovery to be made when the expected present value of projected future recoveries is less than 5% of the gross balance before write-off. This point is estimated based on account status, behavioural score and consecutive missed payments.
- Determining and weighting of assumptions used in the forward-looking economic model. Three forward-looking scenarios are probability weighted by management to determine the ECL (positive, negative and a baseline scenario). The Company utilises the 3 year macro-economic outlook of the Bureau of Economic Research to project future changes in unemployment and the real wage rate. These scenarios are then linked to Probability of Defaults (PDs) and Loss Given Defaults (LGDs) to derive a forward looking ECL.
- Determining event driven management ECL overlays. Management increase the results produced by the modelled output for events that influence the modelled output, which are not yet captured by the model.
- Calibrating of the ECL statistical model components (Probability of Default "PD", Exposure at Default "EAD", Loss Given default "LGD") used to estimate the timing and amount of the forecasted cash flows based on historical default data, roll rates and recoveries. The Company stratifies aspects such as client risk groups, time on book, product term, payment frequency, default statuses, employment, industry and rescheduling status and the behaviour score of the client. Management judgement is required to consider how historical data is used to project ECL.

We determined the ECL on loans and advances to be a matter of most significance to our current year audit due to the following:

- the first time adoption of IFRS 9 by the Company;
- the magnitude of the ECL;
- the degree of judgement and estimation applied by management in determining the ECL.

Our audit procedures addressed the key areas of significant judgement and estimation in determining the ECL on loans and advances as follows:

*Evaluation of SICR*

- We recalculated the impact of SICR, applying the assumptions and data included in management's model, including the performance of rehabilitated accounts.
- We tested the performance of SICR thresholds applied and the resultant transfer rate into stage 2 for SICR. This included benchmarking of the volume of up to date accounts transferred to stage 2 based on history.
- We performed a sensitivity analysis of SICR to determine the impact of change in SICR thresholds on the ECL recognised.
- We evaluated management's supporting documentation for the performance of behavioural scores, granting scores and the correlation of these to default rates.
- We obtained an understanding of management's process for identifying employer groups under stress and found these employer groups to have been considered in management's calculation of the granting scores.

*Determination of write-off point*

- For the term lending portfolio, we evaluated management's assessment of historical post write-off recoveries, to determine the point at which there was no reasonable expectation of further recovery.
- Through recalculation, we tested the application of the IFRS 9 write-off policy, including the exclusion of post write-off recoveries from the Loss Given Default (LGD).

*Inclusion of forward looking information and macro-economic variables in the ECL*

- We considered the assumptions used in the forward looking economic model, specifically around the forward-looking scenarios used, the macro-economic variables considered as well as the macro-economic outlook. We compared these to our own actuarial statistics and independent market data.
- We tested the performance and sensitivity of the forward looking model in order to evaluate whether the chosen macro-economic factors and model fit provide a reasonable representation of the impact of macro-economic changes on the ECL results.

*Event driven management overlays in the ECL*

- We assessed the reasonableness of event driven overlays raised by management, based on our understanding of the industry, emerging risks and regulatory changes. Based on our reperformance of the ECL model, we considered effects already taken into account by the ECL model to determine whether the impact of the overlay was not double counted.
- We evaluated whether these overlays were subject to an appropriate governance process.

*Calibrating of ECL statistical model components (PD, EAD, LGD)*

- We obtained an understanding of the methodologies and assumptions used by management in the various ECL model components and how these were calibrated to use historical information to estimate future cash flows.
- In gaining this understanding, we re-performed the ECL model.

We found the accounting policies and the credit impairment methodologies applied by management to loans and advances to be in accordance with IFRS 9 – *Financial Instruments.*

## Other information

The directors are responsible for the other information. The other information comprises the information included in the *Capitec Bank Limited Annual Report 2019*, which includes the Directors' Report, the Audit Committee Report and the Certificate by the Company Secretary as required by the Companies Act of South Africa. Other information does not include the financial statements and our auditor's report thereon.

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

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

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

## Responsibilities of the directors for the financial statements

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

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

## Auditor's responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

We also provide the directors with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with the directors, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

## Report on other legal and regulatory requirements

In terms of the IRBA Rule published in Government Gazette Number 39475 dated 4 December 2015, we report that PricewaterhouseCoopers Inc. has been the auditor of Capitec Bank Limited for 18 years.

PricewaterhouseCoopers Inc.
Director: Michael Meyer
Registered Auditor

Johannesburg
27 March 2019

# *Statement of financial position*

*As at 28 February 2019*

| R'000 | Notes | 2019 | 2018 |
|---|---|---|---|
| **Assets** | | | |
| Cash, cash equivalents and money market funds | 4 | **29 130 717** | 25 080 848 |
| Financial investments (Held-to-maturity investments)* | 5 | **10 732 394** | 11 780 934 |
| Term deposit investments | 6 | **9 331 297** | 2 528 331 |
| Net loans and advances | 7 | **44 509 305** | 41 802 360 |
| Other receivables | 8 | **1 639 428** | 714 505 |
| Net insurance receivable | 9 | **236 391** | 245 204 |
| Derivative assets | 10 | **479** | 129 |
| Financial assets – equity instruments at FVOCI (Available-for-sale financial assets)* | 11 | **100 000** | 100 000 |
| Current income tax asset | | **286 046** | 107 154 |
| Group loans receivable | 12 | **331 465** | 182 410 |
| Equipment | 13 | **1 863 897** | 1 608 584 |
| Intangible assets | 14 | **316 283** | 283 011 |
| Deferred income tax asset | 15 | **1 583 582** | 416 936 |
| **Total assets** | | **100 061 284** | 84 850 406 |
| **Liabilities** | | | |
| Derivative liabilities | 38, 39 | **14 704** | 51 365 |
| Retail deposits | 16 | **71 365 285** | 57 824 498 |
| Other liabilities | 17 | **2 543 228** | 2 178 883 |
| Wholesale funding | 16 | **5 078 328** | 6 205 726 |
| Provisions | 18 | **91 005** | 66 835 |
| **Total liabilities** | | **79 092 550** | 66 327 307 |
| **Equity** | | | |
| **Capital and reserves** | | | |
| Ordinary share capital and premium | 19 | **6 105 981** | 6 105 981 |
| Cash flow hedge reserve | 20 | **(9 588)** | (26 737) |
| Retained earnings | | **14 790 738** | 12 331 052 |
| **Share capital and reserves attributable to ordinary shareholders** | | **20 887 131** | 18 410 296 |
| Non-redeemable, non-cumulative, non-participating preference share capital and premium | 19 | **81 603** | 112 803 |
| **Total equity** | | **20 968 734** | 18 523 099 |
| **Total equity and liabilities** | | **100 061 284** | 84 850 406 |

* *Denotes classification of financial assets under IAS 39 in the previous reporting period.*

# *Income statement*

*Year ended 28 February 2019*

| R'000 | Notes | 2019 | 2018 |
|---|---|---|---|
| Lending, insurance and investment income | 21 | **17 226 111** | 17 266 028 |
| Interest income | 21 | **15 499 664** | 15 473 176 |
| Loan fee income | 21 | **931 470** | 919 328 |
| Net insurance income | 9 | **794 977** | 873 524 |
| Lending and investment expenses | | **(4 729 317)** | (4 597 316) |
| Interest expense | 21 | **(4 509 549)** | (4 184 449) |
| Loan fee expense | 21 | **(219 768)** | (412 867) |
| **Net lending, investment and insurance income** | | **12 496 794** | 12 668 712 |
| Transaction fee income | | **8 473 959** | 6 925 526 |
| Transaction fee expense | | **(2 009 669)** | (1 798 483) |
| **Net transaction income** | | **6 464 290** | 5 127 043 |
| Dividend income | 22 | **287** | – |
| Credit impairments | 23 | **(4 450 245)** | (5 279 990) |
| Funeral income | | **53 456** | – |
| Other income/(expense) | | **133** | (1 389) |
| **Net income** | | **14 564 715** | 12 514 376 |
| Operating expenses | 24 | **(7 713 887)** | (6 464 875) |
| **Operating profit before tax** | | **6 850 828** | 6 049 501 |
| Income tax expense | 25 | **(1 718 767)** | (1 655 989) |
| **Profit for the year** | | **5 132 061** | 4 393 512 |

# Statement of other comprehensive income

*Year ended 28 February 2019*

| R'000 | Notes | 2019 | 2018 |
|---|---|---|---|
| **Profit for the year** | | **5 132 061** | 4 393 512 |
| Other comprehensive income that may subsequently be reclassified to profit or loss | | **17 149** | (15 001) |
| Cash flow hedge recognised during the year | 20 | **5 009** | 59 116 |
| Cash flow hedge reclassified to profit and loss for the year | 20 | **18 809** | (79 951) |
| Income tax relating to cash flow hedge | 20 | **(6 669)** | 5 834 |
| **Total comprehensive income for the year** | | **5 149 210** | 4 378 511 |

# *Statement of changes in equity*

*Year ended 28 February 2019*

| R'000 | Notes | Ordinary share capital and premium | Preference share capital and premium | Cash flow hedge reserve | Retained earnings/ accumulated loss | Total |
|---|---|---|---|---|---|---|
| **COMPANY** | | | | | | |
| **Balance at 29 February 2017** | | 6 105 981 | 150 998 | (11 736) | 9 581 370 | 15 826 613 |
| Total comprehensive income for the year | | – | – | (15 001) | 4 393 512 | 4 378 511 |
| **Transactions with shareholders and directly recorded in equity** | | – | (38 195) | – | (1 643 830) | (1 682 025) |
| Ordinary dividend | 26 | – | – | – | (1 631 807) | (1 631 807) |
| Preference dividend | 26 | – | – | – | (12 023) | (12 023) |
| Shares issued/(shares repurchased) | | – | (38 195) | – | – | (38 195) |
| **Balance at 28 February 2018** | | **6 105 981** | **112 803** | **(26 737)** | **12 331 052** | **18 523 099** |
| Changes on initial application of IFRS 9 (see note 2.18.1) | | **–** | **–** | **–** | **(648 039)** | **(648 039)** |
| **Restated balance at 1 March 2018** | | **6 105 981** | **112 803** | **(26 737)** | **11 683 013** | **17 875 060** |
| Total comprehensive income for the year | | **–** | **–** | **17 149** | **5 132 061** | **5 149 210** |
| **Transactions with shareholders and directly recorded in equity** | | **–** | **(31 200)** | **–** | **(2 024 336)** | **(2 055 536)** |
| Ordinary dividend and special dividends | 26 | **–** | **–** | **–** | **(2 015 551)** | **(2 015 551)** |
| Preference dividend | 26 | **–** | **–** | **–** | **(8 785)** | **(8 785)** |
| Preference shares repurchased | | **–** | **(31 200)** | **–** | **–** | **(31 200)** |
| **Balance at 28 February 2019** | | **6 105 981** | **81 603** | **(9 588)** | **14 790 738** | **20 968 734** |
| Notes | | 19 | 19 | 20 | | |

# Statement of cash flows

*Year ended 28 February 2019*

| R'000 | Notes | 2019 | 2018 |
|---|---|---|---|
| **Cash flow from operating activities** | | | |
| Cash flow from operations | 30 | 16 195 587 | 13 535 852 |
| Income taxes paid | 31 | (2 818 959) | (1 746 316) |
| | | 13 376 628 | 11 789 536 |
| **Cash flow from investing activities** | | | |
| Acquisition of equipment | 13 | (710 111) | (628 656) |
| Proceeds from disposal of equipment | | 9 151 | 14 840 |
| Purchase of intangible assets | 14 | (230 127) | (142 943) |
| Loans to group companies | | (149 055) | (69 928) |
| Investment in term deposit investments | 6 | (10 557 000) | (3 153 000) |
| Redemption of term deposit investments | 6 | 3 947 000 | 7 159 000 |
| Acquisition of financial investments | 5 | (12 611 392) | (12 904 350) |
| Redemption of financial investments | 5 | 13 655 132 | 6 650 176 |
| Increase in short-term money market investments | | (14 745) | (13 895) |
| | | (6 661 147) | (3 088 756) |
| **Cash flow from financing activities** | | | |
| Loans from group companies | | – | (11 130) |
| Preference shares repurchased | 19 | (31 200) | (38 195) |
| Issue of institutional bonds and other funding | 16 | 500 000 | 500 000 |
| Redemption of institutional bond and other funding | 16 | (1 119 000) | (1 110 000) |
| Dividends paid | 32 | (2 025 843) | (1 645 796) |
| | | (2 676 043) | (2 305 121) |
| **Net increase in cash and cash equivalents** | | 4 039 438 | 6 395 659 |
| Cash and cash equivalents at the beginning of the year | | 25 060 098 | 18 664 439 |
| **Cash and cash equivalents at the end of the year** | 4 | 29 099 536 | 25 060 098 |

# *Notes to the annual financial statements*

*Year ended 28 February 2019*

## 1. General information

### 1.1 Nature of business

The company conducts retail banking.

### 1.2 Review of operations

The operating results and the state of affairs of the company are fully set out in the attached statement of financial position, income statement, statement of other comprehensive income, statement of changes in equity, statement of cash flows and the notes thereto.

The company's earnings attributable to ordinary and preference shareholders amounted to R5 132 million (2018: R4 393.5 million).

### 1.3 Directors and secretary

Information relating to the directors and secretary of the company is presented in the directors report.

### 1.4 Company details

The company's place of domicile and country of incorporation is the Republic of South Africa.

Registered office: 1 Quantum Street, Techno Park, Stellenbosch 7600.

## 2. Accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### 2.1 Basis of preparation

The policies comply with International Financial Reporting Standards (IFRS), interpretations issued by the IFRS Interpretations Committee (IFRIC), the JSE Listings Requirements and the requirements of the Companies Act.

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial instruments held at fair value through profit or loss.

Refer to note 2.19 for new standards and interpretations not yet adopted.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the bank's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in note 3.

The bank applied the transitional requirements of IFRS 9 with respect to the classification and measurement of financial assets as well as the measurement of expected credit loss (ECL) retrospectively at the date of initial application.

The difference between the carrying amount of financial assets reported in terms of IAS 39 and that as determined with reference to IFRS 9 has been recognised in the bank's opening retained earnings at 1 March 2018. The bank has continued to account for hedges in terms of IAS 39 hedge accounting on adoption of IFRS 9. Consequently the amendment to IFRS 7 disclosures have also been applied to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

The bank has not restated its previous reporting periods, as permitted in IFRS 9.

In the notes to the financial statements, amounts denoted as current are expected to be recovered/settled no more than 12 months after the reporting period. Amounts denoted as non-current are expected to be recovered more than 12 months after the reporting period.

## 2.2 Cash, cash equivalents and money market funds

Cash, cash equivalents and money market funds comprise balances with less than three months' maturity from the date of acquisition, including: cash, balances with central banks, resale agreements, treasury bills and other eligible bills, amounts due from banks, non-bank money market investments, fixed and notice deposits with original maturities less than three months and short-term government securities. Cash and cash equivalents are stated at cost which approximates fair value due to the short-term nature of these instruments.

Financial instruments purchased under short-term agreements to resell, at either a fixed price or the purchase price plus a lender's rate of return, with an original maturity date of less than 3 months, including government bonds, are included under cash and cash equivalents. The difference between the purchase and sales' price is treated as interest and amortised over the life of the resale agreement using the effective interest rate method.

Mandatory reserve deposits with the SARB must be maintained at the average required by the SARB over a one month period and are non-interest bearing. These deposits may be used to manage significant intra- and inter-day cash outflows but are not considered as available for normal cash planning purposes. A total of 70% of the balance is available without requiring prior regulatory approval.

## 2.3 Financial instruments

### *2.3.1 Financial instruments applied from 1 March 2018*

The bank recognises financial assets on the statement of financial position once it becomes a party to the contractual terms of the particular financial instrument.

At initial recognition, the bank measures a financial asset at its fair value plus, in the case of financial assets not at FVTPL, transaction costs that are directly attributable to the acquisition of the financial asset. Transaction costs of financial assets carried at FVTPL are expensed in the income statement.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the bank has transferred substantially all risks and rewards of ownership.

IFRS 9 contains a new classification and measurement approach for financial assets. The bank classifies its financial assets on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.

The categories of held to maturity, loans and receivables and available for sale financial assets under IAS 39 have been eliminated under IFRS 9.

From 1 March 2018, the bank classifies its financial assets into the following categories:
- Measured at amortised cost
- Fair value through other comprehensive income (OCI)
- Fair value through profit or loss (FVTPL)

## 2. Accounting policies (continued)

### 2.3 Financial instruments (continued)

#### *2.3.1 Financial instruments applied from 1 March 2018 (continued)*

The bank assesses its business model by portfolio of financial assets that are managed together and evaluates the following factors:

- How the performance of the portfolio is evaluated and reported to bank management;
- How the portfolio managers (if applicable) are compensated, including whether management is compensated based on the fair value of the assets or the contractual cash flow collected;
- The risks that affect the performance of the business model and how those risks are managed; and
- The frequency, volume and timing of sales in prior periods, the reasons for such sales and expectation of future sale activities.

The contractual cash flow characteristics are evaluated based on whether the contractual cash flows consist solely of payments of principal and interest (SPPI). This assessment includes assessing whether the financial asset has a contractual term that would change the timing or amount of contractual cash flows. The bank considers whether the contractual cash flows are subject to any contingent events that would change the amount and timing of cash flows, leverage features, prepayment and extension terms and features that would modify the consideration of the time value of money.

*2.3.1.1 Financial Assets*

(a) Debt instruments – amortised cost
The following items are the significant debt instruments held by the bank:

i) loans and advances to clients that are recognised when funds are advanced to the borrowers.

Loan consolidations are treated as a de-recognition of the loans as the contractual cash flows from the financial asset expire.

In instances where the group reschedules a credit agreement, the cash flows are renegotiated with the client, but the effective interest rate remains the same and there are therefore no gains or losses.

When a client goes into debt review, cash flows are renegotiated and in some instances the effective interest rate is affected by the modification of the agreement. Modification gain or loss is disclosed in note 7.

ii) fixed and term notice deposits are non-derivative financial assets with fixed or determinable payments. They arise when the bank invests cash with other banks. These instruments comprise fixed deposits with original maturities longer than three months, deposit investments with the contractual option to call the funds after a period longer than three months and deposits that have effective contractual notice periods greater than three months.

These classes of debt instruments are held for the collection of their contractual cash flow and their cash flows represent solely payments of principal and interest and therefore are measured at amortised cost. Interest income from these financial assets is included in interest income on the bank's income statement using the effective interest rate method. Credit impairments are presented as part of credit impairment charge on the bank's income statement.

(b) Equity instruments – FVOCI
The following item is the only significant equity instrument of the bank:

i) Equity investment in African Bank Holdings Limited
The bank has elected at date of initial application of IFRS 9 to irrevocably designate its equity investment at FVOCI. This election results in fair value gains and losses being recognised in

other comprehensive income and not subsequently being reclassified to profit or loss, including on disposal. Credit impairment (and reversal of credit impairment) are not reported separately from other changes in fair value. Dividends, when representing a return on such investments, continue to be recognised in the income statement when the bank's right to receive such payments is established. Refer to note 11.

(c) Financial instruments – FVTPL
The following item is the only significant financial instrument held at fair value through profit or loss:

i) Derivative assets and derivative liabilities
Derivatives are classified as held for trading and measured at FVTPL unless they are designated as part of a qualifying hedge. All derivative contracts are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Derivatives are held only to cover economic exposures. The use of derivatives is restricted to the hedging of forecast cash flows for specific transactions. Currently derivatives are limited to interest rate swaps and forward foreign exchange contracts.

*2.3.1.2 Financial Liabilities*

The bank recognises a financial liability once it becomes a party to the contractual terms of the financial instrument. Financial liabilities, other than those held at fair value through profit or loss, are recognised initially at fair value, generally being their issue proceeds net of transaction costs incurred and subsequently stated at amortised cost using the effective interest rate method.

A financial liability, or part of a financial liability, is derecognised once the obligation specified in the contract relating to the financial liability is discharged, cancelled or has expired.

*2.3.1.3 Derivative financial instruments and hedging activities*

Derivative financial instruments exclude equity instruments that are accounted for in terms of IFRS 2 Share-based payments.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at fair value. Transaction costs are expensed. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Fair values are obtained from quoted market prices, where available, alternatively using valuation techniques or based on observable market prices where possible, failing which estimates are used.

Interest rate swaps are valued on a discounted cash flow basis using yield curves appropriate for the relevant swap rates. Quoted market prices are used where available and estimates are derived from quoted prices where required.

All contracts are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Derivatives are held only to cover economic exposures.

The bank designates certain derivatives as:

(a) hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge), or

(b) economic hedges if not qualifying in terms of the accounting criteria classified as fair value through profit or loss.

The use of derivatives is restricted to the hedging of forecast cash flows for specific transactions. Currently derivatives are limited to interest rate swaps and forward foreign exchange contracts.

## 2. Accounting policies (continued)

### 2.3 Financial instruments (continued)

#### *2.3.1 Financial instruments applied from 1 March 2018 (continued)*

##### *2.3.1.4 Treatment of hedges qualifying as cash flow hedges*

The bank will continue to apply IAS 39 to hedge accounting with the disclosures required by IFRS 9 and IFRS 7.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income and deferred within equity. The gain or loss relating to the ineffective portion is recognised in the income statement immediately.

Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when the interest payments that are hedged are recognised as an expense). The gain or loss relating to the effective portion of interest rate swaps hedging variable rate borrowings is recognised in the income statement within interest expense. Refer to note 39 for separate disclosure.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement within movement in financial instruments held at fair value through profit or loss disclosed under operating expenses.

At the inception of the transaction the bank designates the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. Movements on the hedging reserve in shareholders' equity are shown in note 20.

##### *2.3.1.5 Treatment of economic hedges classified as fair value through profit or loss*

Where applicable changes in the fair value of these derivatives classified as fair value through profit and loss are taken to profit or loss immediately on remeasurement.

The fair values of various derivative instruments used for hedging purposes are disclosed in note 20.

#### *2.3.2 Financial instrument policy applied at 28 February 2018*

The bank recognises financial assets on the statement of financial position once it becomes a party to the contractual terms of the particular financial instrument.

Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the bank has transferred substantially all risks and rewards of ownership.

Management determines the categorisation of its financial instruments at initial recognition.

##### *2.3.2.1 Financial Assets*

(a) Financial instruments designated at fair value through profit or loss
This category has two subclasses: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is categorised as held for trading if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are categorised as held for trading unless they are designated as hedges.

Purchases and sales of financial assets at fair value through profit or loss are recognised on trade-date, being the date on which the bank commits to purchase or sell the asset.

Gains and losses on financial assets at fair value through profit or loss are measured as the difference between the fair values and the carrying amounts adjusted for dividend income, and are included in the income statement.

(b) Held-to-maturity investments
Financial assets at amortised cost are held-to-maturity, non-derivative financial assets with fixed or determinable payments and fixed maturities that the bank's management has the positive intention and ability to hold to maturity.

These assets are initially recognised at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, they are measured at amortised cost using the effective interest rate method.

Interest on held-to-maturity investments calculated using the effective interest method is recognised in the statement of profit or loss as part of interest income.

(c) Loans and receivables
Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than:

- those that the entity intends to sell immediately or in the short term, which are categorised as held for trading, and those that the entity upon initial recognition designates as at fair value through profit or loss;
- those that the entity upon initial recognition designates as available-for-sale; or
- those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration.

They arise when the bank provides money, goods or services directly to a debtor with no intention of trading the advance. Included within this category are:

(i) Loans and advances to clients that are recognised when funds are advanced to the borrowers and are carried at amortised cost using the effective interest rate method;

(ii) Fixed and term notice deposits are non-derivative financial assets with fixed or determinable payments. They arise when the bank invests cash with other banks. These instruments comprise fixed deposits with original maturities longer than three months, deposit investments with the contractual option to call the funds after a period longer than three months and deposits that have effective contractual notice periods greater than three months. The investments are made with the intention to hold them to maturity and collect the contractual cash flows. Fixed and term notice deposits are carried at amortised cost using the effective interest rate method.

(iii) Bank loans receivable and other receivables.

(d) Available-for-sale investment
An equity investment is measured at fair value with unrealised gains or losses recognised directly in other comprehensive income in the available-for-sale reserve. When the asset is disposed of, the cumulative gain or loss previously recognised in other comprehensive income is reclassified to the income statement. If an available-for-sale instrument is determined to be impaired, the respective cumulative unrealised losses previously recognised in other comprehensive income are included in the income statement in the period in which the impairment is identified.

Dividends earned while holding available-for-sale financial investment are recognised in the income statement when the right to payment has been established.

## 2. Accounting policies (continued)

### 2.3 Financial instruments (continued)

#### *2.3.2 Financial instrument policy applied at 28 February 2018 (continued)*

##### *2.3.2.2 Financial Liabilities*

The bank recognises a financial liability once it becomes a party to the contractual terms of the financial instrument. Financial liabilities, other than those held at fair value through profit or loss, are recognised initially at fair value, generally being their issue proceeds net of transaction costs incurred and subsequently stated at amortised cost using the effective interest rate method.

A financial liability, or part of a financial liability, is derecognised once the obligation specified in the contract relating to the financial liability is discharged, cancelled or has expired.

##### *2.3.2.3 Derivative financial instruments and hedging activities*

Derivative financial instruments exclude equity instruments that are accounted for in terms of IFRS 2 Share-based payments.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at fair value. Transaction costs are expensed. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Fair values are obtained from quoted market prices, where available, alternatively using valuation techniques or based on observable market prices where possible, failing which estimates are used.

Interest rate swaps are valued on a discounted cash flow basis using yield curves appropriate for the relevant swap rates. Cross currency swaps are valued on a discounted cash flow basis using foreign exchange market curves appropriate for the relevant swap rates. Quoted market prices are used where available and estimates are derived from quoted prices where required.

All contracts are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Derivatives are held only to cover economic exposures.

The bank designates certain derivatives as:

(a) hedges of a particular risk associated with a recognised asset or liability or a highly probable forecast transaction (cash flow hedge), or

(b) economic hedges if not qualifying in terms of the accounting criteria classified as fair value through profit or loss.

The use of derivatives is restricted to the hedging of forecast cash flows for specific transactions. Currently derivatives are limited to interest rate swaps and forward foreign exchange contracts.

##### *2.3.2.4 Treatment of hedges qualifying as cash flow hedges*

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income and deferred within equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are reclassified to profit or loss in the periods when the hedged item affects profit or loss (for example, when the interest payments that are hedged are recognised as an expense). The gain or loss relating to the effective portion of interest rate swaps hedging variable rate borrowings is recognised in the income statement within other operating expenses as well as interest expense.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement within movement in financial instruments held at fair value through profit or loss disclosed under operating expenses.

The bank documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items. Movements on the hedging reserve in shareholders' equity are shown in note 20.

*2.3.2.5 Treatment of economic hedges classified as fair value through profit or loss*

Where applicable changes in the fair value of these derivatives classified as fair value through profit and loss are taken to profit or loss immediately on remeasurement.

The fair values of various derivative instruments used for hedging purposes are disclosed in note 20.

## 2.4 Impairment – amortised cost

### *2.4.1 Impairment – amortised cost policy applied from 1 March 2018*

The bank recognises financial assets on the statement of financial position once it becomes a party to the contractual terms of the particular financial instrument.

*2.4.1.1 Impairment – measurement*

ECL is calculated as an unbiased, probability weighted amount which is determined by evaluating the range of reasonably possible outcomes, the time value of money and considering all reasonable and supportable information including that which is forward-looking.

The most significant class of financial asset subject to an ECL is loans and advances. Loans and advances comprise a large number of small, homogeneous assets. The bank uses an ECL provisioning model based on historical roll rates using the Markov chain method.

The bank stratifies the Markov roll rate results into similar groups to ensure results are stable and appropriate to predict future cash flows for clients with similar characteristics. The bank stratifies aspects such as client risk groups, time on book, product term, payment frequency (monthly, fortnightly or weekly), default statuses, employment, industry and rescheduling status and the behaviour score of the client.

## 2. Accounting policies (continued)

### 2.4 Impairment – amortised cost (continued)

#### *2.4.1 Impairment – amortised cost policy applied from 1 March 2018 (continued)*

##### *2.4.1.1 Impairment – measurement (continued)*

Furthermore, the model combines the roll rate matrices with a loan amortisation model on a loan-by-loan basis. The specific features of each loan such as balance, interest rate, fees, remaining term, instalments and arrears status, combined with the roll rates applicable to loans with the same characteristics, enables the bank to estimate the expected cash flow and balance amortisation of the loan. The rolled up results enable the bank to analyse portfolio and segmented views.

Forward-looking economic assumptions are incorporated into the model where relevant and where they influence credit risk. These assumptions are incorporated using the bank's most likely forecast for a range of macro-economic assumptions. Three forward-looking scenarios are incorporated into the range of reasonably possible outcomes (negative, positive and base case scenarios).

The period over which the ECL is calculated is limited to the maximum contractual period.

The resultant ECL calculation amounts to the excess of the balance of a loan above the present value of its expected cash flows, discounted using the effective interest rate on the financial instrument as calculated at initial recognition (initiation fee plus interest).

##### *2.4.1.2 Impairment – recognition*

Stage 1
An ECL is recognised at the time of initial recognition of the financial debt instruments and represents the lifetime cash shortfall arising from possible default events up to 12 months into the future from the balance sheet date.

An ECL continues to be determined on this basis until there is a significant increase in credit risk (SICR) event or the financial debt instrument becomes credit impaired.

A cash shortfall is the difference between the cash flows that are due in accordance with the contractual terms of the loan and the cash flows that the bank expects to receive over the contractual life of the loan.

For loans and advances, up-to-date loans are included in stage 1.

Clients that applied for debt review more than 12 months ago and remained up-to-date are classified as stage 1 subject to the SICR assessment.

Stage 2
The bank monitors financial debt instruments subject to impairment requirements at each reporting date to determine whether evidence exists that there has been a significant increase in credit risk (SICR) since initial recognition of the financial instrument.

The bank identifies SICR for clients that are up-to-date on their loans, but who have reached certain behaviour risk thresholds or specific events have occurred that raise a SICR flag in the model. The 12 month ECL is extended to a lifetime ECL for these clients.

The bank considers the following to be SICR for all loans and advances extended to the client:

- A client who has been reported as being unemployed.
- A client with a term loan that is up-to-date, but has a credit card which is in arrears. The term loan is identified as SICR.
- A client with a behaviour score that has decreased below the internal SICR threshold set by the bank.
- A client with an updated granting score below the internal SICR threshold set by the bank.

The following loans and advances are included in stage 2:
- Up-to-date loans with SICR;
- Loans up to 1 month in arrears and;
- Loans that applied for debt review between 6 and 12 months ago which are currently performing.

Stage 3 – Credit impaired
Financial debt instruments are considered impaired if, and only if, there is objective evidence of impairment as a result of events that occurred after initial asset recognition (known as loss events). These loss events have an adverse impact on the asset's estimated future cash flows that can be measured reliably.

The bank defines loans and advances as being 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset has occurred. Loans and advances are considered to be credit impaired upon the occurrence of any of the following events:
- client is placed under debt review;
- client is handed over for collection or has another legal status;
- client is in default. The bank defines default as the point at which the client is past due on 2 contractual payments, i.e. more than 1 month in arrears;
- loans that applied for debt review less than 6 months ago that are currently performing;
- up-to-date loans that rescheduled from up-to-date not yet rehabilitated; or
- up-to-date loans that rescheduled from arrears not yet rehabilitated.

Interest on loans and advances categorised as stage 3 is recognised in the income statement and balance sheet net of ECL impairments.

*2.4.1.3 Impairment – Loan write-offs applied from 1 March 2018*

Write-off is a derecognition event.

Following the implementation of IFRS 9, loans and advances are written off when it is has been determined that no reasonable expectation of recovery either in its entirety or in portion exists.

Under IAS 39, loans and advances that would have previously been written off when the loans and advances were in a legal status or in arrears for more than 3 months; under IFRS 9, loans and advances continue to be recognised until no reasonable certainty exists that any further recovery is expected on these loans and advances.

The bank considers the point at which there is no reasonable expectation of further recovery to be when the loan has a present value of future recovery less than 5% of the gross balance before write-off. This point applied from 1 March 2018 provides a simpler and more reliable method to that intended to be applied at transition that considered partial write-offs and time since last payment. It is currently estimated as:

1) Terminated from debt review:
   - 4 consecutive missed payments
2) Loans that have been handed over/other legal status:
   - handover score less than a predetermined threshold; or
   - handover score more than a predetermined threshold and 4 consecutive missed payments.

The expected recoveries receivable represents the present value of expected future recoveries net of impairments receivable on loans and advances that were written off in full prior to 1 March 2018.

## 2. Accounting policies (continued)

### 2.4 Impairment – amortised cost (continued)

#### *2.4.1 Impairment – amortised cost policy applied from 1 March 2018 (continued)*

##### *2.4.1.3 Impairment – Loan write-offs applied from 1 March 2018 (continued)*

The expected recovery receivable is assessed for impairment using a lifetime ECL from 1 March 2018, and placed in stage 3.

Where actual cash flows exceeds the amount written off, the excess is disclosed as bad debts recovered.

#### *2.4.2 Impairment of advances applied at 28 February 2018*

Loans and advances are stated at amortised cost net of identified impairments and incurred but unidentified impairments.

Loans and advances are considered impaired if, and only if, there is objective evidence of impairment as a result of events that occurred after initial asset recognition (known as loss events) and these loss events have an adverse impact on the assets' estimated future cash flows that can be measured reliably.

Objective evidence that loans and advances may be impaired includes the following observable data:

(a) A breach of contract, such as a default or delinquency in interest or principal payments. In this regard, instalments past due date are considered in breach of contract.

(b) Historical loss experience of groups of financial assets with similar repayment terms.

(c) Data indicating that there is a measurable decrease in the estimated future cash flows from a bank of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the bank including:
- adverse changes in the payment status of borrowers in the bank; or
- national or local economic conditions that correlate with defaults on the assets in the bank.

In determining whether a loss event has occurred, loans and advances are subjected to regular evaluations of the overall client risk profile and payments record.

The historical loss experience is adjusted on the basis of observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

On a collective basis, the bank assesses whether objective evidence of impairment exists for groups of financial assets with similar repayment terms. If there is objective evidence that an impairment loss on loans and advances has been incurred, the amount of the loss is measured as the difference between the assets' carrying amounts and the present value of estimated future cash flows (excluding future credit losses that have not yet been incurred) discounted at the respective financial assets' original effective interest rates (the recoverable amount).

The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce differences between loss estimates and actual loss experience.

All impaired loans and advances are reviewed on a monthly basis and any changes to the amount and timing of the expected future cash flows compared to previous estimates will result in a change to the charges for impairment of loans and advances in the income statement.

#### 2.4.2.1 *Identified impairment*

Loans and advances within the bank comprise a large number of small, homogeneous assets. Statistical techniques are used to calculate impairment allowances collectively, based on historical default and recovery rates. These statistical analyses use as primary inputs the extent to which accounts in the portfolio are in arrears and historical loss experience on the eventual losses encountered from similar delinquent portfolios.

These statistics feed discounted cash flow models, which have been developed for each of the loan products offered by the bank. The models are updated periodically in order to reflect appropriate changes in inputs.

Models contain both judgemental and non-judgemental inputs. The extent of judgement utilised in models developed for new loan products is greater than that for older products, given the limited historical experience available for the new products.

In outline, the statistical analyses are performed on a portfolio basis as follows:

- Loans and advances are monitored on a product basis, with each month's advances being treated as a discrete portfolio, on which an analysis of the run-off of recoveries, in period buckets and stratified between default statistics, is performed in order to develop a historical base for statistics on probability of default (PD).
- These derived statistics, based on actual experience, are used in plotting default values on a model curve that reflects the risk profile of the portfolio.
- Clients in arrears by more than 90 days are handed over for collection and written-off. The estimated recoveries is then discounted at the contractual rates and recognised in gross loans and advances.
- Upon write-off, the accrual of interest income on the original term of the advance is discontinued.
- The expected amount outstanding when default occurs that is not subsequently recovered, or the loss given default (LGD), is taken into account in calculating the impairment allowance.

Loans and advances with outstanding balances that would otherwise have been reflected as past due are included in loans and advances not past due, due to renegotiated payment terms. The renegotiated loans are subject to continuous individual or collective impairment assessment. Loans that were past due and have been renegotiated within the past six months are separately disclosed and are subject to stricter impairment assessment than loans renegotiated more than six months ago. Past due renegotiated loans cease to be disclosed separately if they are up to date six months after being rescheduled. If a rescheduled loan goes into arrears, it forms part of the loans in arrears classification.

#### 2.4.2.2 *Incurred but unidentified impairment*

In addition to the impairment estimated for assets with recognised objective evidence of impairment, an estimate is made for impairments associated with those assets in the statement of financial position that are impaired, but for which objective evidence is not yet available.

- The impairment calculation utilises the results of the statistical analyses referred to above to estimate the proportion of assets in each portfolio that are likely to display objective evidence of impairment over the emergence period. The emergence period is defined as the experience of the length of time that it takes for objective evidence to become apparent after the asset has become impaired.
- In considering the occurrence of a loss event over the life of a loan, it is assumed that there is a constant risk of the loss event occurring at any point in the life of the loan.
- For a portfolio of loans in a particular month most of the provision is recognised in the early stages of the contractual period, as the outstanding loan balances are larger.

Loans and advances impaired on this basis are reflected as loans not past due.

## 2. Accounting policies (continued)

### 2.4 Impairment – amortised cost (continued)

#### *2.4.2 Impairment of advances (continued)*

##### *2.4.2.3 Loan write-offs*

Clients (and the related impairment allowance accounts) are written off at the earliest of when they are in arrears for 90 days or more or legal hand-over occurs.

### 2.5 Interest-free loans granted

Interest-free group loans with no written terms are carried at cost net of impairment.

### 2.6 Current tax

Income tax payable on profits, based on the applicable tax law, is recognised as an expense in the period in which profits arise. The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date.

### 2.7 Deferred tax

Deferred income tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax is determined using tax laws and rates that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

The principal temporary differences arise from depreciation of property and equipment, provisions for doubtful debts, revaluation of certain financial assets and liabilities, prepaid expenses and tax losses carried forward. Deferred tax assets are raised only to the extent that it is probable that future taxable income will be available against which the unused tax losses can be utilised.

Deferred tax assets and liabilities are only offset when there is both a legal right to set-off and an intention to settle on a net basis.

### 2.8 Equipment

All equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the assets' 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 bank and the cost of the item can be measured reliably. All other repairs and maintenance costs are charged to the income statement during the financial period in which they were incurred.

Depreciation on assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, which currently are as follows:

| | |
|---|---|
| • Automated teller machines | 10 years |
| • Banking application hardware | 3–5 years |
| • Computer equipment | 3–7 years |
| • Motor vehicles | 5 years |
| • Office equipment | 5–8 years |

The assets' residual values and useful lives are annually reviewed and adjusted, if appropriate.

Gains and losses on disposals are determined by comparing proceeds with carrying amounts. These are included in the income statement.

## 2.9 Intangible assets

### *2.9.1 Computer software*

Computer software licences are acquired and are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Computer software is carried at cost less accumulated amortisation and impairment losses.

Costs associated with developing and maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the creation of identifiable and unique systems controlled by the bank, and that will probably generate economic benefits beyond one year, are recognised as intangible assets. Other development expenditures are recognised as an expense as incurred.

Amortisation on computer software is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, which currently are as follows:

- Banking application software 6 years
- Desktop application software 2–4 years
- Server software 3–5 years

### *2.9.2 Internally generated intangible assets*

Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the bank are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use or sell it;
- there is an ability to use or sell the software product;
- adequate technical, financial and other resources to complete the development and to use or sell the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Other development expenditures that do not meet these criteria are recognised as an expense when incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Amortisation on internally generated intangible assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives, which currently are as follows:

- Internally generated intangible assets 3–10 years

The assets' useful lives are annually reviewed and adjusted where appropriate.

## 2.10 Impairment of non-financial assets

Equipment and other non-financial assets (for example computer software) are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units). Non-financial assets that suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

## 2. Accounting policies (continued)

### 2.11 Share capital

#### *2.11.1 Categories of share capital*

Authorised share capital consists of:

- ordinary shares;
- non-redeemable, non-cumulative, non-participating preference shares; and
- convertible or written-off, loss-absorbent preference shares.

#### *2.11.2 Share issue costs*

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

#### *2.11.3 Dividends declared*

Dividends on ordinary shares and preference shares are recognised in equity in the period in which they have been approved by the directors. Dividends for the year that are declared after the statement of financial position date are dealt with in the directors' report.

### 2.12 Employee benefits

#### *2.12.1 Pension obligations*

The bank contributes to a provident fund classified as a defined-contribution fund.

For defined-contribution plans, the bank pays fixed contributions to privately administered provident fund plans on a contractual basis. The bank has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expenses when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

#### *2.12.2 Share-based compensation*

The bank operates cash-settled, share-based compensation plans. The fair value of the liability incurred for employee services received is recognised as an expense over the vesting period. Until the liability is settled, the bank re-measures the fair value of the liability at each reporting date and at the date of settlement, with any changes in value recognised in profit or loss for the period.

#### *2.12.3 Performance incentive scheme*

The bank operates a performance incentive scheme for senior and other employees, who are seen to be in leadership roles critical to the current and future success of the bank's business.

The amount recognised as a liability is the present value of the obligation at the end of the reporting period. The rate used to discount the obligation is determined by reference to market yields at the end of the reporting period on government bonds. The currency and term of the bonds is consistent with the currency and term of the obligation.

The employee service cost is recognised in the income statement as the obligation arises.

### 2.13 Foreign currency translation

#### *2.13.1 Functional and presentation currency*

Items included in the financial statements are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The financial statements are presented in South African Rand ('Rand'), which is the bank functional and presentation currency.

#### *2.13.2 Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing on the date of the transaction. Foreign currency balances are translated into rand at the reporting period end exchange rates. Exchange gains and losses on such balances are taken to profit or loss.

## 2.14 Net insurance receivable

Insurance contracts are defined as those contracts or agreements containing significant insurance risk. Significant insurance risk arises if an insured event could cause the issuer of the insurance contract to pay significant additional benefits as envisaged at the inception of the contract. Such contracts remain designated as insurance contracts until all rights and obligations are extinguished or expire.

The bank has provided capital to the third party cell captive and allows the bank to benefit from the ring-fenced insurance business. The cell captive arrangement effectively represents an investment in separate classes of shares in the cell captive insurer, which entitles the bank to participate in the insurance profits generated in terms of insurance policies sold to the bank's loan clients. The bank's participation is restricted to the results of the insurance business which is placed with the licensed cell captive insurer. The bank also earns interest on the capital and retained profits in the cell.

The cell captive arrangement exposes the bank to insurance risk on the reinsured and retained insurance risk components in the cell captive. The bank's insurance risk on the reinsured component relates to the risk that the reinsurer will fail to honour its obligations under the reinsurance agreement. The bank's insurance risk on the retained component relates to the risk that there will be insufficient capital available to honour the claims made by the policyholders in the cell captive arrangement.

The bank's exposure to insurance risk for both the reinsured and retained components in the cell captive is evidenced by the bank's obligation to maintain the solvency of the cell captive structure.

With respect to the retained insurance risk, judgement is required in determining the actuarial movements of the insurance contract liabilities held by the cell captive. There is uncertainty with regards to the claims that will be made by customers, which is dependent on a number of unpredictable factors. The bank makes this judgement based on the best estimate and in accordance with Standards of Actuarial Practice (SAP) 104 principles.

The insurance risk associated with the investment in the cell captive arrangement is disclosed as a non-current asset in the statement of financial position as "Net insurance receivable".

## 2.15 Revenue recognition

### *2.15.1 Interest income and expense*

Interest income and expense are recognised in the income statement for all instruments measured at amortised cost and at fair value through profit or loss using the effective interest rate method. Interest income and expense are recognised separately from other fair value movements.

The effective interest rate method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. 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 bank estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees paid or received between parties to the contract that are an integral part of the effective interest rate.

Once a financial asset or a group of similar financial assets have been written down as a result of an impairment loss, interest income is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss, which is the effective interest rate calculated at origination of the financial asset measured at amortised cost.

Loan origination fees that relate to the creation of a financial asset are amortised over the expected term of the loan on an effective interest rate basis and included in interest income.

## 2. Accounting policies (continued)

### 2.15 Revenue recognition (continued)

#### *2.15.2 Loan fee income and expenses*

Service-related loan fee income is recognised when the services are provided.

Loan fee expenses comprise credit insurance premiums paid and are recognised when the services are received from the first party credit life insurance cell captive.

#### *2.15.3 Interest income and expense*

Transaction income and expenses are recognised on an accrual basis in the period in which the services are rendered.

Transaction fee income and expenses arise due to the use of the Banks' branch, ATM and POS networks, along with the various electronic banking channels that the Bank has, namely the banking app, USSD and internet banking platform.

#### *2.15.4 Dividend income*

Dividend income is recognised in the income statement when the entity's right to receive payment is established. Dividends on listed preference shares accrue on a day-to-day basis based on the terms of the underlying instruments. Dividend income is recognised separately from other fair value movements.

#### *2.15.5 Net insurance income*

Net insurance income represents the movement before distributions paid to the bank in the net insurance receivable and comprises profits from the third party cell captive after reinsurance and tax. Investment returns have been included in interest income.

#### *2.15.6 Funeral income*

Funeral income comprises dividends and commissions from a cell captive profit-sharing arrangement after reinsurance. Capitec entered into a cell captive agreement that is 100% reinsured by a third party. The bank is the owner of a cell, through a preference share investment, that holds the credit insurance underwritten by the cell captive insurer. This preference share investment is classified as a receivable measured at fair value through P&L. Capitec would not be required to recapitalise the cell if any losses were suffered by the in-force policies. Due to the reinsurance risk being transferred to the third party, Capitec does not have any obligation to recapitalise the cell.

Funeral income is received as dividend from cell captive after tax. The tax expense is included in funeral income.

### 2.16 Segment reporting

The executive management committee, headed by the CEO has been identified by the bank as the chief operating decision maker (CODM), who are responsible for assessing the performance and allocation of resources of the bank.

The bank reports a single segment – retail banking within the South African economic environment. The business is widely distributed with no reliance on any major clients. In addition, no client accounts for more than 10% of revenue.

The CODM regularly review the operating results of the retail banking segment for which discrete financial information is made available on a monthly basis and against which performance is measured and resources are allocated across the segment.

Within the segment are a number of products and services that the bank derives its revenue from. These include:

- Transactional and deposit-taking banking services of which transaction fee income is disclosed on the face of the income statement; and
- Loan products that are granted to loan clients. There are three products granted by the segment, namely term loans and credit facilities and credit cards. Details of these loans are disclosed in note 7. Interest earned, monthly service fees and net insurance income is disclosed in note 21, and
- Profit sharing arrangement with regards to the funeral insurance policy sold by the bank.

## 2.17 Leases

### *2.17.1 Where the bank is the lessee*

Leases where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases, net of any incentives received from the lessor, are charged to the income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any penalty payment to the lessor is recognised as an expense in the period in which termination takes place.

### *2.17.2 Where the bank is the lessor*

Rental from the subletting of leased premises is recognised on a straight-line basis over the lease term. Subletting is incidental to the bank's occupation of certain properties.

## 2.18 Effective standards, interpretations and amendments to published standards applied for the first time during the current financial year

### *2.18.1 IFRS 9 Financial Instruments and amendments to IFRS 9 (effective 1 March 2018)*

The bank adopted IFRS 9 on 1 March 2018. The bank has not restated its comparative financial statements for the adoption of IFRS 9. Accordingly, the impact of adopting IFRS 9 has resulted in an adjustment to the bank's opening retained earnings on the date of initial application (DIA).

*Impact on the statement of financial position as at 1 March 2018*

The table on the next page summarises the IFRS 9 transition impact on the bank's statement of financial position as at 1 March 2018 by statement of financial position line item.

## 2. Accounting policies (continued)

### 2.18 Effective standards, interpretations and amendments to published standards applied for the first time during the current financial year (continued)

#### *2.18.1 IFRS 9 Financial Instruments and amendments to IFRS 9 (effective 1 March 2018) (continued)*

*Condensed consolidated statement of financial position*

| R'000 | IAS 39 as at 28 February 2018 | IFRS 9 Classification and Measurement[1] | IFRS 9 ECL | IFRS 9 as at 1 March 2018 |
|---|---|---|---|---|
| **Assets** | | | | |
| Financial investments | 39 390 242 | – | (13 386) | 39 376 856 |
| Available-for-sale financial assets[1] | 100 000 | – | – | 100 000 |
| Loans and advances to clients | 41 802 360 | – | (886 669) | 40 915 691 |
| Other assets | 3 033 714 | – | – | 3 033 714 |
| Current income tax asset[2] | 107 154 | – | (107 154) | – |
| Deferred income tax asset[2] | 416 936 | – | 770 490 | 1 187 426 |
| **Total assets** | 84 850 406 | – | (236 719) | 84 613 687 |
| Other liabilities[3] | 66 327 307 | – | 411 320 | 66 738 627 |
| **Total liabilities** | 66 327 307 | – | 411 320 | 66 738 627 |
| **Equity** | | – | | |
| **Equity attributable to ordinary shareholders** | 18 410 296 | – | (648 039) | 17 762 257 |
| Non-redeemable, non-cumulative, non-participating preference share capital and premium | 112 803 | – | – | 112 803 |
| **Total equity** | 18 523 099 | – | (648 039) | 17 875 060 |
| **Total equity and liabilities** | 84 850 406 | – | (236 719) | 84 613 687 |

[1] *The investment in African Bank is an equity investment and as such has been designated at fair value through OCI. Previously, the investment had been recognised as an available for sale security. All other financial assets retained their measurement basis as amortised cost under IFRS 9.*

[2] *Change in deferred tax and current income tax relates to the increase in the ECL provisions and change in tax law under the new section 11(jA) of the Income Tax Act of 1962 which is effective from the date that IFRS 9 applies.*

[3] *Increase in Other liabilities relates to the increase in current year taxation due to changes in the Tax Act section 11(jA).*

*Impact on the statement of changes in equity as at 1 March 2018*

The below table summarises the IFRS 9 transition impact on the bank's statement of changes in equity as at 1 March 2018.

*Condensed statement of changes in equity*

| R'000 | IAS 39 at 28 February 2018 | IFRS 9 ECL | IFRS 9 at 1 March 2018 |
|---|---|---|---|
| Ordinary share capital and share premium | 6 105 981 | – | 6 105 981 |
| Preference share capital and premium | 112 803 | – | 112 803 |
| Retained earnings[1] | 12 331 052 | (648 039) | 11 683 013 |
| Cash flow hedge reserve | (26 737) | – | (26 737) |
| **Total equity** | 18 523 099 | (648 039) | 17 875 060 |

[1] *The impact on the bank's capital is explained under capital impact.*

***Impact of IFRS 9 and amendments to IFRS 9 on loans and advances as at 1 March 2018***

*IAS 39 versus IFRS 9*

| IAS 39 | Up-to-date | Re-scheduled from up-to-date not re-habilitated | Re-scheduled from arrears not re-habilitated | Arrears | Expected recoveries receivable[4] | Total |
|---|---|---|---|---|---|---|
| Gross loans and advances | 41 661 660 | 1 085 352 | 1 277 234 | 2 699 936 | 906 273 | 47 630 455 |
| Cumulative provision | (3 234 766) | (188 907) | (649 648) | (1 754 774) | – | (5 828 095) |
| Net loans and advances | 38 426 894 | 896 445 | 627 586 | 945 162 | 906 273 | 41 802 360 |
| Provision % | **7.8** | **17.4** | **50.9**[5] | **65.0** | **–** | **12.2** |

| | Stage 1 | Stage 2 | | Stage 3 | | | | |
|---|---|---|---|---|---|---|---|---|
| IFRS 9 | Up-to-date | Up-to-date loans and advances with SICR and applied for debt review > 6 months | Up to 1 month in arrears | Re-scheduled from up-to-date not re-habilitated | Re-scheduled from arrears not re-habilitated | More than 1 month in arrears[3], legal statuses, and applied for debt review < 6 months | Expected recoveries receivable[4] | Total |
| Gross loans and advances | 37 152 772 | 4 401 434 | 1 002 862 | 1 085 352 | 1 277 234 | 1 804 528 | 906 273 | 47 630 455 |
| Cumulative provision | (2 674 424) | (1 032 799) | (558 281) | (462 365) | (609 432) | (1 377 463) | – | (6 714 764) |
| Net loans and advances | **34 478 348** | **3 368 635** | **444 581** | **622 987** | **667 802** | **427 065** | **906 273** | **40 915 691** |
| Provision % | **7.2**[1] | **23.5**[2] | **55.7** | **42.6**[2] | **47.7**[5] | **76.3** | **–** | **14.1** |

*(1) The provision percentage for up-to-date under IFRS 9 reduces to 7.2% from 7.8% under IAS 39 even though a 12 month ECL is applied versus a 3 month emergence period methodology. The main reason is due to up-to-date loans with SICR transferring to stage 2, where a lifetime ECL is applied under IFRS 9 compared to a 3 month emergence period provision under IAS 39.*

*(2) The increase in the ECL under IFRS 9 for this category of loans and advances relates to the change from a 3 month emergence period to a lifetime ECL.*

*(3) This includes loans that are currently up to 1 month in arrears that were previously rescheduled but have not rehabilitated.*

*(4) Shown net of provisions.*

*(5) Although the ECL model predicts a lower default rate on rescheduled clients, the provision is maintained at the same rate when the client was in arrears, until the rescheduled client starts performing in terms of the rescheduled arrangement.*

## Taxation impact

The adoption of IFRS 9 results in a tax credit to the bank's reserves on the DIA based on the statutory tax rate of 28%.

The amended tax legislation in section 11(jA) of the Income Tax Act, which is effective from when IFRS 9 applies, allows for a 25% doubtful debt allowance relating to the impairment (stage 1). The allowance is increased to 40% where the impairment is measured at an amount equal to the lifetime ECL (i.e. stage 2), and to 85% where the impairment is on a lifetime ECL and the loan meets the definition of "default" in terms of Regulation 67 of section 90 of the Banks Act (stage 3).

Effectively, from our 2019 tax year of assessment, we will claim 25% allowance on stage 1, 40% on stage 2 and 85% allowance on loans classified as stage 3.

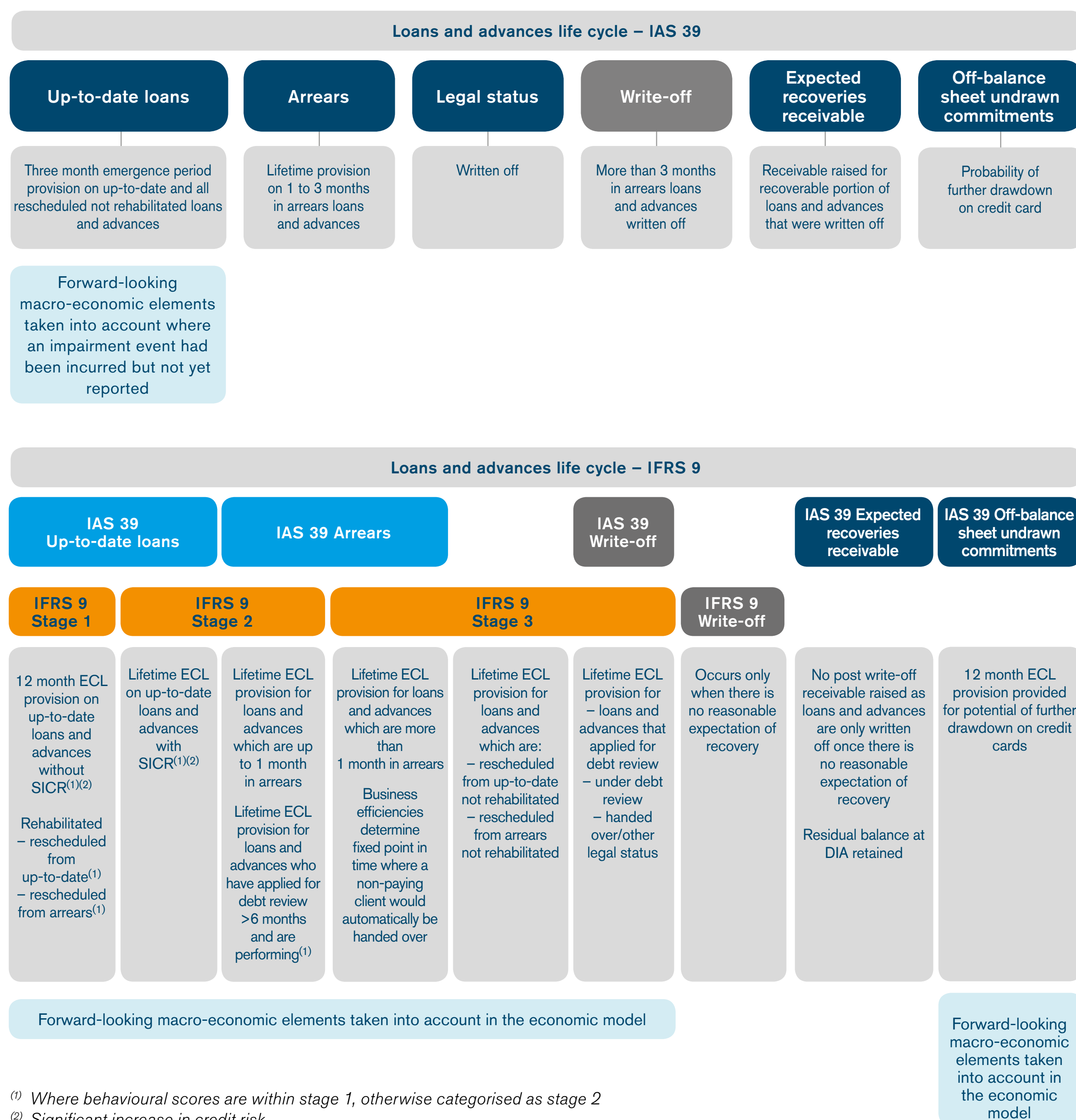
The increase in the impairment provisions in terms of IFRS 9, together with the proposed change in the tax treatment, results in an increase in deferred tax asset of R770 million. In addition, the liability for current tax was increased by R518 million to take into account the increase in tax payable due to the changes in the amended tax legislation.
At 1 March 2018, the bank's current income tax asset of R107 million was set off against the current tax liability of R518 million, resulting in a net liability for current tax of R411 million.

## 2. Accounting policies (continued)

### 2.18 Effective standards, interpretations and amendments to published standards applied for the first time during the current financial year (continued)

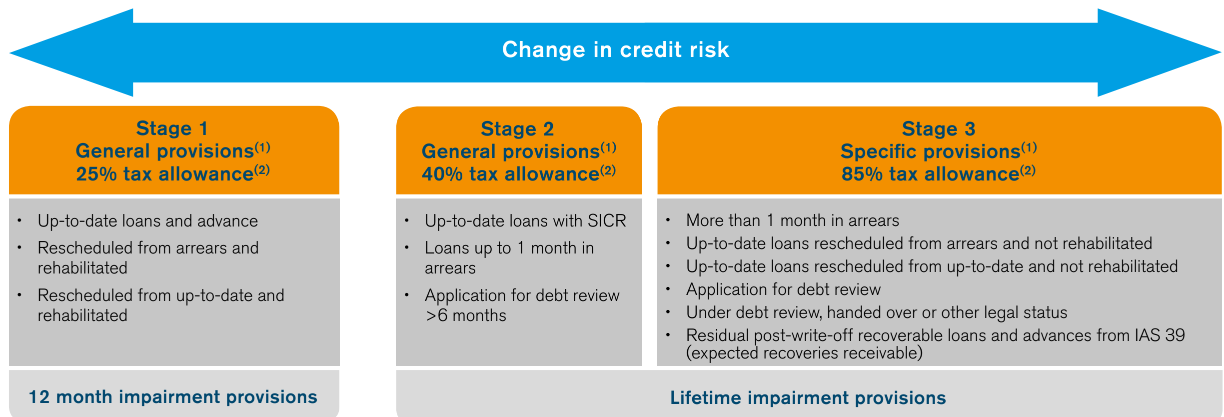
*2.18.1 IFRS 9 Financial Instruments and amendments to IFRS 9 (effective 1 March 2018) (continued)*

**The application of IFRS 9 compared to previous IAS 39 on the loan life cycle is illustrated below:**

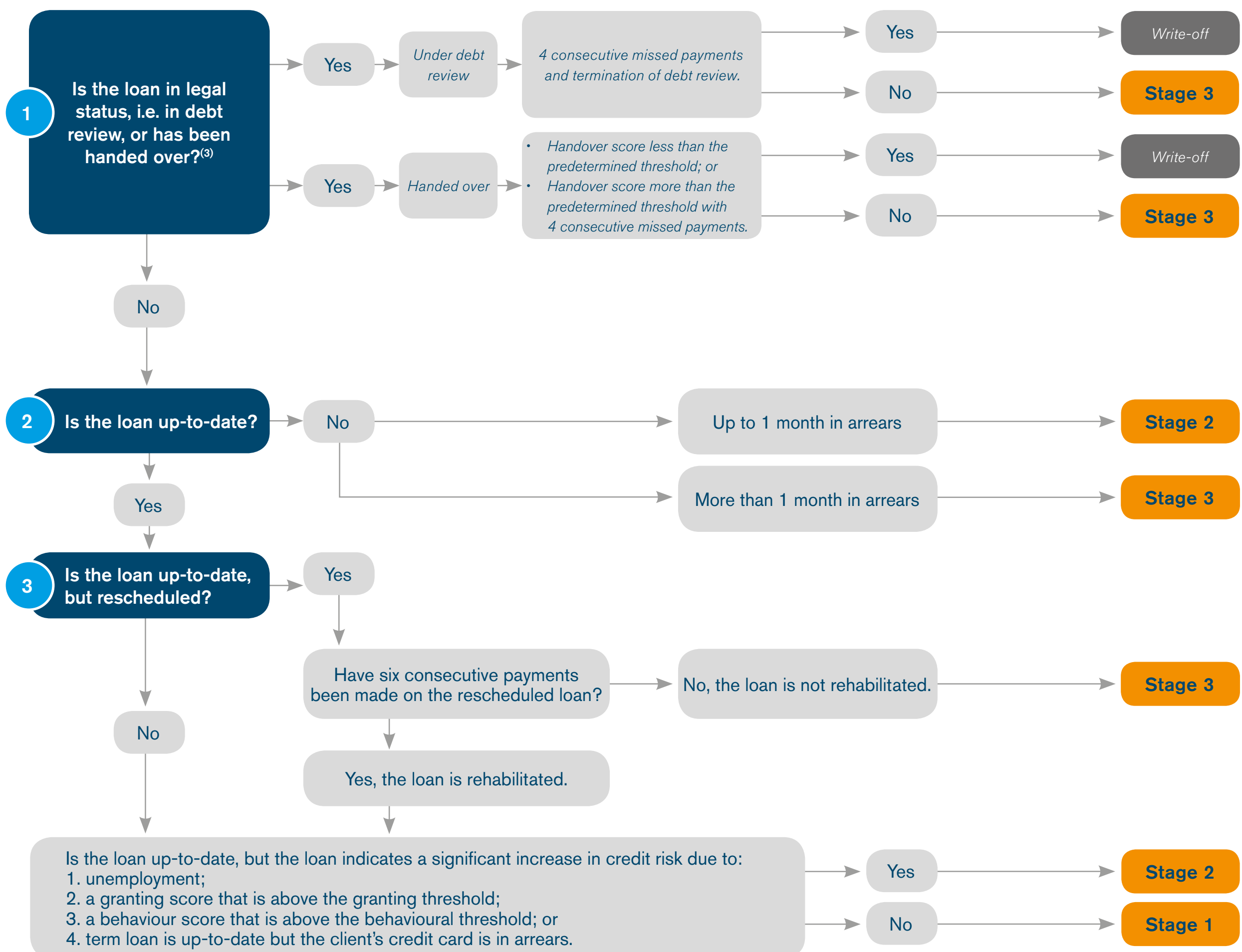



(1) *Where behavioural scores are within stage 1, otherwise categorised as stage 2*
(2) *Significant increase in credit risk*

**The diagram below depicts the SICR decision tree applied to loans and advances:**




**The following decision tree is performed to determine in which stage the loans and advances should be:**




(1) *As per SARB directive D5/2017.*
(2) *As per section 11(jA) of the Income Tax Act of 1962.*
(3) *Refer to note 2.4.1.3.*

## 2. Accounting policies (continued)

### 2.18 Effective standards, interpretations and amendments to published standards applied for the first time during the current financial year (continued)

#### *2.18.1 IFRS 9 Financial Instruments and amendments to IFRS 9 (effective 1 March 2018) (continued)*

The following is a high-level overview of the changes of total impairment loss provisions under IAS 39 to those under IFRS 9, showing the key factors driving the increase in the impairment loss provision.

| Loans and advances status as reported in the 2018 financial statements | Treatment under IAS 39 | Treatment under IFRS 9 |
|---|---|---|
| Up-to-date loans and advances, rehabilitated rescheduled loans | The bank applied an incurred but not yet reported (IBNR) emergence period of three months for all up-to-date loans. | IFRS 9 requires a minimum 12 month ECL for loans and advances for which there has not been a SICR.<br>SICR is identified for loans and advances that are up-to-date, but have reached certain behaviour risk thresholds or specific events have occurred that raise a SICR flag in the model, extending to a lifetime ECL. |
| Rescheduled from up-to-date and arrears not rehabilitated | The bank applied an IBNR emergence period of three months for all non-rehabilitated rescheduled loans.<br>The difference in the arrears provision and the rescheduling provision was released over a period of 12 months. | Loans and advances rescheduled from up-to-date and arrears not rehabilitated have a lifetime ECL under stage 3.<br>Rescheduled from up-to-date:<br>Loans rescheduled from up-to-date are considered to be stage 1 once these loans have rehabilitated, unless their behaviour score is seen as a SICR, in which case the loan will be in stage 2.<br>Rescheduled from arrears:<br>Loans rescheduled from arrears are considered to be stage 1 once these loans have rehabilitated, unless their behaviour scores are seen as a SICR, where the client will remain in stage 2. |
| Arrears | The bank applied a lifetime impairment provision for arrears as one payment missed was defined as a loss event under IAS 39.<br>The expected lifetime of the loans and advances were calculated with reference to the bank's policy to write-off loans at the earliest of when loans and advances were more than 3 months in arrears or legal status has occurred. | Loans that are up to one month in arrears are seen as stage 2 and have a lifetime ECL.<br>Loans that are more than one month in arrears are seen as stage 3, being credit impaired and have a lifetime ECL applied.<br>The expected lifetime of loans and advances are now calculated with reference to the bank's updated write-off policy under IFRS 9. |
| Expected recovery receivable | A receivable was raised by the bank for the present value of future expected cash flows arising from the recoverable portion of loans written off. | No receivable is recognised for expected cash flows arising from the recoverable portion of loans written off, due to the change in definition of write-off under IFRS 9.<br>The balance at DIA remained in loans and advances and a lifetime ECL was applied. Cash collected relating to this balance will be used to settle the balance. The receivable was recovered in the current year. Any additional cash will be disclosed as a bad debt recovered. |
| Write-off | Loans and advances at the earliest of more than 3 months in arrears or that had a legal status were fully derecognised. An expected recovery receivable was raised at the write-off point. | Loans and advances are only written off when there is no reasonable expectation of recovery. Loans previously written off are not written back. No expected recovery receivable is raised after write-off.<br>The period to write-off is therefore significantly longer under IFRS 9. |
| Forward-looking macro-economic assumptions | The bank already took forward-looking information into account on the up-to-date loans and advances, where an impairment event had been incurred but not yet reported. | IFRS 9 requires that forward-looking macro-economic assumptions be applied to both the 12 month and lifetime ECL calculation. |

#### 2.18.2 *IFRS 15 Revenue from Contracts with Customers and amendments to IFRS 15 (effective 1 March 2018)*

IFRS 15 *Revenue from Contracts with Customers* was adopted with effect from 1 March 2018. The accounting policy was updated to reflect the terminology in the new standard, but it had no impact on the financial information reported in the current or comparative periods. Interest income and expense continue to be recognised using the effective interest rate method for financial instruments measured at amortised cost.

Capitec assessed revenue recognised from contracts with customers by nature, amount, timing and uncertainty of revenue and cash flows that are affected by economic factors. Based on this assessment, revenue is appropriately dis-aggregated for loan fee income, transaction fee income and funeral income.

Interest income and expenses continue to be recognised using the effective interest rate method for financial instruments measured at amortised cost in terms of IFRS 9.

#### 2.18.3 *Other*

- Amendments to IFRS 2 *Share-based Payments* (effective 1 March 2018)
- Annual improvements to IFRS's 2014–2016 cycle (1 March 2018)
- IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

These amendments have no impact on measurements of assets and liabilities at the previous year-end. Comparatives are provided for new disclosures where required by the standards.

### 2.19 Standards, interpretations and amendments to published standards that are not yet effective

Certain effective new standards, amendments and interpretations to existing standards have been published that are mandatory for the bank's accounting periods beginning on or after 1 March 2019 or later periods but which the bank has not early adopted, as follows:

| Title | Impact |
|---|---|
| IFRS 16 *Leases* (effective 1 March 2019) | High<br><br>The bank will apply IFRS 16 using the modified retrospective approach and therefore the comparative information for the financial year ending 28 February 2020 will not be restated and will continue to be reported under IAS 17 and IFRIC 4.<br><br>IFRS 16 introduces a single lessee accounting model and requires a lessee to recognise right-of-use assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. As a consequence, a lessee recognises depreciation of the right-of-use asset and interest on the lease liability, and also classifies cash repayments of the lease liability into a principal portion and an interest portion and presents them in the statement of cash flows.<br><br>The bank has assessed the requirements of IFRS 16 and considers the impact to be high given the changes in the composition of the statement of financial position and the income statement.<br><br>The bank will recognise lease liabilities estimated at R2.6 billion in relation to leases that were previously classified as operating leases under IAS 17. The associated right-of-use asset will be approximately R2.5 billion. The estimates include the determination of lease extensions based on hindsight. |
| IFRS 17 *Insurance Contracts* (effective 1 March 2021) | Low<br><br>The bank has not yet assessed the impact IFRS 17 will have on the insurance liabilities contained within the net insurance receivable presented on the face of the statement of financial position. |
| Amendment to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* | No impact |
| Amendment to IFRS 3 *Business Combinations* | No impact |
| Amendments to IAS 28 *Investment in Associates and Joint Ventures* | No impact |

## 3. Critical accounting estimates and judgements in applying accounting policies

The preparation of financial statements for the bank requires management to make estimates that affect the reported amounts in the financial statements and accompanying notes. Management applies their knowledge of current events and actions that may be undertaken in the future but actual results may ultimately differ from estimates. The following represents the most material estimates and judgements applied in preparing these financial statements. They relate to the determination of the Expected Credit Loss (ECL) on loans and advances and are discussed below.

### 3.1 Judgements

#### *3.1.1 Significant increases in credit risk (SICR)*

In terms of IFRS9, all loans and advances are assessed at each reporting date to determine whether there has been a significant increase in credit risk (SICR). In cases where SICR has occurred an impairment equal to the lifetime expected credit loss (ECL) is recognised. If, at reporting date the ECL has not increased, the bank recognises a 12 month ECL. The bank identifies SICR on clients that are up-to-date on their loans but who have been subject to SICR events.

The bank considers the following to be SICR events:

- Shifts in behaviour score beyond certain thresholds. A behaviour score is utilised in the ECL model to provide a measure of a client's propensity to default in the next 12 months. The score was built on a client level, using Capitec's loan and savings account information, as well as credit exposure and payment behaviour at external credit providers. The score is updated monthly on all existing loan clients to ensure a consistent view of the client. The score also separately considers the performance of rescheduled accounts, which are assumed to have rehabilitated if they have made contractual payments for 6 months and are up to date with their amended contractual obligations.
- A granting score that is below the threshold set by the bank. The updated granting score in the ECL model aims to provide an assessment of SICR on a collective basis for groups of exposure that share similar credit characteristics, such as same employer group, in order to account for forward-looking information that may not be identified at an individual loan level.
- Clients that have been reported as unemployed, impacting on granting scores.
- Term loans that are up-to-date while the client's credit card is in arrears, impacting on behaviour scores.

In addition, a lifetime ECL is recognised on all loans that reflect arrears.

| **Impact of SICR on ECL** | | **Positive** | **Base** | **Negative** |
|---|---|---|---|---|
| Shifting of the SICR threshold by 5%* | R'm | 633 | 730 | 852 |
| Percentage change on total SICR ECL | % | 13.2 | 0.0 | 16.7 |

* *Reflects the full stage 2 ECL if the deterioration or improvement in the factor used, as a behavioural or granting scores threshold, is stressed by 5%.*

#### *3.1.2 Loan write-offs*

Loans are written off when there is no reasonable expectation of further recovery. Refer to note 2.4.1.3.

## 3.2 Estimates

### *3.2.1 Forward-looking information*

It is a fundamental principle of IFRS9 that the ECL impairment provision that the bank holds against potential future losses should take into account changes in the economic environment in the future.

To capture the effects of changes to the economic environment the bank utilises the Bureau of Economic Research (BER) macro-economic outlook for the country over a planning horizon of at least 3 years. The outlook is provided to the asset and liability committee (ALCO) for review and approval.

Three economic scenarios (negative, baseline and positive scenario) are taken into account when calculating future expected credit losses. The probability of each scenario is determined by management estimation.

The relevance to Capitec's book is proven by a historic linear relationship between a change in a basket of macro-economic variables, mainly comprising changes in unemployment and real wage rates. The three scenarios project the future change in the basket, which is translated into an expected change in bad debt. Management has assigned a probability of 60% to the baseline scenario, 35% to the negative scenario and 5% to the positive scenario for the 12 month forecast.

| Impact of forward looking information on ECL | R'm | % change in ECL |
|---|---|---|
| **Probability weighted impact of all 3 scenarios** | 361 | |
| 100% negative scenario | 480 | 33% |
| 100% baseline scenario | 390 | 8% |
| 100% positive scenario | 294 | (19%) |

### *3.2.2 Event driven management credit estimates*

Certain events/risks arise from time to time that may not be incorporated into the statistical forward looking model. In such instances, the additional inclusions into the ECL are reviewed and approved by the credit committee (CC) on a monthly basis.

These events, for which an amount was included in ECL, include the introduction of DebiCheck from October 2019. DebiCheck will have an impact on the collection of cash flows on loans and advances with clients who move their bank accounts, change debit order dates or where changes in the rescheduled contractual cash flows are greater than 1.5 times the original debit order. If the client fails to electronically confirm the updated debit order, the bank could fail to collect the agreed upon instalment from the client on the agreed upon loan date.

Also included is management's estimate relating to certain specific economic events such as the impact of load-shedding and mining strikes on employer groups as well as adjustments for the impact of new entrants on projected loan recoveries.

### *3.2.3 Modelling assumptions*

Historical data may not always be reflective of the future. The way in which it is used by statistical ECL models (PD, EAD, LGD) to estimate the timing and amount of the forecasted cash flows based on historical default data, roll rates and recoveries, requires consideration of sub-segments. These include aspects such as client risk groups, time on book, product term, payment frequency, default statuses, employment, industry and rescheduling status and the behaviour score of the client.

| R'000 | 2019 | 2018 |
|---|---|---|

## 4. Cash, cash equivalents and money market funds

| | 2019 | 2018 |
|---|---|---|
| Cash on hand | **3 601 994** | 3 472 067 |
| Bank balances | **13 222 529** | 15 683 690 |
| Resale agreements: Corporate | **506 222** | 403 672 |
| Resale agreements: Banks | **10 605 141** | 4 363 010 |
| **Central bank balances** | | |
| Mandatory reserve deposits with central bank | **1 163 650** | 1 137 659 |
| **Cash and cash equivalents** | **29 099 536** | 25 060 098 |
| Non-cash adjustment: ECL | **(4 315)** | – |
| Money market unit trusts | **35 496** | 20 750 |
| **Total cash, cash equivalents and money market funds** | **29 130 717** | 25 080 848 |
| Maximum exposure to credit risk | **29 130 717** | 25 080 848 |
| Current | **29 130 717** | 25 080 848 |

Stage 1 with no movement between stages

12-month ECL of R4.3 million (1 March 2018: R2.7 million)

*Cash, cash equivalents and money market funds are classified as financial assets measured at amortised cost.*

## 5. Financial investments (Held-to-maturity investments)*

| | 2019 | 2018 |
|---|---|---|
| **Interest-bearing instruments**[1] | | |
| Balance at the beginning of the year | **11 780 934** | 5 326 724 |
| Additions | **12 611 392** | 12 904 350 |
| Interest accrued[2] | **891 332** | 603 278 |
| Expected credit loss (ECL) | **(8 663)** | – |
| Maturities – capital | **(13 655 132)** | (6 650 176) |
| Maturities – interest accrued[2] | **(887 469)** | (403 242) |
| **Total investments at amortised cost** | **10 732 394** | 11 780 934 |
| Maximum exposure to credit risk | **10 732 394** | 11 780 934 |
| Current | **10 732 394** | 11 780 934 |

Stage 1 with no movement between stages

12-month ECL of R8.7 million (1 March 2018: R9.5 million)

* *Financial investments were classified as held to maturity measured at amortised cost in 2018. Under IFRS 9, these financial instruments met the criteria to be classified as financial assets measured at amortised cost.*

[1] *Interest-bearing instruments are unlisted instruments with a maturity greater than three months from date of acquisition. This figure comprises South African National Treasury bills. These factors were considered when determining the ECL.*

[2] *Comparatives previously included both interest and capital within additions and maturities respectively. The current year figures show both interest and capital separately, the prior year was amended to reflect this more granular disclosure.*

| R'000 | 2019 | 2018 |
|---|---|---|

## 6. Term deposit investments

| | 2019 | 2018 |
|---|---|---|
| **Term deposit investments** | | |
| Balance at the beginning of the year | 2 528 331 | 6 600 749 |
| Additions | 10 557 000 | 3 153 000 |
| Interest accrued[3] | 442 787 | 474 765 |
| Expected credit loss (ECL) | (2 888) | – |
| Maturities – capital | (3 947 000) | (7 159 000) |
| Maturities – interest accrued[3] | (246 933) | (541 183) |
| **Total term deposit investments[1][2]** | 9 331 297 | 2 528 331 |
| Maximum exposure to credit risk | 9 331 297 | 2 528 331 |
| Current | 9 331 297 | 2 528 331 |

Stage 1 with no movement between stages

12-month ECL of R2.9 million (1 March 2018: R0.7 million)

Term deposits are classified at amortised cost.

*[1] All balances are due by banks and have original maturity dates of more than three months but contractually less than one year. Investments comprise term-to-notice and fixed term instruments. (Refer to note 27.1 Credit Risk Ratings for ratings). These factors were taken into account when determining the ECL.*

*[2] R3.09 billion of the balance serves as security for the guarantee to acquire Mercantile Bank. Refer to note 41.*

*[3] Comparatives previously included both interest and capital within additions and maturities respectively. The current year figures show both interest and capital separately, the prior year was amended to reflect the more granular disclosure.*

## 7. Net loans and advances

| | 2019 | 2018 |
|---|---|---|
| **Maturity analysis** | | |
| **Current (less than 1 year)** | 20 882 862 | 16 718 015 |
| Demand to 1 month | 4 047 202 | 2 132 063 |
| 1 to 3 months | 3 350 098 | 2 870 556 |
| 3 months to 1 year | 13 485 562 | 11 715 396 |
| **Non-current (more than 1 year)** | 34 599 646 | 31 589 925 |
| 1 to 2 years | 14 794 810 | 13 484 033 |
| 2 to 5 years | 19 317 510 | 17 640 835 |
| More than 5 years | 487 326 | 465 057 |
| Total | 55 482 508 | 48 307 940 |
| Loan origination fees | (608 742) | (677 485) |
| Gross loans and advances | 54 873 766 | 47 630 455 |
| Term loans and credit facility | 51 245 519 | 45 616 341 |
| Credit card | 3 628 247 | 2 014 114 |
| Provision for credit impairment (ECL) | (10 364 461) | (5 828 095) |
| **Net loans and advances[1]** | 44 509 305 | 41 802 360 |
| Current | 16 752 698 | 14 466 617 |
| Non-current | 27 756 607 | 27 335 743 |
| **Maximum exposure to credit risk** | | |
| Loans and advances | 55 482 508 | 48 307 940 |
| Retail loan commitments[2] | 911 740 | 796 274 |
| Maximum exposure to credit risk | 56 394 248 | 49 104 214 |

*[1] The bank currently does not hold any loans and advances that are past due but not impaired.*

*[2] There are irrevocable commitments totalling R911.7million (2018: R796.3 million) relating to 64% (2018: 48%) of products that may be drawn down without any credit intervention from Capitec within 1 month. Loan commitments are stage 1, with no movement between stages.*

## 7. Net loans and advances (continued)

The following terminology is used by the bank when discussing the credit quality of loans and advances to clients.

| Loans status | 2019 – Description (IFRS 9) | 2018 – Description (IAS 39) |
|---|---|---|
| Up-to-date | Clients that are fully up to date with their original contractual obligations or amended contractual obligations and rehabilitated post rescheduling, are classified as up-to-date. | Same description applied as detailed under 2019 |
| Arrears | Arrears reflect the outstanding balances, where 1 or more instalments (or part of an instalment on any of the client's loans and advances) remain unpaid after the contractual payment date, that is 1 day past the contractual payment date. The arrears balance therefore includes rescheduled loans when the amended instalment was not paid in full. | Same description applied as detailed under 2019 |
| Rescheduling | Rescheduling refers to an amendment of the original terms of the loan contract, as formally agreed between the bank and the client. Rescheduling is used as a rehabilitation mechanism for clients in arrears who are contacted successfully by centralised collections. It is also used as a proactive mechanism to assist up-to-date clients who contact the bank when wanting to reschedule their loans due to changes in their circumstances. No initiation fee is charged on a rescheduled loan as no new credit is granted. Rescheduled loans do not form part of loan sales. | Same description applied as detailed under 2019 |
| Rehabilitated | Clients with rescheduled loans are deemed to be rehabilitated once they have made contractual payments for 6 months post rescheduling and are up-to-date with their amended contractual obligations. This is supported by statistical analysis. | Same description applied as detailed under 2019 |
| Rescheduled from up-to-date not rehabilitated | These are loans and advances relating to clients that were fully up to date with their original contractual obligations, have contacted the bank to reschedule the original terms of their loan due to a change in their circumstances and have made payment under the rescheduled terms. These loans are up-to-date with their amended contractual obligations post rescheduling but have not yet made payments for 6 consecutive months under the amended contract. | Same description applied as detailed under 2019 |
| Rescheduled from arrears not rehabilitated | These are loans and advances relating to clients that were in arrears and were subsequently rescheduled and have made payment under the rescheduled terms. These clients are up-to-date with their amended contractual obligations but have not yet made payments for six consecutive months under the amended contract. | Same description applied as detailed under 2019 |
| Application for debt review | Clients that apply for debt review are identified as credit impaired, and the related loan classified as stage 3 for the first 6 months following application.<br><br>Clients that applied for debt review more than 6 months ago that are up-to-date are identified as SICR and the related loan classified as stage 2 between 6 to 12 months following application.<br><br>Clients that applied for debt review more than 12 months ago and remained up-to-date; the related loan is classified as stage 1 subject to the SICR assessment. | Clients that applied for debt review were impaired taking into account the historical roll rates for this segment of clients |
| Expected recoveries receivable | The expected recoveries receivable that existed at transition date was disclosed as stage 3. | The net present value of expected future recoveries on loans written off. |
| Stage 1 | These are loans and advances which are up-to-date with no indication of SICR as well as loans that have been rescheduled from up-to-date or arrears and have been rehabilitated. | |
| Stage 2 | These are loans and advances that have raised a SICR flag due to:<br>▪ Unemployment<br>▪ Behaviour score below the threshold<br>▪ Granting score below the threshold<br>▪ A client that has a term loan that is up-to-date but has a credit card in arrears<br><br>Stage 2 also includes loans that are up to 1 month in arrears, as well as loans that applied for debt review more than 6 months ago, but who are performing. | |

| Loans status | 2019 – Description (IFRS 9) | 2018 – Description (IAS 39) |
|---|---|---|
| Stage 3 | These are loans and advances that are more than 1 month in arrears or:<br>▪ have been rescheduled but not yet rehabilitated;<br>▪ where the client has applied for debt review less than 6 months ago;<br>▪ is currently under debt review; or<br>▪ has another legal status (amongst others, under administration). | |
| Write-off | Loans are written off when there is no reasonable expectation of further recovery.<br><br>The bank considers this point to be when the loan has a present value of future recovery of approximately 5%. This is currently estimated based on account status, behavioural score and consecutive missed payments. This current estimate, applied from 1 March 2018, provides a simpler and more reliable method to that intended to be applied at transition, that considered partial write-offs and time since last payment. Refer to note 2.4.1.3. | The earlier of loan balances that have a legal status, e.g. debt review or deceased, handed over or are 3 months or more in arrears, are subsequently written off. |

**Credit risk exposure**

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

## Analysis of net loans and advances by status – 28 February 2019

| | Stage 1 | Stage 2 | | Stage 3 | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 12 month ECL | Lifetime ECL | | Lifetime ECL | | | | | |
| R'000 | Up-to-date | Up-to-date loans with SICR and applied for debt review >6 months | Up to 1 month in arrears | 2 and 3 months in arrears | Re-scheduled from up-to-date (not yet rehabilitated) | Re-scheduled from arrears (not yet rehabilitated) | More than 3 months in arrears, legal statuses and applied for debt review <6 months | Expected recoveries receivable | Total |
| Gross loans and advances | 41 582 114 | 3 764 623 | 1 086 541 | 1 388 736 | 856 394 | 1 271 887 | 4 923 471 | – | 54 873 766 |
| Credit impairment (ECL) | (2 671 379) | (770 597) | (581 911) | (1 097 400) | (344 826) | (534 249) | (4 364 099) | – | (10 364 461) |
| | 38 910 735 | 2 994 026 | 504 630 | 291 336 | 511 568 | 737 638 | 559 372 | – | 44 509 305 |
| ECL coverage % | 6.4 | 20.5 | 53.5 | 79.0 | 40.3 | 42.0 | 88.6 | | 18.9 |

The credit quality of Stage 1 loans is detailed on the pages that follow for this note. The internal credit rating risk buckets used to explain this of low risk, medium risk and high risk are subjectively determined by bucketing accounts by behavioural scores. New loans may be granted to certain high-risk clients, depending on the credit-granting strategy and granting scorecards. The credit quality of Stage 2 loans is reflected in the differentiation of exposure buckets between "Up to 1 month in arrears" and "Up-to-date loans with SICR and applied for debt review more than 6 months ago". The increased ECL coverage ratio detailed above reflects the financial impact of the increased risk. The internal credit rating for the former bucket is high risk due to arrears. For the latter bucket, the internal credit rating is reflected as R1.2 billion low risk, R1.3 billion medium risk and R1.3 billion as high risk. The increased risk resulting from SICR events is detailed in note 3.1.1.

## 7. Net loans and advances (continued)

### Analysis of net loans and advances by status – 1 March 2018

| R'000 | Stage 1 | Stage 2 | | Stage 3 | | | | |
|---|---|---|---|---|---|---|---|---|
| | Up-to-date | Up-to-date loans and advances with SICR and applied for debt review > 6 months | Up to 1 month in arrears | Re-scheduled from up-to-date not re-habilitated | Re-scheduled from arrears not re-habilitated | More than 1 month in arrears, legal statuses, and applied for debt review < 6 months | Expected recoveries receivable | Total |
| Gross loans and advances | 37 152 772 | 4 401 434 | 1 002 862 | 1 085 352 | 1 277 234 | 1 804 528 | 906 273 | 47 630 455 |
| Cumulative provision | (2 674 424) | (1 032 799) | (558 281) | (462 365) | (609 432) | (1 377 463) | – | (6 714 764) |
| Net loans and advances | 34 478 348 | 3 368 635 | 444 581 | 622 987 | 667 802 | 427 065 | 906 273 | 40 915 691 |
| Provision % | 7.2 | 23.5 | 55.7 | 42.6 | 47.7 | 76.3 | | 14.1 |

### Analysis of net loans and advances by status – 28 February 2018

| R'000 | Performing book | | | | | Non-performing book | | |
|---|---|---|---|---|---|---|---|---|
| | Up-to-date | Rescheduled from up-to-date not rehabilitated | Subtotal | Rescheduled from arrears not rehabilitated | Subtotal | Arrears | Expected recoveries receivable | Total |
| Gross loans and advances | 41 661 660 | 1 085 352 | 42 747 012 | 1 277 234 | 44 024 246 | 2 699 936 | 906 273 | 47 630 455 |
| Cumulated provision | (3 234 766) | (188 907) | (3 423 673) | (649 648) | (4 073 321) | (1 754 774) | – | (5 828 095) |
| | 38 426 894 | 896 445 | 39 323 339 | 627 586 | 39 950 925 | 945 162 | 906 273 | 41 802 360 |
| Provision % | 7.8 | 17.4 | 8 | 50.9 | 9.3 | 65.0 | | 12.2 |

### Analysis of gross loans and advances

| | Stage 1 | Stage 2 | Stage 3 | Expected recoveries | Total |
|---|---|---|---|---|---|
| Balance at 1 March 2018 | 37 152 772 | 5 404 296 | 4 167 114 | 906 273 | 47 630 455 |
| Net loan sales[1] | 32 394 884 | (1 020 656) | (405 881) | – | 30 968 347 |
| New loan sales[1] | 43 711 610 | – | – | – | 43 711 610 |
| Loans derecognised (other than write-off)[1] | (11 316 726) | (1 020 656) | (405 881) | – | (12 743 263) |
| Income accrued for the year* | 13 777 786 | 1 118 324 | 740 927 | – | 15 637 037 |
| ***Transfers*** | | | | – | – |
| Stage 1 to Stage 2 | (5 278 256) | 5 278 256 | – | – | – |
| Stage 1 to Stage 3 | (6 799 033) | – | 6 799 033 | – | – |
| Stage 2 to Stage 3 | – | (1 746 142) | 1 746 142 | – | – |
| Stage 3 to Stage 2 | – | 327 089 | (327 089) | – | – |
| Stage 3 to Stage 1 | 785 419 | – | (785 419) | – | – |
| Stage 2 to Stage 1 | 1 855 634 | (1 855 634) | – | – | – |
| Repayments | (32 306 735) | (2 654 190) | (2 226 618) | (906 273) | (38 093 816) |
| Write-offs | (357) | (179) | (1 267 721) | – | (1 268 257) |
| Balance at 28 February 2019 | 41 582 114 | 4 851 164 | 8 440 488 | – | 54 873 766 |

* *The income accrued for the year comprises interest received on loans, initiation fees, monthly service fees and gross insurance income.*
[1] *New loan sales include new loans issued on consolidating loans. The loans settled are disclosed separately.*

### Modifications on loans and advances – 28 February 2019

| R'000 | Amortised cost before modification | Net modification loss |
|---|---|---|
| Debt review | 1 797 483 | 668 263 |
| | 1 797 483 | 668 263 |

### Credit quality of gross loans and advances shown in up to date

| R'000 | 2019 Stage 1 | 2018 IAS 39 |
|---|---|---|
| Up-to-date[1] | **38 929 565** | 39 440 767 |
| Up-to-date – rescheduled from up-to-date[2] | **1 897 304** | 1 228 460 |
| Up-to-date – rescheduled from arrears[2] | **755 245** | 992 433 |
| | **41 582 114** | 41 661 660 |

[1] *Based on internal credit ratings, the up-to-date book of R38.9 billion is rated as R25.1 billion low risk, R12.3 billion as medium risk and R1.5 billion as high risk.*
[2] *The up-to-date – rescheduled from up-to-date and fully rehabilitated book is rated as R1.1 billion low risk and R0.8 billion medium risk. The up-to-date – rescheduled from arrears and fully rehabilitated book is rated as medium risk.*

## 7. Net loans and advances (continued)

**Factors impacting and contributing to significant changes in the ECL during the current period:**

- Net new loan sales of R31.0 billion contributed to R4.0 billion to the ECL at 28 February 2019.
- The stage 1 up-to-date book increased by 12% compared to 1 March 2018 while up-to-date loans with SICR and applied for debt review between 6 and 12 months ago decreased by 14% from R4.4 billion to R3.8 billion.
- Total arrears from 1 to 3 months in stages 2 and 3 decreased to R2.5 billion while the net loans and advances grew by 9%.
- The total up-to-date loans rescheduled from up-to-date and arrears less than 6 months ago (not yet rehabilitated) in stage 3 decreased by 10%, thereby decreasing the stage 3 ECL.
- The factors set out above resulted in more loans in lower risk buckets, reducing ECL coverage by 1%. Overall ECL coverage, however, increased by 5% compared to 1 March 2018 due to the bank implementing a new write-off policy on transition to IFRS 9. Loans are written off when there is no reasonable expectation of recovery. This has resulted in loans remaining on book for a longer period, increasing stage 3 loans by R4.9 billion. These loans have an ECL coverage ratio of 89%.

The impact of forward-looking information on the ECL was R361 million.

### Analysis of impairment allowance

### Requirement to describe what factors impact the ECL (continued)

| | Stage 1 | Stage 2 | Stage 3 | Unidentified impairment | Identified impairment | Total |
|---|---|---|---|---|---|---|
| At 1 March 2017 | | | | 4 011 869 | 1 918 508 | 5 930 377 |
| Provision for doubtful debts raised | | | | 61 452 | (163 734) | (102 282) |
| Balance at 28 February 2018 | | | | 4 073 321 | 1 754 774 | 5 828 095 |
| Change in initial application of IFRS 9 | 2 674 424 | 1 591 080 | 2 449 260 | (4 073 321) | (1 754 774) | 886 669 |
| Restated balance at 1 March 2018 | 2 674 424 | 1 591 080 | 2 449 260 | | | 6 714 764 |
| ***Movement in the income statement*** | | | | | | |
| New loan sales | 1 643 069 | 780 057 | 1 780 375 | | | 4 203 502 |
| Transfer from stage 1 to stage 2 | (139 488) | 349 039 | – | | | 209 552 |
| Transfer from stage 1 to stage 3 | (360 255) | – | 2 622 389 | | | 2 262 134 |
| Transfer from stage 2 to stage 3 | – | (493 610) | 1 052 741 | | | 559 131 |
| Transfer from stage 2 to stage 1 | 72 252 | (388 034) | – | | | (315 782) |
| Transfer from stage 3 to stage 1 | 41 222 | – | (302 060) | | | (260 838) |
| Transfer from stage 3 to stage 2 | – | 63 399 | (143 947) | | | (80 548) |
| Remain in same stage | (507 050) | (93 607) | 394 511 | | | (206 146) |
| Loans and advances settled in current year | (915 565) | (408 951) | (346 073) | | | (1 670 589) |
| Write-offs | (26 208) | (147 461) | (476 342) | | | (650 010) |
| Stage 3 interest not recognised | – | – | (1 016 166) | | | (1 016 166) |
| Change in model assumptions and methodology | 188 977 | 100 595 | 325 885 | | | 615 458 |
| **Balance at 28 February 2019** | **2 671 379** | **1 352 508** | **6 340 574** | | | **10 364 461** |

| R'000 | 2019 | 2018 |
|---|---|---|

## 8. Other receivables

| R'000 | 2019 | 2018 |
|---|---|---|
| **Financial receivables** | **1 416 026** | 572 470 |
| Deposits | **33 248** | 33 363 |
| SARB settlement balance | **991 691** | 211 710 |
| Other receivables | **345 334** | 327 397 |
| Funeral income receivable | **45 753** | – |
| **Non-financial receivables** | **223 402** | 142 035 |
| Prepayments[1] | **223 402** | 142 035 |
| **Total other receivables** | **1 639 428** | 714 505 |
| Current | **1 619 106** | 711 062 |
| Non-current | **20 322** | 3 443 |
| **Maximum exposure to credit risk** | **1 639 428** | 714 505 |

[1] *Prepayments refer to monthly rental paid in advance and client cards inventory.*

## 9. Net insurance receivable[1]

| R'000 | 2019 | 2018 |
|---|---|---|
| Opening balance | **245 204** | 255 360 |
| Net insurance income[3] | **794 977** | 873 524 |
| Interest on investment | **25 275** | 22 214 |
| Distribution paid to the bank | **(829 065)** | (905 894) |
| | **236 391** | 245 204 |
| **Net insurance income** | | |
| Residual from cell captive business after reinsurance[2] | **794 977** | 873 524 |
| **Net insurance income** | **794 977** | 873 524 |
| Current | **236 391** | 245 204 |
| Non-current | **–** | – |

[1] *The amount receivable from the insurer represents the right to the residual interest in the cell captive reduced by distributions declared by the cell captive insurer on the specific class of preference shares held by the bank.*
[2] *The residual from the cell captive business after insurance represents net results after premiums received, claims paid and reinsurance paid.*
[3] *Insurance profit is received from the cell captive as a dividend after tax. The tax expense on insurance profit is included in net insurance income and for the financial year ended February 2019.*

## 10. Derivative assets

| R'000 | 2019 | 2018 |
|---|---|---|
| Derivatives[1], [2] | **479** | 129 |
| Other | **–** | – |
| | **479** | 129 |
| Current | **(21)** | 129 |
| Non-current | **500** | – |

[1] *Refer to notes 38 and 39 for more information on derivatives.*
[2] *The amount represents the maximum exposure to credit risk.*

| R'000 | 2019 | 2018 |
|---|---|---|

## 11. Financial assets – equity instruments at FVOCI (Available-for-sale financial assets)*

| | | |
|---|---|---|
| **Unlisted securities**[1] | | |
| Balance at the beginning and end of the year | 100 000 | 100 000 |
| **Total financial assets – equity instruments at FVOCI** | 100 000 | 100 000 |

* *The investment was classified as available-for-sale in 2018, but upon transition to IFRS 9, the classification was changed to FVOCI with no fair value movements being recycled to the income statement.*

(1) *Capitec Bank is a participant in a consortium that recapitalised African Bank. The other members of the consortium comprise the Public Investment Corporation and five other South African banks.*

## 12. Group loans receivable

| R'000 | 2019 | 2018 |
|---|---|---|
| Loan to share incentive trust | 4 716 | 8 510 |
| Loan to fellow subsidiary[1] | 313 284 | 159 145 |
| Loans owing from holding company | 13 465 | 14 755 |
| **Total group loans receivable** | 331 465 | 182 410 |
| Current | 331 465 | 182 410 |
| Non-current | – | – |

(1) *All loans to bank companies are repayable on demand, bear interest as agreed by the parties from time to time and no fixed repayment terms have been set.*

Stage 1 with no movement between stages. Refer to note 29.

## 13. Equipment

| R'000 | Computer equipment | Office equipment and vehicles | Total |
|---|---|---|---|
| **2019** | | | |
| Opening net book value | **862 741** | **745 843** | **1 608 584** |
| Additions | **471 552** | **238 559** | **710 111** |
| Disposals | **(10 065)** | **(8 228)** | **(18 293)** |
| Depreciation charge | **(213 351)** | **(223 154)** | **(436 505)** |
| **Net book value at the end of the year** | **1 110 877** | **753 020** | **1 863 897** |
| Cost | **2 246 374** | **1 428 703** | **3 675 077** |
| Accumulated depreciation | **(1 135 497)** | **(675 683)** | **(1 811 180)** |
| **Net book value at the end of the year** | **1 110 877** | **753 020** | **1 863 897** |
| Non-current | **1 110 877** | **753 020** | **1 863 897** |
| **2018** | | | |
| Opening net book value | 772 193 | 641 580 | 1 413 773 |
| Additions | 316 931 | 311 725 | 628 656 |
| Disposals | (3 524) | (10 731) | (14 255) |
| Depreciation charge | (222 859) | (196 731) | (419 590) |
| **Net book value at the end of the year** | 862 741 | 745 843 | 1 608 584 |
| Cost | 1 848 411 | 1 355 040 | 3 203 451 |
| Accumulated depreciation | (985 670) | (609 197) | (1 594 867) |
| **Net book value at the end of the year** | 862 741 | 745 843 | 1 608 584 |
| Non-current | 862 741 | 745 843 | 1 608 584 |

## 14. Intangible assets

| R'000 | Computer software[1] | Internally generated intangible assets[2] | Total |
|---|---|---|---|
| **2019** | | | |
| Opening net book value | **283 011** | **–** | **283 011** |
| Additions | **213 403** | **16 724** | **230 127** |
| Disposals | **(474)** | **–** | **(474)** |
| Amortisation charge | **(196 381)** | **–** | **(196 381)** |
| **Net book value at the end of the year** | **299 559** | **16 724** | **316 283** |
| Cost | **776 204** | **16 724** | **792 928** |
| Accumulated amortisation | **(476 645)** | **–** | **(476 645)** |
| **Net book value at the end of the year** | **299 559** | **16 724** | **316 283** |
| **2018** | | | |
| Opening net book value | 279 946 | – | 279 946 |
| Additions | 142 943 | – | 142 943 |
| Disposals | – | – | – |
| Amortisation charge | (139 878) | – | (139 878) |
| **Net book value at the end of the year** | 283 011 | – | 283 011 |
| Cost | 587 935 | – | 587 935 |
| Accumulated amortisation | (304 924) | – | (304 924) |
| **Net book value at the end of the year** | 283 011 | – | 283 011 |

*[1] Computer software comprises primarily of main banking infrastructure applications, which are purchased from our respective vendors.*
*[2] Internally generated intangible assets comprise assets under construction relating to SAP software, expected to be completed in 2023. Refer to note 33 for commitments.*

## 15. Deferred income tax asset

| R'000 | Impairments, provisions and accruals | Cash flow hedge | Capital allowances | Prepayments | Total |
|---|---|---|---|---|---|
| **2019** | | | | | |
| Balance at the beginning of the year | **471 610** | **10 298** | **(45 090)** | **(19 882)** | **416 936** |
| IFRS 9 transitional adjustment | **770 490** | **–** | **–** | **–** | **770 490** |
| Income statement charge | **427 129** | **–** | **(19 317)** | **(4 987)** | **402 825** |
| Debited to equity through other comprehensive income | **–** | **(6 669)** | **–** | **–** | **(6 669)** |
| **Balance at the end of the year[1]** | **1 669 229** | **3 629** | **(64 407)** | **(24 869)** | **1 583 582** |
| **2018** | | | | | |
| Balance at the beginning of the year | 510 232 | 4 464 | (39 494) | (16 932) | 458 270 |
| Income statement charge | (38 622) | – | (5 596) | (2 950) | (47 168) |
| Debited to equity through other comprehensive income | – | 5 834 | – | – | 5 834 |
| **Balance at the end of the year[1]** | 471 610 | 10 298 | (45 090) | (19 882) | 416 936 |
| Estimated to be recovered in 1 year | | | | | – |
| Estimated to be recovered after 1 year | | | | | 1 583 582 |
| | | | | | 1 583 582 |

*[1] Deferred income taxes are calculated on all temporary differences under the liability method using an effective tax rate of 28% (2018: 28%). The deferred tax assets are stated at the rate at which the assets are expected to be realised and are fully recoverable.*

## 16. Retail deposits and wholesale funding

| R'000 | 2019 | 2018 |
|---|---|---|
| **Retail funding** | | |
| **By maturity** | | |
| Within 1 month | 46 470 518 | 36 050 140 |
| 1 to 3 months | 2 719 456 | 2 332 182 |
| 3 months to 1 year | 10 641 494 | 9 297 982 |
| 1 to 2 years | 4 624 199 | 3 463 227 |
| 2 to 5 years | 6 909 618 | 6 680 967 |
| **Deposits[1]** | 71 365 285 | 57 824 498 |
| **Wholesale funding** | | |
| **By maturity** | | |
| Within 1 month | 69 066 | 93 504 |
| 1 to 3 months | 303 124 | 660 627 |
| 3 months to 1 year | 1 948 044 | 1 055 117 |
| 1 to 2 years | 1 559 473 | 2 196 385 |
| 2 to 5 years | 1 147 362 | 2 145 452 |
| More than 5 years | 51 259 | 54 641 |
| **Bonds[1]** | 5 078 328 | 6 205 726 |
| **By nature** | | |
| **Retail funding** | | |
| Retail call savings | 45 140 650 | 34 908 877 |
| Retail fixed deposits | 26 224 635 | 22 915 621 |
| | 71 365 285 | 57 824 498 |
| **Wholesale funding[3]** | | |
| Subordinated debt – unlisted bonds | 508 640 | 552 889 |
| Subordinated debt – listed bonds[2] | 1 336 980 | 1 928 971 |
| Listed senior bonds[2] | 2 737 447 | 2 738 062 |
| Unlisted negotiable instruments | 396 490 | 885 622 |
| Other wholesale funding | 98 771 | 100 182 |
| | 5 078 328 | 6 205 726 |
| **Total retail deposits and wholesale funding** | 76 443 613 | 64 030 224 |

## 16. Retail deposits and wholesale funding (continued)

| Description | Nominal amount | Issue date | Term | Rate |
|---|---|---|---|---|
| **Subordinated debt analysis** | | | | |
| Subordinated debt – unlisted bonds – floating rate | R500 million[3] | 2012/07/06 | 7 years | 3-month JIBAR plus 4.75% |
| Subordinated debt – listed bonds – floating rate | R400 million[3] | 2012/08/23 | 7 years | 3-month JIBAR plus 4.49% |
| Subordinated debt – listed bonds – fixed rate | R350 million | 2012/08/23 | 7 years | R204 government bond plus 4.60% |
| Subordinated debt – listed bonds – floating rate | R572 million[3] | 2012/12/14 | 7 years | 3-month JIBAR plus 4.49% |
| **Listed senior bonds analysis** | | | | |
| Senior debt – listed bonds – fixed rate | R450 million | 2013/05/06 | 7 years | R208 government bond plus 2.50% |
| Senior debt – listed bonds – floating rate | R500 million[3] | 2015/11/02 | 5 years | 3-month JIBAR plus 2.60% |
| Senior debt – listed bonds – fixed rate | R500 million | 2016/05/06 | 5 years | R208 government bond plus 2.40% |
| Senior debt – listed bonds – floating rate | R250 million[3] | 2016/05/06 | 3 years | 3-month JIBAR plus 2.20% |
| Senior debt – listed bonds – floating rate | R500 million[3] | 2017/05/12 | 3 years | 3-month JIBAR plus 2.00% |
| Senior debt – listed bonds – floating rate | R500 million[3] | 2018/05/21 | 3 years | 3-month JIBAR plus 1.53% |
| **Unlisted negotiable instruments analysis** | | | | |
| Negotiable certificate of deposit – fixed rate | R100 million | 2016/08/08 | 3 years | 3-year mid swap plus 1.60% |
| Negotiable certificate of deposit – fixed rate | R21 million | 2017/02/13 | 3 years | 3-year mid swap plus 1.50% |
| Negotiable certificate of deposit – fixed rate | R6 million | 2017/03/09 | 3 years | 3-year mid swap plus 1.70% |
| Negotiable certificate of deposit – fixed rate | R46 million | 2017/06/08 | 5 years | 5-year mid swap plus 2.40% |
| Floating rate note | R100 million[3] | 2017/11/24 | 3 years | 3-month JIBAR plus 1.60% |
| Negotiable certificate of deposit – fixed rate | R33 million | 2018/01/22 | 5 years | 5-year mid swap plus 2.00% |
| Negotiable certificate of deposit – fixed rate | R12 million | 2018/03/09 | 3 years | 3-year mid swap plus 1.50% |
| Negotiable certificate of deposit – fixed rate | R22 million | 2018/03/09 | 1 year | 1-year mid swap plus 1.00% |
| Negotiable certificate of deposit – fixed rate | R41 million | 2018/04/10 | 5 years | 5-year mid swap plus 2.00% |
| Negotiable certificate of deposit – fixed rate | R5 million | 2018/04/10 | 3 years | 3-year mid swap plus 1.50% |
| Negotiable certificate of deposit – fixed rate | R4 million | 2018/04/10 | 1 year | 1-year mid swap plus 1.00% |
| **Other wholesale funding analysis** | | | | |
| Bilateral loan – fixed rate | R90 million | 2004/01/12 | 20 years | Fixed rate of 11% NACM |

(1) *All deposits and bonds are unsecured.*
(2) *Comprises notes listed on Capitec Bank's DMTN programme registered on the JSE's interest rate board.*
(3) *Wholesale funding issued at variable rates is hedged through interest rate swap agreements as set out in notes 20 and 39. The nominal value of hedged funding totals R3 322 million and consists of:*

| | |
|---|---|
| *Subordinated debt – unlisted bonds* | *R500 million* |
| *Subordinated debt – listed bonds* | *R972 million* |
| *Listed senior bonds* | *R1 750 million* |
| *Unlisted negotiable instruments* | *R100 million* |

**Reconciliation of movements in cash flows arising from financing activities**

| | *Subordinated debt – unlisted* | *Subordinated debt – listed* | *Senior listed bonds* | *Total* |
|---|---|---|---|---|
| *Opening balance at 1 March 2018* | *552 889* | *1 928 971* | *2 738 062* | *5 219 922* |
| *Instruments issued* | *–* | *–* | *500 000* | *500 000* |
| *Instruments redeemed* | *(44 000)* | *(575 000)* | *(500 000)* | *(1 119 000)* |
| *Interest expense accrued* | *62 887* | *203 531* | *266 310* | *532 728* |
| *Swap interest accrued* | *(730)* | *(3 368)* | *(13 054)* | *(17 152)* |
| *Interest paid* | *(62 406)* | *(217 154)* | *(253 871)* | *(533 431)* |
| ***Balance at 28 February 2019*** | ***508 640*** | ***1 336 980*** | ***2 737 447*** | ***4 583 067*** |
| *Other funding (Operating activities: unlisted negotiable instruments and other wholesale funding)* | | | | *495 261* |
| ***Total wholesale funding*** | | | | ***5 078 328*** |

| R'000 | 2019 | 2018 |
|---|---|---|

## 17. Other liabilities

| R'000 | 2019 | 2018 |
|---|---|---|
| Trade payables | **1 035 795** | 937 974 |
| Dividends payable | **3 786** | 5 293 |
| Accruals | **847 977** | 766 739 |
| Share option and share appreciation rights accrual (notes 36 and 37) | **655 670** | 468 877 |
| **Total other liabilities** | **2 543 228** | 2 178 883 |
| Current | **1 998 594** | 1 699 838 |
| Non-current | **544 634** | 479 049 |

## 18. Provisions

| R'000 | 2019 | 2018 |
|---|---|---|
| **Performance incentive scheme[(1)]** | | |
| Balance at the beginning of the year | **66 835** | 81 024 |
| Addition | **67 741** | 46 107 |
| Used during the year | **(43 571)** | (60 296) |
| **Balance at the end of the year** | **91 005** | 66 835 |
| Non-current | **91 005** | 66 835 |

[(1)] *Senior management qualify for a cash-settled performance bonus scheme. The scheme rewards managers based on the growth in headline earnings per share and, in order to foster a long-term approach by management, the bonus is paid out over a 3-year period. The bonuses that have been earned and will be paid out in the 2021 and 2022 financial years are included in provisions. The bonus to be paid in the 2020 financial year is included in accruals.*

| R'000 | 2019 | 2018 |
|---|---|---|

## 19. Share capital and premium

| | | |
|---|---|---|
| **Authorised** | | |
| **Ordinary shares** | | |
| 5 000 000 000 shares of R0.01 each | **50 000** | 50 000 |
| **Non-redeemable, non-cumulative, non-participating preference shares**[1] | | |
| 100 000 000 shares of R0.01 each | **1 000** | 1 000 |
| **Compulsorily convertible or written-off, non-redeemable, non-cumulative, non-participating preference shares**[2] | | |
| 100 000 000 shares of R0.01 each | **–** | – |
| **Loss absorbent preference shares (conversion)**[2] | | |
| 100 000 000 shares of R0.01 each | **1 000** | 1 000 |
| **Loss absorbent preference shares (write-off)**[2] | | |
| 100 000 000 shares of R0.01 each | **1 000** | 1 000 |
| | **53 000** | 53 000 |
| **Issued** | | |
| 1 300 000 (2018: 1 300 000) shares of R0.01 each at par | **13** | 13 |
| Share premium | **6 105 968** | 6 105 968 |
| **Ordinary share capital and premium** | **6 105 981** | 6 105 981 |
| 904 049 (2018: 1 249 707) shares of R0.01 each at par | **9** | 12 |
| Share premium | **81 594** | 112 791 |
| **Non-redeemable, non-cumulative, non-participating preference share capital and premium**[1] | **81 603** | 112 803 |
| **Total issued share capital and premium** | **6 187 584** | 6 218 784 |

[1] *The preference shares carry a coupon rate of 83.33% of the prime rate on a face value of R100 per share. The base value of preference shares phasing out in terms of Basel 3 is R258 969 000. At year-end, 68.48% (2018: 56.45%) of these shares had been repurchased as they no longer contributed to qualifying regulatory capital.*

[2] *Effective 9 July 2015 the authorised share capital of Capitec Bank was increased from R52 million to R53 million by the creation of 100 000 000 loss absorbent preference shares (write-off) with a par value of R0.01 each. In addition, the authorised, but unissued compulsorily convertible or written-off, non-redeemable, non-cumulative, non-participating preference shares was substituted for 100 000 000 loss absorbent preference shares (conversion) with a par value of R0.01 each.*

| R'000 | 2019 | 2018 |
|---|---|---|

## 20. Cash flow hedge reserve

| | 2019 | 2018 |
|---|---|---|
| Balance at the beginning of the year | **(26 737)** | (11 736) |
| Amount recognised in other comprehensive income during the year | **5 009** | 59 116 |
| Amount reclassified from other comprehensive income and included in profit and loss for the year | **18 809** | (79 951) |
| | **(2 919)** | (32 571) |
| Deferred tax recognised in other comprehensive income during the year | **(6 669)** | 5 834 |
| **Balance at the end of the year[1]** | **(9 588)** | (26 737) |

*[1] The hedging reserve is released to the income statement on realisation of the interest expense on the hedged items. The hedged items comprise floating rate DMTN bonds, unlisted floating rate subordinated debt, a Rand denominated bi-lateral loan and negotiable floating rate notes ('FRNs'). Refer to notes 16 and 39 for additional disclosure.*

## 21. Net lending, investment and insurance income

| | 2019 | 2018 |
|---|---|---|
| **Interest income** | | |
| Loans and advances | **11 934 172** | 12 438 989 |
| Loan origination fees | **787 560** | 775 807 |
| Non-bank money market placements | **185** | 568 |
| Money market funds and term deposit investments | **1 729 494** | 1 522 756 |
| Treasury bills | **1 743** | 21 972 |
| Bank balances | **2 028** | 6 058 |
| Resale agreements | **127 220** | 79 658 |
| Debentures | **–** | 1 517 |
| Interest-bearing instruments[3] | **917 262** | 625 851 |
| **Total interest income** | **15 499 664** | 15 473 176 |
| **Loan fee income** | | |
| Monthly service fee | **931 470** | 919 328 |
| Net insurance income[1] | **794 977** | 873 524 |
| **Total loan fee and insurance income** | **1 726 447** | 1 792 852 |
| **Total lending, investment and insurance income** | **17 226 111** | 17 266 028 |
| **Interest expense** | | |
| Retail savings | **(1 839 676)** | (1 626 026) |
| Retail fixed deposits | **(2 068 356)** | (1 813 130) |
| Other unlisted wholesale | **(8 693)** | (79 824) |
| Subordinated debt | **(266 418)** | (297 452) |
| Domestic medium term notes | **(266 310)** | (283 035) |
| Negotiable deposits | **(57 339)** | (82 468) |
| Other | **(2 757)** | (2 514) |
| **Total interest expense** | **(4 509 549)** | (4 184 449) |
| **Loan fee expense[2]** | **(219 768)** | (412 867) |
| **Total lending, investment and insurance expense** | **(4 729 317)** | (4 597 316) |
| **Net lending, investment and insurance income** | **12 496 794** | 12 668 712 |

*[1] Refer to Note 9. Credit life insurance net income on the 3rd party cell captive for loans issued subsequent to 6 May 2016.*
*[2] Credit life insurance cost on the 1st party cell captive for loans issued prior to May 2016.*
*[3] Interest-bearing instruments includes Treasury Bills with maturity of greater than 3 months.*

| R'000 | 2019 | 2018 |
|---|---|---|

## 22. Dividend income

| | 2019 | 2018 |
|---|---|---|
| Investments at fair value through profit or loss | **287** | – |
| | **287** | – |

## 23. Credit impairments

| | 2019 | 2018 |
|---|---|---|
| Bad debts | **1 268 257** | 6 662 691 |
| Movement in provision of credit impairments[(1)] | **3 649 162** | (102 282) |
| Bad debts recovered[(2)] | **(467 174)** | (1 280 419) |
| **Net impairment charge** | **4 450 245** | 5 279 990 |

[(1)] *The movement in provision for credit impairments is disclosed in note 7.*
[(2)] *Bad debts recovered include R6.1 million in recoveries on loans written off after 1 March 2018.*

## 24. Operating expenses

The following more significant items are included in operating expenses:

| | 2019 | 2018 |
|---|---|---|
| Loss/(profit) on disposal on plant and equipment | **9 142** | (585) |
| Loss on scrapping of intangibles | **474** | – |
| Depreciation on plant and equipment | **436 505** | 419 590 |
| Amortisation of computer software | **196 381** | 139 878 |
| | **642 502** | 558 883 |
| Advertising and marketing | **219 961** | 198 882 |
| Bank charges | **308 238** | 257 054 |
| Consumables | **272 645** | 239 581 |
| Communications | **196 030** | 204 573 |
| Security expense | **304 827** | 258 553 |
| Information technology | **327 636** | 259 170 |
| Operating lease rentals | | |
| Land and buildings | **505 052** | 462 877 |
| Office equipment | **39** | 929 |
| | **505 091** | 463 806 |
| Income from subletting | **(2 285)** | (2 224) |
| Auditors' remuneration | | |
| Audit fees | **14 785** | 5 873 |
| Other services | **555** | 2 589 |
| | **15 340** | 8 462 |
| Employee costs | | |
| Salaries and bonus costs | **3 472 106** | 2 995 857 |
| Cash-settled share-based payment | **255 707** | 138 657 |
| Cash-settled share appreciation rights | **188 712** | 107 567 |
| Social security cost | **108 860** | 99 344 |
| Training cost | **76 160** | 60 075 |
| Training refund | **(6 511)** | (5 701) |
| | **4 095 034** | 3 395 799 |

| R'000 | 2019 | 2018 |
|---|---|---|

## 25. Income tax expense

| | 2019 | 2018 |
|---|---|---|
| Current tax | **2 121 593** | 1 608 821 |
| Deferred tax | **(402 826)** | 47 168 |
| **Income tax expense** | **1 718 767** | 1 655 989 |
| Effective tax rate (%) | **25** | 27 |

The tax on the profit before tax differs from the theoretical amount that would arise using the basic normal company tax rate as follows:

| | 2019 | 2018 |
|---|---|---|
| **Operating profit before tax** | **6 850 828** | 6 049 501 |
| Tax calculated at a tax rate of 28% | **1 918 232** | 1 693 860 |
| Adjustments for prior period | **75 000** | – |
| Income not subject to tax[(1)] | **(236 734)** | (355) |
| Expenses not deductible for tax purposes[(2)] | **719** | – |
| Allowances not in income statement[(3)] | **(38 450)** | (37 516) |
| **Income tax expense** | **1 718 767** | 1 655 989 |

*(1) This relates to exempt income in the form of dividends received from both the credit life insurance and funeral insurance cell captive arrangements.*
*(2) Donations.*
*(3) Other permanent differences in the form of learnership agreements.*

## 26. Dividends

The company declared the following dividends for the current and previous financial years:

| | Rand | Declared | LDT | Date paid |
|---|---|---|---|---|
| **2019** | | | | |
| Ordinary dividend | | | | |
| Interim | **728 450** | **27 Sep 2018** | **16 Oct 2018** | **22 Oct 2018** |
| Final[(1)] | **1 295 022** | **26 Mar 2019** | **15 Apr 2019** | **23 Apr 2019** |
| Special dividend | **15 000** | **26 Mar 2018** | **–** | **29 Mar 2018** |
| Special dividend | **124 683** | **14 Jun 2018** | **–** | **15 Jun2018** |
| Special dividend | **54 743** | **3 Sep 2018** | **–** | **10 Sep 2018** |
| Preference dividend | | | | |
| Interim | **4 999** | **31 Aug 2018** | **18 Sep 2018** | **25 Sep 2018** |
| Final | **3 786** | **28 Feb 2019** | **18 Mar 2019** | **25 Mar 2019** |
| **2018** | | | | |
| Ordinary dividend | | | | |
| Interim | 607 042 | 27 Sep 2017 | 17 Oct 2017 | 23 Oct 2017 |
| Final | 1 092 675 | 26 Mar 2018 | 17 Apr 2018 | 23 Apr 2018 |
| Preference dividend | | | | |
| Interim | 6 730 | 31 Aug 2017 | 19 Sep 2017 | 26 Sep 2017 |
| Final | 5 293 | 28 Feb 2018 | 19 Mar 2018 | 26 Mar 2018 |

*(1) The directors declared a final dividend in respect of 2019 on 27 March 2019 amounting to R1 295 million (2018: R1 093 million). These financial statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as a regulatory appropriation of retained earnings in the year ending 28 February 2019, which is in line with recommended accounting practice.*

## 27. Financial risk management

The board of directors is responsible for risk management and views it as an integral part of providing a responsible return on shareholders' equity.

Note 27 should be read with the sections of the annual report marked as audited in the risk management report from page 22 to 47.

To assist the board, the company is managed through a system of internal controls functioning throughout the entity. Risk awareness pervades every aspect of the business and is the responsibility of each employee of the company. The board established a risk and capital management committee (RCMC) comprising four independent non-executive directors which operates in compliance with a formal charter. The committee assists the board in reviewing the processes followed to identify risk and in assessing the potential impact of identified risks in the company environment.

Specific risks are dealt with in a structured manner by the following sub-committees comprising executives and senior management:

- Credit committee – credit and counterparty risk
- Assets and liability committee (ALCO) – interest rate, market, liquidity, counterparty, currency and capital adequacy risk
- Risk committee – legal, compliance, technology, operational and reputational risk

The bank operates in a structured manner with defined processes and procedures enabling risk assessment within a controlled environment. Accordingly, an assessment of key risks is performed with weightings on impact and probability assigned. Existing controls are assessed, and if necessary, adjusted. Thereafter reports are generated at regular intervals to enable monitoring of risk levels.

## 27.1 Credit risk

Refer to page 28 to 33 of the annual report for the qualitative disclosure of credit risk, marked as audited, as well as note 7.

The bank grants retail loans for which no security is obtained and accordingly the entire balance as per the balance sheet is exposed to credit risk. Exposure to systemic credit risk is regarded as being potentially higher due to the demographic credit characteristics of the client base. However, exposure to single-name concentration credit risk is low due to the nature (smaller average loan sizes) and distribution (numerous individuals across the spectrum of economic sectors and provinces) of the loan book.

Credit risk is managed through every stage of the credit life cycle by following a combination of governance, decision support and business support. Governance includes regulators, industry associations, the bank's financial governance and committees which supports and influences credit strategy. Decision support is a specialist credit risk statistical analysis team that develops credit models and scorecards that are aligned with business strategies and credit risk appetite. Credit risk management is provided by other areas of business to ensure optimisation of the granting, collections and recoveries models and systems.

Measures taken by the bank to limit credit risk to acceptable levels include, inter alia, the application of standard credit acceptance procedures to assess potential clients, daily monitoring of collectible balances at both branch and head office level and monitoring by the RCMC.

The key to consideration regarding credit risk management for the bank, is to maintain the retail lending book within the bank's credit risk appetite through customised acquisition, retention and rehabilitation strategies.

The reason why clients approach credit providers for credit is that they have specific requirements. These requirements include the need for emergency cash, education, second-hand vehicles, and housing.

In order to execute on this solution, we incorporate a comprehensive assessment of the client's behaviour, affordability and source of income. For the assessment, we use information from the credit bureau, bank statements and payslips. We apply 3 parallel disposable income calculations i.e. the NCA affordability calculation, a Capitec client disposable income calculation that maintains conservative buffers and the client's own calculation. We then apply the most stringent of the 3. Branch staff have no credit granting discretion and all exceptions are managed and monitored by a centralised specialist team.

During the loan application process, we present the maximum loan amount, maximum term and maximum instalment to the client. Within these constraints, the client may select any combination that best suits him or her. We encourage clients to take up credit for shorter periods of time and for smaller amounts. This is done through a pricing model that discounts the interest rate in instances where clients select a term that is shorter than the maximum for which they qualify. This is due to the manner in which the pricing for risk model reacts to the lower default rates for such clients.

## 27. Financial risk management (continued)

### 27.1 Credit risk (continued)

When existing clients apply for further credit, we conduct a full credit assessment. If a client qualifies for further credit, it can be extended as a further agreement in addition to the current credit; or the client can have the existing credit consolidated into a new credit agreement. This is only available for clients if instalments are up-to-date on all Capitec loans and to clients who have a satisfactory credit risk.

Our scoring models react to instances where a client repeatedly takes up credit, and when their debt to income ratio becomes too high. In such instances we limit the term and amount of credit offered to clients or we decline the application for credit.

Acquisition and retention strategies are built on the principles of the client's credit behaviour (willingness to pay), affordability and source of income. Rehabilitation strategies are need-driven to assist clients based on their unique circumstances.

Unforeseen circumstances may lead to reduced income or increased expenditure for the client. The circumstances may include:
- employers that reduce overtime and bonuses or place staff on short pay due to difficult economic conditions;
- strikes;
- clients may be forced to change employment at reduced salaries due to poor performance or health problems; or
- financial problems faced by employers.

These instances may result in a client missing an instalment on a loan and being in arrears.

If the client is in arrears due to challenges regarding the client's inability to repay the debt, we either negotiate with the client to either immediately bring the arrears instalments up to date, or we attempt to help and manage the situation through agreeing a course of action with the client by amending the loan agreement (loan reschedule).

The first solution is preferable, as it:
- reduces arrears if the client pays on the same date;
- improves our cash flow;
- helps restore the client to a creditworthy position; and
- limits the overall cost of credit for clients.

Practically, there is a risk that placing too much pressure on clients (such as expecting clients in financial distress to repay 2 instalments in a single month when they cannot afford to do so) can be counter-productive. In such a case, clients could refuse to cooperate, stop communicating with us and stop paying instalments.

We have extensive history that measures the yields we can receive by handing clients over to external debt collectors. We monitor the cash flow yields that we receive from this process against internal collection processes, including rescheduling. We optimise the strategy for different client groups and use handover samples for each strategy to monitor the relative performance and validate the strategy for each client group.

Factors that we consider in delivering the optimal strategy for a client include:
- the risk profile and payment history of the client;
- the arrears status of the client (1 or 89 days in arrears, for example);
- whether the client was rescheduled previously;
- the credit exposure amount;
- free cash flow estimates derived from clients' bank accounts or credit bureau records (salary less debit orders); and
- any information we have about the client's employer.

Depending on a combination of factors, the optimal strategy is to encourage clients with some free cash flow or limited credit exposure to bring arrear instalments up to date; or assist clients that have cash flow difficulty but have good behaviour history, to reduce their instalments and extend the term of the credit agreement (i.e. reschedule). When there is a clear temporary interruption of income such as a strike or a client is on maternity leave, we may allow a reduced instalment for a short period (typically 3 months) with subsequent increased instalments, in order to assist the client through this period (i.e. variable reschedule). We hand over clients and write the loan off, when the problem appears to relate to the clients' unwillingness or inability to pay.

We use system-based rules to limit instances where we allow rescheduling. The rules engine determines whether clients are eligible for rescheduling as well as the maximum term for which the loan can be extended. We do not reschedule all loans that meet our criteria, as this depends on the individual circumstances of each client applying to reschedule. Successfully treating clients that were in arrears increases the overall quality of the loan book, as clients who would otherwise have been written off remain on balance sheet. We do however, treat, monitor and separately disclose the performance of these clients. (See provisions discussed below.)

We monitor the performance and cure rate of reschedules using a segmented approach to ensure that it remains within the bank's risk appetite. Refer to note 7 for reschedule information.

This process allows us to optimise collections and reduce clients' debt levels. Our aim is always to partner with our clients through both good and tough times and act in their best interest.

**Credit risk mitigation**

Interest rate limits and fees for credit agreements were changed on 6 May 2016 by the National Credit Regulator (NCR). Prior to this date, we charged our clients an all –inclusive rate and Capitec insured the loan book against death and retrenchment. We continue to insure our pre- May 2016 loan book through a first party cell captive structure. Following the changes from May 2016, all loans granted that are greater than 6 months require our clients to take out credit life insurance. This protects them against the unfortunate event of retrenchment and in the case of death; there is no claim against their deceased estate for any amount outstanding. We provide our clients with the option to take out the appropriate credit life insurance through a third party cell captive. The exposure within the cell captives is fully re-insured to the reinsurance market except for temporary disability cover which has been retained by the cell captive.

**Measurement of ECL**

The key inputs used for measuring ECL are:

- probability of default (PD);
- loss given default (LGD); and
- exposure at default (EAD).

PD is an estimate of the likelihood of default over a given time horizon. PDs are estimated considering the contractual maturities of exposures and estimated prepayment rates. The estimation is based on current conditions, adjusted to take into account estimates of future conditions that will impact the PD.

The calculation is based on a statistical model that predicts the future repayment performance of clients based on their arrears status, model segment and tenure. Future cash flows and arrears status probabilities are generated from which an expected ECL provision is calculated. The prediction of future repayment is based on observed roll rates over the last 12 months. Roll rates refer to the rates at which clients transition or roll from a repayment status in a given month to a repayment status in the following month.

LGD is an estimate of the loss arising on default. LGD models for unsecured assets consider time of recovery and recovery rates. The calculation is on a discounted cash flow basis.

EAD is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on committed facilities.

## 27. Financial risk management (continued)

### 27.1 Credit risk (continued)

The EAD is calculated by creating an amortisation structure for each account. This structure includes the expected monthly repayment, as well as the projected monthly cumulative repayment status probabilities and the cash flows associated with every repayment status.

The bank's modelling approach for EAD reflects expected changes in the balance outstanding over the lifetime of the loan exposure that are permitted by the current contractual terms, such as amortisation profiles, early repayment or overpayment, changes in utilisation of undrawn commitments and credit mitigation actions taken before default. The bank uses EAD models that reflect the characteristics of the portfolios.

#### Impairment – Measurement of the expected credit loss (ECL)

The developing and measuring of the bank's processes for measuring ECL, including the monitoring of significant increases in credit risk (SICR), the incorporation of economic forward looking information and the methods used to calculate ECL and ensuring that polices and procedures are in place to appropriately maintain and validate models used to measure ECL, are overseen by the bank's credit committee. The internal audit function performs regular audits to ensure that established controls and procedures are both adequately designed and implemented.

#### Impairment implementation

***Staged approach to the determination of ECL***

IFRS 9's ECL model requires the classification and measurement of ECL using the general model for loans and advances measured at amortised cost. In essence, the general model is a three stage model. Capitec has interpreted the three stages as being up-to-date (stage 1), up-to-date loans with SICR and loans up to 1 month in arrears (stage 2) and credit impaired (stage 3). Loans and advances within stage 1 are measured based on a 12 month ECL and a lifetime ECL is determined for loans and advances within stage 2 and stage 3.

***Significant increase in credit risk (SICR)***

The bank considers reasonable and supportable information based on the bank's historical experience, credit risk assessment and forward-looking information (including macro-economic factors) when determining whether the credit risk (i.e. the risk of default) of loans and advances has increased significantly since initial recognition. The assessment of SICR is key in determining when to move from measuring an impairment provision based on a 12 month ECL to one that is based on a lifetime ECL (the move from stage 1 to stage 2). The bank's ECL framework aligns with the bank's credit granting strategy.

#### SICR

As disclosed in note 2.4, the bank monitors financial debt instruments subject to impairment requirements at each reporting date to determine whether evidence exists that there has been a significant increase in credit risk (SICR) since initial recognition of the financial instrument. If there has been a significant increase in credit risk the bank will measure the loss allowance based on lifetime rather than 12-month ECL.

In terms of IFRS 9, all loans and advances exposures are assessed at each reporting date (monthly) to determine whether there has been a SICR, in which case an impairment provision equal to the lifetime expected loss is recognised. If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, the bank measures the impairment provision at an amount equal to the 12 month ECL. The bank identifies SICR for clients that are up-to-date on their loans, but who have reached certain behaviour risk thresholds or where specific events have occurred that raise a SICR flag. The 12 month ECL is extended to a lifetime ECL for these clients.

The bank has set certain behaviour and granting score thresholds which are used to identify a significant increase in credit risk.

The purpose of the behaviour score in the ECL model is to provide a measure of an existing client's propensity to default on a loan within 12 months. The score was built on a client level, utilising Capitec loans and savings account information, as well as the credit exposure and repayment behaviour at external credit providers. The behaviour score is updated monthly on all existing loan clients to ensure that Capitec has a consistently updated view of the client.

The updated granting score in the ECL model aims to provide an assessment of SICR on a collective basis for groups of exposure that share similar credit characteristics in order to account for forward-looking information that may not be identified at an individual loan level.

The updated granting view is simply a reinterpretation of the information available at granting date and is not an updated view on the client. Updated client information is incorporated in the behaviour score.

The SICR thresholds are reviewed on an annual basis to ensure that they are able to identify SICR throughout the lifetime of the loan.

**Incorporation of forward-looking information**

It is a fundamental principle of IFRS 9 that the ECL impairment provision that the bank holds against potential future credit losses should not only depend on the health of the economy presently, but should take into account changes to the economic environment in the future.

To capture the effects of changes to the economic environment in the future, the forward-looking model considers economic variables specific to South Africa that directly impacts the bank's clients. The bank utilises the Bureau of Economic Research (BER) macro-economic outlook for the country over a planning horizon of at least 3 years. The outlook is provided to the asset and liability committee (ALCO) for review and approval. Refer to note 3.

***Write-off policy***

Under IAS 39, loans and advances were written off at the earlier of loan balances that were more than 3 months in arrears or had a legal status, e.g. debt review or handed over. An expected recovery receivable was raised at the write-off-point.

Under IFRS 9, loans can only be written off when there is no reasonable expectation of recovery. The bank therefore applies write-off for loans when the present value of projected future recoveries is less than 5% of the gross balance before write-off. Refer to note 2.4.1.3.

All recoveries after full write-off are recognised as bad debts recovered.

The bank only invests centrally managed cash surpluses and liquidity buffers in cash and liquid assets with the SARB, National Treasury, South African registered banking entities and money market funds of high credit standing. Potential exposure to concentration credit risk exists principally in cash and cash equivalents, financial investments and term deposit investments (notes 4, 5 and 6). Concentrations are controlled using ALCO recommended limits which are monitored and enforced by the credit committee, and monitored and approved by the RCMC. This ensures that the financial assets that the bank may place with any one counterparty are limited, by reference to the long-term and short-term credit ratings assigned for that counterparty by Moody's.

## 27. Financial risk management (continued)

### 27.1 Credit risk (continued)

**Credit quality of investments**

At financial year end date the international long-term credit ratings, using Moody's ratings, were as follows:

| R'000 | Notes | Aaa to A3 | Baa1 to Baa3 | Below Baa3 | Not rated | Adjustment[5] | Total carrying amount |
|---|---|---|---|---|---|---|---|
| **2019** | | | | | | | |
| Cash on hand | 4 | – | 3 601 994 | – | – | – | 3 601 994 |
| Bank balances[1] | 4 | 2 | 13 222 413 | – | 114 | (4 281) | 13 218 248 |
| Resale agreements | 4 | – | 10 605 141 | – | 506 222 | (34) | 11 111 329 |
| Short-term corporate bills | 4 | – | – | – | – | – | – |
| Central bank balances[3] | 4 | – | 1 163 650 | – | – | – | 1 163 650 |
| Treasury bills (<3 months) | 4 | – | – | – | – | – | – |
| Money market funds[2] | 4 | – | – | – | 35 496 | – | 35 496 |
| Treasury bills (>3 months) | 5 | – | 10 741 057 | – | – | (8 663) | 10 732 394 |
| Negotiable certificates of deposit (>3 months) | 5 | – | – | – | – | – | – |
| Term deposit investments[4] | 6 | 811 086 | 8 413 100 | 110 000 | – | (2 889) | 9 331 297 |
| SARB settlement and other receivables | 8 | – | 991 691 | – | 345 334 | – | 1 337 025 |
| Net insurance receivable | 9 | – | 236 391 | – | – | – | 236 391 |
| Derivative assets | 39 | – | 479 | – | – | – | 479 |
| | | 811 088 | 48 975 916 | 110 000 | 887 166 | (15 867) | 50 768 303 |
| **2018** | | | | | | | |
| Cash on hand | 4 | – | 3 472 067 | – | – | – | 3 472 067 |
| Bank balances[1] | 4 | 25 275 | 15 658 357 | – | 58 | – | 15 683 690 |
| Resale agreements | 4 | – | 4 363 010 | – | 403 672 | – | 4 766 682 |
| Central bank balances[3] | 4 | – | 1 137 659 | – | – | – | 1 137 659 |
| Money market funds[2] | 4 | – | – | – | 20 750 | – | 20 750 |
| Treasury bills (>3 months) | 5 | – | 11 625 523 | – | – | – | 11 625 523 |
| Negotiable certificates of deposit (>3 months) | 5 | – | 155 412 | – | – | – | 155 412 |
| Term deposit investments[4] | 6 | 1 303 077 | 1 225 254 | – | – | – | 2 528 331 |
| Other receivables | 8 | – | 211 710 | – | 327 397 | – | 539 107 |
| Net insurance receivable | 9 | – | 245 204 | – | – | – | 245 204 |
| Derivative assets | 39 | 129 | – | – | – | – | 129 |
| | | 1 328 481 | 38 094 195 | – | 751 877 | – | 40 174 554 |

[1] *The bank balances were with 9 institutions (2018: 8), with the maximum exposure to one institution being R13 057 million (2018: R8 092 million)*
[2] *Money market funds consist of money market unit trusts. The placements were with 5 institutions (2018: 3).*
[3] *All central bank balances are with the SARB and includes the mandatory reserve deposit requirement.*
[4] *The balance is the maximum exposure to credit risk.*
[5] *The adjustment relates to ECL. The credit ratings determine the ECL raised.*

## 27.2 Interest rate risk

The exposure to interest rate risk is managed within board approved tolerances. These tolerances are monitored at RCMC and ALCO and escalated according to tolerance bands. The current bank interest rate profile is monitored by ALCO, which meets monthly and considers the results of management's analysis of the impact of interest rates on the bank, including inter alia, the results of various models. The risk arising from volatility in interest rates is lower on a relative basis when compared to other risks in the business due to the higher net interest income margin earned on the retail unsecured lending portfolio.

Capitec's interest rate risk position is primarily the result of offering fixed-rate retail term loans and a conservative liquidity strategy. Interest rate management has a number of drivers including mismatches in the repricing of assets and liabilities, changes in yield curve risk, optionality inherent in certain products and basis risk.

ALCO only allows derivatives for the hedging of interest rate risk in the funding book. Interest rate swaps are used to convert floating-rate funding to fixed-rate funding with the objective of economically matching fixed rate assets with fixed rate liabilities and floating rate assets with floating rate liabilities. The nominal amounts and the payment dates of the hedging instrument (interest rate swaps) match the hedged item (floating-rate liabilities) exactly from the origination of the hedge and as a consequence there is 100% hedge effectiveness.

Forward foreign-exchange contracts are used to cover obligations relating to capital equipment, technology and technology support services needed for core banking activities.

### Cash flow interest rate risk

Cash, cash equivalents, money market funds and term deposit investments are invested in a mix of instruments earning a fixed rate of interest and those paying interest based on a floating rate. The bank has discretion over the rates paid on its demand savings deposits and pays a fixed interest on its fixed term retail deposits. Wholesale funding comprise a mix of floating and fixed rate instruments. The bank's most significant financial asset, loans and advances, which are carried at amortised cost, are exposed to fixed rates.

The bank actively manages interest rate risk by minimising its exposure to fixed rate financial assets by in part cash flow hedging elements of its variable rate funding book to a fixed rate. Interest rate swaps have the economic effect of converting floating rate debt to fixed rate debt. The net unmatched position, resulting from the bank's exposure to variable rate funding from its retail deposits, exposes the bank to cash flow interest rate risk

### Compliance with the prescribed maximum interest rates

The NCA prescribes the ceilings for the maximum interest rates that may be charged for retail lending. The bank operates within the ambit of the NCA ceilings when pricing its retail loans and advances to clients.

### Sensitivity analysis

The ALCO meets monthly and considers the results of management's analysis of the impact of interest rates on the bank which includes, inter alia, the results of various models and the impact of interest rate strategy on the gross margin.

The sensitivity analysis below is a run-off analysis and reflects the impact of a 200 basis point increase or decrease in the South African interest rate environment:

- Immediately following the reporting date for a period of 1 year
- Considering the contractual maturity buckets of financial assets and liabilities, with fixed interest rate instruments becoming variable on maturity
- Including notional derivative cash flows, included in repricing maturity buckets

| | Impact on income statement | |
|---|---|---|
| **200 basis points** | **2019** | **2018** |
| **R'000** | **Pre-tax** | **Pre-tax** |
| Increase | **(111 408)** | (84 695) |
| Decrease | **111 408** | 84 695 |

## 27. Financial risk management (continued)

### 27.3 Currency risk

The exposure to foreign currency purchase risk relating to the importation of capital equipment, technology and technology support services needed for the core banking activities is managed through the purchase of forward foreign exchange contracts.

### 27.4 Other market risk

Market prices and rates typically include equity, bond and commodity prices, currency exchange and interest rates. Our exposure to market risk is mainly due to interest rate risk arising on the retail banking activities.

### 27.5 Liquidity risk

The bank manages liquidity cautiously with a low appetite for liquidity risk and operates a conservative maturity profile which is monitored by ALCO in terms of an approved Asset and Liability Management (ALM) policy. The maturity profile reflects the deliberate strategy of funding longer-term assets with a significant portion of long-term funding with limited use of core call deposit funding. Our conservative approach at times results in the holding of cash in excess of immediate operational requirements. Funding that is surplus to operational requirements is managed in terms of the liquidity philosophy to ensure that obligations can be met as they become due without incurring unacceptable losses.

The table below analyses the bank's assets and liabilities into maturity groupings based on the remaining period, at statement of financial position date, to the contractual maturity date. The table was prepared on the following basis:

- Asset and liability cash flows are presented on an undiscounted basis with an adjustment to reflect the total discounted result.
- The cash flows of floating rate financial instruments are calculated using published forward market rates at statement of financial position date.
- The cash flows of the derivative financial instruments are included on a gross basis.
- Contractual cash flows with respect to items which have not yet been recorded on the statement of financial position are excluded. Refer to note 33.
- Conditionally revocable retail loan commitments totalling R911.7 million (2018: R796.3 million) are not included in the liquidity analysis above. The commitments are a result of undrawn loan amounts. The loans are advanced with a contractual repayment period of one month or less.
- The bank's contractual commitment is revocable should a client not meet their contractual obligations or where the bank has determined that the client's credit risk profile has changed. A total of 64.0% (2018: 48.1%) of these commitments is expected to be drawn down within one month. As these are one month loans, repayment of any future draw downs must also occur within the month.
- Adjustments to loans and advances to clients relate to initiation fee income.
- Non-cash liabilities, representing leave pay and the straight-lining of operating leases, are disclosed as adjustments to trade and other payables.

Refer to pages 22 to 47 of the annual report for more on management's objectives, policies and processes for managing risk.

## 27.5 Liquidity risk (continued)

| Maturities of financial assets and financial liabilities[1][2] - R'000 | Note | Demand to 1 month | 1 to 3 months | 3 months to 1 year | More than 1 year | Adjustment[3] | Total |
|---|---|---|---|---|---|---|---|
| **2019** | | | | | | | |
| **Undiscounted assets** | | | | | | | |
| Cash and cash equivalents – sovereigns | 4 | 1 163 650 | – | – | – | – | 1 163 650 |
| Cash and cash equivalents – banks | 4 | 22 524 242 | 5 494 806 | – | – | (4 315) | 28 014 733 |
| Short-term corporate bills | 4 | – | – | – | – | – | – |
| Money markets unit trusts – corporate other | 4 | 35 496 | – | – | – | – | 35 496 |
| Financial investments – sovereigns & banks[4] | 5 | 1 471 610 | 1 728 260 | 7 936 690 | – | (8 663) | 11 127 897 |
| Term deposit investments | 6 | 24 403 | 1 102 809 | 8 586 860 | – | (2 889) | 9 711 183 |
| Financial assets – equity instruments at FVOCI | 11 | – | – | – | 100 000 | – | 100 000 |
| Loans and advances to clients – retail personal | 7 | 5 223 786 | 5 496 816 | 21 748 562 | 56 585 656 | (608 742) | 88 446 078 |
| Loans and advances to clients - corporate other | 7 | 23 372 | – | – | – | – | 23 372 |
| Other receivables | 8 | 1 195 889 | 115 080 | 84 734 | 20 323 | – | 1 416 026 |
| Net insurance receivable | 9 | – | – | 236 391 | – | – | 236 391 |
| Derivative assets | 10 | – | 59 | (83) | 575 | – | 551 |
| Group loans receivable | 12 | 331 465 | – | – | – | – | 331 465 |
| Current income tax asset | | – | – | 286 046 | – | – | 286 046 |
| **Undiscounted assets** | | 31 993 913 | 13 937 830 | 38 879 200 | 56 706 554 | (624 609) | 140 892 888 |
| Adjustments for undiscounted assets | | (1 218 922) | (2 273 769) | (8 975 530) | (21 986 086) | – | (34 454 307) |
| **Discounted assets** | | | | | | | |
| Loan impairment provision ECL | 7 | (3 021 694) | (563 073) | (2 038 570) | (4 741 124) | – | (10 364 461) |
| **Total discounted assets** | | 27 753 297 | 11 100 988 | 27 865 100 | 29 979 344 | (624 609) | 96 074 120 |
| **Undiscounted liabilities** | | | | | | | |
| Retail deposits | 16 | 46 497 972 | 2 866 125 | 11 495 083 | 14 022 798 | – | 74 881 978 |
| Wholesale funding | 16 | 72 154 | 371 916 | 2 222 196 | 3 034 663 | – | 5 700 929 |
| Current income tax liabilities | | – | – | – | – | – | – |
| Trade and other payables | 17 | 1 107 102 | 743 587 | 147 905 | 305 354 | 239 280 | 2 543 228 |
| Derivative liability | | 272 | 2 599 | 7 389 | 5 316 | – | 15 576 |
| Provisions | 18 | – | – | – | 91 005 | – | 91 005 |
| **Undiscounted Liabilities** | | 47 677 500 | 3 984 227 | 13 872 573 | 17 459 136 | 239 280 | 83 232 716 |
| Adjustments for undiscounted liabilities to depositors | | (30 544) | (215 494) | (1 128 074) | (2 766 055) | – | (4 140 167) |
| **Total discounted liabilities** | | 47 646 956 | 3 768 733 | 12 744 499 | 14 693 081 | 239 280 | 79 092 549 |
| **Net liquidity excess/(shortfall)[5]** | | (18 705 281) | 9 390 530 | 22 968 057 | 34 506 294 | (863 889) | 47 295 711 |
| **Cumulative liquidity excess/(shortfall)[1]** | | (18 705 281) | (9 314 751) | 13 653 306 | 48 159 600 | 47 295 711 | 47 295 711 |

## 27. Financial risk management (continued)

### 27.5 Liquidity risk (continued)

| Maturities of financial assets and financial liabilities[1][2] – R'000 | Note | Demand to 1 month | 1 to 3 months | 3 months to 1 year | More than 1 year | Adjustment[3] | Total |
|---|---|---|---|---|---|---|---|
| **2018** | | | | | | | |
| **Undiscounted assets** | | | | | | | |
| Cash and cash equivalents – sovereigns | 4 | 1 137 659 | – | – | – | – | 1 137 659 |
| Cash and cash equivalents – banks | 4 | 17 758 859 | 6 237 218 | – | – | – | 23 996 077 |
| Money markets unit trusts – corporate other | 4 | 20 750 | – | – | – | – | 20 750 |
| Financial investments – sovereigns and banks[4] | 5 | 200 000 | 2 754 240 | 9 241 211 | – | – | 12 195 451 |
| Term deposit investments | 6 | 120 173 | 1 062 131 | 1 404 658 | – | | 2 586 962 |
| Available-for-sale financial assets | 11 | – | – | – | 100 000 | – | 100 000 |
| Loans and advances to clients – retail personal | 7 | 3 107 374 | 4 899 080 | 19 590 006 | 51 520 902 | (677 485) | 78 439 877 |
| Loans and advances to clients – corporate other | 7 | 27 018 | – | – | – | – | 27 018 |
| Other receivables | 8 | 432 321 | 107 351 | 29 355 | 3 443 | – | 572 470 |
| Net insurance receivable | 9 | – | – | 245 204 | – | – | 245 204 |
| Derivative assets | 10 | – | 58 | 75 | – | – | 133 |
| Group loans receivable | 12 | 182 409 | – | – | – | – | 182 409 |
| Current income tax asset | | – | – | 107 154 | – | – | 107 154 |
| **Undiscounted assets** | | 22 986 563 | 15 060 078 | 30 617 663 | 51 624 345 | (677 485) | 119 611 164 |
| Adjustments for undiscounted assets | | (1 012 529) | (2 140 774) | (8 298 949) | (19 930 977) | – | (31 383 229) |
| **Discounted assets** | | | | | | | |
| Provision for doubtful debts | 7 | (558 587) | (282 284) | (1 129 994) | (3 857 230) | – | (5 828 095) |
| **Total discounted assets** | | 21 415 447 | 12 637 020 | 21 188 720 | 27 836 138 | (677 485) | 82 399 840 |
| **Undiscounted liabilities** | | | | | | | |
| Retail deposits | 16 | 36 074 638 | 2 463 316 | 10 065 863 | 12 634 549 | – | 61 238 366 |
| Wholesale funding | 16 | 97 009 | 741 558 | 1 447 674 | 4 960 805 | – | 7 247 046 |
| Trade and other payables | 17 | 1 067 761 | 578 784 | 53 293 | 244 277 | 234 772 | 2 178 887 |
| Derivative liability | | 13 117 | 4 651 | 15 507 | 21 168 | – | 54 443 |
| Provisions | 18 | – | – | – | 66 835 | – | 66 835 |
| **Undiscounted liabilities** | | 37 252 525 | 3 788 309 | 11 582 337 | 17 927 634 | 234 772 | 70 785 577 |
| Adjustments for undiscounted liabilities to depositors | | (28 004) | (212 127) | (1 161 145) | (3 056 990) | – | (4 458 266) |
| **Total discounted liabilities** | | 37 224 521 | 3 576 182 | 10 421 192 | 14 870 644 | 234 772 | 66 327 311 |
| **Net liquidity excess/(shortfall)[5]** | | (14 824 549) | 10 989 485 | 17 905 332 | 29 839 481 | (912 257) | 42 997 492 |
| **Cumulative liquidity excess/(shortfall)[1]** | | (14 824 549) | (3 835 064) | 14 070 268 | 43 909 749 | 42 997 492 | 42 997 492 |

[1] *Much of the liquidity shortfall in the demand to three month categories results from the investment of excess cash in treasury bills and SARB debentures with maturities in excess of three months (financial investments – sovereigns). These instruments are highly liquid and can be converted to cash should the need arise. In addition, term deposits may also be liquidated to fund the shortfall.*

[2] *The definitions of sovereign, corporate and retail are aligned with the Banks Act Regulations.*

[3] *The adjustment includes adjustments to deferred initiation fees, leave pay provision, deferred income, the straight-lining of lease accruals.*

[4] *100% of financial investments – sovereigns and banks relates to investments in sovereigns.*

[5] *Calculated as undiscounted assets net of loan impairment provision ECL less undiscounted liabilities.*

## 27.5 Liquidity risk (continued)

| Maturities of financial assets and financial liabilities – R'000 | Note | 1 to 2 years | 3 to 4 years | 3 to 4 years | 4 to 5 years | 5 to 10 years | More than 10 years | Total |
|---|---|---|---|---|---|---|---|---|
| **2019** | | | | | | | | |
| **Undiscounted assets** | | | | | | | | |
| Loans and advances to clients – retail personal | 7 | 22 553 892 | 15 635 163 | 9 885 115 | 5 734 241 | 2 777 245 | – | 56 585 656 |
| Other receivables | 8 | 14 140 | 2 061 | 2 061 | 2 061 | – | – | 20 323 |
| Net insurance receivable | 9 | – | – | – | – | – | | – |
| Financial assets – equity instruments at FVOCI | 11 | – | – | – | – | – | 100 000 | 100 000 |
| Derivative assets | 10 | 295 | 280 | – | – | – | – | 575 |
| Undiscounted assets | | 22 568 327 | 15 637 504 | 9 887 176 | 5 736 302 | 2 777 245 | 100 000 | 56 706 554 |
| Adjustments for undiscounted assets | | (7 759 116) | (5 107 711) | (3 768 120) | (3 061 218) | (2 289 921) | – | (21 986 086) |
| **Discounted assets** | | | | | | | | |
| Loan impairment provision | 7 | (2 266 913) | (1 407 755) | (737 268) | (276 541) | (52 647) | – | (4 741 124) |
| **Total discounted assets** | | 12 542 298 | 9 122 038 | 5 381 788 | 2 398 543 | 434 677 | 100 000 | 29 979 344 |
| **Undiscounted liabilities** | | | | | | | | |
| Retail deposits | 16 | 5 463 116 | 3 674 859 | 2 892 162 | 1 992 661 | – | – | 14 022 798 |
| Wholesale funding | 16 | 1 752 081 | 1 077 257 | 97 809 | 52 142 | 55 374 | | 3 034 663 |
| Trade and other payables | 17 | 167 142 | 60 944 | 51 421 | 18 496 | 7 351 | – | 305 354 |
| Derivative liability | | 5 316 | – | – | – | – | – | 5 316 |
| Provisions | 18 | 54 301 | 30 698 | 2 002 | 2 002 | 2 002 | – | 91 005 |
| Undiscounted Liabilities | | 7 441 956 | 4 843 758 | 3 043 394 | 2 065 301 | 64 727 | – | 17 459 136 |
| Adjustments for undiscounted liabilities to depositors | | (1 032 031) | ( 734 705) | ( 543 701) | ( 451 503) | ( 4 115) | – | (2 766 055) |
| **Total discounted liabilities** | | 6 409 925 | 4 109 053 | 2 499 693 | 1 613 798 | 60 612 | – | 14 693 081 |
| **Net liquidity excess /(shortfall)[5]** | | 12 859 458 | 9 385 991 | 6 106 514 | 3 394 460 | 2 659 871 | 100 000 | 34 506 294 |
| **Cumulative liquidity excess/ (shortfall)** | | 26 512 764 | 35 898 755 | 42 005 269 | 45 399 729 | 48 059 600 | 48 159 600 | 48 159 600 |

## 27. Financial risk management (continued)

### 27.5 Liquidity risk (continued)

| Maturities of financial assets and financial liabilities – R'000 | Note | 1 to 2 years | 2 to 3 years | 3 to 4 years | 4 to 5 years | 5 to 10 years | More than 10 years | Total |
|---|---|---|---|---|---|---|---|---|
| **2018** | | | | | | | | |
| **Undiscounted assets** | | | | | | | | |
| Loans and advances to clients - retail personal | 7 | 20 914 395 | 14 703 010 | 8 970 498 | 4 937 130 | 1 995 869 | – | 51 520 902 |
| Other receivables | 8 | 3 189 | – | – | – | 254 | – | 3 443 |
| Net insurance receivable | 9 | | | | | | | |
| Available-for-sale financial assets | 11 | – | – | – | – | – | 100 000 | 100 000 |
| Derivative assets | 10 | – | – | – | – | – | – | – |
| Undiscounted assets | | 20 917 584 | 14 703 010 | 8 970 498 | 4 937 130 | 1 996 123 | 100 000 | 51 624 345 |
| Adjustments for undiscounted assets | | (7 430 362) | (4 846 618) | (3 295 535) | (2 827 649) | (1 530 813) | – | (19 930 977) |
| **Discounted assets** | | | | | | | | |
| Provision for doubtful debts | 7 | (1 738 024) | (1 174 897) | (609 904) | (234 436) | (99 969) | – | (3 857 230) |
| **Total discounted assets** | | 11 749 198 | 8 681 495 | 5 065 059 | 1 875 045 | 365 341 | 100 000 | 27 836 138 |
| **Undiscounted liabilities** | | | | | | | | |
| Retail deposits | 17 | 4 176 808 | 2 805 969 | 3 004 680 | 2 647 092 | – | – | 12 634 549 |
| Wholesale funding | 17 | 2 554 690 | 1 702 263 | 545 249 | 93 995 | 64 608 | | 4 960 805 |
| Trade and other payables | | 155 033 | 56 934 | 14 586 | 12 722 | 5 002 | – | 244 277 |
| Derivative liability | | 16 195 | 4 973 | – | – | – | – | 21 168 |
| Provisions | 19 | 43 781 | 23 054 | – | – | – | – | 66 835 |
| Undiscounted Liabilities | | 6 946 507 | 4 593 193 | 3 564 515 | 2 753 809 | 69 610 | – | 17 927 634 |
| Adjustments for undiscounted liabilities to depositors | | (1 073 429) | (736 590) | (663 268) | (573 737) | (9 966) | – | (3 056 990) |
| **Total discounted liabilities** | | 5 873 078 | 3 856 603 | 2 901 247 | 2 180 072 | 59 644 | – | 14 870 644 |
| **Net liquidity excess /(shortfall)** | | 12 233 053 | 8 934 920 | 4 796 079 | 1 948 885 | 1 826 544 | 100 000 | 29 839 481 |
| **Cumulative liquidity excess/ (shortfall)** | | 26 303 321 | 35 238 241 | 40 034 320 | 41 983 205 | 43 809 749 | 43 909 749 | 43 909 749 |

### 27.6 Gains and losses per category of financial assets and financial liabilities

| R'000 | Note | At fair value through profit and loss | | At amortised cost | | |
|---|---|---|---|---|---|---|
| | | Deemed held for trading | Designated at initial recognition | Financial assets | Financial liabilities | Total |
| **2019** | | | | | | |
| Interest income | 21 | – | – | **15 499 664** | – | **15 499 664** |
| Interest expense | 21 | – | – | – | **(4 509 549)** | **(4 509 549)** |
| Loan fee income and net insurance income | 21 | – | – | **1 726 447** | – | **1 726 447** |
| Loan fee expense | 21 | – | – | **(219 768)** | – | **(219 768)** |
| Transaction fee income | | – | – | – | **8 473 959** | **8 473 959** |
| Transaction fee expense | | – | – | – | **(2 009 669)** | **(2 009 669)** |
| Credit impairment losses | 23 | – | – | **(4 450 245)** | – | **(4 450 245)** |
| **2018** | | | | | | |
| Interest income | 21 | – | – | 15 473 176 | – | 15 473 176 |
| Interest expense | 21 | – | – | – | (4 184 449) | (4 184 449) |
| Loan fee income and net insurance income | 21 | – | – | 1 792 852 | – | 1 792 852 |
| Loan fee expense | 21 | – | – | (412 867) | – | (412 867) |
| Transaction fee income | | – | – | – | 6 925 526 | 6 925 526 |
| Transaction fee expense | | – | – | – | (1 798 483) | (1 798 483) |
| Credit impairment losses | 23 | – | – | (5 279 990) | – | (5 279 990) |

## 27. Financial risk management (continued)

### 27.7 Fair value hierarchy and classification of financial assets and financial liabilities

**Valuation processes**

*Determination on fair values and valuation processes*

Fair values are market-based, calculated first with reference to observable inputs available in the market, then less observable and finally unobservable inputs only where observable inputs or less observable inputs are unavailable.

Fair values are calculated consistent with the unit of account used for the measurement of the asset or liability in the statement of financial position and income statement and assume an orderly market on a going concern basis.

The company's finance department performs the valuations of financial assets and liabilities required for financial reporting purposes. Selecting the most appropriate valuation methods and techniques, in terms of IFRS 13, is an outcome of internal discussion and deliberation between members of the finance team who have modelling and valuation experience. The valuations are reported to the chief financial officer (CFO) and audit committee (AC). Changes in fair values are analysed at each reporting date.

**Hierarchy of fair value of financial instruments**

IFRS 13 defines a hierarchy of valuation techniques, with 3 levels, for fair value measurements of assets and liabilities. This hierarchy is based on the extent to which the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources and unobservable inputs reflect the company's assessment of what inputs would likely be from the perspective of the market. The company first considers relevant and observable market inputs where these are available. Unobservable inputs are used in the absence of observable inputs. The company's policy is to recognise transfers into and transfers out of fair value hierarchy levels as of the date of the event or change in circumstances that caused the transfer. There were no transfers between levels 1, 2 and 3 during the year.

The fair value hierarchy is applied to both those assets and liabilities measured at fair value through profit and loss and those measured using amortised cost. The table below summarises the classification of financial assets and financial liabilities and their fair values.

## 27.7 Fair value hierarchy and classification of financial assets and financial liabilities (continued)

| R'000 | Notes | At fair value through other comprehensive income/profit and loss: Financial assets | At fair value through other comprehensive income/profit and loss: As hedging instrument | At amortised cost: Financial assets | At amortised cost: Financial liabilities | Total | Fair value | Hierarchy of valuation technique |
|---|---|---|---|---|---|---|---|---|
| **2019** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash, cash equivalents and money market funds | 4 | – | – | 29 130 717 | – | 29 130 717 | 29 130 717 | (2) |
| Financial investments (Held-to-maturity investments)* | 5 | – | – | 10 732 394 | – | 10 732 394 | 10 732 394 | (2) |
| Financial assets – equity instruments at FVOCI (Available-for-sale financial assets)* | 11 | 100 000 | – | – | – | 100 000 | 100 000 | Level 3 |
| Term deposit investments[3] | 6 | – | – | 9 331 297 | – | 9 331 297 | 9 331 297 | (2) |
| Net loans and advances | 7 | – | – | 44 509 305 | – | 44 509 305 | 44 702 714 | Level 3 |
| Net insurance receivable | 9 | – | – | 236 391 | – | 236 391 | 236 391 | |
| Other receivables | 8 | – | – | 1 416 026 | – | 1 416 026 | 1 416 026 | (2) |
| Derivative assets[1] | 10 | – | 479 | – | – | 479 | 479 | Level 2 |
| Bank loans receivable | 12 | – | – | 331 465 | – | 331 465 | 331 465 | (2) |
| **Financial liabilities** | | | | | | | | |
| Deposits and bonds | 16 | – | – | – | 76 443 613 | 76 443 613 | 76 770 498 | Level 2 |
| – Listed bonds | | – | – | – | 4 074 427 | 4 074 427 | 4 148 126 | |
| – Other fixed term institutional deposits | | – | – | – | 1 003 901 | 1 003 901 | 1 017 918 | |
| – Retail deposits | | – | – | – | 71 365 285 | 71 365 285 | 71 604 454 | |
| Derivative liabilities[1] | 38, 39 | – | 14 704 | – | – | 14 704 | 14 704 | Level 2 |
| Trade and other payables[2] | 17 | – | | – | 2 543 228 | 2 543 228 | 2 543 228 | (2) |
| **2018** | | | | | | | | |
| **Financial assets** | | | | | | | | |
| Cash, cash equivalents and money market funds | 4 | – | – | 25 080 848 | – | 25 080 848 | 25 080 848 | (2) |
| Held-to-maturity investments | 5 | – | – | 11 780 934 | – | 11 780 934 | 11 780 934 | (2) |
| Available for sale investment | 11 | 100 000 | – | – | – | 100 000 | 100 000 | Level 3 |
| Term deposit investments | 6 | – | – | 2 528 331 | – | 2 528 331 | 2 528 331 | (2) |
| Net loans and advances | 7 | – | – | 41 802 360 | – | 41 802 360 | 44 147 508 | Level 3 |
| Other receivables | 8 | – | – | 572 470 | – | 572 470 | 572 470 | (2) |
| Net insurance receivable | 9 | – | – | 245 204 | – | 245 204 | 245 204 | |
| Derivative assets[1] | 10 | – | 129 | – | – | 129 | 129 | Level 2 |
| Bank loans receivable | 12 | – | – | 182 410 | – | 182 410 | 182 410 | (2) |
| **Financial liabilities** | | | | | | | | |
| Deposits and bonds | 16 | – | – | – | 64 030 224 | 64 030 224 | 64 499 536 | Level 2 |
| – Listed bonds | | – | – | – | 4 667 033 | 4 667 033 | 4 807 323 | |
| – Other fixed term institutional deposits | | – | – | – | 1 538 693 | 1 538 693 | 1 574 236 | |
| – Retail deposits | | – | – | – | 57 824 498 | 57 824 498 | 58 117 977 | |
| Derivative liabilities[1] | 38, 39 | – | 51 365 | – | – | 51 365 | 51 365 | Level 2 |
| Trade and other payables[2] | 17 | – | – | – | 2 178 883 | 2 178 883 | 2 178 883 | (2) |

* *Denotes classification of financial assets under IAS 39 in the previous reporting period.*
[1] *Cash flow hedges.*
[2] *The fair value of these assets and liabilities closely approximates their carrying amount due to their short-term or on-demand repayment terms.*
[3] *Term deposit investments are short term.*

## 27. Financial risk management (continued)

### 27.8 Fair value calculation methods, inputs and techniques

Fair values of assets and liabilities reported in this note were market-based to reflect the perspective of a market participant.

**Loans and advances to clients**

The expected present value technique was applied, discounting probability weighted cash flows at a discount rate that ensures that no day-one fair value gain or loss arises on new loans. This considers that loans are granted at market related rates at the time of the initiation. In the prior year an adjusted WACC rate was used.

The level 3 fair value disclosed for loans and advances required the use of significant judgement by management in determining what a market-based valuation would be. An income approach was used, which calculated an expected present value in terms of a discount rate for a hypothetical market participant applied to the valuation cash flows. In summary, this approach calculates a discount rate which reflects the cost to the market participant plus that participant's required rate of return on investment.

The cash flows used were probability weighted and were generated by the same model that was used to generate the impairments on loans and advances. The key aspects involving the application of estimation of these cash flows are set out in note 3.2.3.

**Derivative assets and liabilities**

Derivatives, both assets and liabilities, were valued using the income approach. Derivatives comprise interest rate swaps, cross-currency interest rate swaps and forward foreign exchange contracts (FECs). Interest rate swaps were fair valued on a discounted basis using forward interest rates and foreign currency rates extracted from observable yield and foreign currency market curves. FECs were valued using applicable forward rates.

### 27.8 Fair value calculation methods, inputs and techniques (continued)

**Deposits and bonds**

Deposits and bonds comprise liabilities with specified terms for future repayment as well as retail deposits with a call feature which allows them to be withdrawn on demand. The fair value of the retail call deposits closely approximates their carrying amount due to their demand nature. The fair values for instruments with specified future repayment terms were calculated as described below.

*Listed subordinated and senior bonds*

A market approach was used. Calculations used the all-in closing bond prices provided by the Johannesburg Stock Exchange's Interest Rate and Currency (JSE IRC) market. The pricing method used by the JSE IRC links the bond at issue, to a liquid government bond (a companion bond). The companion bond is chosen so as to best fit the characteristics of the Capitec Bank issue, with the time to maturity being the most important factor. Spread information is obtained from market participants and is used to adjust the price subsequent to issue. Very small and very large trades are excluded due to the inherent discounts associated with large trades as well as the premium often charged for odd-lot trades.

*Unlisted wholesale fixed-term deposit and bonds*

These comprised unlisted bonds, unlisted fixed-term negotiable instruments and other unlisted fixed-term wholesale instruments. The income approach was used. Fair values were calculated by discounting the contractual cash flows using publicly quoted closing swap curve rates from a large bank market-maker with a risk premium adjustment to account for non-performance risk. The market rate on the curve was determined with reference to the remaining maturity of the liability.

*Retail fixed-term deposits*

An income approach was used. Fair values were calculated by discounting the contractual cash flows using publicly quoted, closing Capitec Bank fixed-term deposit rates. The relevant rate used was that which matched the remaining maturity of the fixed deposit.

| R'000 | 2019 | 2018 |
|---|---|---|
| **28. Retirement benefits** | | |
| The bank contributed on behalf of all employees who elected to be members of the provident fund. The provident fund, a defined-contribution fund, is administered independently of the bank and is subject to the Pension Funds Act, 1956 (Act 24 of 1956). The amount contributed is included in salaries and bonus cost as per note 24. | **227 894** | 194 272 |

Since 1 July 2001 it is compulsory for all new appointments to be members of the provident fund. The bank will continue to contribute to the fund on behalf of all members. The bank has no exposure in respect of any post-retirement benefits payable.

## 29. Related-party transactions

| R'000 | 2019 | 2018 |
|---|---|---|
| **Holding company** | | |
| **Dividends** | | |
| Ordinary dividend paid | **2 015 551** | 1 631 807 |
| Preference dividend paid | **8 785** | 12 023 |
| **Capitec Bank Holdings Limited (holding company)** | **2 024 336** | 1 643 830 |
| **Management fees paid – Capitec Bank Holdings Limited (holding company)** | **2 201** | 3 704 |
| **Parties with significant shareholding** | | |
| **Income statement charge** | | |
| Interest paid | **8 645** | 6 555 |
| Broker's fees | **248** | 230 |
| **PSG and subsidiaries[1]** | **8 893** | 6 785 |
| **Statement of financial position balance** | | |
| Listed senior bonds | **72 238** | 83 376 |
| Unlisted negotiable instruments | **71 285** | 156 532 |
| **PSG and subsidiaries[1]** | **143 523** | 239 908 |
| **Loans due from:** | | |
| Capitec Bank Holdings Share Trust | **(4 716)** | (8 510) |
| Capitec Properties Proprietary Limited (fellow subsidiary) | **(313 284)** | (159 145) |
| Capitec Bank Holdings Limited (holding company) | **(13 461)** | (14 751) |
| **Guarantee:** | | |
| Capitec Properties Proprietary Limited (fellow subsidiary) | **161 000** | – |
| **Donations** | | |
| Community Keepers[4] | **–** | 2 000 |
| **Key management** | | |
| **Key management employees' remuneration** | | |
| Salaries and other short-term benefits | **80 158** | 76 041 |
| Post-employment benefits | **2 998** | 2 972 |
| Share-based payments | **411 453** | 218 750 |
| **Key management compensation[2]** | **494 609** | 297 763 |
| **Retail deposits from directors and other key management employees[3]** | | |
| Deposits at the beginning of the year | **8 574** | 11 393 |
| Interest earned during the year | **743** | 488 |
| Deposits/(withdrawals) made during the year | **7 922** | (3 307) |
| **Deposits at the end of the year** | **17 239** | 8 574 |

(1) *Transactions requiring the purchase of financial instruments on the open market are conducted through PSG Wealth. PSG Capital is the corporate advisor and sponsor of Capitec Bank Limited.*
(2) *Key management are considered to be the members of the executive management committee (excluding development members and executive directors).*
(3) *Savings and deposits are unsecured, carry variable interest rates and are repayable on demand.*
(4) *A R2 million donation in terms of section 18A was made to Community Keepers, a registered NPO that provides psychological and social services to learners. Our CFO serves as chairman of this organisation.*

### Directors' interest in contracts

All directors of Capitec Bank Limited have given notice that they did not have a material interest in any significant contract with the company or any group company, which could have given rise to a conflict of interest during the year.

### Directors' interest in share capital

At year-end, the directors, did not hold directly or indirectly, beneficially or non-beneficially, any interest in Capitec Bank Limited ordinary or non-redeemable, non-cumulative, non-participating preference shares.

## Directors' remuneration

The total share option expense relating to directors amounted to R115 240 780 (2018: R58 418 362) and share appreciation rights expense amounted to R82 105 694 (2018: R43 965 653). This expense includes the movement on all tranches

| R'000 | Salaries | Fringe benefits | Bonuses | Fees | Total | Fair value of options and rights granted during the year on reporting date |
|---|---|---|---|---|---|---|
| **2019** | | | | | | |
| **Executive**[1] | | | | | | |
| AP du Plessis | **9 106** | **74** | **3 647** | **–** | **12 827** | **3 805** |
| GM Fourie | **11 646** | **30** | **4 651** | **–** | **16 327** | **5 777** |
| NS Mashiya | **4 314** | **44** | **1 718** | **–** | **6 076** | **1 195** |
| **Non-executive** | | | | | | |
| MS du P le Roux | | | | **325** | **325** | **–** |
| LA Dlamini | | | | **660** | **660** | **–** |
| K Makwane | | | | **445** | **445** | **–** |
| DP Meintjes[2] | | | | **84** | **84** | **–** |
| JD McKenzie | | | | **1 165** | **1 165** | **–** |
| NS Mjoli-Mncube | | | | **325** | **325** | **–** |
| PJ Mouton | | | | **685** | **685** | **–** |
| CA Otto | | | | **685** | **685** | **–** |
| R Stassen (Chairman) | | | | **1 390** | **1 390** | **–** |
| JP Verster | | | | **795** | **795** | **–** |
| | **25 066** | **148** | **10 016** | **6 559** | **41 789** | **10 777** |
| **2018** | | | | | | |
| **Executive**[1] | | | | | | |
| AP du Plessis | 8 170 | 77 | 3 118 | – | 11 365 | 1 983 |
| GM Fourie | 10 625 | 329 | 4 049 | – | 15 003 | 3 219 |
| NS Mashiya | 4 001 | 41 | 1 523 | – | 5 565 | 683 |
| **Non-executive** | | | | | | |
| MS du P le Roux | – | – | – | 300 | 300 | – |
| LA Dlamini[3] | – | – | – | 325 | 325 | – |
| K Makwane[4] | – | – | – | 271 | 271 | – |
| JD McKenzie | – | – | – | 670 | 670 | – |
| NS Mjoli-Mncube | – | – | – | 360 | 360 | – |
| PJ Mouton | – | – | – | 480 | 480 | – |
| CA Otto | – | – | – | 670 | 670 | – |
| R Stassen (Chairman) | – | – | – | 1 300 | 1 300 | – |
| JP Verster | – | – | – | 610 | 610 | – |
| | 22 796 | 447 | 8 690 | 4 986 | 36 919 | 5 885 |

[1] *The executive directors are the prescribed officers of the company.*
[2] *Appointed on 28 November 2018.*
[3] *Appointed on 6 April 2017.*
[4] *Appointed on 6 April 2017.*

## 29. Related-party transactions (continued)

### Directors' interest in share incentive scheme – options

| Directors | Maturity date | Issue date | Strike price R | Opening balance Number of share options | (Options exercised)/ options granted Number of share options | Market price R | Exercise date | Closing balance Number of share options |
|---|---|---|---|---|---|---|---|---|
| **2019** | | | | | | | | |
| AP du Plessis | 1 Apr 18 | 11 Apr 12 | 198.52 | 5 000 | (5 000) | 844.00 | 5 Apr 18 | – |
| (direct beneficial) | | 10 Apr 13 | 201.40 | 4 375 | (4 375) | 848.01 | 5 May 18 | – |
| | | 15 Apr 14 | 196.43 | 5 937 | (5 937) | 844.00 | 5 Apr 18 | – |
| | | 1 Apr 15 | 371.88 | 10 937 | (10 937) | 846.00 | 26 Apr 18 | – |
| | | 1 Apr 15 | 371.88 | 6 427 | (6 427) | 848.01 | 5 May 18 | – |
| | 1 Apr 19 | 10 Apr 13 | 201.40 | 4 375 | – | – | – | 4 375 |
| | | 15 Apr 14 | 196.43 | 5 937 | – | – | – | 5 937 |
| | | 1 Apr 15 | 371.88 | 17 363 | – | – | – | 17 363 |
| | | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 29 Mar 20 | 1 Apr 17 | 705.93 | 3 929 | – | – | – | 3 929 |
| | 1 Apr 20 | 1 Apr 15 | 371.88 | 17 363 | – | – | – | 17 363 |
| | | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 28 Mar 21 | 28 Mar 18 | 881.76 | – | 3 781 | – | – | 3 781 |
| | 29 Mar 21 | 1 Apr 17 | 705.93 | 3 929 | – | – | – | 3 929 |
| | 1 Apr 21 | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 28 Mar 22 | 28 Mar 18 | 881.76 | – | 3 780 | – | – | 3 780 |
| | 29 Mar 22 | 1 Apr 17 | 705.93 | 3 928 | – | – | – | 3 928 |
| | 1 Apr 22 | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 28 Mar 23 | 28 Mar 18 | 881.76 | – | 3 780 | – | – | 3 780 |
| | 29 Mar 23 | 1 Apr 17 | 705.93 | 3 928 | – | – | – | 3 928 |
| | 28 Mar 24 | 28 Mar 18 | 881.76 | – | 3 780 | – | – | 3 780 |
| | | | | 115 848 | (17 555) | | | 98 293 |
| GM Fourie | 1 Apr 18 | 11 Apr 12 | 198.52 | 5 000 | (5 000) | 844.00 | 5 Apr 18 | – |
| (direct beneficial) | | 10 Apr 13 | 201.40 | 4 375 | (4 375) | 957.40 | 24 Jul 18 | – |
| | | 15 Apr 14 | 196.43 | 4 583 | (4 583) | 957.40 | 24 Jul 18 | – |
| | | 1 Apr 15 | 371.88 | 22 872 | (22 872) | 844.00 | 5 Apr 18 | – |
| | 1 Nov 18 | 1 Nov 13 | 209.83 | 6 875 | (6 875) | 1 079.54 | 26 Nov 18 | – |
| | 1 Apr 19 | 10 Apr 13 | 201.40 | 4 375 | – | – | – | 4 375 |
| | | 15 Apr 14 | 196.43 | 4 583 | – | – | – | 4 583 |
| | | 1 Apr 15 | 371.88 | 22 872 | – | – | – | 22 872 |
| | | 1 Apr 16 | 473.05 | 9 170 | – | – | – | 9 170 |
| | 1 Nov 19 | 1 Nov 13 | 209.83 | 6 875 | – | – | – | 6 875 |
| | 29 Mar 20 | 1 Apr 17 | 705.93 | 6 377 | – | – | – | 6 377 |
| | 1 Apr 20 | 1 Apr 15 | 371.88 | 22 871 | – | – | – | 22 871 |
| | | 1 Apr 16 | 473.05 | 9 169 | – | – | – | 9 169 |
| | 28 Mar 21 | 28 Mar 18 | 881.76 | – | 5 740 | – | – | 5 740 |
| | 29 Mar 21 | 01 Apr 17 | 705.93 | 6 377 | – | – | – | 6 377 |
| | 1 Apr 21 | 1 Apr 16 | 473.05 | 9 169 | – | – | – | 9 169 |
| | 28 Mar 22 | 28 Mar 18 | 881.76 | – | 5 739 | – | – | 5 739 |
| | 29 Mar 22 | 1 Apr 17 | 705.93 | 6 377 | – | – | – | 6 377 |
| | 1 Apr 22 | 1 Apr 16 | 473.05 | 9 169 | – | – | – | 9 169 |
| | 28 Mar 23 | 28 Mar 18 | 881.76 | – | 5 739 | – | – | 5 739 |
| | 29 Mar 23 | 1 Apr 17 | 705.93 | 6 376 | – | – | – | 6 376 |
| | 28 Mar 24 | 28 Mar 18 | 881.76 | – | 5 739 | – | – | 5 739 |
| | | | | 167 465 | (20 748) | | | 146 717 |

### Directors' interest in share incentive scheme – options (continued)

| | | | | Opening balance | (Options exercised)/ options granted | | | Closing balance |
|---|---|---|---|---|---|---|---|---|
| Directors | Maturity date | Issue date | Strike price R | Number of share options | Number of share options | Market price R | Exercise date | Number of share options |
| **2019** | | | | | | | | |
| NS Mashiya | 1 Nov 18 | 2 Nov 15 | 539.88 | 8 875 | – | – | – | 8 875 |
| (direct beneficial) | 1 Apr 19 | 1 Apr 16 | 473.05 | 1 948 | – | – | – | 1 948 |
| | 1 Nov 19 | 2 Nov 15 | 539.88 | 8 875 | – | – | – | 8 875 |
| | 29 Mar 20 | 1 Apr 17 | 705.93 | 1 354 | – | – | – | 1 354 |
| | 1 Apr 20 | 1 Apr 16 | 473.05 | 1 948 | – | – | – | 1 948 |
| | 1 Nov 20 | 2 Nov 15 | 539.88 | 8 875 | – | – | – | 8 875 |
| | 28 Mar 21 | 28 Mar 18 | 881.76 | – | 1 188 | – | – | 1 188 |
| | 29 Mar 21 | 1 Apr 17 | 705.93 | 1 354 | – | – | – | 1 354 |
| | 1 Apr 21 | 1 Apr 16 | 473.05 | 1 948 | – | – | – | 1 948 |
| | 28 Mar 22 | 28 Mar 18 | 881.76 | – | 1 187 | – | – | 1 187 |
| | 29 Mar 22 | 1 Apr 17 | 705.93 | 1 353 | – | – | – | 1 353 |
| | 1 Apr 22 | 1 Apr 16 | 473.05 | 1 947 | – | – | – | 1 947 |
| | 28 Mar 23 | 28 Mar 18 | 881.76 | – | 1 187 | – | – | 1 187 |
| | 29 Mar 23 | 1 Apr 17 | 705.93 | 1 353 | – | – | – | 1 353 |
| | 28 Mar 24 | 28 Mar 18 | 881.76 | – | 1 187 | – | – | 1 187 |
| | | | | 39 830 | 4 749 | | | 44 579 |
| R Stassen | 1 Apr 18 | 11 Apr 12 | 198.52 | 12 500 | (12 500) | 862.83 | 29 Mar 18 | – |
| (direct beneficial) | | | | | | | | |
| | | | | 12 500 | (12 500) | | | – |
| **Total** | | | | 335 643 | (46 054) | | | 289 589 |

## 29. Related-party transactions (continued)

### Directors' interest in share incentive scheme – share appreciation rights

| Directors | Maturity date | Issue date | SAR exercise price R | Opening balance Number of SARs | (SARs exercised)/ SARs granted Number of SARs | Market price R | Exercise date | Closing balance Number of SARs |
|---|---|---|---|---|---|---|---|---|
| **2019** | | | | | | | | |
| AP du Plessis | 1 Apr 18 | 11 Apr 12 | 198.52 | 5 000 | (5 000) | 874.00 | 25 Apr 18 | – |
| (direct beneficial) | | 10 Apr 13 | 201.40 | 4 375 | (4 375) | 874.00 | 25 Apr 18 | – |
| | | 15 Apr 14 | 0.01 | 2 016 | (2 016) | 874.00 | 25 Apr 18 | – |
| | | 1 Apr 15 | 0.01 | 5 904 | (5 904) | 874.00 | 25 Apr 18 | – |
| | 1 Apr 19 | 10 Apr 13 | 201.40 | 4 375 | – | – | – | 4 375 |
| | | 15 Apr 14 | 0.01 | 2 017 | – | – | – | 2 017 |
| | | 1 Apr 15 | 0.01 | 5 903 | – | – | – | 5 903 |
| | | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 29 Mar 20 | 1 Apr 17 | 705.93 | 3 929 | – | – | – | 3 929 |
| | 1 Apr 20 | 1 Apr 15 | 0.01 | 5 903 | – | – | – | 5 903 |
| | | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 28 Mar 21 | 28 Mar 18 | 881.76 | – | 3 781 | – | – | 3 781 |
| | 29 Mar 21 | 1 Apr 17 | 705.93 | 3 929 | – | – | – | 3 929 |
| | 1 Apr 21 | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 28 Mar 22 | 28 Mar 18 | 881.76 | – | 3 780 | – | – | 3 780 |
| | 29 Mar 22 | 1 Apr 17 | 705.93 | 3 928 | – | – | – | 3 928 |
| | 1 Apr 22 | 1 Apr 16 | 473.05 | 5 605 | – | – | – | 5 605 |
| | 28 Mar 23 | 28 Mar 18 | 881.76 | – | 3 780 | – | – | 3 780 |
| | 29 Mar 23 | 1 Apr 17 | 705.93 | 3 928 | – | – | – | 3 928 |
| | 28 Mar 24 | 28 Mar 18 | 881.76 | – | 3 780 | – | – | 3 780 |
| | | | | 73 627 | (2 174) | | | 71 453 |
| GM Fourie | 1 Apr 18 | 11 Apr 12 | 198.52 | 5 000 | (5 000) | 874.00 | 15 May 18 | – |
| (direct beneficial) | | 10 Apr 13 | 201.40 | 4 375 | (4 375) | 874.00 | 15 May 18 | – |
| | | 15 Apr 14 | 0.01 | 1 556 | (1 556) | 874.00 | 15 May 18 | – |
| | | 1 Apr 15 | 0.01 | 7 777 | (7 777) | 874.00 | 15 May 18 | – |
| | 1 Nov 18 | 1 Nov 13 | 209.83 | 6 875 | (6 875) | 1 090.00 | 23 Nov 18 | – |
| | 1 Apr 19 | 10 Apr 13 | 201.40 | 4 375 | – | – | – | 4 375 |
| | | 15 Apr 14 | 0.01 | 1 557 | – | – | – | 1 557 |
| | | 1 Apr 15 | 0.01 | 7 776 | – | – | – | 7 776 |
| | | 1 Apr 16 | 473.05 | 9 170 | – | – | – | 9 170 |
| | 1 Nov 19 | 1 Nov 13 | 209.83 | 6 875 | – | – | – | 6 875 |
| | 29 Mar 20 | 1 Apr 17 | 705.93 | 6 377 | – | – | – | 6 377 |
| | 1 Apr 20 | 1 Apr 15 | 0.01 | 7 776 | – | – | – | 7 776 |
| | | 1 Apr 16 | 473.05 | 9 169 | – | – | – | 9 169 |
| | 28 Mar 21 | 28 Mar 18 | 881.76 | – | 5 740 | – | – | 5 740 |
| | 29 Mar 21 | 1 Apr 17 | 705.93 | 6 377 | – | – | – | 6 377 |
| | 1 Apr 21 | 1 Apr 16 | 473.05 | 9 169 | – | – | – | 9 169 |
| | 28 Mar 22 | 28 Mar 18 | 881.76 | – | 5 739 | – | – | 5 739 |
| | 29 Mar 22 | 1 Apr 17 | 705.93 | 6 377 | – | – | – | 6 377 |
| | 1 Apr 22 | 1 Apr 16 | 473.05 | 9 169 | – | – | – | 9 169 |
| | 28 Mar 23 | 28 Mar 18 | 881.76 | – | 5 739 | – | – | 5 739 |
| | 29 Mar 23 | 1 Apr 17 | 705.93 | 6 376 | – | – | – | 6 376 |
| | 28 Mar 24 | 28 Mar 18 | 881.76 | – | 5 739 | – | – | 5 739 |
| | | | | 116 126 | (2 626) | | | 113 500 |

**Directors' interest in share incentive scheme – share appreciation rights (continued)**

| Directors | Maturity date | Issue date | SAR exercise price R | Opening balance Number of SARs | (SARs exercised)/ SARs granted Number of SARs | Market price R | Exercise date | Closing balance Number of SARs |
|---|---|---|---|---|---|---|---|---|
| **2019** | | | | | | | | |
| NS Mashiya | 1 Nov 18 | 2 Nov 15 | 0.01 | 3 000 | – | – | – | 3 000 |
| (direct beneficial) | 1 Apr 19 | 1 Apr 16 | 473.05 | 1 948 | – | – | – | 1 948 |
| | 1 Nov 19 | 2 Nov 15 | 0.01 | 3 000 | – | – | – | 3 000 |
| | 29 Mar 20 | 1 Apr 17 | 705.93 | 1 354 | – | – | – | 1 354 |
| | 1 Apr 20 | 1 Apr 16 | 473.05 | 1 948 | – | – | – | 1 948 |
| | 1 Nov 20 | 2 Nov 15 | 0.01 | 3 000 | – | – | – | 3 000 |
| | 28 Mar 21 | 28 Mar 18 | 881.76 | – | 1 188 | – | – | 1 188 |
| | 29 Mar 21 | 1 Apr 17 | 705.93 | 1 354 | – | – | – | 1 354 |
| | 1 Apr 21 | 1 Apr 16 | 473.05 | 1 948 | – | – | – | 1 948 |
| | 28 Mar 22 | 28 Mar 18 | 881.76 | – | 1 187 | – | – | 1 187 |
| | 29 Mar 22 | 1 Apr 17 | 705.93 | 1 353 | – | – | – | 1 353 |
| | 1 Apr 22 | 1 Apr 16 | 473.05 | 1 947 | – | – | – | 1 947 |
| | 28 Mar 23 | 28 Mar 18 | 881.76 | – | 1 187 | – | – | 1 187 |
| | 29 Mar 23 | 1 Apr 17 | 705.93 | 1 353 | – | – | – | 1 353 |
| | 28 Mar 24 | 28 Mar 18 | 881.76 | – | 1 187 | – | – | 1 187 |
| | | | | 22 205 | 4 749 | | | 26 954 |
| R Stassen | 1 Apr 18 | 11 Apr 12 | 198.52 | 12 500 | (12 500) | 900.00 | 28 Mar 18 | – |
| (direct beneficial) | | | | | | | | |
| | | | | 12 500 | (12 500) | | | – |
| **Total** | | | | 224 458 | (12 551) | | | 211 907 |

The executive management committee (excluding development members) are the prescribed offices of the company.

| R'000 | Salaries | Fringe benefits | Bonuses | Total | Fair value of options and rights granted during the year on reporting date |
|---|---|---|---|---|---|
| **2019** | | | | | |
| JC Carstens | 4 591 | 48 | 1 846 | 6 485 | 1 651 |
| W De Bruyn | 6 534 | 74 | 2 617 | 9 225 | 2 730 |
| HAJ Lourens | 5 819 | 61 | 2 330 | 8 210 | 2 431 |
| NST Motjuwadi | 3 163 | 39 | 1 259 | 4 461 | 876 |
| A Olivier | 5 646 | 62 | 2 250 | 7 958 | 2 124 |
| L Venter | 4 953 | 53 | 1 973 | 6 979 | 1 764 |
| F Viviers | 3 033 | 95 | 1 227 | 4 355 | 1 097 |
| | 33 739 | 432 | 13 502 | 47 673 | 12 673 |
| **2018** | | | | | |
| JC Carstens | 4 042 | 46 | 1 537 | 5 625 | 689 |
| W De Bruyn | 5 867 | 66 | 2 237 | 8 170 | 1 142 |
| HAJ Lourens | 5 175 | 179 | 1 993 | 7 347 | 1 017 |
| NST Motjuwadi | 2 945 | 46 | 1 121 | 4 112 | 428 |
| A Olivier | 5 212 | 57 | 1 986 | 7 255 | 1 013 |
| L Venter | 4 596 | 50 | 1 749 | 6 395 | 892 |
| F Viviers | 2 500 | 235 | 979 | 3 714 | 374 |
| | 30 337 | 679 | 11 602 | 42 618 | 5 555 |

The total share option expense relating to prescribed officers above amounted to R122 553 670 (2018: R73 804 956) and share appreciation rights expense amounted to R91 444 987 (2018: R42 560 667). This expense includes the movement on all tranches.

Financial assistance amounting to Rnil (2018: Rnil) was granted to prescribed officers for the subscription of options. Loans to prescribed officers outstanding at reporting date amounted to R5 379 395 (2018: R11 647 703).

## 30. Cash flow from operations

| R'000 | 2019 | 2018 |
|---|---|---|
| Net profit before tax and equity accounted earnings | 6 850 828 | 6 049 501 |
| Deduct interest income | (15 499 664) | (15 473 176) |
| Add back interest expenses | 4 509 549 | 4 184 449 |
| Add back interest received | 15 254 118 | 15 334 272 |
| Deduct interest paid | (4 518 607) | (4 194 240) |
| **Adjusted for non-cash items** | | |
| Movement in provision for credit impairments | 3 649 162 | (102 282) |
| Bad debts written off | 1 268 257 | 6 662 691 |
| ECL – non-loan book | 3 016 | – |
| Depreciation | 436 505 | 419 590 |
| Amortisation | 196 381 | 139 878 |
| Loss/(profit) on disposal of assets | 9 616 | (585) |
| **Movements in assets and liabilities** | | |
| Loans and advances[(1)(3)] | (8 465 740) | (9 155 430) |
| Other receivables | (924 923) | 155 693 |
| Net insurance receivables[(3)] | 8 812 | 10 156 |
| Derivatives | (13 193) | 42 916 |
| Retail deposits and other wholesale funding[(2)] | 13 041 447 | 9 067 744 |
| Trade and other payables | 179 060 | 432 834 |
| Movements in provisions | 24 170 | (14 189) |
| Share-based employee costs – options | 113 716 | (7 212) |
| Share-based employee costs – share appreciation rights | 73 077 | (16 758) |
| **Cash flow from operations** | 16 195 587 | 13 535 852 |

| | 2019 | 2018 |
|---|---|---|
| [(1)] *Movement in loans and advances to clients* | (8 465 740) | (9 155 430) |
| Gross loans advances opening balance | 47 630 455 | 45 132 430 |
| Gross loans and advances closing balance | (54 873 766) | (47 630 455) |
| Movement in accrued interest | 45 828 | 5 286 |
| Bad debts written off | (1 268 257) | (6 662 691) |
| [(2)] *Retail deposits and wholesale funding* | 13 041 447 | 9 067 744 |
| Movement in retail deposits | 13 531 990 | 9 769 871 |
| Movement in other wholesale funding and other unlisted negotiable instruments | (490 543) | (702 127) |

[(3)] *In the movements in assets and liabilities reconciliation of the comparatives, third-party cell captive costs of R563 million was shown as a cash outflow of net insurance receivables and cash inflow of loans and advances. As these are cash flows of the cell captive as opposed to the bank, the comparatives have been netted in the current year.*

## 31. Income taxes paid

| | 2019 | 2018 |
|---|---|---|
| Balance at the beginning of the year | (107 154) | 30 341 |
| Changes on initial application of IFRS 9 taken to equity (see note 2.18.1) | 518 474 | – |
| Income statement charge | 1 718 767 | 1 655 989 |
| Movement in deferred tax | 402 826 | (47 168) |
| Balance at the end of the year | 286 046 | 107 154 |
| **Income tax paid** | 2 818 959 | 1 746 316 |

## 32. Dividends paid

| R'000 | 2019 | 2018 |
|---|---|---|
| Balance at the beginning of the year | **5 293** | 7 259 |
| Dividend declared during the year: | | |
| Ordinary dividend | **2 015 551** | 1 631 807 |
| Preference dividend | **8 785** | 12 023 |
| Balance at the end of the year | **(3 786)** | (5 293) |
| **Dividends paid** | **2 025 843** | 1 645 796 |

## 33. Commitments and contingent liabilities

| | 2019 | 2018 |
|---|---|---|
| **Property operating lease commitments[1]** | | |
| The future aggregate minimum lease payments under non-cancellable leases are as follows: | | |
| Within 1 year | **511 129** | 468 968 |
| From 1 to 5 years | **1 267 249** | 1 292 109 |
| After 5 years | **174 335** | 269 015 |
| **Total future cash flows** | **1 952 713** | 2 030 092 |
| Straight-lining accrued | **(147 418)** | (135 151) |
| **Future expenses** | **1 805 295** | 1 894 941 |
| Sublease payments: | | |
| Future minimum lease payments expected to be received in relation to non-cancellable subleases of operating leases | **3 162** | 4 395 |

[1] *The bank leases various branches under non-cancellable operating leases expiring within 1 to 11 years. The leases have varying terms, escalation clauses and renewal rights. On renewal, the terms of the leases are renegotiated. Excess space is sub-let to third parties also under non-cancellable operating leases.*

| | 2019 | 2018 |
|---|---|---|
| **Capital commitments – approved by the board** | | |
| **Contracted for** | | |
| Property and equipment | **170 353** | 97 720 |
| Intangible assets | **116 017** | 15 777 |
| **Not contracted for** | | |
| Property and equipment | **874 951** | 896 644 |
| Intangible assets | **439 616** | 242 522 |
| | **1 600 937** | 1 252 663 |

## 34. Borrowing powers

In terms of the memorandum of incorporation of Capitec Bank Limited, the directors may at their discretion raise or borrow money for the purpose of the business of the company without limitation.

These borrowing powers are subject to the limitations of the Banks Act, 1990 (Act 94 of 1990) and section 45(3)(a)(ii) of the Companies Act, 2008. A special resolution was passed at the Annual General Meeting on 30 May 2014 authorising the board to approve that the company provides any financial assistance that it deems fit to any related or inter-related company to the company, on the terms and conditions and for the amounts that the board may determine.

The increase in borrowings from the previous year is for the purposes of funding the general banking business including future expansion of the loan book and capital expenditure.

## 35. Share incentive scheme

The share incentive scheme is authorised and adopted by the shareholders of Capitec Bank Holdings Limited (CBHL). The trustees act in terms of the powers bestowed on them by the trust deed and receive instructions from time to time from the boards of CBHL and the bank. The bank provides the finance required from time to time by the trustees to perform their duties. Service costs of options issued to employees of subsidiaries of CBHL are financed by the relevant subsidiary.

The bank allows its employees to purchase shares in Capitec Bank Holdings Limited up to a value not exceeding 20% (2018: 20%) of their monthly salary.

The purchase price includes a subsidy of 20% (2018: 20%) and the transaction costs are borne by the company.

The shares are held by the trustees on behalf of the participants for as long as required to save the holding expenses of a broker account for participants.

The bank offers share options in CBHL to members of management who are able to make significant contributions to the achievement of the bank's objectives. Options are conditional on the employee completing the vesting period applicable to each group of options issued to that employee.

The share incentive scheme prescribes that options, with durations ranging from 2 to 6 years, should be allocated at the market value, determined as the weighted average price per share over a period of 30 trading days on the JSE Limited prior to the date of allocation.

| | 2019 | | 2018 |
|---|---|---|---|
| | Weighted average share price R | Number | Number |
| **Options issued to employees of Capitec Bank Limited** | | | |
| Balance at the beginning of the year | 385.61 | 777 342 | 962 709 |
| Options granted | 881.76 | 99 085 | 96 188 |
| Options cancelled and/or lapsed | – | – | – |
| Options exercised | 266.98 | (236 926) | (281 555) |
| Balance at the end of the year | 506.44 | 639 501 | 777 342 |
| **SARs issued to employees of Capitec Bank Limited** | | | |
| Balance at the beginning of the year | 319.95 | 518 652 | 602 547 |
| SARs granted | 881.76 | 99 085 | 96 188 |
| SARs cancelled and/or lapsed | – | – | – |
| SARs exercised | 134.73 | (146 952) | (180 083) |
| Balance at the end of the year | 496.18 | 470 785 | 518 652 |

| Analysis of outstanding share options by year of maturity | 2019<br>Weighted average strike price R | 2019<br>Number | 2018<br>Weighted average strike price R | 2018<br>Number |
|---|---|---|---|---|
| **Financial year** | | | | |
| 2018/2019 | **482.31** | **10 750** | 276.32 | 247 676 |
| 2019/2020 | **324.78** | **232 954** | 324.78 | 232 954 |
| 2020/2021 | **459.69** | **152 860** | 459.69 | 152 860 |
| 2021/2022 | **661.94** | **84 687** | 571.02 | 59 910 |
| 2022/2023 | **661.93** | **84 673** | 571.02 | 59 902 |
| 2023/2024 | **795.16** | **48 809** | 705.93 | 24 040 |
| 2024/2025 | **881.76** | **24 768** | – | – |
| | **506.44** | **639 501** | 385.61 | 777 342 |

| Number | 2019 | 2018 |
|---|---|---|
| Treasury shares available from previous period | **–** | – |
| Shares purchased/issued during the year | **236 926** | 281 555 |
| Shares utilised for settlement of options | **(236 926)** | (281 555) |
| **Shares available for settlement of options** | **–** | – |
| Settled in shares | **(236 926)** | (281 555) |
| **Options exercised** | **(236 926)** | (281 555) |

| Analysis of outstanding SARs by year of maturity | 2019<br>Weighted average strike price R | 2019<br>Number | 2018<br>Weighted average strike price R | 2018<br>Number |
|---|---|---|---|---|
| **Financial year** | | | | |
| 2017/2018 | **–** | **–** | 209.83 | 1 875 |
| 2018/2019 | **0.01** | **3 000** | 131.04 | 148 077 |
| 2019/2020 | **199.66** | **133 353** | 199.66 | 133 353 |
| 2020/2021 | **373.93** | **91 495** | 373.93 | 91 495 |
| 2021/2022 | **661.94** | **84 687** | 571.02 | 59 910 |
| 2022/2023 | **661.93** | **84 673** | 571.02 | 59 902 |
| 2023/2024 | **795.16** | **48 809** | 705.93 | 24 040 |
| 2024/2025 | **881.76** | **24 768** | – | – |
| | **496.18** | **470 785** | 319.95 | 518 652 |

## 36. Share option liability

**Data utilised in the valuation of options granted**

The table below provides detail regarding the data used in the valuation of the share options to which IFRS 2 has been applied. A Black-Scholes option pricing model was used to value the options.[1][4]

| Year granted | Strike price R | Year maturing[3] | Risk-free rate % | Number of options outstanding | Estimated value R'000 | Expected vesting proportion[2] % | Fair value R'000 | Portion of term expired % | Liability at year-end R'000 |
|---|---|---|---|---|---|---|---|---|---|
| 2013/2014 | 201.40 | 2019/2020 | 7.1 | 37 500 | 41 421 | 100.0 | 41 421 | 98.5 | 40 815 |
| | 209.83 | 2018/2019 | 7.1 | 1 875 | 2 056 | 100.0 | 2 056 | 100.0 | – |
| | | 2019/2020 | 7.3 | 8 750 | 9 581 | 100.0 | 9 581 | 88.8 | 8 505 |
| 2014/2015 | 196.43 | 2019/2020 | 7.1 | 29 891 | 33 164 | 100.0 | 33 164 | 98.2 | 32 577 |
| | 253.82 | 2019/2020 | 7.3 | 28 000 | 29 485 | 100.0 | 29 485 | 86.5 | 25 508 |
| 2015/2016 | 371.88 | 2019/2020 | 7.1 | 84 071 | 78 615 | 100.0 | 78 615 | 97.8 | 76 893 |
| | | 2020/2021 | 7.6 | 84 070 | 79 440 | 100.0 | 79 440 | 78.2 | 62 135 |
| | 539.88 | 2018/2019 | 7.1 | 8 875 | 6 802 | 100.0 | 6 802 | 100.0 | – |
| | | 2019/2020 | 7.3 | 8 875 | 6 924 | 100.0 | 6 924 | 83.2 | 5 758 |
| | | 2020/2021 | 7.5 | 8 875 | 7 105 | 100.0 | 7 105 | 66.5 | 4 724 |
| 2016/2017 | 473.05 | 2019/2020 | 7.1 | 33 264 | 27 760 | 100.0 | 27 760 | 97.1 | 26 949 |
| | | 2020/2021 | 7.6 | 33 260 | 28 322 | 100.0 | 28 322 | 72.8 | 20 606 |
| | | 2021/2022 | 7.5 | 33 257 | 28 776 | 100.0 | 28 776 | 58.2 | 16 752 |
| | | 2022/2023 | 7.5 | 33 253 | 29 203 | 100.0 | 29 203 | 48.5 | 14 168 |
| | 576.29 | 2019/2020 | 7.3 | 2 603 | 1 920 | 100.0 | 1 920 | 89.1 | 1 711 |
| | | 2020/2021 | 7.6 | 2 603 | 1 982 | 100.0 | 1 982 | 66.8 | 1 324 |
| | | 2021/2022 | 7.6 | 2 603 | 2 037 | 100.0 | 2 037 | 53.5 | 1 089 |
| | | 2022/2023 | 7.5 | 2 603 | 2 085 | 100.0 | 2 085 | 44.5 | 929 |
| 2017/2018 | 705.93 | 2020/2021 | 7.6 | 24 052 | 15 312 | 100.0 | 15 312 | 63.9 | 9 778 |
| | | 2021/2022 | 7.5 | 24 050 | 16 045 | 100.0 | 16 045 | 47.9 | 7 681 |
| | | 2022/2023 | 7.5 | 24 046 | 16 753 | 100.0 | 16 753 | 38.3 | 6 414 |
| | | 2023/2024 | 7.5 | 24 040 | 17 346 | 100.0 | 17 346 | 31.9 | 5 534 |
| 2018/2019 | 881.76 | 2021/2022 | 7.5 | 24 777 | 13 024 | 100.0 | 13 024 | 30.7 | 4 005 |
| | | 2022/2023 | 7.5 | 24 771 | 14 103 | 100.0 | 14 103 | 23.1 | 3 253 |
| | | 2023/2024 | 7.5 | 24 769 | 15 002 | 100.0 | 15 002 | 18.5 | 2 769 |
| | | 2024/2025 | 7.6 | 24 768 | 15 871 | 100.0 | 15 871 | 15.4 | 2 440 |
| | | | | 639 501 | 540 134 | 100.0 | 540 134 | 62.5 | 382 317 |

[1] *All options were valued using the Black-Scholes model and the following variables:*
*Dividend yield 1.3%*
*Volatility[4] 25.2%*
*Ex dividend share price R1 295.13*

[2] *Executive staff turnover of 0% p.a. (2018:0%) was used to estimate the likelihood of vesting conditions realising. This is re-estimated in terms of IFRS 2 on an annual basis.*

[3] *The remuneration committee approved changes to the performance conditions relating to share options granted in 2017/2018. These performance conditions are that the HEPS growth must exceed the Consumer Price Index (CPI) plus the percentage growth in GDP plus 4%, and the attained ROE must outperform the average ROE of the 4 traditional banks in South Africa. Each performance condition carries a weighting of 50%, and is measured over a cumulative 3year performance period. The assumption that both of the above performance conditions would be met was used to estimate the realisation of these vesting conditions . This is re-estimated in terms of IFRS 2 on an annual basis.*

[4] *The expected price volatility is based on the historic 12-month volatility, adjusted for any expected changes to future volatility due to publicly available information.*

## 37. Share appreciation rights

### Data utilised in the valuation of share appreciation rights granted

The table below provides detail regarding the data used in the valuation of the SARs to which IFRS 2 has been applied. SARs are expected to vest and are re-estimated on an annual basis.[1][5]

| Year granted | Strike price R[3] | Year maturing[4] | Risk-free rate % | Number of SARs outstanding | Fair value R'000 | Portion of term expired % | Expected vesting proportion[2] % | Liability at year-end R'000 |
|---|---|---|---|---|---|---|---|---|
| 2013/2014 | 201.40 | 2019/2020 | 7.1 | 37 500 | 41 421 | 98.5 | 100.0 | 40 815 |
| | – | 2019/2020 | 7.3 | 8 750 | 9 581 | 88.8 | 100.0 | 8 505 |
| 2014/2015 | 0.01 | 2019/2020 | 7.1 | 10 154 | 13 248 | 98.2 | 100.0 | 13 014 |
| | – | 2019/2020 | 7.3 | 9 500 | 12 303 | 86.5 | 100.0 | 10 644 |
| 2015/2016 | 0.01 | 2018/2019 | 7.1 | 3 000 | 3 918 | 100.0 | 100.0 | 3 918 |
| | – | 2019/2020 | 7.1 | 28 582 | 37 292 | 97.8 | 100.0 | 36 476 |
| | – | 2019/2020 | 7.3 | 3 000 | 3 885 | 83.2 | 100.0 | 3 231 |
| | – | 2020/2021 | 7.6 | 28 580 | 36 819 | 78.2 | 100.0 | 28 798 |
| | – | 2020/2021 | 7.5 | 3 000 | 3 836 | 66.5 | 100.0 | 2 550 |
| 2016/2017 | 473.05 | 2019/2020 | 7.1 | 33 264 | 27 760 | 97.1 | 100.0 | 26 949 |
| | – | 2020/2021 | 7.6 | 33 260 | 28 322 | 72.8 | 100.0 | 20 606 |
| | – | 2021/2022 | 7.5 | 33 257 | 28 776 | 58.2 | 100.0 | 16 752 |
| | – | 2022/2023 | 7.5 | 33 253 | 29 203 | 48.5 | 100.0 | 14 168 |
| | 576.29 | 2019/2020 | 7.3 | 2 603 | 1 920 | 89.1 | 100.0 | 1 711 |
| | – | 2020/2021 | 7.6 | 2 603 | 1 982 | 66.8 | 100.0 | 1 324 |
| | – | 2021/2022 | 7.6 | 2 603 | 2 037 | 53.5 | 100.0 | 1 089 |
| | – | 2022/2023 | 7.5 | 2 603 | 2 085 | 44.5 | 100.0 | 929 |
| 2017/2018 | 705.93 | 2020/2021 | 7.6 | 24 052 | 15 312 | 63.9 | 100.0 | 9 778 |
| | – | 2021/2022 | 7.5 | 24 050 | 16 045 | 47.9 | 100.0 | 7 681 |
| | – | 2022/2023 | 7.5 | 24 046 | 16 753 | 38.3 | 100.0 | 6 414 |
| | – | 2023/2024 | 7.5 | 24 040 | 17 346 | 31.9 | 100.0 | 5 534 |
| 2018/2019 | 881.76 | 2021/2022 | 7.5 | 24 777 | 13 024 | 30.7 | 100.0 | 4 005 |
| | – | 2022/2023 | 7.5 | 24 771 | 14 103 | 23.1 | 100.0 | 3 253 |
| | – | 2023/2024 | 7.5 | 24 769 | 15 002 | 18.5 | 100.0 | 2 769 |
| | – | 2024/2025 | 7.6 | 24 768 | 15 871 | 15.4 | 100.0 | 2 440 |
| | | | | 470 785 | 407 845 | 67.0 | 100.0 | 273 353 |
| Note | | | | | | | | 18 |

[1] *All rights were valued using the Black-Scholes model and the following variables:*
*Dividend yield 1.3%*
*Volatility[5] 25.2%*
*Ex dividend share price R1 295.13*

[2] *Executive staff turnover of 0% p.a. (2018:0%) was used to estimate likelihood of vesting conditions realising. A re-estimate in terms of IFRS 2 is done on an annual basis.*

[3] *As from the 2016 financial year:*
*SARs are granted at a strike price equal to the 30 day weighted average share price up to and including the day before the resolution granting the respective SARs was passed.*
*There is a fixed ratio between the number of SARs and share options granted.*

[4] *The remuneration committee approved changes to the performance conditions relating to share appreciation rights granted in 2017/2018. These performance conditions are the HEPS growth must exceed the Consumer Price Index (CPI) plus the percentage growth in GDP plus 4%, and the attained ROE must out perform the average ROE of the four traditional banks in South Africa. Each performance condition carries a weighting of 50%, and is measured over a cumulative three year performance period.*

[5] *The expected price volatility is based on the historic 12 month volatility, adjusted for any expected changes to future volatility due to publicly available information.*

## 38. Derivative financial instruments: Economic hedges

| R'000 | Notional |  | Fair values |  |
|---|---|---|---|---|
|  | Foreign | ZAR | Assets | Liabilities |
| **2019** |  |  |  |  |
| Forward foreign exchange contracts – USD | – | – | – | – |
| **2018** |  |  |  |  |
| Forward foreign exchange contracts – USD | 1 921 | 35 461 | – | 12 820 |

Forward foreign exchange contracts represent commitments to purchase foreign currency, including undelivered spot transactions and were entered into to match corresponding expected future transactions.

## 39. Derivative financial instruments: Cash flow hedges

| R'000 | Notional |  | Fair values |  |
|---|---|---|---|---|
|  | USD | ZAR | Assets | Liabilities |
| **2019** |  |  |  |  |
| Interest rate swaps | – | 3 322 000 | (479) | 14 704 |
| Net | – | 3 322 000 | (479) | 14 704 |
| **2018** |  |  |  |  |
| Interest rate swaps | – | 3 766 000 | (129) | 38 545 |
| Net | – | 3 766 000 | (129) | 38 545 |

| R'000 | Demand to 1 month | 1 to 3 months | 3 months to 1 year | More than 1 year | Grand total |
|---|---|---|---|---|---|
| **2019** |  |  |  |  |  |
| Discounted swap cash flows | 271 | 2 508 | 7 134 | 4 312 | 14 225 |
| Net | 271 | 2 508 | 7 134 | 4 312 | 14 225 |
| **2018** |  |  |  |  |  |
| Discounted swap cash flows | 296 | 4 532 | 14 728 | 18 861 | 38 417 |
| Net | 296 | 4 532 | 14 728 | 18 861 | 38 417 |

Gains and losses recognised in other comprehensive income (note 20) on swap contracts will be continuously released to the income statement in line with the interest expense and foreign currency movement on the underlying hedged items.

The forecast cash flows presented above show how the cash flow hedging reserve will be released to the income statement over time. The swaps have quarterly reset and settlement dates. The forecast cash flows were based on contracted interest and ruling exchange rates. The hedged items comprise variable rate bonds and negotiable instruments detailed in note 16. To ensure hedge effectiveness, the variable rate cash flows on the hedged items are matched with variable rate interest rate swap cash flows (hedging instruments) by entering into swaps where amounts, interest rates and maturities of the swaps exactly match the hedged items.

At 28 February 2019, the swap fixed interest rates were between 7.030% and 8.510% (2018: 6.590% and 8.510%) and the floating rates were based on forecast 3-month JIBAR rates at 28 February 2019.

The fair value adjustment transferred to the income statement amounted to R19 million (2018: R80 million) and is included in interest expense and other operating expenses. In 2018 and 2019 there were no transactions for which cash flow hedge accounting had to be discontinued due to highly probable cash flow no longer expected to occur.

## 40. Persons holding more than 5% of the company's issued debt securities

| Holder | Instrument held | Amount held R'000 | Holding %[1] |
|---|---|---|---|
| **Year ended 28 February 2019** | | | |
| Sanlam Life Insurance Limited | Listed senior bond | 314 134 | 11.5% |
| Stanlib Income Fund | Listed senior bond | 205 979 | 7.5% |
| Channel Life Limited | Listed senior bond | 200 028 | 7.3% |
| Stanlib Income Fund | Subordinated unlisted bond | 406 912 | 80.0% |
| Liberty Group Limited | Subordinated unlisted bond | 81 382 | 16.0% |
| Old Mutual Specialised Finance Offshore Fund | Subordinated listed bond | 335 740 | 25.1% |
| Nedgroup Investments Flexible Income Fund | Subordinated listed bond | 127 301 | 9.5% |
| Investec Corporate Bond Fund | Subordinated listed bond | 112 536 | 8.4% |
| Old Mutual Life Assurance Company (South Africa) Limited | Subordinated listed bond | 79 601 | 6.0% |
| Momentum Income Plus Fund | Subordinated listed bond | 69 593 | 5.2% |
| Sanlam Life Insurance Limited | Other unlisted negotiable instruments | 100 096 | 25.2% |
| PSG Balanced Fund | Other unlisted negotiable instruments | 85 526 | 21.6% |
| PSG Stable Fund | Other unlisted negotiable instruments | 28 929 | 7.3% |
| PSG Money Market Fund | Other unlisted negotiable instruments | 23 745 | 6.0% |
| Sanlam Investment Management (Pty) Ltd | Other unlisted negotiable instruments | 22 123 | 5.6% |
| Channel Life Ltd | Wholesale | 68 479 | 69.3% |
| Guardrisk | Wholesale | 30 292 | 30.7% |

[1] *Percentage holding is of the respective class of instruments.*

## 41. Events past the date of the statement of financial position

In November 2018, Capitec Bank Limited was announced as the winning bidder for the 100% acquisition of Mercantile Bank Holdings Limited.

The deal was signed in January 2019 subject to regulatory approval. All regulatory applications, both Prudential Authority and Competition Commission, were filed in the 2019 financial year.

In terms of the Share Sale and Purchase Agreement, Capitec Bank Limited has paid a deposit of R110 million to the seller and instructed a bank guarantee to be issued to the seller to the value of R3.09 billion, secured by term deposits included in note 6.

It is expected that the regulators will provide their feedback within the first half of the 2020 financial year.

# glossary

| Acronym | Description |
|---|---|
| **AGM** | Annual general meeting |
| **ALCO** | Asset and liability committee |
| **ALM** | Asset and liability management |
| **ALSI** | JSE All Share Index |
| **AMPS** | All Media and Products Survey |
| **AT1** | Additional tier 1 |
| **ATM** | Automated Teller Machine |
| **BASA** | Banking Association of South Africa |
| **Basel** | Basel Committee on Banking Supervision |
| **B-BBEE** | Broad-based Black Economic Empowerment |
| **C.Connect** | Electronic Communications |
| **C.Net** | Web-based employee portal |
| **Capitec** | Capitec Bank Holdings Limited |
| **Capitec Bank** | Capitec Bank Limited |
| **Capitec Bank pillars** | Simplicity, Affordability, Accessibility and Personal Service |
| **CCS** | Centralised collection services |
| **CET1** | Common equity tier 1 |
| **CMT** | Continuity management team |
| **CPA** | Credit Providers Association |
| **CSI** | Corporate Social Investment |
| **DEFRA** | UK Department for Environment, Food and Rural Affairs |
| **DMTN** | Domestic Medium Term Note Programme |
| **DPS** | Dividends per share |
| **DR** | Disaster recovery |
| **D-SIB** | Domestically systemically important bank |
| **ECL** | Expected credit loss |
| **EEA2** | Employment Equity Act form 2 |
| **EPS** | Earnings per Share |
| **EXCO** | Executive management committee |
| **FICA** | Financial Intelligence Centre Act, 2001 |
| **FRN** | Floating rate note |
| **FSC** | Forest Stewardship Council |
| **GDP** | Gross domestic product |
| **GHG** | Greenhouse gas |
| **GRI** | Global Reporting Initiative |
| **HEPS** | Headline Earnings per Share |
| **IA** | Internal Audit |
| **IAR** | Integrated annual report |
| **ICAAP** | Internal capital adequacy assessment process |
| **ICR** | Individual capital requirement |

| Acronym | Description |
|---|---|
| **IFRS** | International Financial Reporting Standards |
| **IFRIC** | International Financial Reporting Standards Interpretations Committee |
| **IIRC** | International Integrated Reporting Council |
| **IIRF** | International Integrated Reporting Framework |
| **IRM** | Integrated risk management |
| **ISMS** | Information security management system |
| **IT** | Information Technology |
| **JIBAR** | Johannesburg Interbank Agreed Rate |
| **JSE** | Johannesburg Stock Exchange |
| **King IV™** | King IV Report on Corporate Governance™ for South Africa 2016 |
| **LCR** | Liquidity coverage ratio |
| **LDT** | Last day of trade |
| **LRP** | Liquidity recovery plan |
| **LSM** | Living standards measure |
| **Moody's** | Moody's Investors Services Inc. |
| **NAEDO** | Non-authenticated early debit order |
| **NCA** | National Credit Act, 2005 |
| **NCD** | Negotiable Certificate of Deposit |
| **NCR** | National Credit Regulator |
| **NSFR** | Net stable funding ratio |
| **OCR** | Optical character recognition |
| **PASA** | Payments Association of South Africa |
| **PD** | Probability of default |
| **POCA** | Prevention of Organised Crime Act, 1998 |
| **Polproc** | Policies and procedures department |
| **POS** | Point-of-Sale Merchant |
| **PwC** | PricewaterhouseCoopers Inc. |
| **RCMC** | Risk and capital management committee |
| **REMCO** | Human resources and remuneration committee |
| **RISCO** | Risk committee |
| **ROE** | Return on equity |
| **SAMOS** | South African Multiple Options Settlement |
| **SARB** | South African Reserve Bank |
| **SARS** | South African Revenue Services |
| **SARs** | Share Appreciation Rights |
| **Stats SA** | Statistics South Africa |
| **T2** | Tier 2 |
| **The group** | Capitec Bank Holdings Limited and subsidiaries |
| **VWAP** | Volume weighted average price |
| **WACC** | Weighted average cost of capital |

# statutory information

## Shareholders' calendar

**Financial year-end**
28 February 2019

**Annual report**
April 2019

**Interim report**
September 2018

**JSE interest rate market code**
CBL

## Administration and addresses

**Capitec Bank Limited**

**Registration number**
1980/003695/06

**Auditors**
PricewaterhouseCoopers Inc.

**Directors**
R Stassen (Chairman)
GM Fourie (Chief executive officer)*
LA Dlamini (Ms)
AP du Plessis (Chief financial officer)*
MS du Pré le Roux
K Makwane
NS Mashiya (Chief risk officer)*
JD McKenzie
DP Meintjes (appointed 29 November 2018)
NS Mjoli-Mncube (Ms)
PJ Mouton
CA Otto
JP Verster

* *Executive*

**Secretary**
YM Mouton (Ms)

**Registered address**
1 Quantum Street, Techno Park,
Stellenbosch 7600

**Postal address**
PO Box 12451, Die Boord,
Stellenbosch 7613

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