Out of the Ordinary

Investec

Investec Bank Limited group

IFRS 9 Financial Instruments

Transition Report

2018

Introduction and objective of these disclosures

The objective of these transition disclosures is to provide an understanding of the impacts of the change in accounting standard from IAS 39 ‘Financial Instruments: Recognition and Measurement’ to IFRS 9 ‘Financial Instruments’, which became effective for the group on 1 April 2018.

The information in this document serves as a point-in-time bridge between IAS 39 and IFRS 9. This includes the day one impact on retained income and regulatory capital as well as changes to the classification and measurement of certain financial assets and liabilities as required under IFRS 9.

IFRS 9 requires a move from incurred loss methodology under IAS 39 to an expected credit loss (ECL) methodology. This disclosure document explains the new ECL methodology, what its implications are for the group and what the implications are of the main judgements the group has made in implementing ECL, as well as the impacts from reclassification of certain assets and liabilities.

The disclosures that follow reflect the impact of the adoption of IFRS 9 on the group’s balance sheet and regulatory capital. Further details of specific IFRS 9 accounting policies (as well as previous IAS 39 policies) are described in more detail on from pages 25 to 29.

All information in this document is audited unless it has not been denoted with the audited information icon.

Cross reference tool

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Audited information

Denotes audited information

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Overview of the group's IFRS 9 transition impact

The adoption of IFRS 9 is expected to result in the following day one impact for Investec Bank Limited:

Balance sheet impairment allowance and provisions

Total balance sheet impairment allowance and provisions increased by R653 million from R1.5 billion as at 31 March 2018 to R2.2 billion as at 1 April 2018. This is driven by an increase in Stage 1, Stage 2 and Stage 3 impairments of R807 million, partially offset by a reduction of R154 million as a result of the changes in classification and measurement of certain of the bank's financial assets to fair value. The increase in impairment allowance and provisions reduced the common equity tier 1 (CET 1) ratio by approximately 15bps on a fully loaded basis, or 4bps on a day one impact transitional basis.

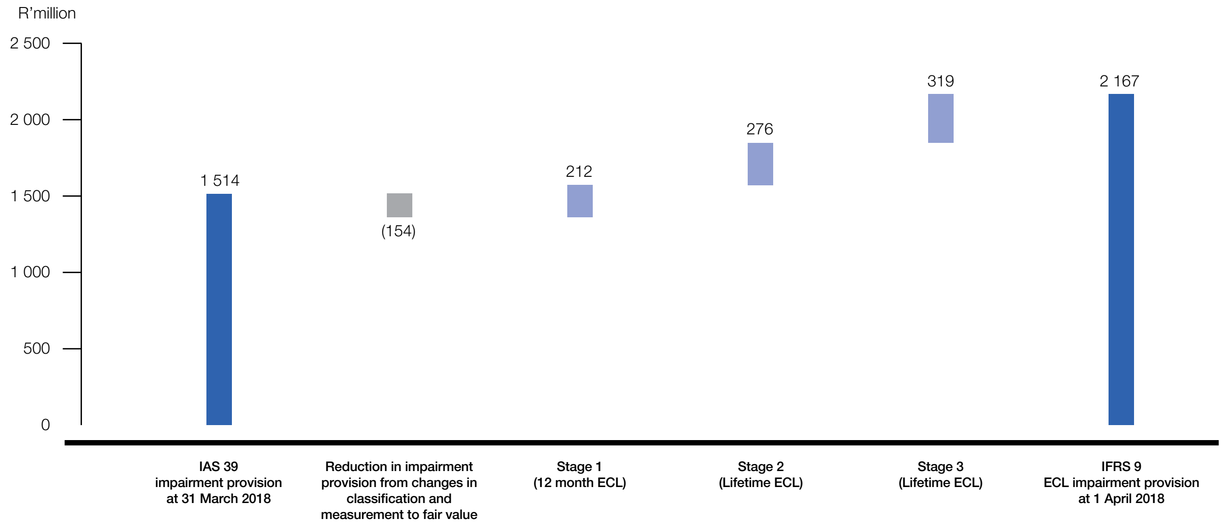
Changes in classification and measurement of certain financial assets

In addition, changes in classification and measurement of certain of the group's other financial assets resulted in a decrease to equity of R423 million (post taxation), with an 13bps impact on the CET 1 ratio.

Taken together, the adoption of IFRS 9 resulted in a decrease in Investec Bank Limited's transitional CET 1 ratio of 17bps from 10.9% to 10.7%, in line with the group's target and in excess of minimum regulatory requirements. Investec Bank Limited confirmed to the SARB that it will use the transitional arrangements to absorb the full impact permissible of IFRS 9 in regulatory capital calculations.

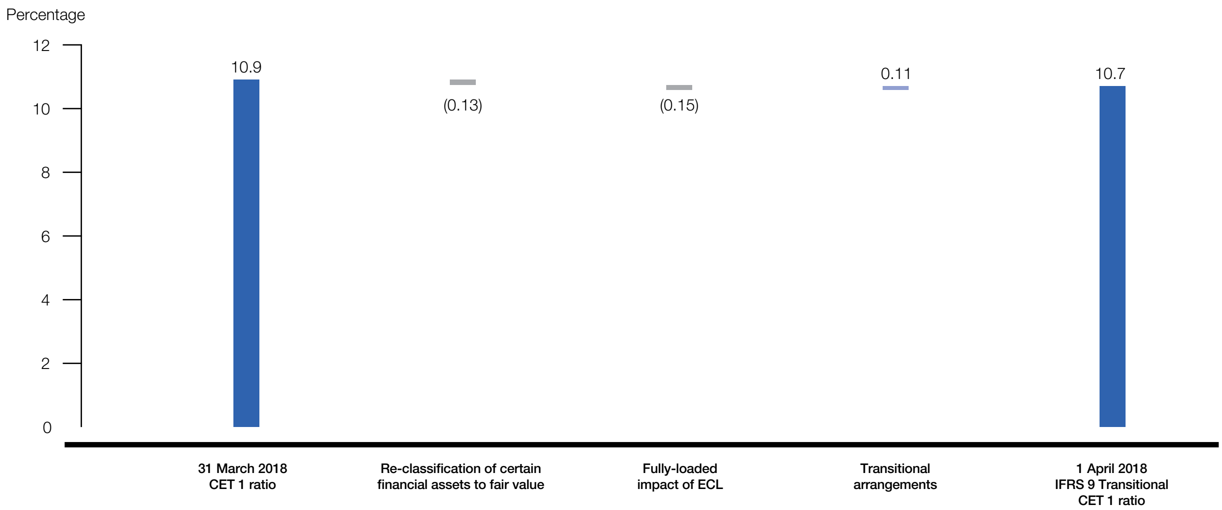
IAS 39 to IFRS 9 impairment allowance

The following chart highlights the key drivers of the overall increase in the group's impairment provision under IFRS 9 relative to IAS 39.



Day one impact on CET 1 ratio

The following chart highlights the day one impact on CET 1 ratio as well as the fully loaded impact of ECL.



IAS 39 to IFRS 9 consolidated balance sheet

The adoption of IFRS 9, by applying the accounting policies and ECL measurement methodologies outlined in this document has resulted in a decrease of shareholders' equity of R894 million at 1 April 2018.

The following table sets out the day one IFRS 9 transition impact on the group by balance sheet line item:

R'million	At 31 March 2018	IFRS 9 transition adjustments*	At 1 April 2018
Assets			
Cash and balances at central banks	9 187	(7)	9 180
Loans and advances to banks	17 265	(2)	17 263
Non-sovereign and non-bank cash placements	9 993	(21)	9 972
Reverse repurchase agreements and cash collateral on securities borrowed	20 480	–	20 480
Sovereign debt securities	62 403	(40)	62 363
Bank debt securities	8 051	(18)	8 033
Other debt securities	10 342	15	10 357
Derivative financial instruments	12 586	(22)	12 564
Securities arising from trading activities	875	–	875
Investment portfolio	7 943	1 181	9 124
Loans and advances to customers	247 474	(2 312)	245 162
Own originated loans and advances to customers securitised	6 830	(4)	6 826
Other loans and advances	265	–	265
Other securitised assets	241	–	241
Interest in associated undertakings	6 288	–	6 288
Deferred taxation assets	586	347	933
Other assets	6 686	(13)	6 673
Property and equipment	2 494	–	2 494
Investment properties	1	–	1
Goodwill	171	–	171
Intangible assets	412	–	412
Loans to group companies	13 499	–	13 499
	444 072	**(896)**	**443 176**
Liabilities			
Deposits by banks	24 607	–	24 607
Derivative financial instruments	15 907	–	15 907
Other trading liabilities	2 305	–	2 305
Repurchase agreements and cash collateral on securities lent	8 395	–	8 395
Customer accounts (deposits)	321 893	(32)	321 861
Debt securities in issue	3 473	–	3 473
Liabilities arising on securitisation of own originated loans and advances	1 551	–	1 551
Current taxation liabilities	202	–	202
Deferred taxation liabilities	99	–	99
Other liabilities	6 844	30	6 874
Loans from group companies	7 007	–	7 007
	392 283	**(2)**	**392 281**
Subordinated liabilities	13 374	–	13 374
	405 657	**(2)**	**405 655**
Equity			
Ordinary share capital	32	–	32
Share premium	14 885	–	14 885
Other reserves	1 293	60	1 353
Retained income	21 855	(954)	20 901
Shareholders' equity excluding non-controlling interests	**38 065**	**(894)**	**37 171**
Other Additional Tier 1 securities in issue	350	–	350
Total equity	**38 415**	**(894)**	**37 521**
Total liabilities and equity	**444 072**	**(896)**	**443 176**

* *For the detailed impact on classification and measurement and ECL on transition refer to pages 22 and 24.*

Disclosures

Implementation of IFRS 9

The group established an IFRS 9 steering committee comprising of executive representation and key management from Risk, Finance, Analytics and IT. The committee is accountable for IFRS 9 implementation and is supported by working groups responsible for various work streams. The committee has provided regular updates on the status of the project to the appropriate board committees.

The group's approach to risk management has not changed substantially with the introduction of IFRS 9. Credit decisions are undertaken on a case-by-case basis and the quality of clients and underlying cash flows remain paramount in decision-making.

We have made a number of management judgements around subjective elements and inputs in order to implement ECL capabilities in the organisation. Some of these judgements pertain to decisions made throughout the design and build of the ECL methodology and others to the application of ECL methodology. Whilst only the latter category will be subject to periodic monitoring and review at subsequent reporting intervals, all of these judgements, to varying degrees, give rise to inherent measurement uncertainty in our reportable ECL.

The key judgements made by the group upon the implementation of IFRS 9 are highlighted in this document and include changes to asset quality definitions, use of expert judgement and risks arising from the use of internal models and forward-looking macro-economic scenarios overlaying these models. These key judgements have been approved by the board through the board risk and capital committee (BRCC) and audit committee, and ongoing decision-making is governed by the appropriate forums, which have been adapted to ensure they are enabled to implement IFRS 9.

The group has developed internal models to be suitable for use under IFRS 9. These models, which have been developed for all material asset classes, are subject to review and challenge by the technical risk committee which is attended by members of Credit, Finance and Model Validation teams and mandated by the relevant board approved risk committees. This forum is mandated to review and approve model changes as required.

Credit and counterparty risk management

Credit and counterparty risk is assumed through a range of client-driven lending activities with private and corporate clients as well as through other counterparties, such as financial institutions and sovereigns. These activities are diversified across a number of business activities.

Credit and counterparty risk governance structure

To manage, measure, monitor and mitigate credit and counterparty risk, independent credit committees exist in each geography where we assume credit risk. These committees operate under board-approved delegated limits, policies and procedures. There is a high level of executive involvement and non-executive review and oversight in the credit decision-making forums depending on the size and complexity of the deal. It is our policy that all centralised credit committees are comprised of voting members who are independent of the originating business unit. All decisions to enter into a transaction are based on unanimous consent.

In addition to the credit committees, the following processes assist in managing, measuring and monitoring credit and counterparty risk. The scope of these forums and committees have been adjusted where necessary to incorporate changes to governance processes arising from IFRS 9 implementation:

- Day-to-day arrears management and regular arrears reporting ensure that individual positions and any potential trends are dealt with in a timely manner.
- Watchlist committees, review the management of distressed loans, potential problem loans and exposures in arrears that require additional attention and supervision. These committees review ECL impairments and staging at an asset level as well as potential fair value adjustments to loans and advances to customers and provide recommendations for the appropriate staging and level of ECL impairment if needed.
- Credit watchlist forum, reviews and manages exposures that may potentially become distressed as a result of changes in the economic environment or adverse share price movements, or that are vulnerable to volatile exchange rate or interest rate movements or idiosyncratic financial distress.
- Arrears, default and recoveries forums specifically review and manage distressed loans and potentially distressed loans for private clients and corporates. These forums also reviews and monitors counterparties who have been granted forbearance measures.

Credit risk classification and provisioning policy

The group has incorporated IFRS 9 requirements into our group credit risk classification and provisioning policy. A framework has been established that incorporates both quantitative and qualitative measures. Any decisions in relation to significant increase in credit risk will be management decisions subject to approval by the appropriate committees. The policies for financial assets at amortised cost, designated at fair value and at fair value through other comprehensive income (FVOCI, in accordance with IFRS 9) have been developed as described below:

Definition of default

The group has aligned the IFRS 9 and regulatory definitions of default, credit impaired and non-performing exposure. Assets that are more than 90 days past due, or considered by management as unlikely to pay their obligations in full without realisation of collateral are considered as exposures in default.

Stage 1

All assets that are considered performing and have not had a significant increase in credit risk will be reported as Stage 1 assets. Under IFRS 9 these Stage 1 financial assets have loss allowances measured at an amount equal to a 12-month ECL.

Stage 2

Financial assets are considered to be in Stage 2 when their credit risk has increased significantly since initial recognition. The group was not required to hold specific impairments against these assets under IAS 39, however, a loss allowance equivalent to a lifetime ECL is now required to be held under IFRS 9.

The group's primary indicator for Stage 2 assets are distressed loans, potential problem loans and exposures in arrears that require additional attention and supervision from Watchlist committees and are under management review. This comprises exposures that may potentially become distressed as a result of changes in the economic environment or adverse share price movements, or that are vulnerable to volatile exchange rate or interest rate movements or idiosyncratic financial distress, or private clients who have undergone a significant deterioration in financial circumstances.

Assets that have been subject to forbearance are considered to be, at a minimum, Stage 2. Forbearance measures refer to concessions such as modification of the terms and conditions or refinancing that has been granted to a debtor in financial difficulties. These exposures are assessed on a case by case basis to determine whether the proposed modifications will be considered as forbearance. Where the credit committee considers it likely that the client will be able to return to perform against the original contractual obligations within a reasonable timeframe these assets will be considered performing and in Stage 2. Forbearance is distinguished from commercial renegotiations which take place as part of normal business activity and standard banking practice.

Credit risk classification and provisioning policy *(continued)*

In addition to loans under management review, an asset may also move from Stage 1 to Stage 2 if the model calculated probability of default (PD) has significantly increased since origination. This is tested as both a relative and absolute measure, to further inform whether a significant deterioration in lifetime risk of default has occurred.

As a backstop, the group does not rebut the presumption in IFRS 9 that all financial assets that are more than 30 days past due have experienced a significant increase in credit risk.

Exposures move back to Stage 1 once they no longer meet the criteria above for a significant increase in credit risk and as cure periods (specifically relating to forborne exposure) are met.

Stage 3

Financial assets will be included in Stage 3 when there is objective evidence of credit impairment. Under IFRS 9, the group assesses a loan as Stage 3 when contractual payments of either principal or interest are past due for more than 90 days, the debtor is assessed as unlikely to pay and credit impaired, or the loan is otherwise considered to be in default, for example due to the appointment of an administrator or in receivership.

The group's policy is not to rebut the presumption in IFRS 9 that loans which are more than 90 days past due are in default.

ECL

The assessment of credit risk and the estimation of ECL are required to be unbiased, probability-weighted and should incorporate all available information relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39, and the resulting impairment charge may be more volatile. IFRS 9 will result in an increase in the total level of impairment allowances, since all financial assets if not measured at fair value through profit and loss (FVPL) will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

Write-offs

The group's policy on when financial assets are written off has not significantly changed on adoption of IFRS 9. A loan or advance is normally written off, in full, against the related allowance when the proceeds from realising any available security have been received or there is a reasonable amount of certainty that the exposure will not be recovered. Similarly the treatment and recognition of recoveries is unaffected by the implementation of IFRS 9. Any recoveries of amounts previously written off decrease the amount of impairment losses.

IAS 39 to IFRS 9 – increase in impairment allowance

Expected credit losses

At 1 April 2018 R'million	Stage 1	Stage 2	Stage 3	Changes in classification and measurement	Total increase in impairment allowances
Southern Africa	**212**	**276**	**319**	**(154)**	**653**

Stage 1 (12-month ECL): IFRS 9 requires that for financial assets where there has been no significant increase in credit risk since origination a loss allowance equivalent to 12-month expected credit losses should be held. Previously under IAS 39 these exposures would not be subject to a specific impairment allowance.

Stage 2 (Lifetime ECL): IFRS 9 requires financial assets that have experienced a significant increase in credit risk since initial recognition to carry a lifetime expected credit loss allowance. Under IAS 39, no specific impairment provision was held for Stage 2 assets.

Stage 3 (Lifetime ECL): This relates to additional impairment allowances required on Stage 3 exposures already in default or impaired under IAS 39. This is due to the differences in the way ECL under IFRS 9 and incurred loss provisions under IAS 39 are calculated, including the introduction of a range of forward looking probability weighted macro-economic scenarios as opposed to an expected outcome. Assets are individually assessed using multiple economic scenarios under IFRS 9, whereas assets treated as impaired under IAS 39 carried a provision reducing the carrying value to the expected recoverable amount.

Changes in classification and measurement: Certain assets had impairments assigned under IAS 39, however under IFRS 9 these assets are now classified as fair value through profit and loss where previously classified as amortised cost and are therefore no longer in scope of impairment allowances.

Credit risk – analysis of gross credit and counterparty exposures under IFRS 9

The table below indicates in which class of asset (on the face of the consolidated balance sheet) credit and counterparty exposures are reflected. Not all assets included in the balance sheet bear credit and counterparty risk.

The IFRS 9 impairment model is applicable to all financial assets at amortised cost, lease receivables, debt financial assets at fair value through other comprehensive income and designated at fair value, loan commitments and financial guarantee contracts not measured at FVPL. This contrasts to the IAS 39 impairment model which was not applicable to loan commitments and financial guarantee contracts, which were covered by IAS 37.

On balance sheet credit and counterparty exposure

At 1 April 2018 R'million	Total credit and counterparty exposure	of which FVPL	of which Amortised cost and FVOCI	Expected credit losses^	Assets that we deem to have no legal credit exposure	Notes	Total assets
Cash and balances at central banks	9 165	–	9 165	(7)	22		9 180
Loans and advances to banks	17 265	–	17 265	(2)	–		17 263
Non-sovereign and non-bank cash placements	9 993	574	9 419	(21)	–		9 972
Reverse repos & cash collateral on securities borrowed	20 480	9 205	11 275	–	–		20 480
Sovereign debt securities	62 365	11 704	50 661	(22)	–		62 343
Bank debt securities	8 036	298	7 738	(10)	–		8 026
Other debt securities	10 361	953	9 408	(7)	–		10 354
Derivative financial instruments	6 858	6 858	–	–	5 706		12 564
Securities arising from trading activities	698	698	–	–	177		875
Investment portfolio	–	–	–	–	9 124	1	9 124
Loans and advances to customers	247 128	19 254	227 874	(1 966)	–		245 162
Own originated loans and advances to customers securitised	6 836	–	6 836	(10)	–		6 826
Other loans and advances	290	–	290	(25)	–		265
Other securitised assets	–	–	–	–	241	2	241
Interest in associated undertakings	–	–	–	–	6 288		6 288
Deferred taxation assets	–	–	–	–	933		933
Other assets	3 364	–	3 364	(67)	3 376	3	6 673
Property and equipment	–	–	–	–	2 494		2 494
Investment properties	–	–	–	–	1		1
Goodwill	–	–	–	–	171		171
Intangible assets	–	–	–	–	412		412
Loans to group companies	–	–	–	–	13 499		13 499
Total on-balance sheet exposures	**402 839**	**49 544**	**353 295**	**(2 137)**	**42 444**		**443 146**
Guarantees	10 588	–	10 588	(5)	1 102		11 685
Committed facilities related to Loans and advances to customers	47 531	–	47 531	(25)	–		47 506
Contingent liabilities and other	7 076	1 421	5 655	–	18 732		25 808
Total off-balance sheet exposures	**65 195**	**1 421**	**63 774**	**(30)**	**19 834**		**84 999**
Total gross exposures	**468 034**	**50 965**	**417 069**	**(2 167)**	**62 278**		**528 145**

^ *Expected credit losses include R29 million ECL held against financial assets held at FVOCI, which is reported on the balance sheet within reserves. This will result in minor differences between certain balance sheet lines reported above (largely sovereign debt securities) and the statutory balance sheet.*

1. *Largely relates to exposures that are classified as equity risk in the banking book.*
2. *Largely cash in the securitised vehicles.*
3. *Other assets include settlement debtors where we deem to have no credit risk exposure as they are settled on a delivery against payment basis.*

Total credit and counterparty exposure

Exposures other than loans and advances to customers: Remaining exposures outside of core loans largely sit in Stage 1 and therefore staging of exposures will remain focused on our core loan portfolio only.

Loans and advances to customers: The tables that follow provide information with respect to the asset quality of our core loans and advances to customers, which account for the material ECL allowances.

Loans and advances to customers held at fair value through profit and loss (FVPL): The combined effect of the application of the business model and the contractual cash flow characteristics tests has resulted in some differences in the population of financial assets measured at amortised cost or fair value compared with IAS 39. In SA this has resulted in a R2 billion reduction in Investec Bank Limited's loans and advances to customers primarily due to the reclassification of certain loans and advances to customers to FVPL, which now total R19 254 billion at 1 April 2018.

Off-balance sheet exposures: IFRS 9 requires a loss allowance to be held against off balance sheet items such as undrawn lending commitments held at amortised cost or FVOCI. Previously, an impairment provision would only have been held for a commitment in the event that a loss event had occurred. Exposures that are undrawn but that are intended to be sold down to mitigate concentration risk will be classified as FVPL. Exposures that are undrawn and that may be sold down will be classified as FVOCI.

Credit risk – analysis of gross core loans and advances under IFRS 9

The tables that follow provide information with respect to the asset quality of our core loans and advances.

R'million	At 1 April 2018
Loans and advances to customers	247 128
Add: own originated loans and advances to customers	6 836
Gross core loans and advances to customers	**253 964**
IFRS 9 ECL	**(1 976)**
Net core loans and advances to customers per the balance sheet	**251 988**
of which subjected to ECL	249 984

R'million	At 1 April 2018
Gross core loans and advances to customers	**253 964**
of which subject to ECL	251 960
Gross exposure (R'million)	**251 960**
Stage 1	239 753
Stage 2	9 346
of which past due greater than 30 days	313
Stage 3	2 861
Gross exposure (%)	
Stage 1	95.16%
Stage 2	3.71%
Stage 3	1.13%
IFRS 9 ECL (R'million)	**(1 976)**
Stage 1	(592)
Stage 2	(269)
Stage 3	(1 115)
ECL coverage ratio (%)	
Stage 1	0.25%
Stage 2	2.88%
Stage 3	38.97%

Stage 1: 95.16% of gross exposure in scope for IFRS 9 is in Stage 1 and has not experienced a significant increase in credit risk since origination. Impairment is calculated based on a 12-month expected credit loss. Coverage for these performing, non-deteriorated assets is 0.25%.

Stage 2: 3.71% of gross exposure is in Stage 2 and has seen a significant increase in credit risk since origination. Under IFRS 9, these assets require a lifetime expected loss to be held, resulting in an increase in coverage to 2.88%. Only R313 million or 0.1% of gross core loans shown in Stage 2 are greater than 30 days past due. An asset reported in Stage 2 does not imply we expect a loss on these assets. Stage 2 assets are assessed relative to their expected performance at the point of origination. While assets may underperform original expectations, the level of ECL indicates that our expected losses from these positions remain low.

Stage 3: 1.13% of gross exposure is in Stage 3 which is made up of assets that are credit impaired. Coverage ratio totals 38.97%. SA Stage 3 ECL is predominantly driven by specific impairments raised against the non-performing loan portfolio.

Credit risk – an analysis of gross core loans and advances by risk category under IFRS 9

At 1 April 2018 R'million	Gross core loans and advances at Amortised cost, FVOCI and FVPL (subject to ECL)* — Stage 1 Drawn exposure	Stage 1 ECL	Stage 2 Drawn exposure	Stage 2 ECL	Stage 3 Drawn exposure	Stage 3 ECL	Total Drawn exposure	Total ECL	Gross core loans and advances at FVPL (not subject to ECL)	Gross core loans and advances
Lending collateralised by property	**37 608**	**(109)**	**1 891**	**(17)**	**865**	**(351)**	**40 364**	**(477)**	**252**	**40 616**
Commercial real estate	34 156	(55)	1 669	(9)	695	(272)	36 520	(336)	252	36 772
Commercial real estate – investment	30 563	(43)	1 452	(9)	673	(256)	32 688	(308)	252	32 940
Commercial real estate – development	2 905	(7)	130	–	8	(2)	3 043	(9)	–	3 043
Commercial vacant land and planning	688	(5)	87	–	14	(14)	789	(19)	–	789
Residential real estate	3 452	(54)	222	(8)	170	(79)	3 844	(141)	–	3 844
Residential real estate – investment	–	–	–	–	–	–	–	–	–	–
Residential real estate – development	2 819	(35)	70	–	146	(58)	3 035	(93)	–	3 035
Residential vacant land and planning	633	(19)	152	(8)	24	(21)	809	(48)	–	809
High net worth and other private client lending	**128 445**	**(196)**	**1 438**	**(39)**	**1 368**	**(452)**	**131 251**	**(687)**	**–**	**131 251**
Mortgages	65 740	(44)	655	(18)	874	(188)	67 269	(250)	–	67 269
High net worth and specialised lending	62 705	(152)	783	(21)	494	(264)	63 982	(437)	–	63 982
Corporate and other lending	**73 700**	**(287)**	**6 017**	**(213)**	**628**	**(312)**	**80 345**	**(812)**	**1 752**	**82 097**
Acquisition finance	12 670	(75)	1 216	(21)	97	(2)	13 983	(98)	–	13 983
Asset-based lending	4 055	(41)	515	(10)	236	(148)	4 806	(199)	604	5 410
Fund finance	4 909	(5)	–	–	–	–	4 909	(5)	–	4 909
Other corporate and financial institutions and governments	43 347	(146)	3 082	(165)	156	(73)	46 585	(384)	1 148	47 733
Asset finance	2 596	(8)	57	(6)	24	–	2 677	(14)	–	2 677
Small ticket asset finance	2 184	(5)	41	(6)	–	–	2 225	(11)	–	2 225
Large ticket asset finance	412	(3)	16	–	24	–	452	(3)	–	452
Project finance	5 494	(11)	1 147	(11)	–	–	6 641	(22)	–	6 641
Resource finance	629	(1)	–	–	115	(89)	744	(90)	–	744
Gross core loans and advances	**239 753**	**(592)**	**9 346**	**(269)**	**2 861**	**(1 115)**	**251 960**	**(1 976)**	**2 004**	**253 964**

* *This includes exposures of R17.25 billion of fixed rate loans which have passed the solely payments of principal and interest test and are held in a business model to collect contractual cash flows but have been designated at FVPL to eliminate accounting mismatches (interest rate risk is being economically hedged). The underlying loans have been fair valued for interest rate risk and are subject to the ECL calculation in order to obtain a reasonable estimate of the credit risk component. The portfolio is managed on the same basis as gross core loans and advances measured at amortised cost. The drawn exposure in Stage 1, Stage 2 and Stage 3 amounts to R15.96 billion, R1.29 billion and R3 million respectively. The related ECL on the portfolio is R54 million, R24 million of this is in Stage 1, R27 million is in Stage 2 and the remaining R3 million in Stage 3. These amounts have been included in the table above.*

Key drivers of measurement uncertainty – subjective elements and inputs

The measurement of ECL under IFRS 9 has increased complexity and reliance on expert credit judgements. Key judgemental areas under the implementation of IFRS 9 are highlighted in this document and are subject to robust governance processes. Key drivers of measurement uncertainty include:

- the assessment of what constitutes a significant increase in credit risk;
- the introduction of a range of forward-looking probability weighted macro-economic scenarios; and
- estimations of probabilities of default, loss given default and exposures at default using models.

We will continue to assess and monitor the group's measurement uncertainty and sensitivity to changes in economic credit conditions and expect to provide additional disclosures relating to sensitivities in the 2019 Annual Report.

Forward-looking macro-economic scenarios

The measurement of ECL also requires the use of multiple economic scenarios to calculate an unbiased and a probability weighted forward-looking estimate. These scenarios are updated at least twice a year, or more frequently if there is a macro-economic shock or significant shift in expectations. The weighting of these scenarios for IFRS 9 as well as the scenarios themselves are discussed and approved in Investec Limited and Investec Bank Limited Capital Committee, which forms part of the principal governance framework for macro-economic scenarios.

A number of forecast economic scenarios are considered for capital planning, stress testing (including Investec specific stress scenarios) and IFRS 9, including an expected scenario, two upside scenarios and two Investec specific downside scenarios.

IFRS 9 is likely to result in an increase in the volatility of provisions going forward, particularly for Stage 1 and Stage 2 assets, as a result of macro-economic scenario changes. Sensitivities to macro-economic scenarios and factors will form part of our overall monitoring of credit risk.

Management and measurement of credit and counterparty risk

Fundamental principles employed in the management of credit and counterparty risk are:

- A clear definition of our target market
- A quantitative and qualitative assessment of the creditworthiness of our counterparties
- Analysis of risks, including concentration risk (concentration risk considerations include asset class, industry, counterparty and geographical concentration)
- Decisions are made with reference to risk appetite limits
- Prudential limits
- Regular monitoring and review of existing and potential exposures once facilities have been approved
- A high level of executive involvement in decision-making with non-executive review and oversight
- Portfolio reviews and stress testing.

Within the credit approval process, internal and external ratings are included in the assessment of client quality.

A large proportion of the group's portfolio is not rated by external rating agencies. We place reliance upon internal consideration of counterparties and borrowers, and use ratings prepared externally where available as support in our decision-making process.

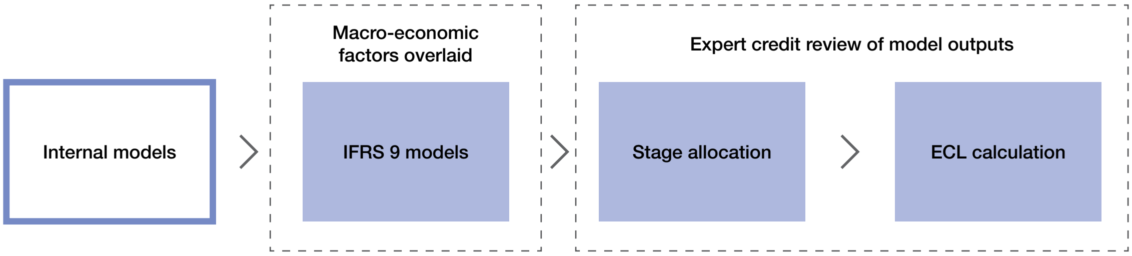
Regular reporting of credit and counterparty risk exposures within our operating units are made to management, the executives and the board at the group risk and capital committee (GRCC) and board risk and capital committee (BRCC). The board regularly reviews and approves the appetite for credit and counterparty risk, which is documented in risk appetite statements and policy documents. This is implemented and reviewed by the credit risk management teams in each jurisdiction. Credit policies have been updated and amended to include changes to reflect the implementation of IFRS 9.

Portfolio reviews and stress testing are undertaken on all material businesses, where the exposures are analysed to assess any migration in portfolio quality, highlight any vulnerabilities, identify portfolio concentrations and make appropriate recommendations, such as a reduction in risk appetite limits or specific exposures.

Internal credit rating models and ECL methodology

Internal credit rating models have been developed to cover all material asset classes. These internal credit rating models are then used for IFRS 9 modelling but adjusted for key differences. Internal credit models calculate through the economic cycle losses whereas IFRS 9 requires 12-months or lifetime point-in-time losses based on conditions at the reporting date and multiple economic scenarios of the future economic conditions over the expected lives.

Process to determine expected credit loss



ECLs are calculated using three main components:

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

Under IFRS 9, the 12-month and lifetime PDs represent the probability of a default occurring over the next 12 months or the lifetime of the financial exposures, respectively, based on conditions existing at the balance sheet date and future forecasted macro-economic conditions that affect credit risk.

The LGD represents the losses expected on default, taking into account the macro-economic environment.

The EAD represents the expected balance at default, taking into account the repayment of principal and interest from the balance sheet date to the default event together with any expected drawdown of a committed facility.

The calculation of the 12-month ECL is based on the 12-month PD, LGD and EAD along with the effective interest rate (EIR) for the asset. Lifetime ECL is calculated using the lifetime PD curve, and the appropriate LGDs and EADs and discount rates derived from the EIR based on the remaining life of the financial asset.

Capital management

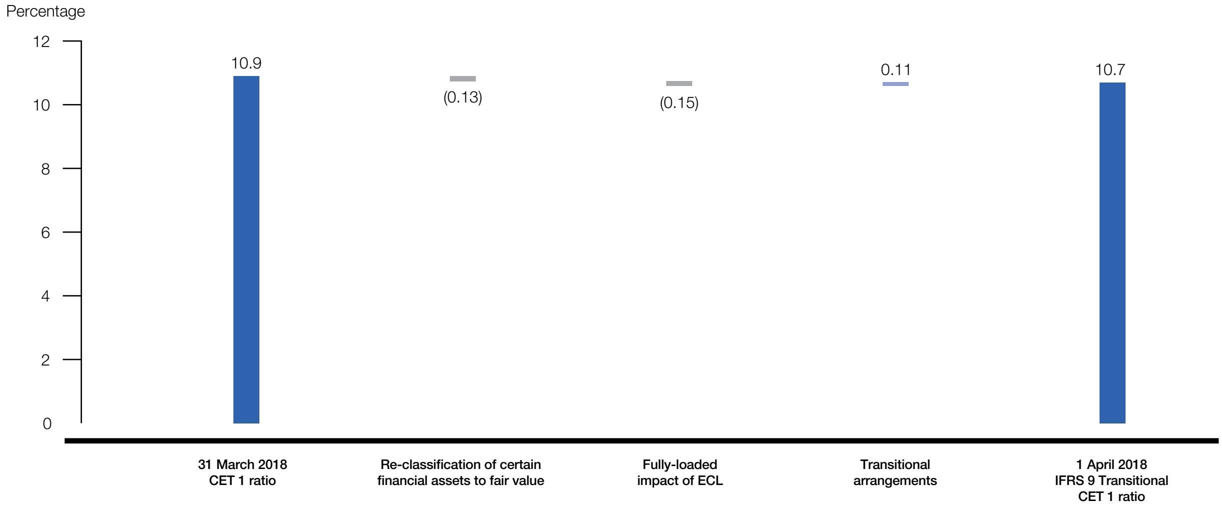
Investec Bank Limited applies the Standardised approach when calculating capital requirements. The impact of IFRS 9 on the group's CET 1 ratio is potentially more significant when compared to similar Internal Ratings Based approach banks, who already deduct from CET 1 capital any excess expected losses over impairment allowances.

We remain lowly leveraged and target a leverage ratio in all our banking subsidiaries in excess of 6%.

The most recent capital plans have been prepared on an IFRS 9 basis to ensure the bank remains sufficiently capitalised under both normal and stressed market conditions.

The South African Reserve Bank has issued Directive 5/2017 that sets out the IFRS 9 transitional arrangements banks may apply to minimise the impact of the IFRS 9 expected credit loss accounting on regulatory capital.

The transitional arrangements allow the day one and any subsequent increases in Stage 1 and Stage 2 expected credit loss provisions to be phased in over three years, recognising 25% on 1 April 2018 , 50% on 31 March 2019, 75 % on 31 March 2020, with full recognition in CET 1 capital in 2021. Investec Bank Limited notified the SARB in April 2018 of its intention to apply the IFRS 9 transitional arrangements, effective 1 April 2018.



Capital impact

The impact on the composition of our regulatory capital under a SARB regulations basis is provided in the table below:

R'million	At 31 March 2018 IAS 39	At 1 April 2018 IFRS 9 Transitional	At 1 April 2018 IFRS 9 Full adoption
Shareholder's equity	36 531	35 637	35 637
Transitional add-back of ECL	–	351	–
Other deductions	(1 702)	(1 702)	(1 702)
Common equity tier 1 capital	**34 829**	**34 286**	**33 935**
Additional tier 1 capital	963	963	963
Tier 1 capital	**35 792**	**35 249**	**34 898**
Tier 2 capital	14 009	14 332	14 332
Transitional add-back of ECL	–	(242)	–
Total regulatory capital	**49 801**	**49 339**	**49 230**
Risk-weighted assets	**320 607**	**320 475**	**320 634**
Capital ratios			
Common equity tier 1 ratio	10.9%	10.7%	10.6%
Tier 1 ratio	11.2%	11.0%	10.9%
Total capital adequacy ratio	15.5%	15.4%	15.4%

Capital ratios R'million	At 31 March 2018 IAS 39	At 1 April 2018 IFRS 9 Transitional	At 1 April 2018 IFRS 9 Full adoption
Tier 1 capital	35 792	35 249	34 898
Total exposure	466 846	466 522	466 278
Leverage ratio	7.7%	7.6%	7.5%

Classification and measurement overview

From 1 April 2018, the group will classify all of its financial assets which fall within the scope of IFRS 9 in the following measurement categories:

- Amortised cost
- Fair value through other comprehensive income (FVOCI)
- Fair value through profit or loss (FVPL).

The classification into one of these categories is based on the entity's business model for managing the assets and the contractual cash flow characteristics of the assets.

The standard sets out different types of business models:

- **Hold to collect:** it is intended to hold the asset to maturity to earn interest; collecting repayments of principal and interest from the customer. These assets are accounted for at amortised cost.
- **Hold to collect and sell:** this model is similar to the hold to collect model, except that the entity may elect to sell some or all of the assets before maturity as circumstances change. These assets are accounted for at FVOCI.
- **Hold to sell/managed on a fair value basis:** the entity originates or purchases an asset with the intention of disposing of it in the short- or medium-term to benefit from capital appreciation or the portfolio is managed on a fair value basis. These assets are accounted for at FVPL.

Solely payments of principal and interest (SPPI)

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the group assesses whether the assets' cash flows represent solely payments of principal and interest (the 'SPPI test'). In making this assessment, the group considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related asset is classified and measured at FVPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payments of principal and interest.

Designation at fair value

The adoption of IFRS 9 also necessitates a review of the designation of financial instruments at fair value. IFRS 9 requires that the designation is revoked where there is no longer an accounting mismatch at 1 April 2018 and permits designations to be revoked or additional designations created at 1 April 2018 if there are accounting mismatches at that date.

As a result:

- fair value designations for financial liabilities have been created where there is an accounting mismatch, as permitted by IFRS 9; and
- fair value designations have been revoked for certain assets where accounting mismatches no longer exist as a result of the adoption of the classification rules of IFRS 9.

For the detailed accounting policies adopted by the group on the adoption of IFRS 9 refer to pages 25 to 29.

Analysis of financial assets and liabilities by measurement basis under IAS 39 and measurement category under IFRS 9

The tables below shows an analysis of assets and liabilities under IAS 39 at 31 March 2018 and under IFRS 9 on 1 April 2018:

IAS 39 measurement basis

	At fair value through profit or loss		
At 31 March 2018 R'million	**Trading**	**Designated at inception**	**Available-for-sale**
Group			
Assets			
Cash and balances at central banks	–	–	–
Loans and advances to banks	–	–	–
Non-sovereign and non-bank cash placements	574	–	–
Reverse repurchase agreements and cash collateral on securities borrowed	9 205	–	–
Sovereign debt securities	–	41 050	17 890
Bank debt securities	–	–	6 135
Other debt securities	–	–	9 053
Derivative financial instruments	12 586	–	–
Securities ongoing from trading activities	875	–	–
Investment portfolio	–	4 847	3 096
Loans and advances to customers	–	17 250	–
Own originated loans and advances to customers securitised	–	–	–
Other loans and advances	–	–	–
Other securitised assets	–	–	–
Interest in associated undertakings	–	–	–
Deferred taxation assets	–	–	–
Other assets	625	–	–
Property and equipment	–	–	–
Investment properties	–	–	–
Goodwill	–	–	–
Intangible assets	–	–	–
Loans to group companies	45	–	–
	23 910	**63 147**	**36 174**
Liabilities			
Deposits by banks	–	–	–
Derivative financial instruments	15 907	–	–
Other trading liabilities	2 305	–	–
Repurchase agreements and cash collateral on securities lent	917	–	–
Customer accounts (deposits)	–	39 485	–
Debt securities in issue	–	–	–
Liabilities arising on securitisation of own originated loans and advances	–	–	–
Current taxation liabilities	–	–	–
Deferred taxation liabilities	–	–	–
Other liabilities	291	–	–
Loans from group companies and subsidiaries	–	–	–
Subordinated liabilities	–	–	–
	19 420	**39 485**	**–**

Total instruments at fair value	Loans and receivables	Held-to-maturity	Financial liabilities at amortised cost	Total instruments at amortised cost	Non-financial instruments or scoped out of IAS 39	Total
–	9 187	–	–	9 187	–	9 187
–	17 265	–	–	17 265	–	17 265
574	9 419	–	–	9 419	–	9 993
9 205	11 275	–	–	11 275	–	20 480
58 940	–	3 463	–	3 463	–	62 403
6 135	583	1 333	–	1 916	–	8 051
9 053	1 205	84	–	1 289	–	10 342
12 586	–	–	–	–	–	12 586
875	–	–	–	–	–	875
7 943	–	–	–	–	–	7 943
17 250	230 224	–	–	230 224	–	247 474
–	6 830	–	–	6 830	–	6 830
–	265	–	–	265	–	265
–	241	–	–	241	–	241
–	–	–	–	–	6 288	6 288
–	–	–	–	–	586	586
625	4 090	–	–	4 090	1 971	6 686
–	–	–	–	–	2 494	2 494
–	–	–	–	–	1	1
–	–	–	–	–	171	171
–	–	–	–	–	412	412
45	13 454	–	–	13 454	–	13 499
123 231	**304 038**	**4 880**	**–**	**308 918**	**11 923**	**444 072**
–	–	–	24 607	24 607	–	24 607
15 907	–	–	–	–	–	15 907
2 305	–	–	–	–	–	2 305
917	–	–	7 478	7 478	–	8 395
39 485	–	–	282 408	282 408	–	321 893
–	–	–	3 473	3 473	–	3 473
–	–	–	1 551	1 551	–	1 551
–	–	–	–	–	202	202
–	–	–	–	–	99	99
291	–	–	3 377	3 377	3 176	6 844
–	–	–	7 007	7 007	–	7 007
–	–	–	13 374	13 374	–	13 374
58 905	**–**	**–**	**343 275**	**343 275**	**3 477**	**405 657**

Analysis of financial assets and liabilities by measurement basis under IAS 39 and measurement category under IFRS 9 *(continued)*

IFRS 9 measurement categories

At 1 April 2018 R'million	At fair value through profit or loss		
	IFRS 9 mandatory		
	Trading	Non-trading	Designated at initial recognition
Group			
Assets			
Cash and balances at central banks	–	–	–
Loans and advances to banks	–	–	–
Non-sovereign and non-bank cash placements	–	574	–
Reverse repurchase agreements and cash collateral on securities borrowed	7 061	2 144	–
Sovereign debt securities	–	11 704	–
Bank debt securities	–	298	–
Other debt securities	–	953	–
Derivative financial instruments	12 564	–	–
Securities arising from trading activities	875	–	–
Investment portfolio	–	6 028	–
Loans and advances to customers	–	2 004	17 211
Own originated loans and advances to customers securitised	–	–	–
Other loans and advances	–	–	–
Other securitised assets	–	–	–
Interest in associated undertakings	–	–	–
Deferred taxation assets	–	–	–
Other assets	325	300	–
Property and equipment	–	–	–
Investment properties	–	–	–
Goodwill	–	–	–
Intangible assets	–	–	–
Loans to group companies	45	–	–
	20 870	**24 005**	**17 211**
Liabilities			
Deposits by banks	–	–	–
Derivative financial instruments	15 907	–	–
Other trading liabilities	2 305	–	–
Repurchase agreements and cash collateral on securities lent	917	–	–
Customer accounts (deposits)	–	–	39 453
Debt securities in issue	–	–	–
Liabilities arising on securitisation of own originated loans and advances	–	–	–
Current taxation liabilities	–	–	–
Deferred taxation liabilities	–	–	–
Other liabilities	291	–	–
Loans from group companies	–	–	–
Subordinated liabilities	–	–	–
	19 420	**–**	**39 453**

At fair value through other comprehensive income					
Debt instrument with dual business model	Equity instruments	Total instruments at fair value	Amortised cost	Non-financial instruments or scoped out of IFRS 9	Total
–	–	–	9 180	–	9 180
–	–	–	17 263	-	17 263
–	–	574	9 398	–	9 972
–	–	9 205	11 275	–	20 480
46 091	–	57 795	4 568	–	62 363
4 111	–	4 409	3 624	–	8 033
5 844	–	6 797	3 560	–	10 357
–	–	12 564	–	–	12 564
–	–	875	–	–	875
–	3 096	9 124	–	–	9 124
–	–	19 215	225 947	–	245 162
–	–	–	6 826	–	6 826
–	–	–	265	–	265
–	–	–	241	–	241
–	–	–	–	6 288	6 288
–	–	–	–	933	933
–	–	625	4 077	1 971	6 673
–	–	–	–	2 494	2 494
–	–	–	–	1	1
–	–	–	–	171	171
–	–	–	–	412	412
–	–	45	13 454	–	13 499
56 046	**3 096**	**121 228**	**309 678**	**12 270**	**443 176**
–	–	–	24 607	–	24 607
–	–	15 907	–	–	15 907
–	–	2 305	–	–	2 305
–	–	917	7 478	–	8 395
–	–	39 453	282 408	–	321 861
–	–	–	3 473	–	3 473
–	–	–	1 551	–	1 551
–	–	–	–	202	202
–	–	–	–	99	99
–	–	291	3 407	3 176	6 874
–	–	–	7 007	–	7 007
–	–	–	13 374	–	13 374
–	**–**	**58 873**	**343 305**	**3 477**	**405 655**

Reconciliation of IAS 39 carrying amount to IFRS 9 carrying amount

The table below reflects the impact of IFRS 9 implementation on the balance sheet lines and shows movements between amortised cost and fair value:

Only assets and liabilities which have changed are shown.

R'million	IAS 39 carrying amount At 31 March 2018	Reclassifi-cations in	Reclassifi-cations out	Remeasure-ments	ECL	IFRS 9 carrying amount At 1 April 2018
Group						
Assets						
Financial assets at amortised cost (previously loans and receivables and held-to-maturity)						
Cash and balances at central banks	9 187	–	–	–	(7)	9 180
Loans and advances to banks	17 265	–	–	–	(2)	17 263
Non-sovereign and non-bank cash placements	9 419	–	–	–	(21)	9 398
Reverse repurchase agreements and cash collateral on securities borrowed	11 275	–	–	–	*	11 275
Sovereign debt securities	3 463	1 144[2]	–	(36)	(3)	4 568
Bank debt securities	1 916	1 727[2]	–	(16)	(3)	3 624
Other debt securities	1 289	2 255[2]	–	20	(4)	3 560
Loans and advances to customers	230 224	–	(3 625)[1]	–	(652)	225 947
Own originated loans and advances to customers securitised	6 830	–	–	–	(4)	6 826
Other assets	4 090	–	–	–	(13)	4 077
Financial assets at fair value through profit or loss (previously trading and designated at inception)						
Sovereign debt securities	41 050	–	(29 346)[3]	–	–	11 704
Bank debt securities	–	298[4]	–	–	–	298
Other debt securities	–	953[4]	–	–	–	953
Derivative financial instruments	12 586	–	(22)[1]	–	–	12 564
Investment portfolio	4 847	1 641[1]	–	(460)	–	6 028
Loans and advances to customers	17 250	2 004[1]	–	–	(39)	19 215
Financial assets at fair value through other comprehensive income (previously available-for-sale)						
Sovereign debt securities	17 890	29 345[3]	(1 144)[2]	19	(19)	46 091
Bank debt securities	6 135	–	(2 024)[2&4]	7	(7)	4 111
Other debt securities	9 053	–	(3 209)[2&4]	3	(3)	5 844
Liabilities						
Financial liabilities at amortised cost						
Other liabilities	3 377	–	–	–	30	3 407
Financial liabilities at fair value						
Customer accounts (deposits)	39 485	–	–	(32)	–	39 453

1 *Certain loans and advances to customers which were previously classified as amortised cost but which do not meet the SPPI test required for amortised cost classification under IFRS 9 have been reclassified to FVPL.*
2 *Certain debt instruments previously held as available-for-sale under IAS 39, have been reclassified to amortised cost under IFRS 9 as it is the intention to hold these specific assets to collect contractual cash flows which meet the SPPI test.*
3 *Certain sovereign debt securities of R29.3 billion have been reclassified to FVOCI as a dual business model was applicable to these assets.*
4 *Certain debt securities previously held as available-for-sale which do not meet the SPPI test have been reclassified to FVPL.*
* *Less than R1 million.*

Reconciliation of impairment allowance balance from IAS 39 to IFRS 9

The following table reconciles prior year's closing impairment allowance measured in accordance with the IAS 39 incurred loss model to the new impairment allowance measured in accordance with the IFRS 9 expected credit loss model at 1 April 2018:

R'million	Loan loss allowance and provision IAS 39 and and IAS 37 at 31 March 2018	Reclassification	Remeasurement	ECL under IFRS 9 at 1 April 2018	Total increase in impairment allowances
Group					
Assets					
Loans and receivables (IAS 39)/Financial assets at amortised cost (IFRS 9)					
Cash and balances at central banks	–	–	(7)	(7)	(7)
Loans and advances to banks	–	–	(2)	(2)	(2)
Non-sovereign and non-bank cash placements	–	–	(21)	(21)	(21)
Reverse repurchase agreements and cash collateral on securities borrowed	–	–	*	*	*
Sovereign debt securities	–	–	(3)	(3)	(3)
Bank debt securities	–	–	(3)	(3)	(3)
Other debt securities	–	–	(4)	(4)	(4)
Loans and advances to customers	(1 430)	154	(690)	(1 966)	(536)
Own originated loans and advances to customers securitised	(6)	–	(4)	(10)	(4)
Other loans and advances	(25)	–	–	(25)	–
Other assets	(53)	–	(14)	(67)	(14)
Available for sale (IAS 39)/Financial assets at FVOCI (IFRS 9)					
Sovereign debt securities	–	–	(19)	(19)	(19)
Bank debt securities	–	–	(7)	(7)	(7)
Other debt securities	–	–	(3)	(3)	(3)
Liabilities					
Off balance sheet exposures (recognised in other liabilities					
Guarantees	–	–	(5)	(5)	(5)
Committed facilities related to loans and advances to customers	–	–	(25)	(25)	(25)
Total	**(1 514)**	**154**	**(807)**	**(2 167)**	**(653)**

* *Less than R1 million.*

The impact of transition to IFRS 9 on equity is as follows:

Only components of equity which have changed are shown.

R'million	Other reserves: Own credit revaluation reserve	Other reserves: Available-for sale reserve/ Fair value through OCI reserve	Retained income	Total affected equity components
Closing balance under IAS 39 at 31 March 2018	**–**	**528**	**21 855**	**22 383**
Recognition of ECL, including those measured at FVOCI	–	29	(653)	(624)
Reclassification of loans from amortised cost to FVPL	–	–	(618)	(618)
Reclassification of debt instruments FVPL to FVOCI	–	29	(29)	–
Reclassification of debt instruments from OCI to FVPL	–	24	(24)	–
Reclassification of debt instruments from OCI to amortised cost	–	(31)	–	(31)
Remeasurement of financial liabilities designated at fair value	–	–	32	32
Transfer of fair value adjustments attributable to own credit risk	32	–	(32)	–
Deferred taxation	(9)	(14)	370	347
Opening balance under IFRS 9 at 1 April 2018	**23**	**565**	**20 901**	**21 489**

Accounting policies

Basis of preparation

This transition report has been prepared based on IFRS 9's transition guidelines and these disclosures compare the closing balance sheet at 31 March 2018 (under IAS 39) to the opening balance sheet at 1 April 2018 (under IFRS 9). These disclosures enable the reconciliation between:

- the balance sheet line items under IAS 39 and IFRS 9;
- the measurement category under IAS 39 and IFRS 9; and
- the class of financial instrument as required by IFRS 7.

The group accounting policies related to financial instruments, which have been significantly changed as the result of the implementation of IFRS 9, are applicable with effect from 1 April 2018. The full set of accounting policies is set out in the 2018 integrated annual report.

Standards adopted during the year ending 31 March 2019

The requirements of IFRS 9 'Financial Instruments' were adopted from 1 April 2018. IFRS 9 includes an accounting policy choice to remain with IAS 39 hedge accounting, which the group has exercised.

The adoption of IFRS 9 includes the adoption of 'Prepayment Features with Negative Compensation (Amendments to IFRS 9)' which is effective for annual periods beginning on or after 1 January 2019 with early adoption permitted. The group has decided to apply the amendment from 1 April 2018.

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The group is not restating comparatives on initial application as permitted by IFRS 9.

Financial instruments

Financial instruments are initially recognised at their fair value. For financial assets or financial liabilities not held at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial assets or financial liabilities are included in the initial measurement. All other transaction costs are recorded in the income statement immediately. Regular way purchase and sales transactions in respect of financial assets that require delivery of a financial instrument within the timeframe established by market convention are recorded at trade date.

Business model assessment

For financial assets, IFRS 9 requires that a business model assessment is carried out which reflects how the group manages the assets in order to generate cash flows. The assessment is at a portfolio level, being the level at which the portfolio is managed. Factors considered by the group in determining the business model for a group of assets include past experience on how the cash flows for these assets were collected, how the assets' performance is evaluated and reported and how risks are assessed and managed.

The standard sets out different types of business models:

- **Hold to collect:** it is intended to hold the asset to maturity to earn interest, collecting repayments of principal and interest from the customer. These assets are accounted for at amortised cost.
- **Hold to collect and sell:** this model is similar to the hold to collect model, except that the entity may elect to sell some or all of the assets before maturity to achieve the objectives of the business model. These assets are accounted for at FVOCI.
- **Hold to sell/managed on a fair value basis:** the entity originates or purchases an asset with the intention of disposing of it in the short- or medium- term to benefit from capital appreciation or the portfolio is managed on a fair value basis. These assets are accounted for at FVPL.

However, the group may make the following irrevocable election/designation at initial recognition of a financial asset on an asset-by-asset basis:

- elect to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies, in OCI; and
- a debt instrument that meets the amortised cost or FVOCI criteria as measured at FVPL if doing so eliminates or significantly reduces an accounting mismatch (referred to as the fair value option).

The classification into one of these categories is based on the entity's business model for managing the assets and the contractual cash flow characteristics of the assets.

Solely payment of principal and interest (SPPI)

Where the business model is to hold assets to collect contractual cash flows or to collect contractual cash flows and sell, the group assesses whether the assets' cash flows represent solely payments of principal and interest (the SPPI test). In making this assessment, the group considers whether the contractual cash flows are consistent with a basic lending arrangement (i.e. interest includes only consideration for the time value of money, credit risk, other basic lending risks and a profit margin that is consistent with a basic lending arrangement). Where the contractual terms introduce exposure to risk or volatility that are inconsistent with a basic lending arrangement, the related asset is classified and measured at FVPL.

Financial assets with embedded derivatives are considered in their entirety when determining whether their cash flows are solely payments of principal and interest.

Financial assets and liabilities measured at amortised cost

Financial assets that are held to collect the contractual cash flows and that contain contractual terms that give rise to cash flows that are solely payments of principal and interest, such as most loans and advances to banks and customers and some debt securities, are measured at amortised cost. In addition, most financial liabilities are measured at amortised cost.

The group may commit to provide a loan which has not yet been drawn. When the loan that arises from the lending commitment is expected to meet the criteria to be measured at amortised cost, the undrawn commitment is also considered and is included in the impairment calculation below.

The carrying value of these financial assets at initial recognition includes any directly attributable transactions costs. If the initial fair value is lower than the cash amount advanced, such as in the case of some leveraged finance and syndicated lending activities, the difference is deferred and recognised over the life of the loan through the recognition of interest income, unless the loan is credit impaired.

Financial assets and liabilities measured at fair value through other comprehensive income (FVOCI)

Financial assets held for a business model that is achieved by both collecting contractual cash flows and selling and that contain contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest are measured at FVOCI. They are recognised on the trade date when the group enters into contractual arrangements to purchase and are normally derecognised when they are either sold or redeemed.

They are subsequently remeasured at fair value and changes therein (except for those relating to impairment, interest income and foreign currency exchange gains and losses) are recognised in other comprehensive income until the assets are sold. Upon disposal, the cumulative gains or losses in other comprehensive income are recognised in the income statement as 'Gains less losses arising from derecognition of debt instruments measured at fair value through other comprehensive income'.

Financial assets measured at FVOCI are included in the impairment calculations set out below and impairment is recognised in profit or loss.

On initial recognition of an equity investment that is not held for trading, the group may irrevocably elect to present subsequent changes in fair value in other comprehensive income. This election is made on an investment-by-investment basis.

Impairment of financial assets held at amortised cost or FVOCI

At each balance sheet date each financial asset or portfolio of advances categorised at amortised cost or at fair value through other comprehensive income, issued financial guarantee and loan commitment is measured for ECL impairment. Loss allowances are forward-looking, based on 12-month expected credit losses where there has not been a significant increase in credit risk rating, otherwise allowances are based on lifetime expected losses.

Expected credit losses are a probability-weighted estimate of credit losses. The probability is determined by the risk of default which is applied to the cash flow estimates. On a significant increase in credit risk, credit losses are rebased from 12-month to lifetime expectations. A change in credit risk is typically but not necessarily associated with a change in the expected cash flows.

The costs of loss allowances on assets held at amortised cost are presented as impairments in the income statement. Allowances in respect of financial guarantees and loan commitments are presented as other liabilities and charges recorded within income statement impairments. Financial assets held at amortised cost are presented net of allowances except where the asset has been wholly or partially written off.

Financial assets where 12-month ECL is recognised are considered to be 'Stage 1', financial assets which are considered to have experienced a significant increase in credit risk are in 'Stage 2', and financial assets for which there is objective evidence of impairment or are considered to be in default or otherwise credit-impaired are in 'Stage 3'.

Financial assets and liabilities held at fair value through profit or loss

Financial instruments held at fair value through profit or loss include all instruments classified as held-for-trading, those instruments designated as held at fair value through profit or loss and those financial assets which do not meet the criteria for amortised cost or FVOCI.

Financial instruments classified as FVPL are initially recorded at fair value on the balance sheet with changes in fair value subsequently recognised in the income statement. Financial instruments are classified as trading when they are held with the intention of short-term disposal, held with the intention of generating short-term profit, or are derivatives which are not designated as part of effective hedges. Financial instruments designated as held at fair value through profit or loss are designated as such on initial recognition of the instrument and remain in this classification until derecognition.

Changes in fair value resulting from own credit risk on financial liabilities designated at fair value is recognised in other comprehensive income.

Financial assets and liabilities are designated as held at fair value through profit or loss only if:

- they eliminate or significantly reduce a measurement or recognition inconsistency that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- a group of financial liabilities or both financial assets and financial liabilities is managed and its performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy and information about the group is provided internally on that basis to the group's key management personnel; or
- a financial liability contract contains one or more embedded derivatives (which significantly modifies the cash flows that would be required by the contract and is not clearly prohibited from separation from the host contract) and the group has designated the entire hybrid contract as a financial instrument at fair value through profit or loss.

Securitisation/credit investment and trading activities exposures

The group makes use of securitisation vehicles as a source of finance, as a means of risk transfer and to leverage returns through the retention of equity tranches in low default rate portfolios. The group predominantly focuses on the securitisation of lease receivables. The group also trades in structured credit investments.

The structured entities are consolidated under IFRS 10 Consolidated Financial Statements when the group has exposure to or rights to, variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Loans and advances that are originated are transferred to structured entities, and the structured entities issue debt securities to external investors to fund the purchase of the securitised assets. When the group consolidates the structured entity, the group recognises the assets and liabilities on a gross basis. When the group does not consolidate the structured entity, the securitised assets are derecognised and only any position still held by the group in the structured entity is reflected.

Day-one profit or loss

When the transaction price differs from the fair value of other observable current market transactions in the same instrument or based on the valuation technique whose variables include only data from observable markets, the difference between the transaction price and fair value is recognised immediately in the income statement.

In cases where fair value is determined using data which is not observable, the difference between the transaction price and model value is only recognised in the income statement when the inputs become observable, or when the instrument is derecognised or over the life of the transaction.

Derecognition of financial assets and liabilities

A financial asset, or a portion thereof, is derecognised when the group's rights to cash flows have expired or when the group has transferred its rights to cash flows relating to the financial assets and either (a) the group has transferred substantially all the risks and rewards associated with the financial assets or (b) the group has neither transferred nor retained substantially all the risks and rewards associated with the financial assets but has transferred control of the assets.

The treatment of a renegotiation or modification of the contractual cash flows of a financial asset depends upon whether the modification is done for commercial reasons, in which case if they are significant the old asset is derecognised and a new asset recognised, or because of financial difficulties of the borrower.

A financial liability is derecognised when it is extinguished, that is when the obligation is discharged, cancelled or expired. When an existing financial liability is replaced or modified with substantially different terms, such a replacement or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the income statement.

Reclassification of financial instruments

Financial assets are only reclassified where there has been a change in business model. Financial liabilities cannot be reclassified.

Accounting policies *(continued)*

Derivative financial instruments

All derivative instruments of the group are recorded on the balance sheet at fair value. Positive and negative fair values are reported as assets and liabilities respectively.

Derivative positions are entered into either for trading purposes or as part of the group's asset and liability management activities to manage exposures to interest rate and foreign currency risks. Both realised and unrealised profit or losses arising on derivatives are recognised in the income statement as part of trading income (other than circumstances in which cash flow hedging is applied as detailed in the hedge accounting section below).

Derivative instruments entered into as economic hedges which do not qualify for hedge accounting and derivatives that are entered into for trading purposes are treated in the same way as instruments that are held-for-trading.

Credit derivatives are entered into largely for trading purposes. Credit derivatives are initially recognised at their fair values, being the transaction price of the derivative. Subsequently the derivatives are carried at fair value, with movements in fair value through profit or loss, based on the current market price or remeasured price. The counterparty risk from derivative transactions is taken into account when reporting the fair value of derivative positions. The adjustment to the fair value is known as the credit value adjustment (CVA).

Hedge accounting

The group applies either fair value or hedge of net investments in foreign operations accounting when the transactions meet the specified hedge accounting criteria. To qualify for hedge accounting treatment, the group ensures that all of the following conditions are met:

- At inception of the hedge, the group formally documents the relationship between the hedging instrument(s) and hedged item(s) including the risk management objectives and the strategy in undertaking the hedge transaction. Also at the inception of the hedge relationship, a formal assessment is undertaken to ensure the hedging instrument is expected to be highly effective in offsetting the designated risk in the hedged item. A hedge is expected to be highly effective if the changes in fair value attributable to the hedged risk during the period for which the hedge is designated are expected to offset in a range of 80% to 125%.
- The effectiveness of the hedge can be reliably measured, i.e. the fair value of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured.
- The hedge effectiveness is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.

For qualifying fair value hedges, the change in fair value of the hedging instrument is recognised in the income statement. Changes in fair value of the hedged item that is attributable to the hedged risk are also recognised in the income statement.

Embedded derivatives

To the extent that a derivative may be embedded in a hybrid contract for a financial liability and the hybrid contract is not carried at fair value with changes in fair value recorded in the income statement, the embedded derivative is separated from the host contract and accounted for as a standalone derivative if and only if:

- The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; and
- A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative.

Offsetting of financial assets and liabilities

Financial assets and liabilities are offset when there is both an intention to settle on a net basis (or simultaneously) and a currently enforceable legal right to offset exists.

Issued debt and equity financial instruments

Financial instruments issued by the group are classified as liabilities if they contain a contractual obligation to deliver cash or another financial asset.

Financial instruments issued by the group are classified as equity where they confer on the holder a residual interest in the group, and the group has no obligation to deliver either cash or another financial asset to the holder. The components of compound issued financial instruments are accounted for separately with the liability component separated first and any residual amount being allocated to the equity component.

Equity instruments are initially measured net of directly attributable issue costs.

Sale and repurchase agreements (including securities borrowing and lending)

Securities sold subject to a commitment to repurchase, at a fixed price or a selling price plus a lender's return, remain on balance sheet. Proceeds received are recorded as a liability on balance sheet under 'repurchase agreements and cash collateral on securities lent'. Securities that are purchased under a commitment to resell the securities at a future date are not recognised on the balance sheet. The consideration paid is recognised as an asset under 'reverse repurchase agreements and cash collateral on securities borrowed'.

The difference between the sale and repurchase prices is treated as interest income/expense and is accrued over the life of the agreement using the effective interest method.

Securities borrowing transactions that are not cash collateralised are not included on the balance sheet. Securities lending and borrowing transactions which are cash collateralised are accounted for in the same manner as securities sold or purchased subject to repurchase commitments.

Financial guarantees

Financial guarantee contracts issued by the group are those contracts that require a payment to be made to reimburse the holder for a loss it incurs because the specified debtor fails to make a payment when due, in accordance with the terms of a debt instrument. Financial guarantees are initially recognised at fair value, adjusted for the transaction costs that are directly attributable to the issuance of the guarantee.

Subsequent to initial recognition, the liability under each guarantee is measured at the higher of the amount initially recognised less cumulative revenue and the initial amount less any impairment calculated as set out above. Subsequent to initial measurement, all changes in the balance sheet carrying value are recognised in the income statement.

Independent auditors' report

To the Board of Directors of Investec Bank Limited

Opinion

We have audited the consolidated special purpose financial information, consisting of the consolidated opening balance sheet, related disclosures and a summary of significant accounting policies (the 'consolidated special purpose financial information') which have been denoted with the audited information icon set out on pages 3 to 29, which reflects the impact of the adoption of the International Financial Reporting Standard (IFRS) 9, *Financial Instruments*, on Investec Bank Limited, and its subsidiaries (together the 'Group') at 1 April 2018.

In our opinion, the consolidated special purpose financial information of the Group as at 1 April 2018 is prepared, in all material respects, in accordance with the Basis of preparation paragraph on page 25 to the consolidated special purpose financial information.

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 *Auditors' responsibilities for the audit of the consolidated special purpose financial information* section of our report. We are independent of the Group in accordance with the *Independent Regulatory Board for Auditors Code of Professional Conduct for Registered Auditors (IRBA Code)* and other independence requirements applicable to performing audits of financial statements in South Africa. We have fulfilled our other ethical responsibilities in accordance with the IRBA Code and in accordance with other ethical requirements applicable to performing audits in South Africa. The IRBA Code is consistent with the International Ethics Standards Board for Accountants *Code of Ethics for Professional Accountants* (Parts A and B). We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter – Basis of accounting and restriction on use

We draw attention to the Basis of preparation paragraph on page 25 to the consolidated special purpose financial information which describes the basis of accounting of the consolidated special purpose financial information. The consolidated special purpose financial information is prepared by the Group in order to disclose an understanding of the impacts of the change in accounting standard from IAS 39, *Financial Instruments: Recognition and Measurement*, to IFRS 9, *Financial Instruments*, which became effective for the Group on 1 April 2018. As a result the consolidated special purpose financial information being prepared on a financial reporting framework designed to meet the information needs of a specific user, namely the directors of Investec Bank Limited, the consolidated special purpose financial information may not be suitable for another purpose. Our report is intended solely for the directors of Investec Bank Limited and should not be used by parties other than the directors of the Group. Our opinion is not modified in respect of this matter.

Other information

The directors are responsible for the other information. The other information comprises the information which have not been denoted with the audited information icon in this report. The other information does not include the consolidated special purpose financial information and our auditors' report thereon.

Our opinion on the consolidated special purpose financial information 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 consolidated special purpose financial information, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated special purpose financial information 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 consolidated special purpose financial information

The directors are responsible for the preparation of the consolidated special purpose financial information in accordance with the Basis of preparation paragraph on page 25 to the consolidated special purpose financial information, for determining that the basis of preparation is appropriate in the circumstances, and for such internal control as the directors determine is necessary to enable the preparation of the consolidated special purpose financial information that is free from material misstatement, whether due to fraud or error.

In preparing the consolidated special purpose financial information, the directors are responsible for assessing the Group'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 Group or to cease operations, or have no realistic alternative but to do so.

Auditors' responsibilities for the audit of the consolidated special purpose financial information

Our objectives are to obtain reasonable assurance about whether the consolidated special purpose financial information as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditors' 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 this consolidated special purpose financial information.

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 consolidated special purpose financial information, 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 Group's internal control.
- 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 Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated special purpose financial information 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 auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated special purpose financial information. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

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.

Ernst & Young Inc.
Registered Auditor

Ernst & Young Inc.

Per Gail Moshoeshoe
Chartered Accountant South Africa
Registered Auditor
Director

15 June 2018

KPMG Inc.
Registered Auditor

KPMG Inc

Per Tracy Middlemiss
Chartered Accountant South Africa
Registered Auditor
Director

15 June 2018