



IFRS 9 – *FINANCIAL INSTRUMENTS*  
TRANSITIONAL REPORT  
as at 1 March 2018



## External audit reasonable assurance report

Capitec Bank Holdings Limited (the group) formally transitioned to IFRS 9 – *Financial Instruments* (IFRS 9) on 1 March 2018. This Transition Report has been presented based on the group's 28 February 2018 financial information to illustrate the impact of implementing IFRS 9 on 1 March 2018.

The group requested its external auditors, being PricewaterhouseCoopers Inc. (PwC), to perform a reasonable assurance engagement, in accordance with ISAE 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*, in respect of the Information contained in pages 2 to 20 of the group's Transitional Report as at the date of initial application (DIA), being 1 March 2018.

The group's external auditors' reasonable assurance report is contained in Appendix D on page 22.

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# Executive summary

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In July 2014 the International Accounting Standards Board (IASB) issued International Financial Reporting Standard 9 – *Financial Instruments* (IFRS 9), which is effective for the group from 1 March 2018. IFRS 9 replaces IAS 39 – *Financial Instruments: Recognition and Measurement* (IAS 39).

The objective of IFRS 9 is to establish principles for the reporting of financial assets and financial liabilities in particular relating to the classification and measurement of financial assets, hedging and the introduction of the expected credit loss (ECL) impairment provisioning.

The most significant measurement impact of IFRS 9 on the group therefore relates to the ECL impairment model on the loans and advances book measured at amortised cost. The impact on other debt instruments measured at amortised cost, as well as the undrawn credit card facilities was calculated but found not to have a material impact on DIA.

In terms of IAS 39, loans and advances and other financial assets measured at amortised cost were impaired and impairment losses were recognised when there was objective evidence of default as a result of one or more events that occurred after the initial recognition of the financial assets – hence an incurred loss model was applied.

IFRS 9 introduces an ECL model. At a minimum, an impairment provision is required to be measured at an amount equal to the 12 month ECL for financial assets carried at amortised cost. Where there has been a significant increase in credit risk (SICR) since initial recognition, an impairment provision is measured at an amount equal to the life-time ECL of the financial assets carried at amortised cost. ECL is required to be recognised for both on- and off-balance sheet exposures.

The group has elected to not restate its comparative information as permitted by IFRS 9. Accordingly, the impact of IFRS 9 has been applied retrospectively with an adjustment to the group's opening retained earnings on 1 March 2018. Therefore comparative information in the prior period annual financial statements will not be amended for the impact of IFRS 9.

The ratios and numbers are based on group consolidated numbers. This does not differ materially from bank on DIA. On the DIA, being 1 March 2018, the summarised financial impact for the group is:

**Common equity  
Tier 1 ratio (CET1)  
-0.6%<sup>(1)</sup>**

**Group's reserves  
-R648 million  
(R900 million  
pre-tax)**

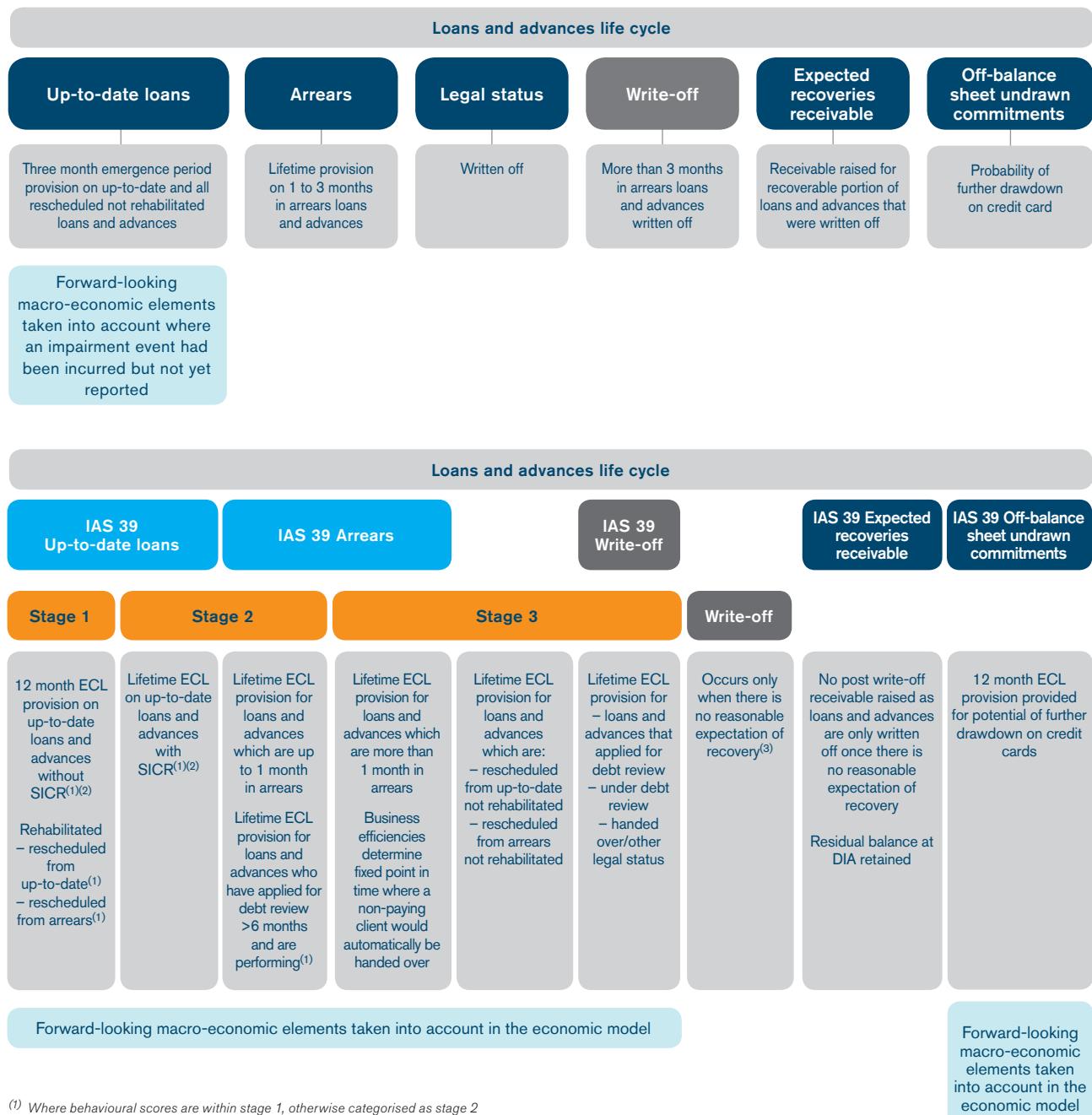
**Impairment  
provisions  
(pre-tax)  
+R900 million**

<sup>(1)</sup> This represents the phased in IFRS 9 transition impact. The impact to the group's CET1 after taking into account the South African Reserve Bank (SARB) phase-in provision, results in a CET1 ratio of 33.3% as at the DIA.

## Other matters upon transition to IFRS 9

As disclosed in the group annual financial statements as at 28 February 2018, there are no major deviations in the classification of financial assets from IAS 39 to IFRS 9 and the group has elected to continue with IAS 39 hedge accounting as permitted by IFRS 9. The group will however still be required to implement the revised hedge accounting disclosures that are required by IFRS 9 related amendments to IFRS 7 – *Financial instruments: Disclosures* amendments.

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



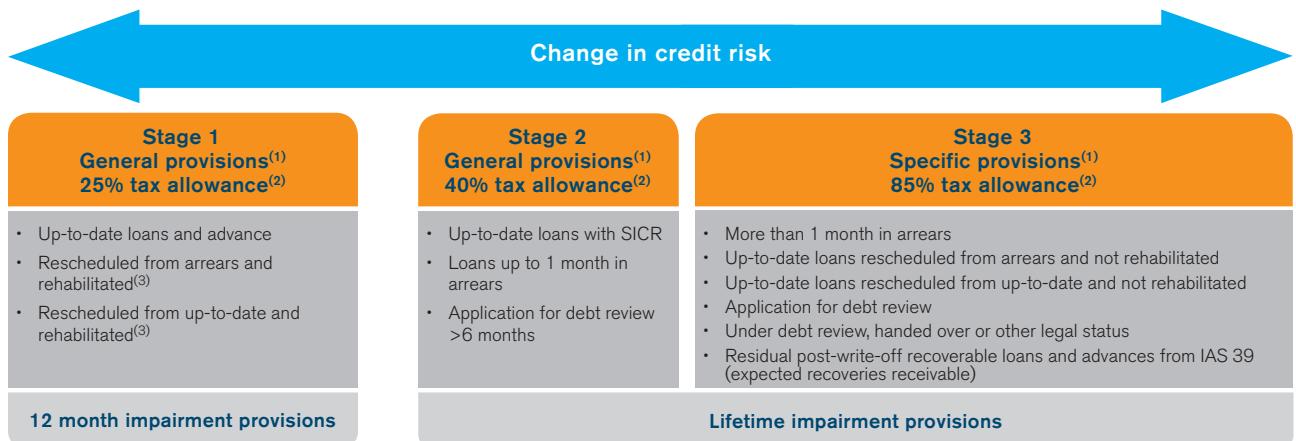
(1) Where behavioural scores are within stage 1, otherwise categorised as stage 2

(2) Significant increase in credit risk

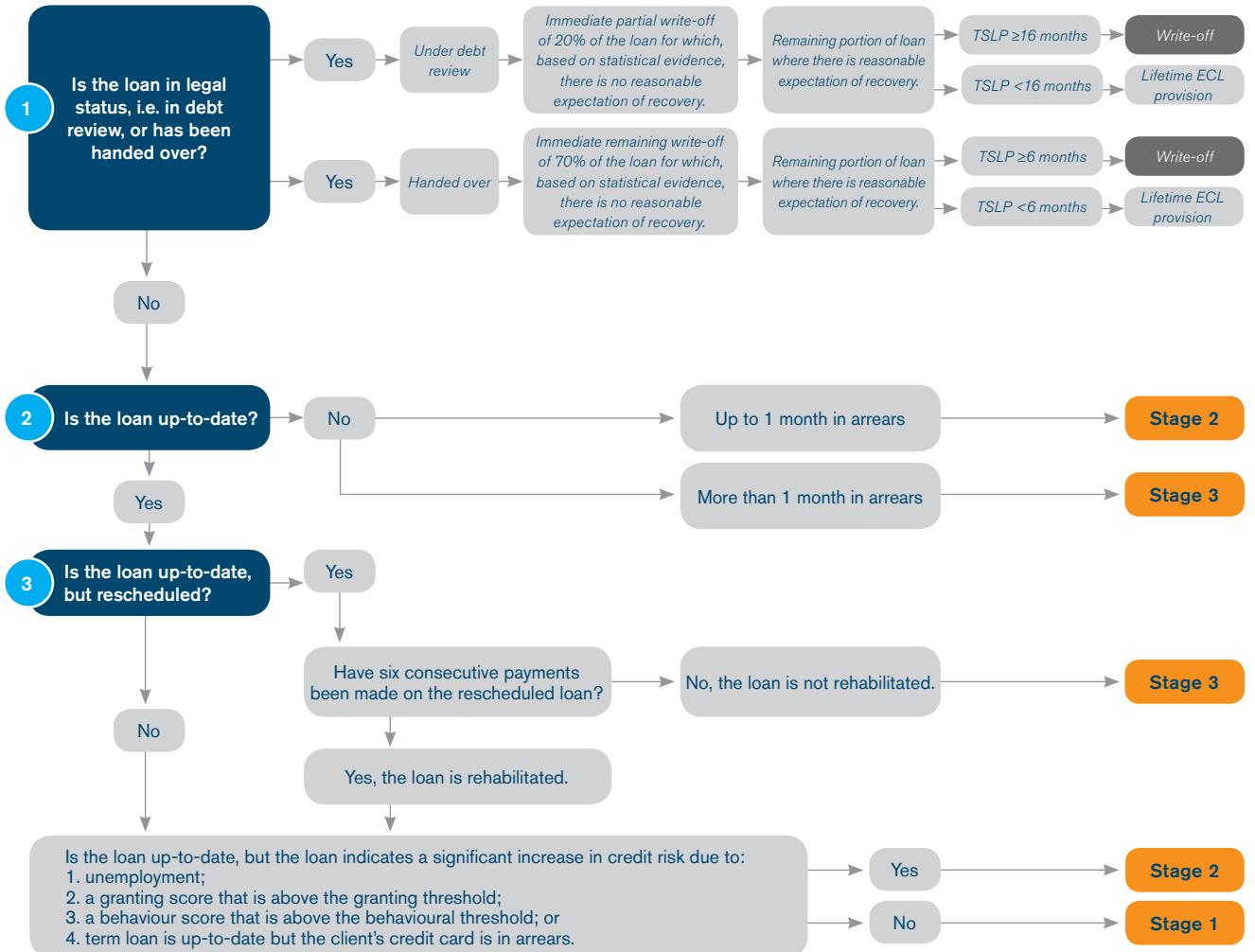
(3) Below diagram illustrates the write-off point under IFRS 9, TSLP = time since last payment:



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) Where behaviour scores are within stage 1, otherwise categorised as stage 2.

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.

<b>Loans and advances status as reported in the 2018 financial statements</b>	<b>Treatment under IAS 39</b>	<b>Treatment under IFRS 9</b>
Up-to-date loans and advances, rehabilitated rescheduled loans	The group 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.  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 group applied an IBNR emergence period of three months for all non-rehabilitated rescheduled loans.  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.  Rescheduled from up-to-date: 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.  Rescheduled from arrears: 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 group applied a lifetime impairment provision for arrears as one payment missed was defined as a loss event under IAS 39.  The expected lifetime of the loans and advances were calculated with reference to the group'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.  Loans that are more than one month in arrears are seen as stage 3, being credit impaired and have a lifetime ECL applied.  The expected lifetime of loans and advances are now calculated with reference to the group's updated write-off policy under IFRS 9.

<b>Loans and advances status as reported in the 2018 financial statements</b>	<b>Treatment under IAS 39</b>	<b>Treatment under IFRS 9</b>
Expected recovery receivable	A receivable was raised by the group 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.  The balance at DIA will remain in loans and advances and a lifetime ECL is applied. Cash collected relating to this balance will be used to settle the balance. It is expected that a significant portion of the receivable will be recovered in the current year, with the remaining balance being phased out over time. If more cash is received than was originally estimated, this 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, or a part thereof, 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.  The period to write-off will therefore be significantly longer under IFRS 9.
Forward-looking macro-economic assumptions	The group 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.

# Application of IFRS 9 ECL to the group

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## 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.

These three stages are in line with the SARB Directive 5/2017.

### *Significant increase in credit risk (SICR)*

The group considers reasonable and supportable information based on the group'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 group's ECL framework aligns with the group's credit granting strategy.

### *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 group therefore applies write-off for loans which are in legal status when the present value of projected future recoveries is less than 5% of the gross balance before partial write-off. Currently this is determined to be 16 months since last payment for a loan in debt review and 6 months since last payment for a loan which is handed over.

To prevent the build-up of the gross loans and advances, the group will be applying partial write-off as allowed under IFRS 9. In the instance of new loans rolling into legal status, the group will immediately apply a partial write-off of 20% of the balance of all accounts rolling into debt review and 70% for handed over and other legal statuses. This is supported by statistical evidence.

All recoveries after full write-off are recognised as bad debts recovered and is not taken into account when calculating the expected recoveries receivable.

#### Examples:

##### *Client in debt review – no further cash is collected after partial write-off point:*

20% immediate partial write-off of loan balance with the remaining balance retained on book for a further 16 months (TSLP) before being written off (the point where less than 5% recovery has been determined).

##### *Client handed over/other legal status – no further cash is collected after partial write-off point:*

70% immediate partial write-off of loan balance with the remaining balance retained on book for a further 6 months (TSLP) before being written off (the point where less than 5% recovery has been determined).

### *Interest income calculation*

For loans and advances in stage 1 and stage 2, the group calculates interest income by applying the effective interest rate (EIR) to the gross carrying amount. Interest income for loans and advances in stage 3 is calculated by applying the EIR to the net amount (i.e. the gross carrying amount less the ECL allowance).

## Model description

### Stage determination

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 group measures the impairment provision at an amount equal to the 12 month ECL. The group 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 group considers the following to be SICR for loans and advances extended to the client:

- A client has been reported as being unemployed;
- A client who has a Capitec credit card which is in arrears, even though no payment has been missed on their term loans;
- A client with a behaviour score that has increased above the internal SICR threshold set by the group; and
- A client with an updated granting score above the internal SICR threshold set by the group.

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 group has set certain behaviour and granting score thresholds which are used to identify a significant increase in credit risk.

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

### Projected cash flows

The ECL model requires the projection of cash flows into the future. For every future month that remains in the contractual lifetime of the loan, a prediction of the probability that a client will be up-to-date, in arrears, written off or settled is required. These probabilities are derived using monthly roll-rates that measure the percentage of clients that roll from one repayment status to the next according to consecutive monthly payments. The roll-rates are applied to the loan book at month-end in order to calculate the 12 month and lifetime ECL provisions.

### *Forward-looking macro-economic expectations*

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 impacts the group's clients. The group 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.

In forecasting the macro-economic variables in the forward-looking model, the group assessed three scenarios. The base forecast reflected the group's view of the most likely outcome. However in line with IFRS 9, the group in addition to the base forecast, simulated a low forecast which reflected a negative view and a high forecast which reflected a more positive outlook on the macro-economic variables. The forward-looking model applies a probability weighting to the three scenarios.

Furthermore, the group applied credit judgement to the forward-looking model with respect to the introduction of DebiCheck from November 2018. The group envisages that 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 of the original debit order. If the client neglects to electronically confirm the amended debit order, the group could fail to collect the agreed upon instalment from the client on the agreed loan date. The group considered the impact of DebiCheck on up-to-date loans at DIA which historically rolled into arrears and that are rescheduled, as well as for loans that are likely to have changes to their debit orders mandates, for example changes in bank account details.

The table below sets out a summary of the macro-economic variables the group considered to be the most important determinants in the forward-looking model as well as a sensitivity on the overall impact the forward-looking model has on ECL:

	<b>Base forecast</b>	<b>Low forecast</b>	<b>High forecast</b>
GDP growth (YoY%) <sup>(1)</sup>	0.8%	0.5%	1.0%
Inflation (YoY%) <sup>(1)</sup>	5.3%	6.1%	4.3%
Impact on total ECL <sup>(2)</sup>	R6.787 million	R7.383 million	R6.191 million

<sup>(1)</sup> Average estimated rate used in the forecast

<sup>(2)</sup> The probability weighted impact of all three scenarios on total ECL is R6.728 million

# IFRS 9 Transitional impact

## Basis of preparation and overview of IFRS 9

This transitional report is based on the group's accounting policies (see Appendix A) which have been revised based on the requirements of IFRS 9. The group adopted IFRS 9 on 1 March 2018. The group 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 group's opening retained earnings at the DIA.

The directors of Capitec Bank Holdings Limited take full responsibility for the preparation of this report.

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

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

### *Condensed consolidated statement of financial position*

R'000	Group IAS 39 as at 28 February 2018	Group IFRS 9 Classification and Measurement <sup>(1)</sup>	Group IFRS 9 ECL	Group IFRS 9 as at 1 March 2018
<b>Assets</b>				
Financial investments	39 400 122	–	(13 386)	39 386 736
Available-for-sale financial assets <sup>(2)</sup>	100 000	–	–	100 000
Loans and advances to clients	41 814 395	–	(886 669)	40 927 726
Other assets	3 138 736	–	–	3 138 736
Current income tax asset <sup>(2)</sup>	107 154	–	(107 154)	–
Deferred income tax asset <sup>(2)</sup>	396 827	–	770 490	1 167 317
<b>Total assets</b>	<b>84 957 234</b>	<b>–</b>	<b>(236 719)</b>	<b>84 720 515</b>
Other liabilities <sup>(3)</sup>	66 065 556	–	411 320	66 476 876
<b>Total liabilities</b>	<b>66 065 556</b>		<b>411 320</b>	<b>66 476 876</b>
<b>Equity</b>				
<b>Equity attributable to ordinary shareholders</b>	18 778 875	–	(648 039)	18 130 836
Non-redeemable, non-cumulative, non-participating preference share capital and premium	112 803	–	–	112 803
<b>Total equity</b>	<b>18 891 678</b>	<b>–</b>	<b>(648 039)</b>	<b>18 243 639</b>
<b>Total equity and liabilities</b>	<b>84 957 234</b>	<b>–</b>	<b>(236 719)</b>	<b>84 720 515</b>

<sup>(1)</sup> 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.

<sup>(2)</sup> 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.

<sup>(3)</sup> 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 group's statement of changes in equity as at 1 March 2018.

### Condensed statement of changes in equity

R'000	Group IAS 39 at 28 February 2018	IFRS 9 ECL	Group IFRS 9 at 1 March 2018
Ordinary share capital and share premium	5 649 020	–	5 649 020
Preference share capital and premium	112 803	–	112 803
Retained earnings <sup>(1)</sup>	13 153 434	(648 039)	12 505 395
Foreign currency translation reserve	3 158	–	3 158
Cash flow hedge reserve	(26 737)	–	(26 737)
<b>Total equity</b>	<b>18 891 678</b>	<b>(648 039)</b>	<b>18 243 639</b>

<sup>(1)</sup> The impact on the group's capital is explained under capital impact.

## Impact of 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 rehabilitated	Re-scheduled from arrears not rehabilitated	Arrears	Expected recoveries receivable <sup>(4)</sup>	Total
Gross loans and advances	41 673 695	1 085 352	1 277 234	2 699 936	906 273	47 642 490
Cumulative provision	(3 234 766)	(188 907)	(649 648)	(1 754 774)	–	(5 828 095)
Net loans and advances	<b>38 438 929</b>	<b>896 445</b>	<b>627 586</b>	<b>945 162</b>	<b>906 273</b>	<b>41 814 395</b>
Provision %	7.8%	17.4%	50.9% <sup>(5)</sup>	65.0%	–	12.2%

IFRS 9	Up-to-date	Stage 1		Stage 2			Stage 3			Total
		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 rehabilitated	Re-scheduled from arrears not rehabilitated	< 6 months	More than 1 month in arrears <sup>(3)</sup> , legal statuses, and applied for debt review	Expected recoveries receivable <sup>(4)</sup>		
Gross loans and advances	37 164 807	4 401 434	1 002 862	1 085 352	1 277 234	1 804 528	906 273	47 642 490	–	
Cumulative provision	(2 674 424)	(1 032 799)	(558 281)	(462 365)	(609 432)	(1 377 463)	–	(6 714 764)	–	
Net loans and advances	<b>34 490 383</b>	<b>3 368 635</b>	<b>444 581</b>	<b>622 987</b>	<b>667 802</b>	<b>427 065</b>	<b>906 273</b>	<b>40 927 726</b>	–	
Provision %	7.2% <sup>(1)</sup>	23.5% <sup>(2)</sup>	55.7%	42.6% <sup>(2)</sup>	47.7% <sup>(5)</sup>	76.3%	–	14.1%	–	

<sup>(1)</sup> 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.

<sup>(2)</sup> 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.

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

<sup>(4)</sup> Shown net of provisions.

<sup>(5)</sup> 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 group'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 group'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.

# Capital impact

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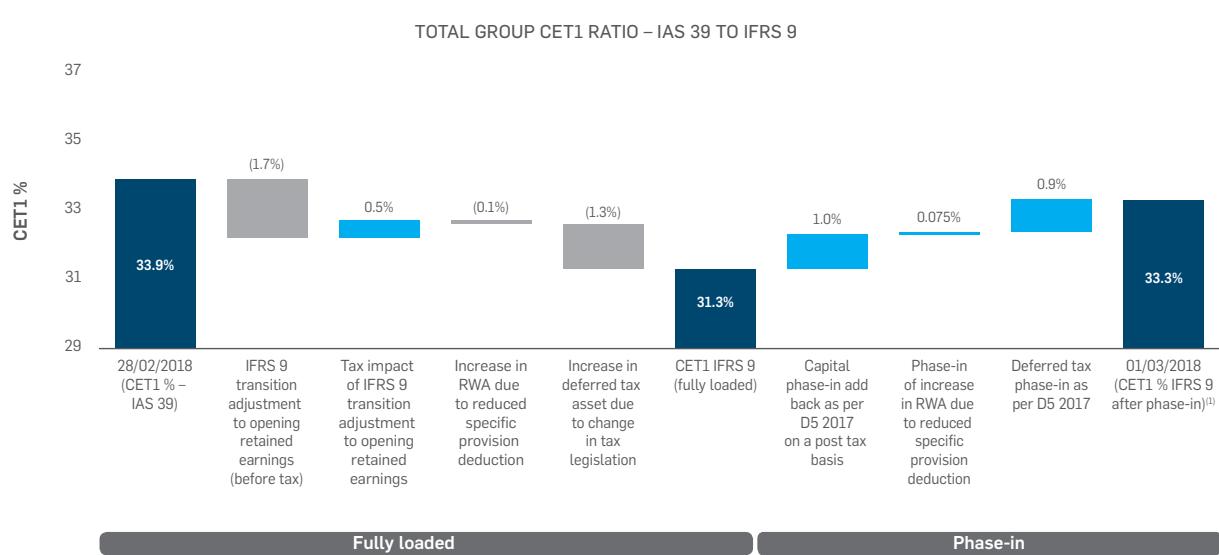
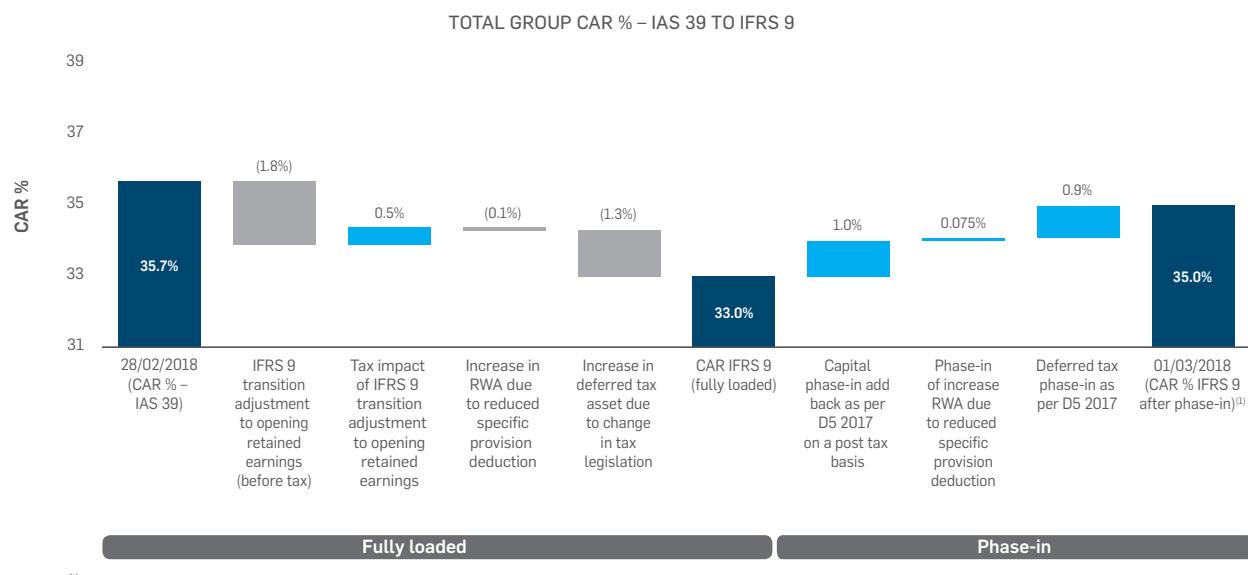
The adoption of IFRS 9 results in a 2.7% decrease in the fully loaded CAR% ratio and a 0.7% decrease in the phased-in CAR% ratio.

The CET1 ratio decreased by 2.6% on a fully loaded basis and decreased by 0.6% on the phased-in basis.

	Total CAR	CET1 ratio
<b>IAS 39 (as at 28 February 2018)</b>	<b>35.7%</b>	<b>33.9%</b>
<b>IFRS 9 transition adjustment to opening retained earnings (pre-tax)</b> This is the group's IFRS 9 opening adjustment of R900 million.	(1.8%)	(1.7%)
<b>Tax impact of IFRS 9 transition adjustment to opening retained earnings</b> Relates to the tax impact on retained earnings of R252 million.	0.5%	0.5%
<b>Decrease in specific provisions allowed as deduction from RWA</b> The decrease in specific provisions allowed to be deducted from risk weighted assets increases total RWA and is driven by the stage allocation classification applied to the exposures.	(0.1%)	(0.1%)
<b>Additional deferred tax asset impact on SARS % allowance</b> The change in tax law (Section 11jA) allows for a lower deduction of impairment provisions which increases the temporary difference of the deferred tax asset. The increased deferred tax asset is risk weighted at 250% for capital adequacy purposes.	(1.3%)	(1.3%)
<b>IFRS 9 – Fully loaded (excluding the phase-in)</b>	<b>33.0%</b>	<b>31.3%</b>
<b>Capital phase-in add back as per D5/2017</b> The post-tax IFRS 9 adjustment will be phased-in on a straight-line basis, from 25% in the 2019 financial year to reach 100% by the 2022 financial year.	1.0%	1.0%
<b>Phase-in increase in specific provisions allowed as deduction from RWA</b> The group will phase in the impact of specific provisions as allowed by the SARB Directive.	0.075%	0.075%
<b>Deferred tax phase-in as per D5 2017</b> The group will phase-in the deferred tax impact as per the SARB's Directive 5/2017.	0.9%	0.9%
<b>IFRS 9 – phased-in<sup>(1)</sup></b>	<b>35.0%</b>	<b>33.3%</b>

<sup>(1)</sup> Rounded to 1 decimal place

The graphs below illustrate the impact of IFRS 9 on both the group's CAR and CET1, as determined in accordance with the SARB's capital regulations:



# Appendix A

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## Basis of preparation and overview of IFRS 9

### *Background*

This transitional report is based on the group's accounting policies which have been revised based on the requirements of IFRS 9. With the exception of IFRS 9's hedge accounting requirements, the group adopted IFRS 9 on 1 March 2018. The group has not restated its comparative financial statements for the adoption of IFRS 9. Accordingly the impact has resulted in an adjustment to the group's opening reserves at the date of initial application.

The directors of Capitec Bank Holdings Limited take full responsibility for the preparation of this report.

## IFRS 9 accounting policies applied at 1 March 2018

### *Accounting policies and basis of preparation*

The group's condensed statement of financial position presented on page 10 has been prepared under the historical cost convention, as modified by the fair value changes of financial instruments held at fair value through profit or loss, as well as fair value through other comprehensive income.

### *IFRS 9 transitional requirements*

In preparing this Transitional Report, the group took the requirements of IFRS 9 Chapter 7.2.1 – 7.2.20 into account.

The group applied the transitional requirements with respect to the classification and measurement of financial assets as well as the measurement of 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 group's opening retained earnings at 1 March 2018.

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

### *Classification of financial assets*

IFRS 9 contains a new classification and measurement approach for financial assets. The group 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 under IAS 39 of held to maturity, loans and receivables and available for sale have been eliminated under IFRS 9.

From 1 March 2018, the group 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)

The group 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 group 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 assessed by an evaluation of whether the contractual cash flows have solely 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. Essentially the group considers whether the contractual cash flows have 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 time value of money.

#### *Measurement of financial assets*

At initial recognition, the group 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.

#### *Debt instruments – amortised cost*

The following items are the significant debt instruments held by the group:

- i) loans and advances to clients that are recognised when funds are advanced to the borrowers;
- ii) fixed and term notice deposits are non-derivative financial assets with fixed or determinable payments. They arise when the group 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 are included in interest income on the face of the group's income statement using the effective interest rate method. Impairment losses are presented as part of net provision for doubtful debts charge on the face of the group's income statement.

#### *Equity instruments – FVOCI*

The following item is the only significant equity instrument of the group:

- i) Equity investment in African Bank Holdings Limited

The group 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 are not subsequently reclassified to profit or loss, including on disposal. Impairment losses (and reversal of impairment losses) 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 group's right to receive such payments is established.

#### *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, cross-currency interest rate swaps and forward foreign exchange contracts.

#### *Impairment – amortised cost*

The group applied the ECL model on all financial debt instruments that are classified at amortised cost as well as undrawn commitments.

#### *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 group uses an ECL provisioning model based on historical roll rates using the Markov chain method.

The group 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 group 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.

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 group to estimate the expected cash flow and balance amortisation of the loan. The rolled up results enable the group 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 (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).

### *Impairment – recognition*

#### **Stage 1**

An ECL is recognised at the time of initial recognition of 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.

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

#### **Stage 2**

The group 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 group 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 group 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 who has a Capitec credit card which is in arrears, even though their loans are up-to-date;
- A client with a behaviour score that has increased above the internal SICR threshold set by the group; and
- A client with an updated granting score above the internal SICR threshold set by the group.

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 group 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; or
- client is in default. The group defines default as the point at which the client is past due on 2 contractual payments, i.e. more than 1 month in arrears.

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

#### *Impairment – loan write-offs*

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 continue to be recognised in gross loans and advances until no reasonable certainty exists that any further recovery is expected on these loans and advances.

For default loans, business efficiencies determine when a client should be handed over at the latest, with a fixed point in time where a non-paying client would automatically be handed over.

The group applies an immediate partial write-off for loans handed over or under debt review. At the time when a loan has been placed under debt review or handed over/other legal status, the group has quantitative evidence to indicate that no reasonable expectation of recovery exists for a certain percentage of the loan and therefore a portion of the loan is written off immediately.

Following this partial write-off, the remaining portion remains recognised in gross loans and advances until the point at which there is no reasonable expectation of recovery.

The group 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 of approximately 5%. This point is determined based on time since last payment (TSLP) and is 16 months after the TSLP of a loan that has been placed under debt review and 6 months after the TSLP of a loan that has been handed over. No receivable is recognised post write-off for any possible recoveries. Any recoveries received post-write-off will be recognised as bad debt recovered, on a cash basis.

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.

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 originally estimated cash flows, the excess is disclosed as bad debts recovered.

## Appendix B

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### Terminology used by the group when discussing credit quality of loans and advances

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 group 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 group 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 group 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	<p>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.</p> <p>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.</p> <p>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.</p>

<b>Loans status</b>	<b>Description</b>
Expected recoveries receivable	The net present value of expected future recoveries on loans written off under IAS 39. The balance is held in stage 3 and is subject to continual assessment for impairment. No expected recovery receivable is recognised under IFRS 9.
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	<p>These are loans and advances that have raised a SICR flag due to:</p> <ul style="list-style-type: none"> <li>• Unemployment</li> <li>• Behaviour score above the threshold</li> <li>• Granting score above the threshold</li> <li>• A client that has a term loan that is up-to-date but has a credit card in arrears</li> </ul> <p>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</p>
Stage 3	<p>These are loans and advances that are more than 1 month in arrears or:</p> <ul style="list-style-type: none"> <li>• have been rescheduled but not yet rehabilitated;</li> <li>• where the client has applied for debt review;</li> <li>• is currently under debt review; or</li> <li>• has another legal status (amongst others, under administration).</li> </ul>
Write-off	<p>Loans are written off when there is no reasonable expectation of recovery.</p> <p>Loans under debt review</p> <ul style="list-style-type: none"> <li>• 20% immediate partial write-off</li> <li>• Remaining 80% written off 16 months after TSLP</li> </ul> <p>Loans that have been handed over/other legal status</p> <ul style="list-style-type: none"> <li>• 70% immediate partial write-off</li> <li>• Remaining 30% written off 6 months after TSLP</li> </ul>

## Appendix C

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### Statement of responsibility by the board of directors relating to the Transitional Report as at 1 March 2018

The directors of Capitec Bank Holdings Limited and its subsidiaries (the group) are responsible for the preparation, integrity and fair presentation of the financial information set out on pages 2 to 20.

The report is based on appropriate accounting policies as contained in Appendix A and are supported by reasonable and prudent judgement and estimates.

The directors' responsibility includes maintaining adequate accounting records. The accounting records should disclose, with reasonable accuracy, the position presented in the Transitional Report.

The group 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 Transitional Report was prepared on a going concern basis. Based on their assessment, the directors have no reason to believe that the group or any company in the group will not continue as a going concern in the foreseeable future.

The Transitional Report as set out on pages 2 to 20 has been approved by the directors on 14 August 2018 and are signed on its behalf by:



**Riaan Stassen**  
Chairman



**Gerrie Fourie**  
Chief executive officer

# Appendix D

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## Independent auditor's assurance report

*To the Directors of Capitec Bank Holdings Limited*

Report on the compilation of pro forma financial information included in the Capitec Bank Holdings Limited IFRS 9 – Financial Instruments Transitional Report

We have completed our assurance engagement, for purposes of the Capitec Bank Holdings Limited IFRS 9 – *Financial Instruments* Transitional Report (“Transitional Report”), to report on the compilation of pro forma financial information of Capitec Bank Holdings Limited (the “Group”) as at 28 February 2018 by the directors.

The pro forma financial information consists of the condensed consolidated statement of financial position as at 1 March 2018, the condensed consolidated statement of changes in equity as at 1 March 2018, the impact of IFRS 9 on loans and advances as at 1 March 2018 and the related notes, as set out in section 3 of the Transitional Report on pages 10 to 12. The applicable criteria on the basis of which the directors have compiled the pro forma financial information are described in Appendix A: Basis of preparation and overview of IFRS 9 (the “Applicable Criteria”) in the Transitional Report.

The pro forma financial information has been compiled by the directors to illustrate the impact of the adoption of IFRS 9 (the “event”), as set out in section 3 on pages 10 to 12 of the Transitional Report, on the Group’s financial position as at 28 February 2018 as if the event had taken place at 28 February 2018. As part of this process, information about the Group’s financial position has been extracted by the directors from the Group’s consolidated financial statements for the year ended 28 February 2018, on which an unmodified audit report was issued on 26 March 2018.

### The directors’ responsibility for the compilation of the financial information

The directors are responsible for compiling the pro forma financial information on the basis of the Applicable Criteria.

### Our independence and quality control

We have complied with the independence and other ethical requirements of the *Code of Professional Conduct for Registered Auditors* issued by the Independent Regulatory Board for Auditors (IRBA Code), which is founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. The IRBA Code is consistent with the International Ethics Standards Board for Accountants *Code of Ethics for Professional Accountants* (Parts A and B).

The firm applies International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements* and accordingly maintains a comprehensive system of quality control including documented policies and procedures regarding compliance with ethical requirements, professional standards and applicable legal and regulatory requirements.

### Auditor’s responsibility

Our responsibility is to express an opinion about whether the pro forma financial information has been compiled, in all material respects, by the directors on the basis specified in the Applicable Criteria based on our procedures performed.

We conducted our engagement in accordance with International Standard on Assurance Engagements (ISAE) 3420, *Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus*, which is applicable to an engagement of this nature, issued by the International Auditing and Assurance Standards Board. This standard requires that the auditor plan and perform procedures to obtain reasonable assurance about whether the pro forma financial information has been compiled, in all material respects, on the basis specified in the Applicable Criteria.

For purposes of this engagement, we are not responsible for updating or reissuing any reports or opinions on any historical information used in compiling the pro forma financial information, nor have we, in the course of this engagement, performed an audit or review of the financial information used in compiling the pro forma financial information.

The purpose of the pro forma financial information included in the Transitional Report is solely to illustrate the impact of the adoption of IFRS 9 on unadjusted financial information of the Group as if the adoption of IFRS 9 had occurred on 28 February 2018.

Accordingly, we do not provide any assurance that the actual outcome of the event or transaction as at 28 February 2018 would have been as presented.

A reasonable assurance engagement to report on whether the pro forma financial information has been compiled, in all material respects, on the basis of the Applicable Criteria involves performing procedures to assess whether the applicable criteria used by the directors in the compilation of the pro forma financial information provide a reasonable basis for presenting the significant effects directly attributable to the event or transaction, and to obtain sufficient appropriate evidence about whether:

- The related pro forma adjustments give appropriate effect to those criteria; and
- The pro forma financial information reflects the proper application of those adjustments to the unadjusted financial information.

The procedures selected depend on our judgement, having regard to our understanding of the nature of the Group, the event or transaction in respect of which the pro forma financial information has been compiled, and other relevant engagement circumstances.

Our engagement also involves evaluating the overall presentation of the pro forma financial information.

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

#### Our opinion

In our opinion, the pro forma financial information included in the Transitional Report has been compiled, in all material respects, on the basis of the Applicable Criteria.

#### Disclaimer and limitations

Our report is intended for the benefit of the directors of the Capitec Bank Holdings Limited. Our work was not be planned or conducted in contemplation of reliance by any third party or with respect to any specific transaction or other purpose other than stated in this report. Therefore, items of possible interest to a third party were not specifically addressed and matters may exist that would be assessed differently by a third party, possibly in connection with a specific transaction.

As noted above, this report has been prepared for the directors of Capitec Bank Holdings Limited to provide reasonable assurance on the compilation of the pro forma financial information as set out in section 3 on pages 10 to 12 of the Transitional Report and for no other purpose. We do not, in giving this report, accept or assume responsibility (legal or otherwise) or accept liability for or in connection with any other purpose for which our report may be used, or to any other person to whom our report is shown or into whose hands it may come, and no other persons shall be entitled to rely on our report save where they have obtained our prior written consent that they may do so.

PricewaterhouseCoopers Inc.

**PricewaterhouseCoopers Inc.**

Director: C van den Heever

Registered Auditor

Cape Town

14 August 2018