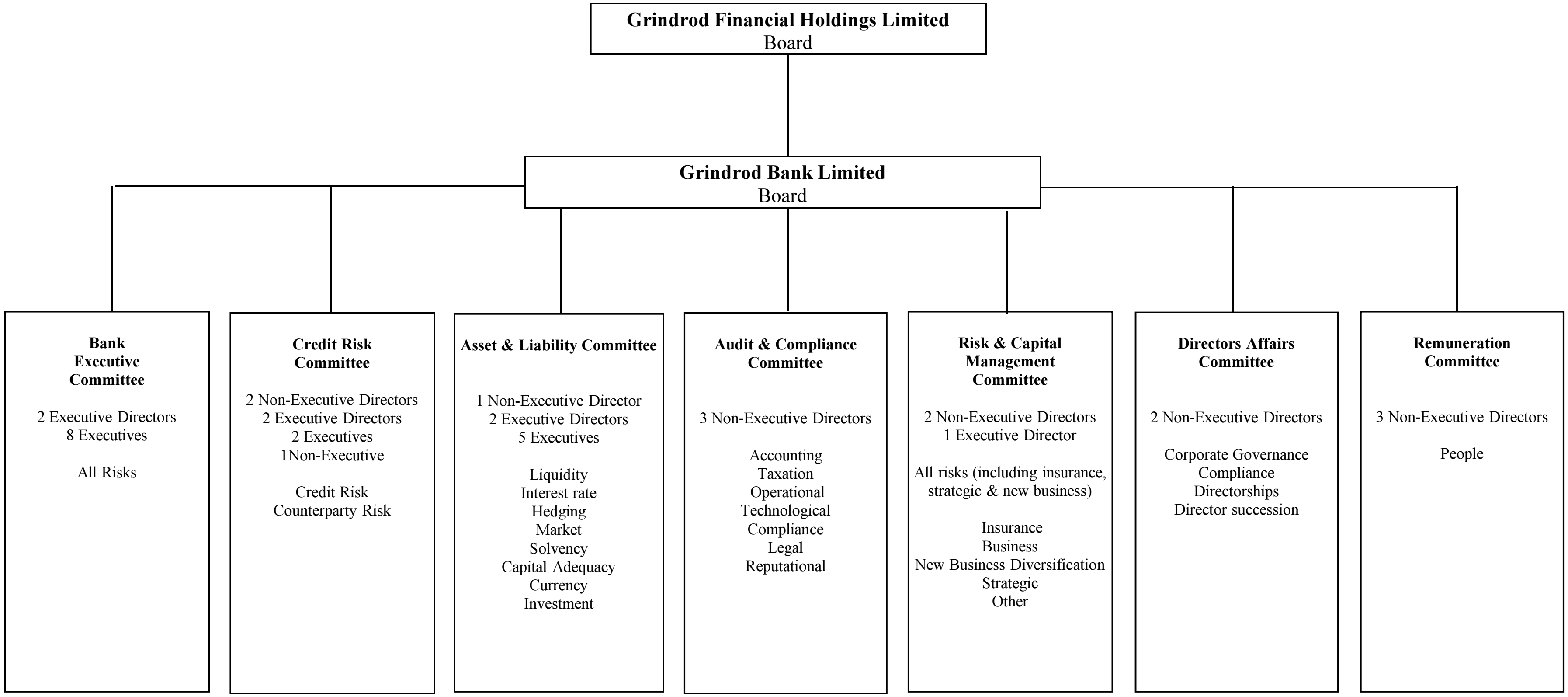
GRINDROD BANK

GRINDROD BANK LIMITED
Registration No. 1994/007994/06

ANNUAL FINANCIAL STATEMENTS
For the year ended 31 December 2012

GRINDROD BANK LIMITED
RISK MANAGEMENT FRAMEWORK
31 December 2012



CREDIT COMMITTEE

Credit Risk
The risk of financial loss resulting from failure of a counterparty to an asset, for any reason, to fully honour its financial and contractual obligations.

Credit Risk Management
Sound credit risk management involves prudently managing the risk and reward relationship and controlling and minimising credit risks across a variety of dimensions, such as quality, concentration, maturity and security. The Credit Committee is responsible for ensuring that credit approval processes are stringent and for monitoring large exposures, associated exposures, sectoral exposure and any irregular or problem loans.

Maximum exposure to credit risk
Maximum exposure to credit risk at the year end is stated before taking into account any collateral or other credit enhancement and after taking in account impairments and netting where applicable. For financial assets recognised on the statement of financial position the maximum exposure to credit risk equals the carrying amount as per the coresponding note. For financial commitments and guarantees the maximum credit risk is the maximum amount the company would have to pay to perform in terms of the commitment.

Definitions
Past Due
Exposures are considered past due where the facility has expired and the Bank is not considering renewal of the facility or where expected cashflows on the facility are more than one month in arrear. Past due exposures are considered impaired and a specific impairment is raised based on the carrying amount less the expected realisable value of the security held, but as a minimum the impairment is equivalent to any regulatory requirement.
Impaired Exposure
Advances are assessed for indicators of impairment and impairments are accounted for when there is objective evidence that the estimated future cash flows from the investment have been negatively impacted by events occurring subsequent to initial recognition. The amount of the impairment is the difference been the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. Advances considered to be irrecoverable are written off to the extent that the loss can be reliably measured.

The Bank has had a low default and bad debt history and as a result does not have adequate internal statistics for the calculation of a portfolio impairment.

Credit Risk Mitigation
The Bank does not have material netting arrangements.

The Bank values property assets on an cyclical basis using a desk-top approach and physical valuations are performed where appropriate or necessary. The value of listed assets is tracked on an on-going basis and unlisted investments and other security assets are valued periodically where possible.

The Bank actively manages and monitors risk concentrations resulting from credit mitigation activities and these tend to arise where guarantees have been taken in addition to other classes of security. The Bank tends to deal with small to medium size corporates and guarantees and suretyships tend to come from similar types of entities.

Counterparty Risk
The risk that a counterparty to a transaction fails to perform in terms of the contract resulting in a potential cost to replace the cash flow or the risk that a counterparty fails to honour an undertaking for payment or delivery in terms of unsettled transactions.

The Bank is extremely cautious when selecting counterparties to transactions and formal limits are established for counterparties to asset or hedging transactions.

The Bank does not hold collateral for interest rate swap positions.

The Bank has adopted the Basel II simplified standardised approach for the measurement of it's exposure to credit risk.

Concentration Risk
The risk of an uneven distribution of loans and advances to individual borrowers, industries or services sectors and geographical regions which could result in significant credit losses.

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RISK MANAGEMENT
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ASSET AND LIABILITY COMMITTEE (ALCO)

Liquidity Risk

In the banking environment liquidity risk may be defined as the risk of a bank not being able to repay its maturing deposits or meet its obligations under a loan agreement. Liquidity risk in a bank includes the risk of incurring excessively high interest costs or being forced to sell assets at a loss in order to meet obligations.

Liquidity Risk Management
The Bank has a prudent liquidity management policy and the Asset & Liability Committee (ALCO) is responsible for monitoring the stability of funding, surplus cash or near cash assets, anticipated cash outflows, exposure to large depositors and exposure to connected parties. The Bank is exposed to a maturity mismatch due to the duration of the lending book when compared against the duration of the funding book. The Bank has been well served by its prudent liquidity management policy, the stability of its deposit base and the high quality of the advances book. The Bank intends to continue to adopt a conservative liquidity policy in the future.

Contractual maturity analysis

31 Dec 2012	**< 3 months**	**> 3 months < 6 months**	**> 6 months < 1 year**	**> 1 year < 5 years**	**> 5 years**	**Non-contractual**	**Total**
	R	**R**	**R**	**R**	**R**	**R**	**R**
Liabilities							
Derivative Instruments	1,002,276	-	-	13,807,942	7,286,364	-	22,096,582
Deposits	4,314,553,231	400,600,651	48,243,690	598,500,000	-	-	5,361,897,572
Other liabilities	-	-	-	-	-	58,975,062	58,975,062
Taxation	-	-	-	-	-	19,677,849	19,677,849
	4,315,555,507	**400,600,651**	**48,243,690**	**612,307,942**	**7,286,364**	**78,652,911**	**5,462,647,065**
Operating lease commitments	1,654,353	1,475,959	2,323,309	7,760,287	-	-	13,213,908
Financing guarantees	179,798,522	-	-	-	-	-	179,798,522
Irrevocable unutilised facilities	108,800,858	-	-	-	-	-	108,800,858
	4,605,809,240	**402,076,610**	**50,566,999**	**620,068,229**	**7,286,364**	**78,652,911**	**5,764,460,353**

31 Dec 2011	**< 3 months**	**> 3 months < 6 months**	**> 6 months < 1 year**	**> 1 year < 5 years**	**> 5 years**	**Non-contractual**	**Total**
Liabilities							
Derivative Instruments	958,399	-	206,504	10,051,974	7,971,234	-	19,188,111
Deposits	2,781,767,177	39,729,298	111,336,656	28,345,624	-	-	2,961,178,755
Other liabilities	-	-	-	-	-	42,849,621	42,849,621
Taxation	-	-	-	-	-	9,392,132	9,392,132
	2,782,725,576	**39,729,298**	**111,543,160**	**38,397,598**	**7,971,234**	**52,241,753**	**3,032,608,619**
Operating lease commitments	1,010,591	889,493	1,819,642	9,155,713	-	-	12,875,439
Financing guarantees	132,302,082	-	-	-	-	-	132,302,082
Irrevocable unutilised facilities	148,228,299	-	-	-	-	-	148,228,299
	3,064,266,548	**40,618,791**	**113,362,802**	**47,553,311**	**7,971,234**	**52,241,753**	**3,326,014,439**

The liquidity gap is prepared on a contractual maturity basis.

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Interest Rate Risk
The risk that fluctuating interest rates will unfavourably affect a financial institution's earnings and the value of its assets, liabilities and capital. The risk is due to assets and liabilities maturing or repricing at different times, or against different base rates. The amount at risk is a function of the magnitude and direction of interest rate changes, and the size and maturity structure of the mismatch position.

Interest Rate Risk Management
Traditional gap analysis is used to measure interest rate exposure. The Bank has a conservative policy on interest rate risk arising from gapping and the duration of this exposure is limited to three months for material aggregated positions or hedged using derivative instruments. The static interest rate gap report is prepared monthly for review by the Asset and Liability Committee (ALCO) and the model assumes each asset class will reprice in full in the relevant repricing timeband.

Interest Rate Repricing Gap

31 Dec 2012	**< 3 months**	**> 3 months < 6 months**	**> 6 months < 1 year**	**> 1 year < 5 years**	**> 5 years**	**Non-rate sensitive**	**Total**
	R	**R**	**R**	**R**	**R**	**R**	**R**
Assets	5,575,212,074	-	-	122,593,559	66,269,178	224,831,334	5,988,906,145
Equity and liabilities	(4,336,649,813)	(400,600,651)	(48,243,690)	(598,500,000)	-	(604,911,991)	(5,988,906,145)
Interest rate hedging activities	187,073,759	-	-	(121,709,910)	(65,363,849)	-	-
Repricing profile	1,425,636,020	(400,600,651)	(48,243,690)	(597,616,351)	905,329	(380,080,657)	-
Cummulative repricing profile	1,425,636,020	1,025,035,369	976,791,679	379,175,328	380,080,657	-	
Expressed as a percentage of total assets	23.8%	17.1%	16.3%	6.3%	6.3%		

31 Dec 2011	**< 3 months**	**> 3 months < 6 months**	**> 6 months < 1 year**	**> 1 year < 5 years**	**> 5 years**	**Non-rate sensitive**	**Total**
Assets	3,101,388,286	-	-	96,470,533	80,684,049	178,575,407	3,457,118,275
Equity and liabilities	(2,900,955,288)	(39,729,298)	(11,336,656)	(28,345,624)	-	(476,751,409)	(3,457,118,275)
Interest rate hedging activities	175,652,264	-	-	(95,725,929)	(79,926,335)	-	-
Repricing profile	376,085,262	(39,729,298)	(11,336,656)	(27,601,020)	757,714	(298,176,002)	-
Cummulative repricing profile	376,085,262	336,355,964	325,019,308	297,418,288	298,176,002	-	
Expressed as a percentage of total assets	10.9%	9.7%	9.4%	8.6%	8.6%		

Interest Income Sensitivity

31 Dec 2012	**< 3 months**	**> 3 months < 6 months**	**> 6 months < 1 year**	**Cumulative impact on net interest income**
	R	**R**	**R**	**R**
2% interest rate increase	3,260,000	4,218,000	9,769,000	17,247,000
2% interest rate decrease	(3,230,000)	(4,149,000)	(9,456,000)	(16,835,000)
31 Dec 2011				
2% interest rate increase	2,647,000	3,155,000	6,955,000	12,757,000
2% interest rate decrease	(2,633,000)	(3,114,000)	(6,754,000)	(12,501,000)

Hedging
Hedging is a technique used to reduce risk by simultaneously entering into a transaction to be hedged and a transaction with equivalent characteristics in terms of size, duration and interest rate but with opposite financial effect.

All fixed rate transactions are required to be hedged, either within the book or synthetically with derivative instruments, whenever a 1% parallel shift in the yield curve could result in a loss exceeding the amounts specified in the policy matrix (maximum loss tolerance R200,000).

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Market Risk (Position Risk)
The risk that the market price of an asset may change, resulting in a loss on realisation of that asset.

The Bank is not a trading bank and does not have any regulatory market risk. Where marketable securities are held as investments the market prices are monitored and reports are tabled at the monthly Asset and Liability Committee (ALCO) meetings.

Investment Risk
The risk that investment values may fluctuate due to changes in market prices or investment specific factors (e.g global influences, business cycle, industry, management, reputational issues).

Equity Investment Risk
All unrealised gains/(losses) are recognised in the income statement and included in primary capital and reserve funds of the Bank.

Unlisted equity investments tend to be yield enhancing investments with an interest rate linked to prime or money market rates.

Sensitivity analysis	**31 Dec 2012**	**31 Dec 2011**
	R	**R**
10% increase in listed equity prices	20,520	31,920
10% decrease in listed equity prices	(20,520)	(31,920)

The Bank has adopted the Basel II standardised approach for the measurement of it's exposure to equity risk.

Currency Risk
The risk that changes in exchange rates will have a negative impact on profitability due to a mismatch between foreign receivables and foreign payables.

All foreign currency exposures are approved and monitored by the Asset and Liability Committee.

	31 Dec 2012	**31 Dec 2011**
	R	**R**
Foreign currency exposure	**-**	**-**

Solvency Risk

Capital Adequacy

The risk that a bank will not have adequate capital and reserve funds to absorb losses, resulting in depositors having to absorb these losses and losing confidence in the bank and/or the banking sector.

	31 Dec 2012	**31 Dec 2011**
	R	**R**
Ordinary share capital	650,000	650,000
Ordinary share premium	247,929,000	225,850,000
Preference share capital	120,000,000	50,000,000
	368,579,000	**276,500,000**
Distributable reserves - formally appropriated by board resolution	133,455,000	113,455,000
Distributable reserves - unappropriated	24,225,080	34,554,655
Primary share capital	**502,034,000**	**389,955,000**
Primary share capital ratio	98.6%	98.5%
General allowance for credit impairment	6,878,277	5,750,996
Secondary share capital	**6,878,277**	**5,750,996**
Secondary share capital ratio	1.4%	1.5%
Total Capital	**508,912,277**	**395,705,996**
Prescribed deductions against capital and reserve funds	218,000	34,000
Aggregate amount of qualifying capital and reserve funds	**508,694,277**	**395,671,996**
Risk weighted exposure	3,790,816,900	3,068,738,000
Minimum required capital and reserve funds	369,604,648	299,201,955
Capital adequacy ratio	13.42%	12.89%
Primary capital adequacy ratio	13.24%	12.71%
Minimum regulatory capital adequacy ratio	9.50%	9.50%
Additional bank specific regulatory capital requirement	0.25%	0.25%
	9.75%	9.75%

The Bank has complied with the minimum regulatory capital requirement at all times during the period.

Capital Management

The Bank projects balance sheet growth on a monthly basis in order to assess liquidity and capital adequacy. The shareholders of the Bank have undertaken to inject capital as required in order to grow the banking business and to ensure that a prudent risk asset ratio is maintained.

Retained earnings appropriation

The Bank intends appropriating earnings retained after dividend distributions as required to ensure minimum capital levels are maintained.

Dividend policy

The Bank has a biannual dividend payment policy of 3.5 times cover (28.57%). Dividends will only be distributed where moderate stress forecasting indicates no capital shortfall or where unappropriated reserves adequately cover dividends and any capital appropriation required to restore capital levels.

No specific items that are subject to rapid or material change have been identified at this stage.

Restrictions or other major impediments on the transfer of funds or qualifying capital within the banking group

The only restriction on the transfer of funds or qualifying capital is in terms of the Banks Act.

AUDIT AND COMPLIANCE COMMITTEE

Accounting Risk
The risk that inappropriate accounting policies are adopted and/or decisions are based on inappropriate accounting information resulting in inadequate returns or loss.

Taxation Risk
The risk of loss to a company as a result of inappropriate tax planning and strategy, new tax legislation or non-compliance with or incorrect interpretation and application of taxation legislation.

Operational Risk
The risk that internal practices, policies and systems are not rigorous or sophisticated enough to cope with adverse market conditions or human or technological errors.
Including:
- error, negligence or fraud
- failure to correctly measure or report risk
- lack of controls to prevent unauthorised or inappropriate transactions being made
- lack of understanding by key staff

It is the responsibility of management and ultimately the Audit and Compliance Committee to assess operational procedures and controls and to ensure the adequacy thereof. Management are assisted by internal audit in this regard.

The Bank has adopted the Basel II basic indicator approach for the measurement of it's exposure to operational risk.

Technological Risk
The risk of loss or fraud due to inadequate system controls or systems failure. Technological risk is also the risk that business processes become inefficient and less competitive due to out-dated or inappropriate technology.

A comprehensive disaster recovery plan is in place for the Bank. Technological upgrade is seen to be an ongoing process.

Legal Risk
The risk of loss to a company as a result of non-compliance with laws and regulations or the risk that a counterparty to a transaction will not be liable to meet its obligations under law.

Compliance Risk
The risk that a company does not comply with applicable laws and regulations or supervisory requirements.

The compliance function is an independent function within the Bank which is responsible for monitoring regulatory and reputational risk processes.

Reputational Risk
The risk that an activity, action or stance performed or taken by the company, its officials or associates will impair its image and/or the long-term trust placed in the organisation by its stakeholders, resulting in the loss of business and/or legal action.

RISK AND CAPITAL MANAGEMENT COMMITTEE

The Risk and Capital Management Committee is responsible for identifying all risks to which the Bank is exposed and for ensuring the risks are adequately managed and monitored.

Insurance Risk
The risk of loss to a company as a result of inadequate insurance cover for insurable business risks.

New Business Risk
The risk of new business generating low returns or losses due to inadequate assessment of strategic, pricing, regulatory, legal, tax, accounting and any other relevant risks.

Diversification Risk
The risk of loss and process failure due to inadequate business synergies and resources to support new products and businesses.

Strategic Risk
The risk to earnings and capital arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to changes in the business environment with respect to: the economy (business cycle); the political landscape; law and regulation; technology; social mores; and the actions of competitors.

DIRECTORS AFFAIRS COMMITTEE

The Directors Affairs Committee is responsible for identifying all corporate governance and directorship risks to which the Bank is exposed and for ensuring the risks are adequately managed and monitored.

REMUNERATION COMMITTEE

The Remuneration Committee is responsible for identifying all people related risks to which the Bank is exposed and for ensuring the risks are adequately managed and monitored.