

RISK REPORT *continued*

## KEY RISKS

Key risks are those risks that require specific and ongoing operational, governance and strategic management. Key risks are different from top risks (set out on pages 84 to 87) as they are anticipated to be ongoing due to the strategy and business model of the group, while top risks are identified through the ERM process.

Transaction Capital's key risks are detailed in the sections that follow:

## CREDIT RISK

Credit risk, or default risk, relates to the lender's risk of loss arising from a borrower who does not pay their full contractual instalment. In the case of Transaction Capital, as a result of its target market, the risk of non-payment is higher than for traditional lenders. This heightened credit risk is controlled through substantial operational capacity, coupled with a higher risk-adjusted yield.

The adoption of IFRS 9 in the 2015 financial year has resulted in the recognition of credit losses utilising an expected loss model. Losses are now recognised prior to actually being incurred, resulting in more conservative credit metrics than in prior years.

The loss allowance for a financial instrument is measured at the lifetime expected credit losses if the credit risk on that financial asset has increased significantly since initial recognition. If, at the reporting date, the credit risk on a financial instrument has not increased significantly since initial recognition, the group measures the loss allowance for that financial instrument at an amount equal to 12-month expected credit losses. Purchased non-performing loan portfolios are considered credit-impaired assets that are specifically impaired (stage 3) and are measured using lifetime expected

credit losses from the onset. These assets remain in stage 3 for the duration of the financial instrument.

At group level, credit risk is monitored by the ARC committee, while SA Taxi and Transaction Capital Business Solutions (TCBS) have their own credit committees responsible for credit risk, which meet at least quarterly.

Aspects of credit risk that are monitored include changes to origination strategies, new business approvals and collections strategy and performance.

The group has limited exposure to a single counterparty, with the largest exposure to a single borrower being negligible as a percentage of assets exposed to credit risk. The largest indirect exposure to any single counterparty group is the minibus taxi industry in general.

During the year, SA Taxi continued to lend to lower-risk applicants and to refurbish and resell high-quality vehicles, both of which improved the non-performing loan (NPL) ratio.

In TCR, purchased non-performing loan portfolios have inherent credit risk and this is reflected in the heavily discounted purchase price to face value. TCR has its own investment committee responsible for credit risk, which meets as required when portfolios are being considered for acquisition. The approval of an investment in a new non-performing loan portfolio involves the divisional executives and group executive directors, depending on whether its value falls above a certain threshold.

Credit risk is managed operationally at the time of origination and in terms of collections thereafter. TCR has entered into a collection agreement with various public-sector counterparties. Public sector finances are generally in a poor state, making it a class of counterparty that needs to be managed closely to ensure payments are received timeously.

The cost of the risk relating to SA Taxi at 30 September is calculated below.

|  | 2016          | 2015   |
|--|---------------|--------|
| Interest income % average gross loans and advances                           | <b>22.2</b>   | 21.6   |
| Interest expense % average gross loans and advances                          | <b>(11.1)</b> | (10.3) |
| Net interest income % average gross loans and advances (net interest margin) | <b>11.1</b>   | 11.3   |
| Impairment expense % average gross loans and advances (cost of credit)       | <b>(3.1)</b>  | (3.9)  |
| Risk-adjusted net interest income % average gross loans and advances         | <b>8.0</b>    | 7.4    |

## Provisions and non-performing loans

|         |                              | 2016 | 2015        |      |
|---------|------------------------------|------|-------------|------|
| SA Taxi | Non-performing loan ratio    | %    | <b>17.4</b> | 18.2 |
|         | Provision coverage           | %    | <b>6.7</b>  | 8.6  |
|         | Non-performing loan coverage | %    | <b>38.3</b> | 47.0 |
|         | Credit loss ratio            | %    | <b>3.1</b>  | 3.9  |
|         | Net repossession stock value | Rm   | <b>335</b>  | 227  |