2011

# debt investor day

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# group treasury

Andries du Toit

# Agenda

- Liquidity risk management philosophy
- Basel III update
- FirstRand's response
  - Liquidity buffer
  - Funds Transfer pricing
  - Funding strategy

# The FirstRand response

- Funds Transfer pricing
  - Behaviour pricing for liquidity and deposits
  - Match funding for illiquid long dated assets
  - Minimum client pricing on both side of the balance sheet

- Funding strategy
  - New measurement on deposit franchise
  - New product offering and development
  - Capital market issuance to extend term of institutional funding

The above will protect shareholders

# Group Treasury

Set frameworks, risk appetite and strategy

Centralised Treasury Functions

Global Funding & Liquidity Management

Capital & Cross Border Flows
*exchange control*

Finance

Intra-day liquidity management

Treasury ALM

Strategic Relationship Management

Portfolio Management
*Open positions of the banking book (interest rate, FX, funding)*

Multi Currency Funds Transfer Pricing
*(FTP)*

African Subsidiaries

International Branches

Integrated approach to funding and liquidity management

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# liquidity management

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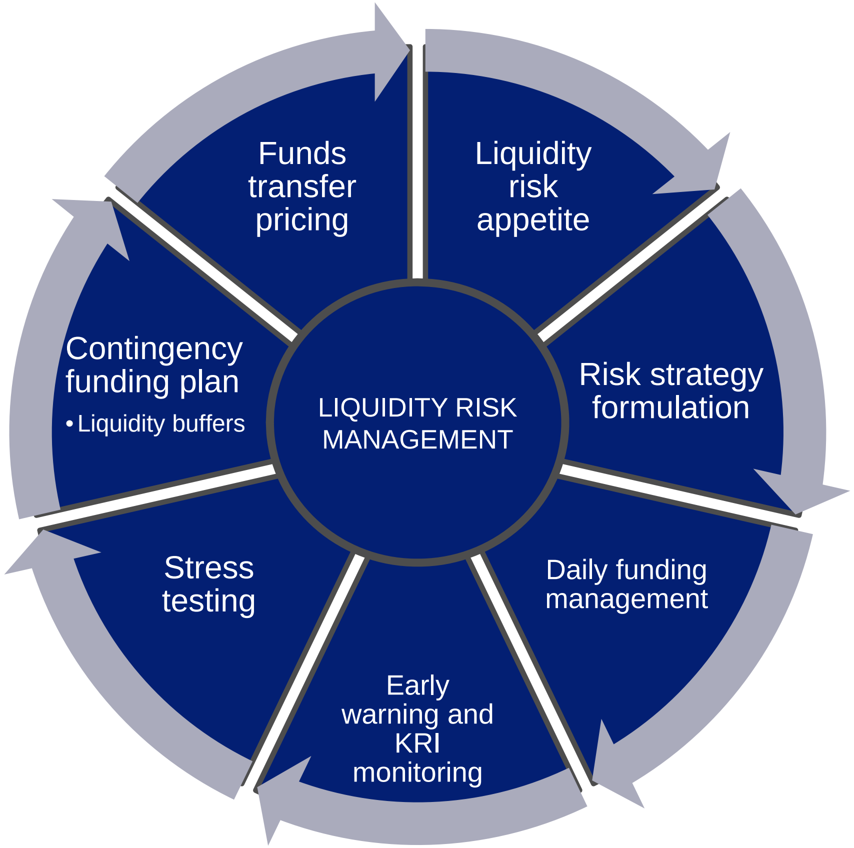
# Liquidity risk management philosophy




- Consequential risk
- Continuous funding and liquidity cycle
- Liquidity is a consequential risk
- Forward looking
- Integrated across:
  - Macro economic outlook
  - All business units
  - All financial risk disciplines
  - Financial markets outlook
- Ensure compliance with:
  - Internal risk appetite
  - Regulatory requirements
  - Rating agencies' requirements
- Maintain appropriate liquidity buffers
- Self-funded

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# basel III update

Bhulesh Singh

# G20 leaders endorse the Basel framework

*"We endorsed the landmark agreement reached by the Basel Committee on the new bank capital and liquidity framework, which increases the resilience of the global banking system by raising the quality, quantity and international consistency of bank capital and liquidity, constrains the build-up of leverage and maturity mismatches, and introduces capital buffers above the minimum requirements that can be drawn upon in bad times.*

*This will result in a banking system that can better support stable economic growth."*

*Source: G20 Finance Ministers statement, November 2010*

# Basel III – liquidity ratios

**Proposed changes to SA Bank Regulations**
1 January 2012

- Credit Risk Scalar
- Market Risk
- Re-securitisations

**Basel III framework**
1 January 2013

- Minorities
- Deferred Tax Assets
- Securitisations
- Credit Valuation Adjustments
- Asset Value Correlation
- Expected loss > Provisions

**Basel III framework**
1 January 2015

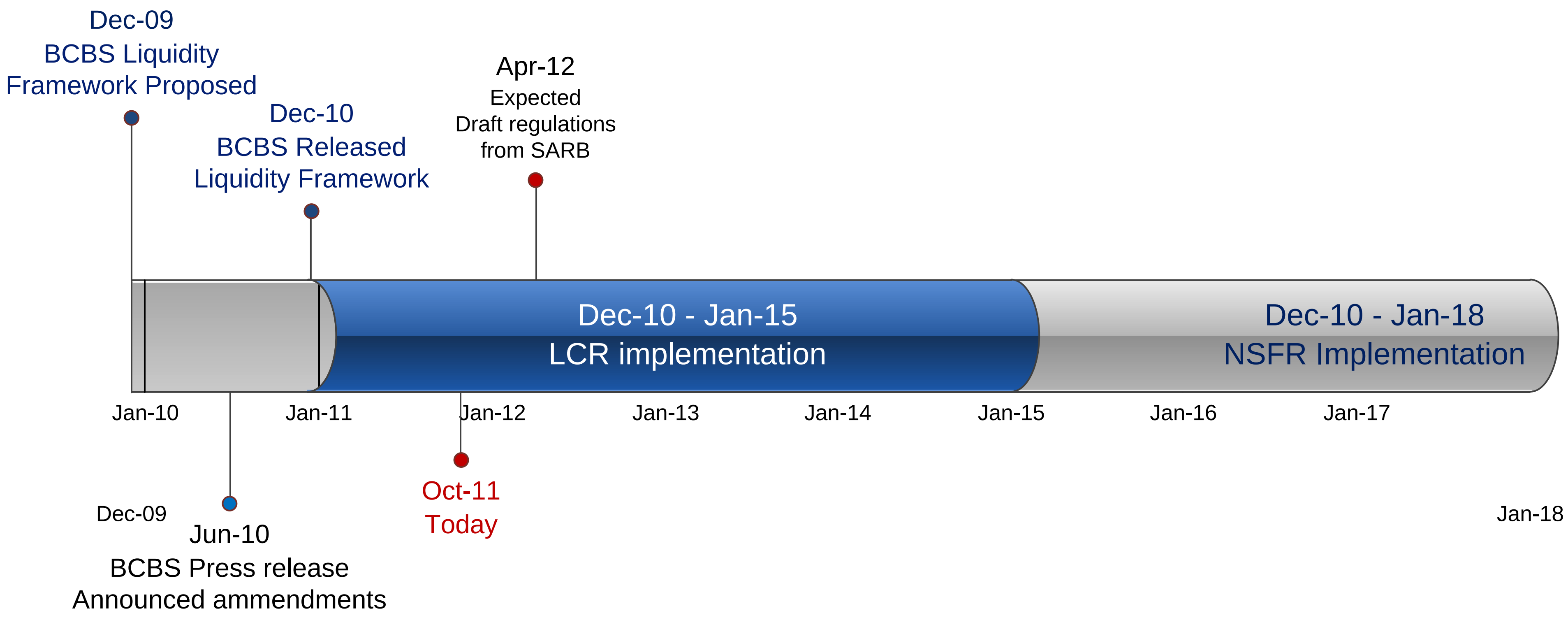
- Liquidity Ratios
- Leverage Ratio

# Basel III – new liquidity rules recap

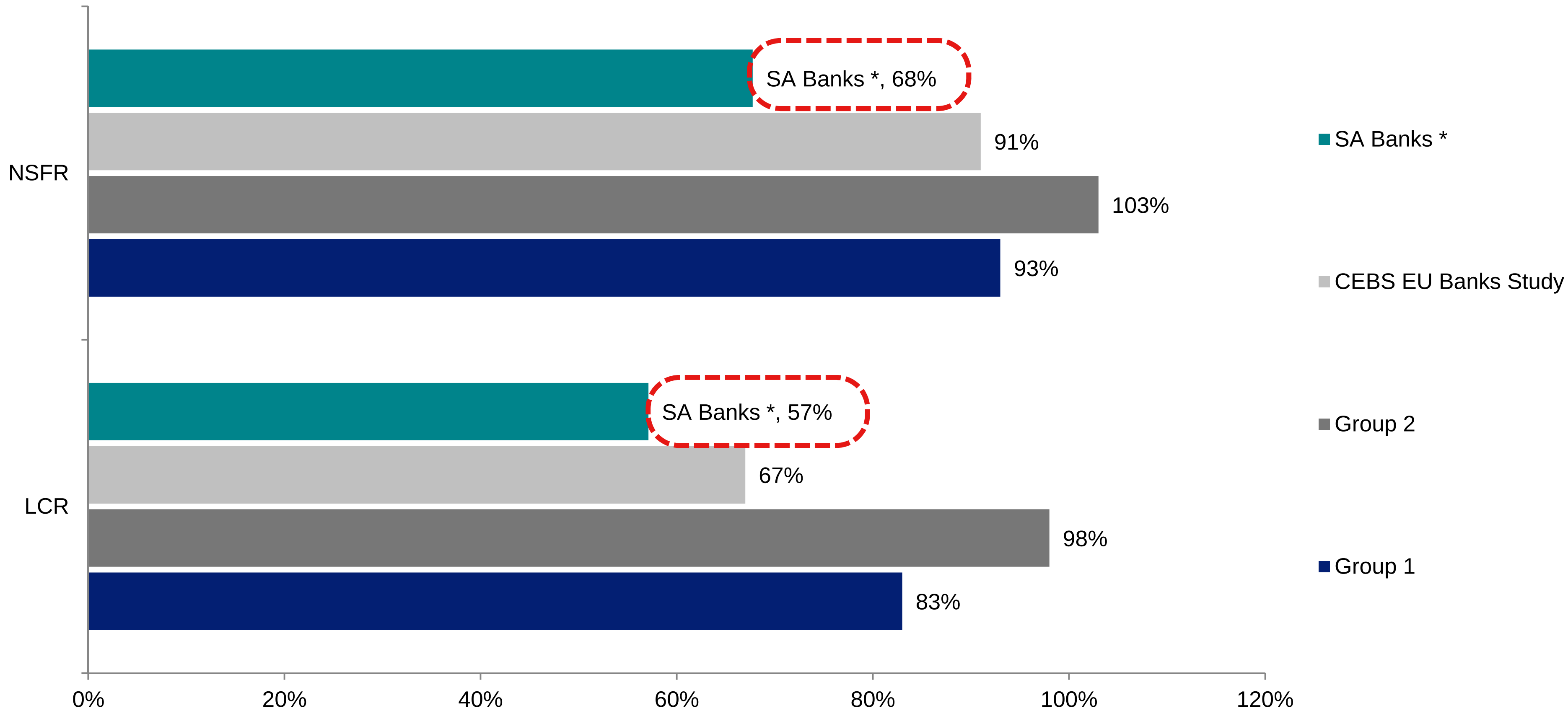
- Liquidity Coverage Ratios (LCR)
  - Addresses short-term liquidity risk and cash management
  - Banks must hold high-quality liquid assets sufficient to cover
    - all net cash outflows
    - over a 30-day period
    - under an acute liquidity stress scenario (combined idiosyncratic and systemic shock)
  - An enhancement of statutory liquid asset and cash reserve requirement to be risk sensitive where current statutory liquid assets and cash reserve are based on balance sheet size.
- Net Stable Funding Ratio (NSFR)
  - Long-term focus addressing the structural liquidity risk of the balance sheet
  - Ratio requires that assets maturing after 1 year be funded with “stable” funding
  - “Stable” funding takes into account the stability of funding over a year during an extended firm-specific stress scenario (decline in profitability or solvency, potential downgrade, event affecting reputation/credit quality)

*Source: The Basel III international framework for liquidity risk measurement. Dec 2010*

# Implementation timeline



# Basel III QIS – liquidity ratios

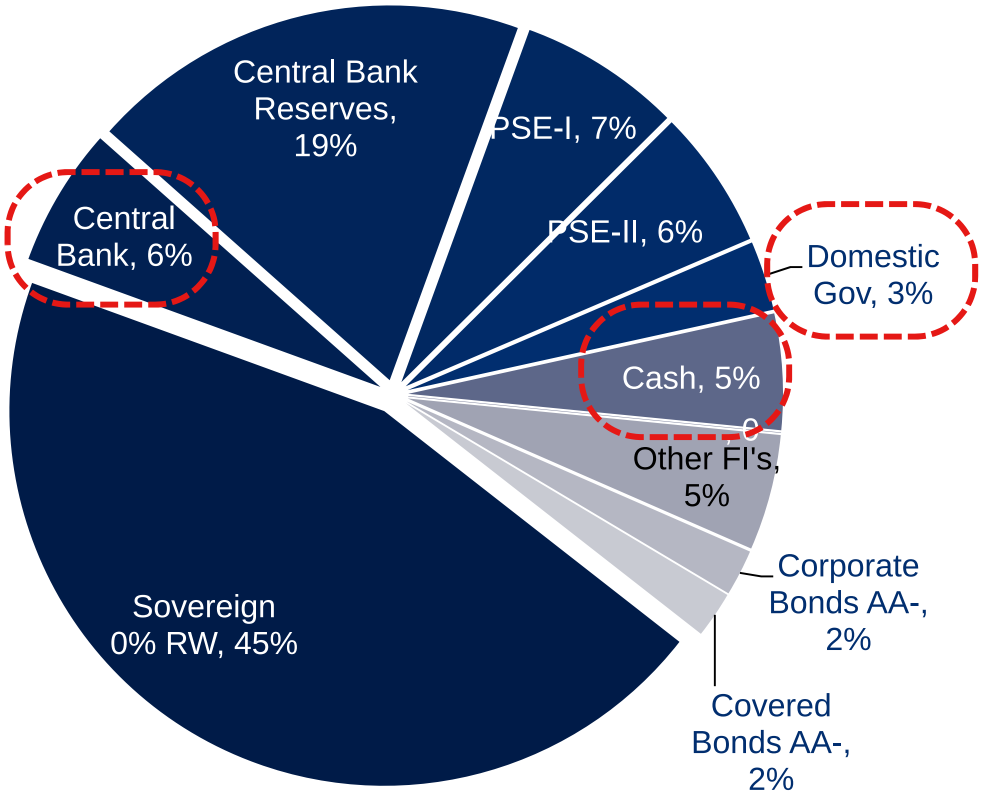



- QIS results above incorporate extraordinary central bank intervention in-force at the time
- The SA banks do not comply
  - Working with SARB on national discretion process
  - Structural reform is required

*Source: BCBS186 QIS*
*SARB BA Returns, June 2011, estimates*
*BNP Paribas, Basel III: no Achilles' spear, Jun 2011*

# Basel III QIS – liquidity standards

Composition of stock of liquid assets of submitting banks




- South Africa has limited qualifying liquid assets
- One of the constraints is the international scale rating of AA- or better as an eligibility criteria
- As is stands the SARB has also disallowed inclusions of the cash reserve deposits of banks

# Basel III QIS – liquidity criteria & SOE securities

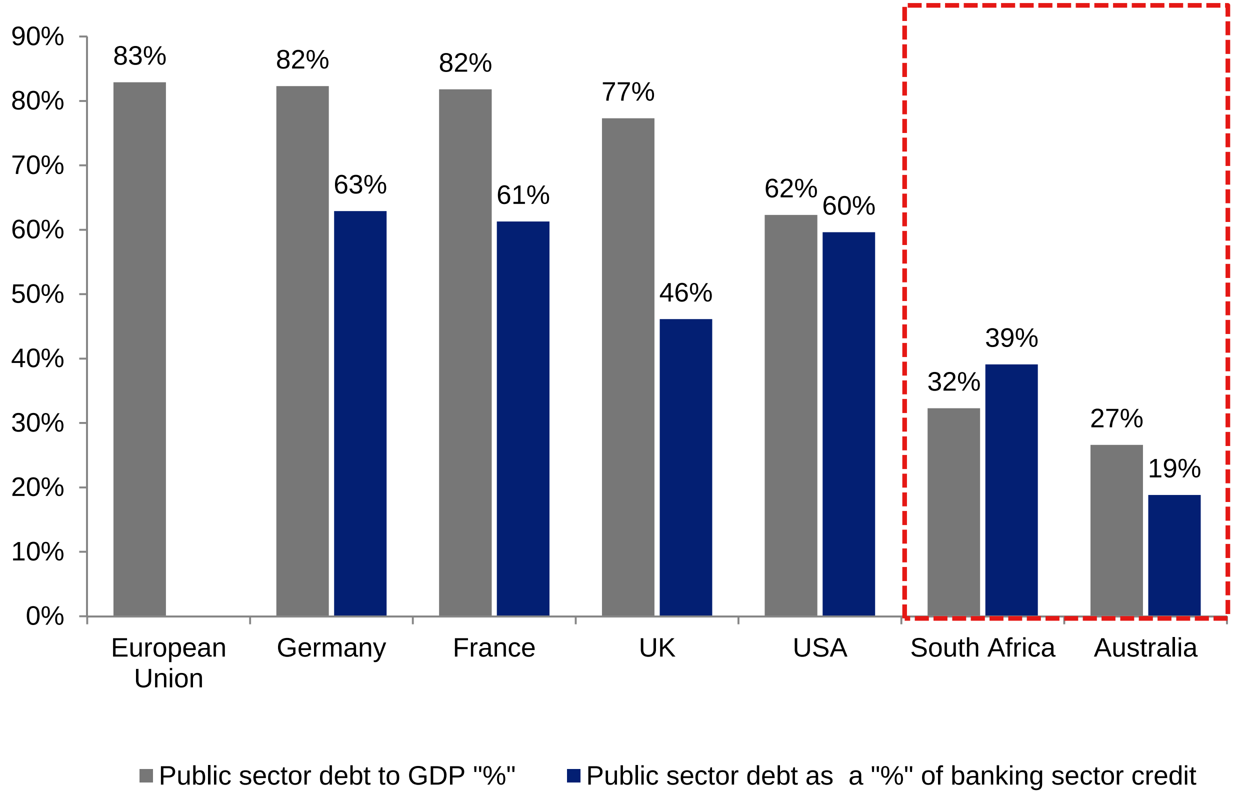
| Characteristics | Status<br>SOE securities |
|---|---|
| *Fundamental characteristics* | |
| Low credit and market risk | ✓ |
| Ease and certainty of valuation | ✓ |
| Low correlation with risky assets | ✓ |
| Listed on a developed and recognised exchange market | ✓ |
| *Market-related characteristics* | |
| Active and sizable market | ½ |
| Presence of committed market makers | ½ |
| Low market concentration | ½ |
| Flight to quality | ½ |

- In addition to rating criteria the Basel committee set out the characteristics of high quality liquid assets
- We have made the case for public sector debt securities to SARB
- This would have additional benefits :
  - Improve secondary market trade
  - Promote financing liquidity
  - Reduce the liquidity premium
- We have proposed the use national scale ratings to determine eligibility
  - Should be possible to manage liquidity within a currency
  - ZAR risk can be mitigated by ZAR assets

*Basel III: International framework for liquidity risk measurement, standards and monitoring", Basel Committee on Banking Supervision, December 2010,* Para 22

# Level 1 asset shortfall

Comparing public debt to GDP and the banking sector

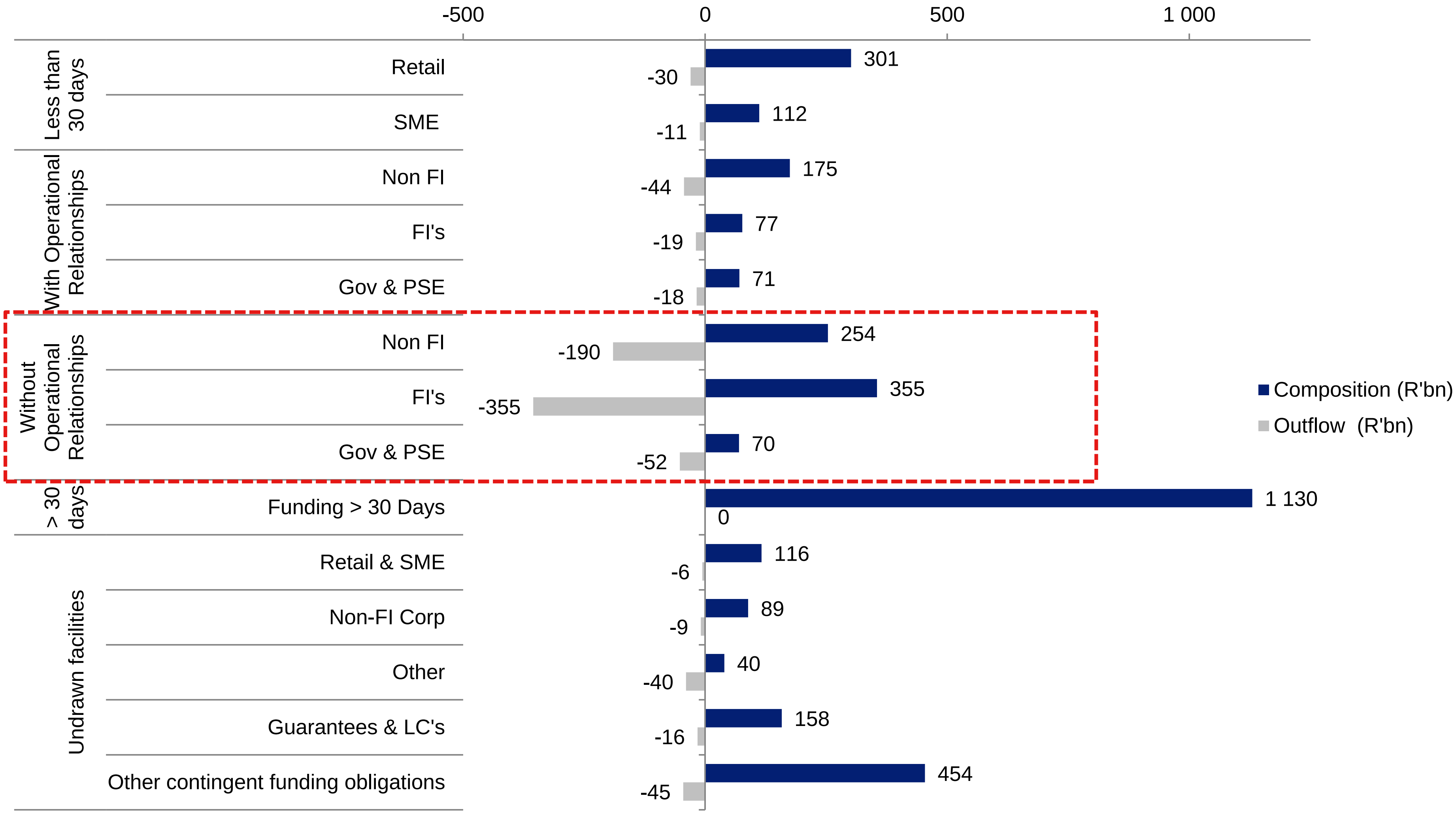



- Countries that have sufficient Level 1 assets have high levels of government debt
- We would not suggest higher government debt levels to meet the LCR
- There is a conflicting nature of these requirements.
- South Africa like Australia has much lower levels of government debt and therefore L1 securities.
- Australia has already progressed to adopting option 1.

*SA is not overly indebted leading to a shortage of eligible liquid assets*

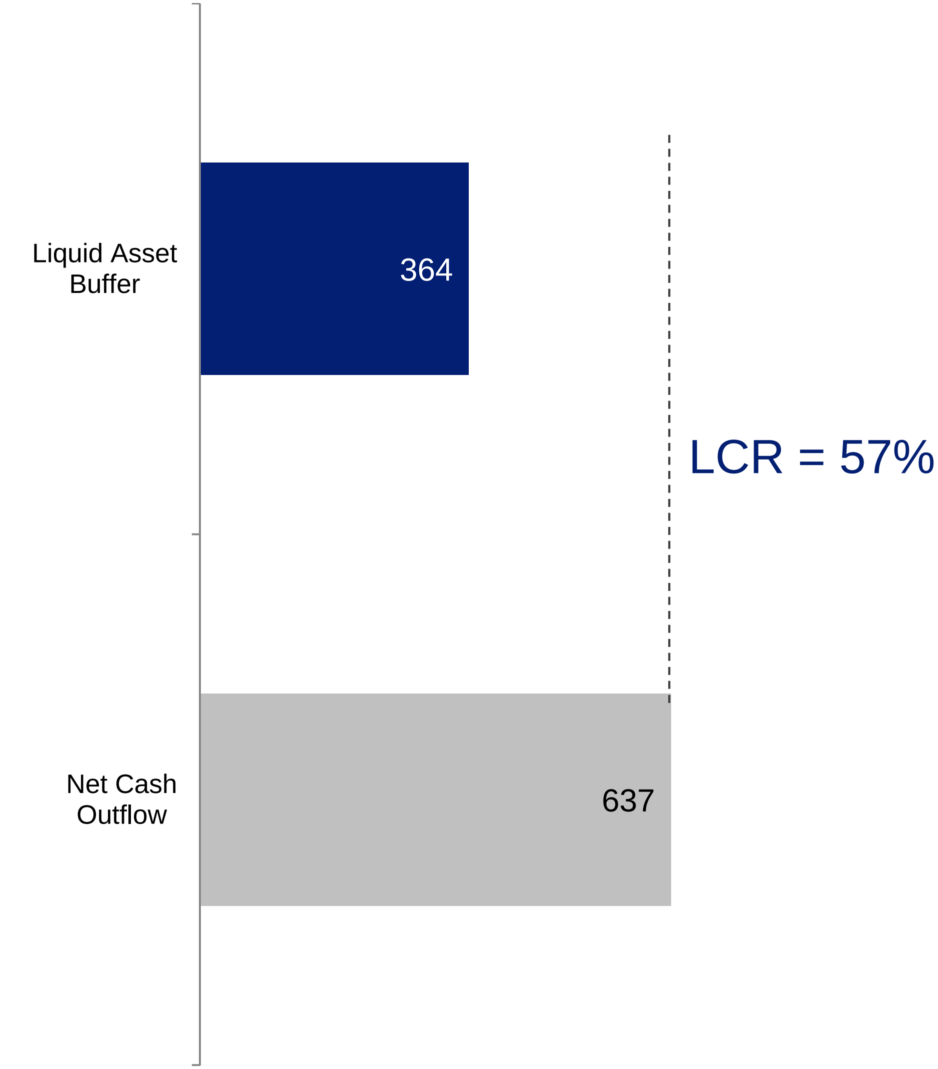
*Source: Economist Intelligence Unit Aggregates 2010*

# LCR liability outflows – surplus cash of FI's and corporates reflect poorly




Source: SARB BA900, Dec-2010, SA Banking Sector Aggregate

# Bringing the LCR liquid asset and outflows together




## *Main LCR components*

***Liquid Assets***

- R16bn physical cash
- R61bn central bank reserves
- R280bn net sovereign securities

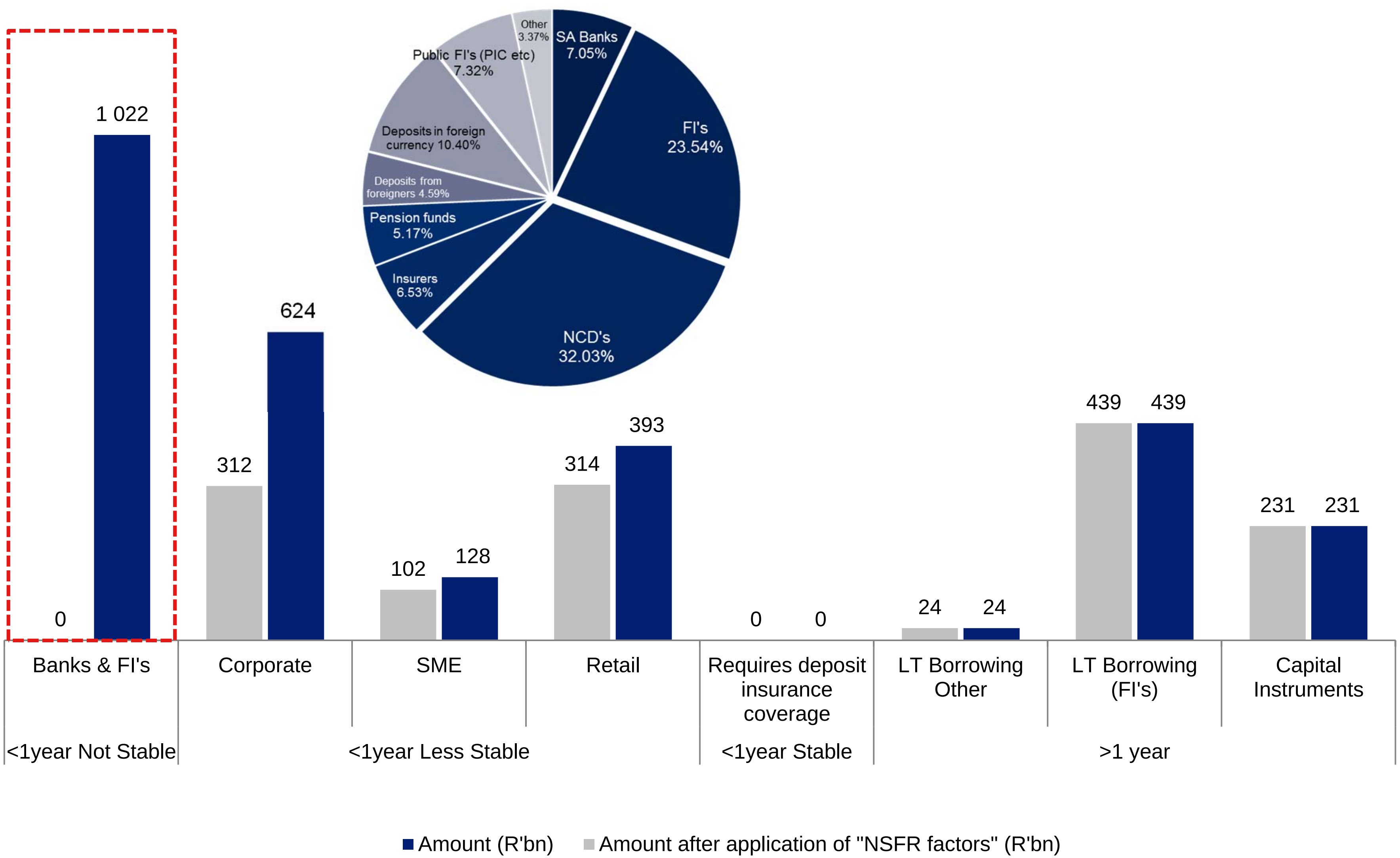
***R840bn Outflows***

- R30bn retail
- R80bn operational deposit
- R600bn non-operational
  - R190bn corporate
  - R52bn Government & Public sector
  - R355bn FI's
- R120bn contingent outflows

***R200bn In-flows***

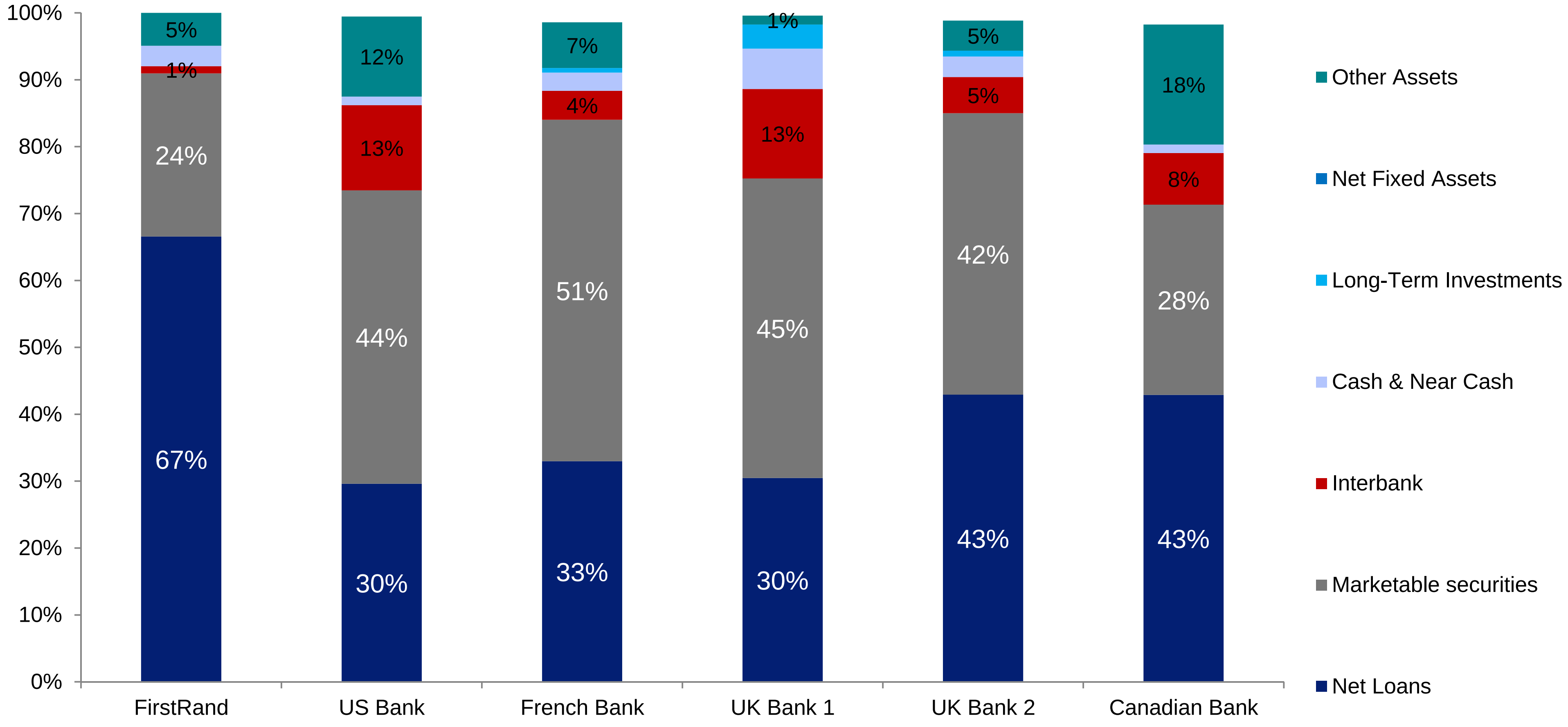
*Note: Includes 100% of cash reserves*

# NSFR re-weighting effect on liabilities




Source: SARB BA900, Dec-2011, SA Banking Sector Aggregate

# Basel III – it's the balance sheet structure




*Source: FirstRand Research*

# Basel III
# & the SA structure

# Structural funding and liquidity task team

- SA banking sector does not comply given structural features

- Under the guidance of National Treasury a structural funding and liquidity task team has been established

  To make recommendations to the Finance Ministry

- It is not the intention of National Treasury to dramatically increase the costs of credit in the economy at the expense of growth
  - Concerned about the costs of banking and credit and its impact on economic growth
  - They are further concerned about the pro-cyclical nature of bank risk appetite and pricing

- There is recognition of the structural liquidity gap of SA that arises from:
  - Savings behavior
  - Regulatory asymmetries
  - Tax incentives
  - Inflation stability and real rates, etc.
- Regulatory reform, modernisation and policy to improve savings behaviour would be required

# National Treasury view

Savings are channeled into investment through numerous channels, directly and through financial institutions of which banks are one of them

## Investors

- Individuals
- Corporates
- Government
- Foreign

## Decision levers I

- Economic incentives
- Tax incentives
- Regulatory incentives

## Institutions

- Pension funds
- Long term insurance
- Investment funds
- Banks
- Corporate - JSE
- Government

## Decision Levers II

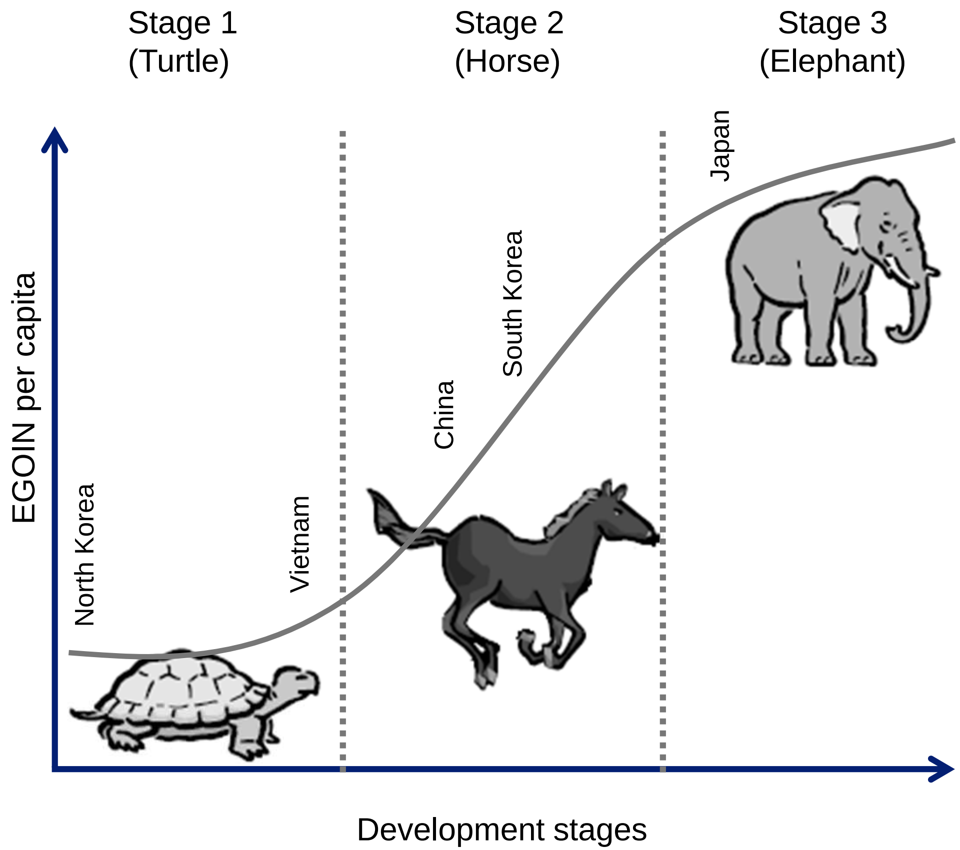
- Economic incentives
- Tax incentives
- Regulatory incentives

## Investments (AUM)

- Cash and near cash
- Money market funds
- Banks
- Corporate bonds
- Government bonds
- Equity
- Alternative investments
- Property
- Foreign sector

*Source: National Treasury Structural Liquidity & Funding Task Group*

# Lim's development s-curve hypothesis

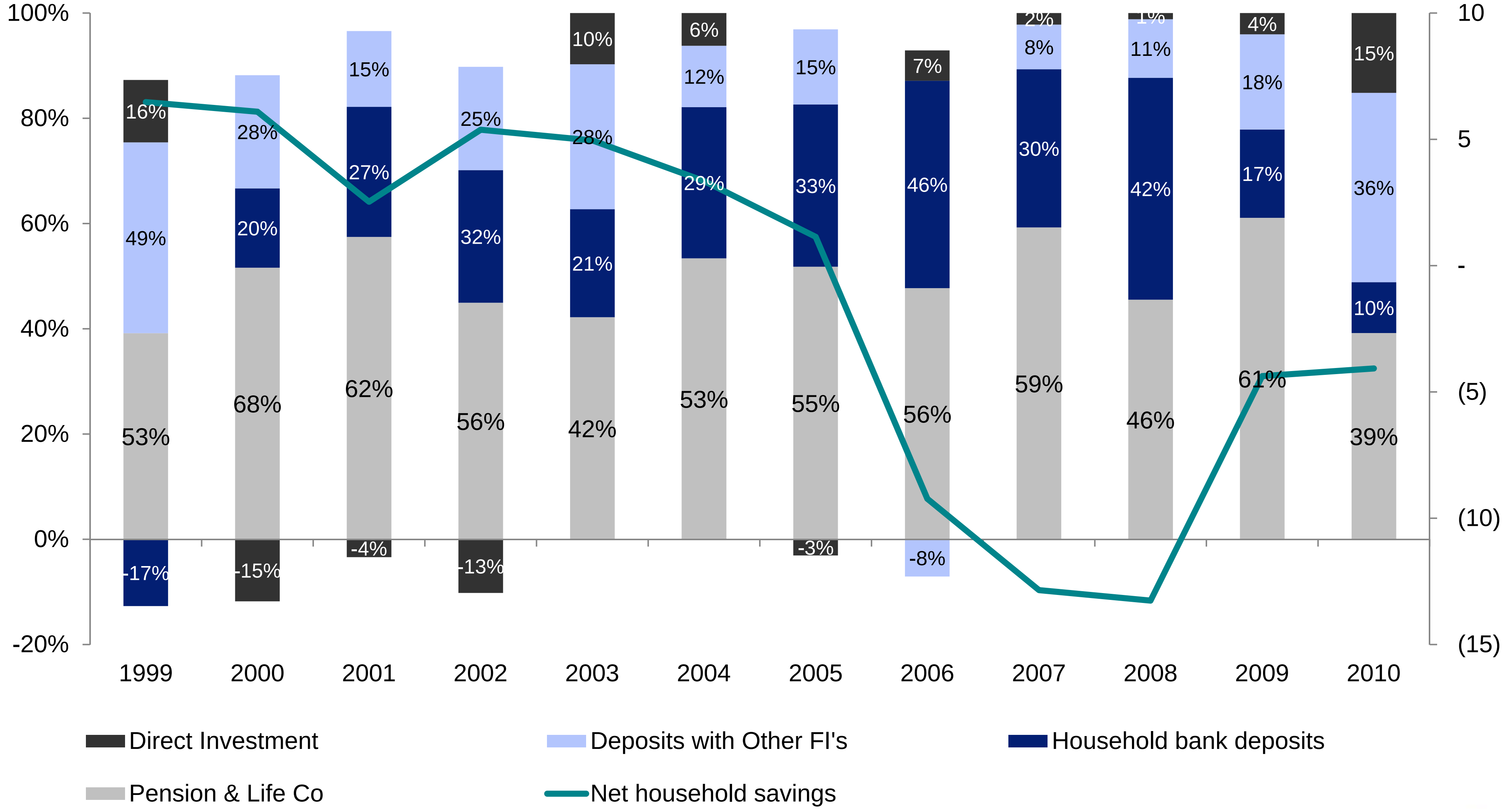



- Lims's development s-curve hypothesis provides a theoretical framework albeit empirical evidence is sometimes inconsistent
- Economies in different development phases have different features and different needs
- Arguably SA is dichotomous in this regard displaying many developed economy traits as well as 3rd world traits

| | Stage I | Stage II | Stage III |
|---|---|---|---|
| Savings rate | Low | High | Low |
| Fixed capital accumulation | Poor infrastructure and low level of private sector capital accumulation | Rapidly improving infrastructure and rapid increase in private sector capital accumulation | Infrastructure and private sector capital stock well built up |

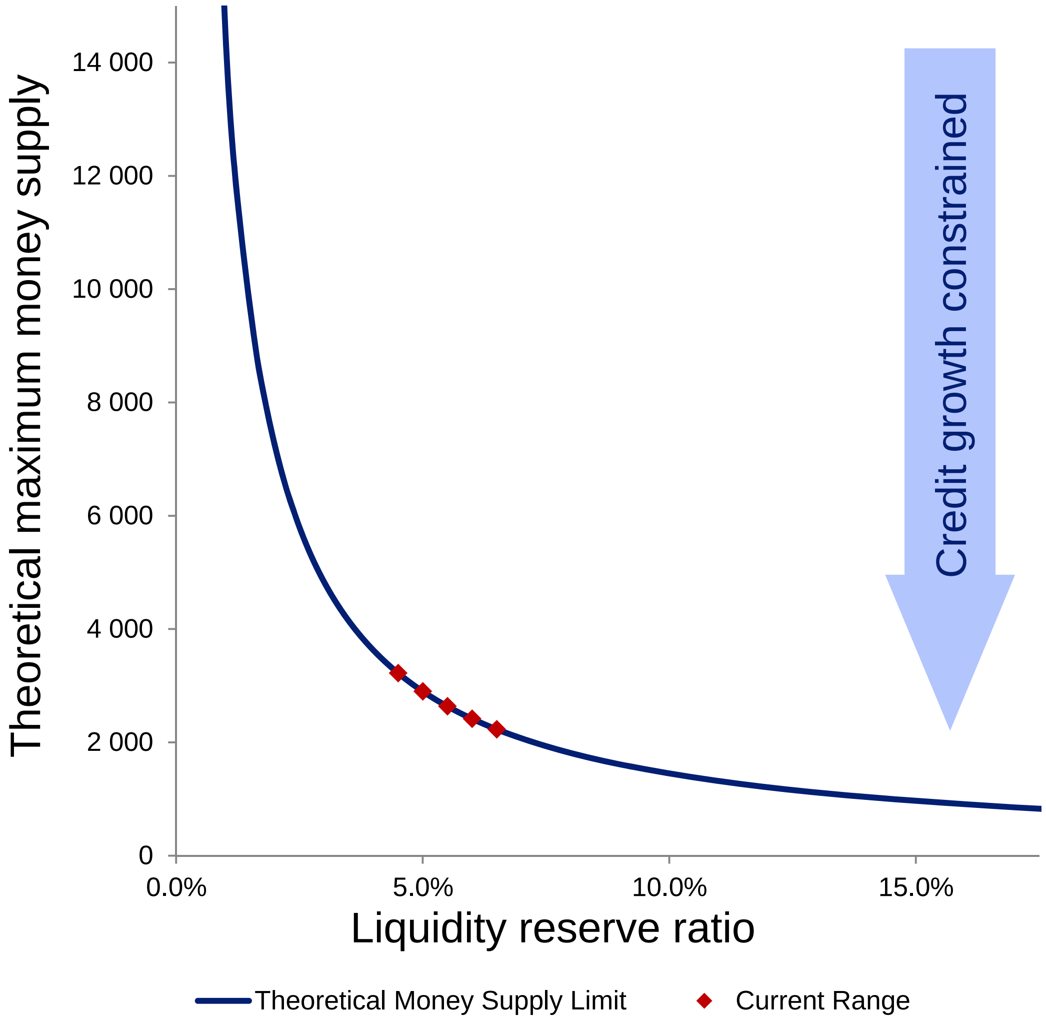
*Source: Economic Growth And Transition - Econometric Analysis Of Lim's S-curve Hypothesis*

# SA's household flows – reflects a contractual savings scheme (i.e. low discretionary savings)




Source: SARB QB, 2011Q2

# Liquidity reserves and private credit




+ As maturity transformation increases *(liquidity mismatch)*

+ Increase liquidity reserves

- Constrains private credit extension

*Purchase of government securities leeds to public sector credit instead…*

- *Change to the transmission mechanism*
- *Multiplier can only grow in a specific way*
  - *Term savings is required*
- *Limits the potential intervention by central banks when money multiplier collapses in stress*

*Source: Economic Growth And Transition - Econometric Analysis Of Lim's S-curve Hypothesis*

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# firstrand's response

Andries du Toit

# The FirstRand response

- Funds Transfer pricing
  - Behaviour pricing for liquidity and deposits
  - Match funding for illiquid long dated assets
  - Minimum client pricing on both side of the balance sheet

- Funding strategy
  - New measurement on deposit franchise
  - New product offering and development
  - Capital market issuance to extend term of institutional funding

The above will protect shareholders

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# funds transfer pricing (ftp)

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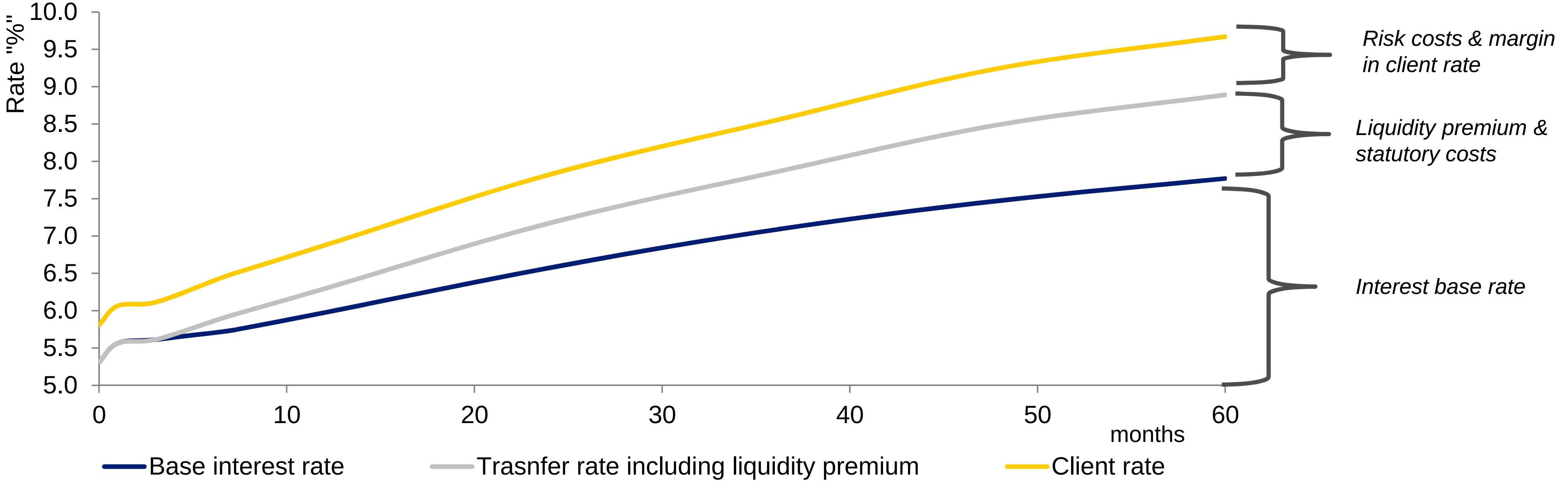
# Numerous approaches to FTP

- No right or wrong
- If the FTP does not reflect economic reality, then
- The resultant behaviour can have incorrect impact and results

It is not just about the price, but also about the availability

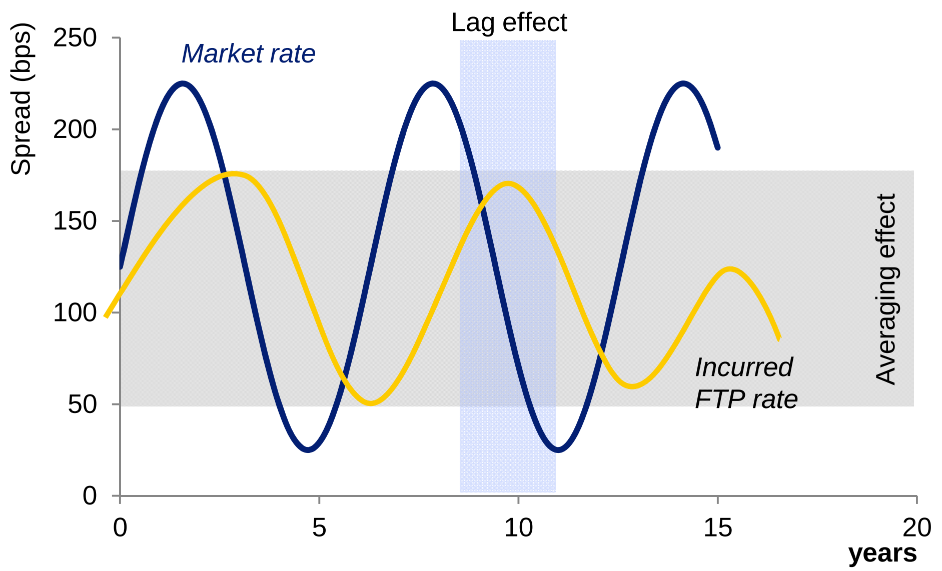
# Components of FTP




- The funding curve represents the bank‘s total marginal capital market
- The FTP rate can be split into an
  - interest rate component, and a
  - liquidity spread
- The liquidity spread comprises:
  - credit spread compensates investors for the default risk
  - market liquidity

# Why we do not like average-incurred-cost approaches

Illustration of FTP and market rates




- In each time period the costs actually incurred by outstanding funding are allocated to outstanding assets

- These are deficits from this approach:
  - Averaging effect - it is possible that a customer loan successfully sold above market rate at time of inception will never earn its internal FTP allocation over its lifetime, that is, always look unprofitable
  - Due to the lagging effect - it is possible that the internal FTP-rate is increasing in times of falling market rates, and vice versa
  - Thus, it is "funds transfer" rather than "fund transfer pricing"

# Addressing the economic value of deposits for a sustainable funding base

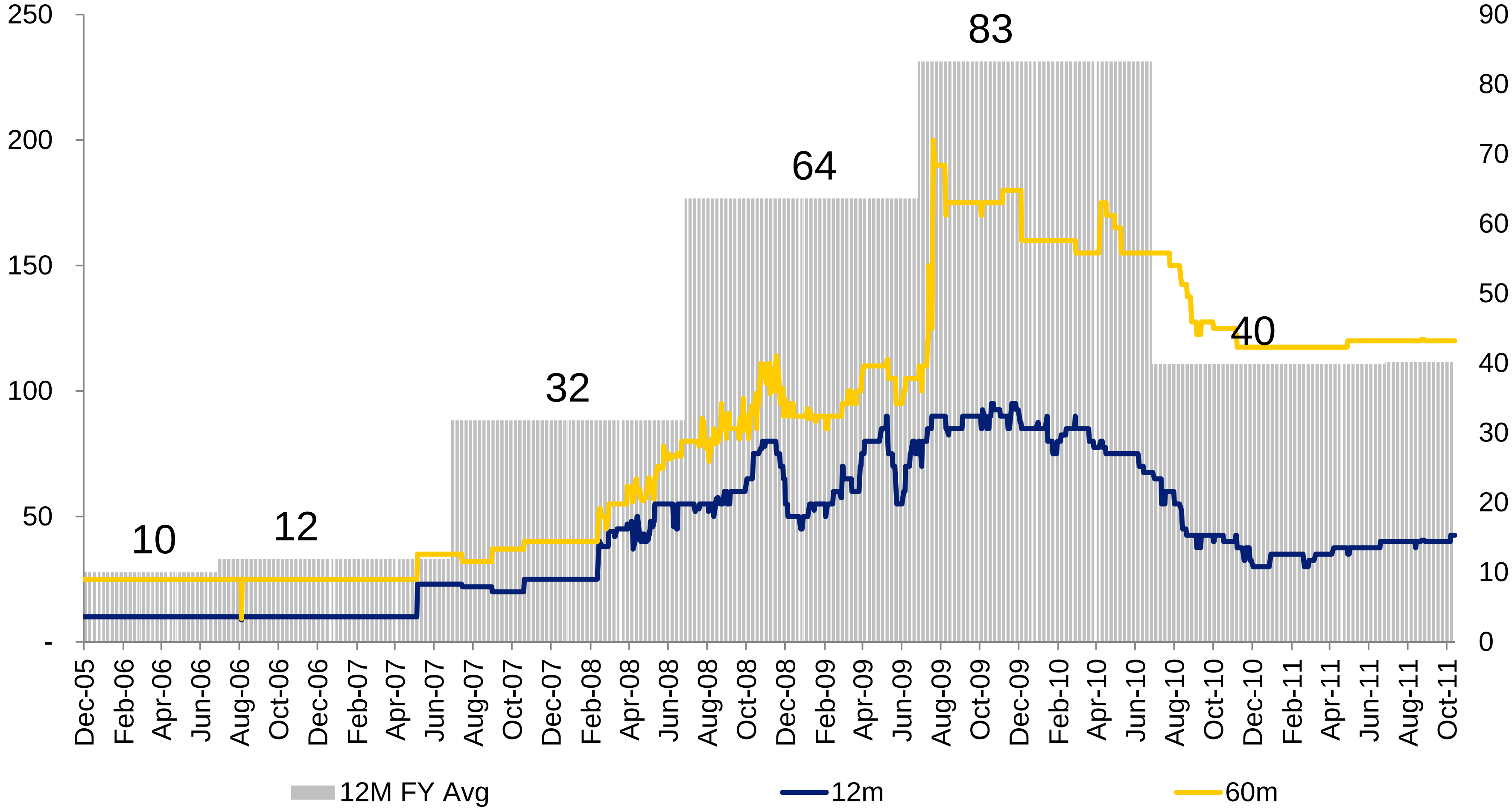
*Economic Models to determine the risk for pricing and measurement*

| *Assets* | *Liabilities* |
| --- | --- |
| • *Credit* | • *Capital* |
| • *Market Risk* | • *Liquidity on deposits* — Outstanding |
| • *Liquidity* | • *Funding* |
| • *Investment Risk* | • *Operational Risk* |
| • *Operational Risk* | |

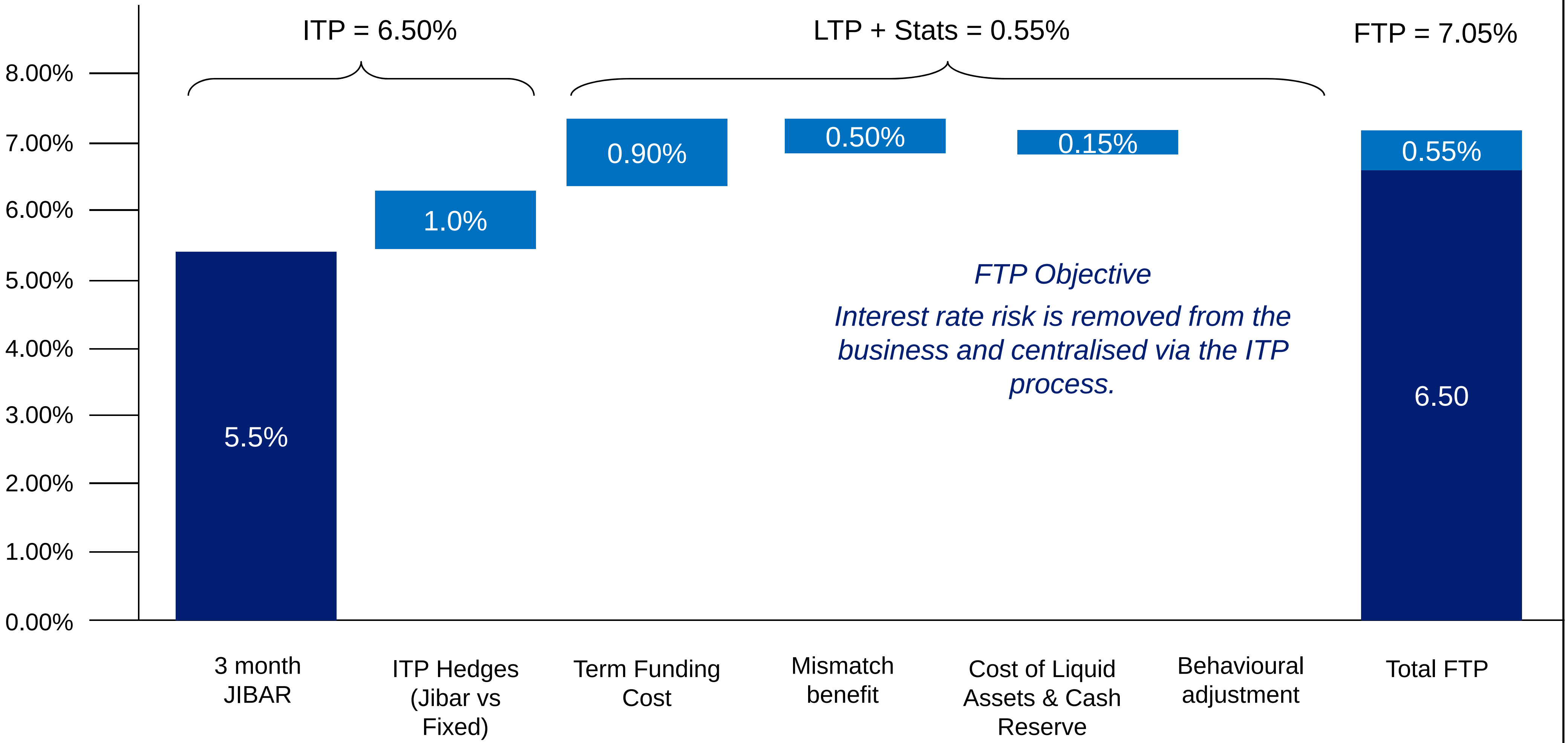
FirstRand measures, manages and prices according to economic risks and principles. Regulations (BASEL III) are a constraint

# The significance of the liquidity component

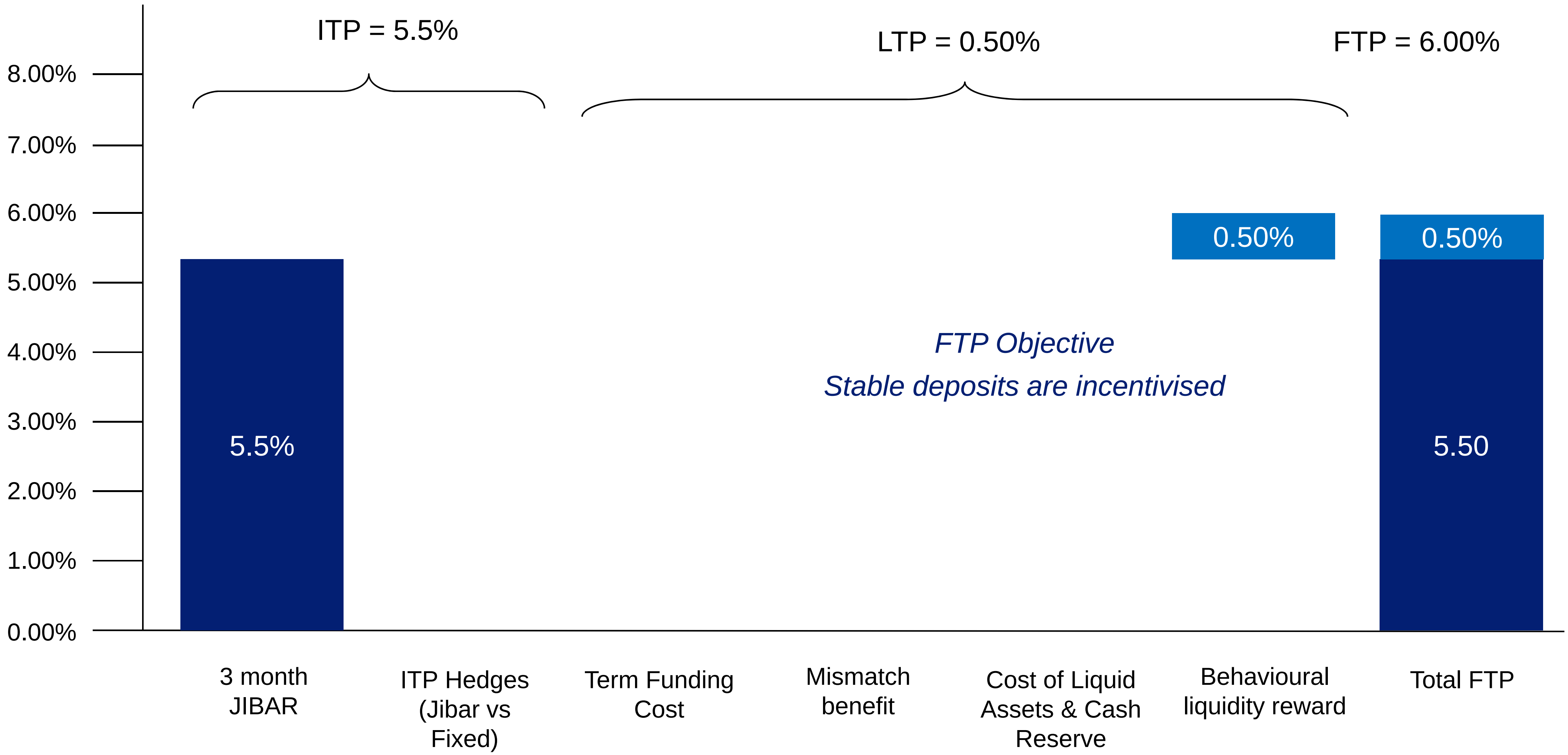
Liquidity premium re-prices every 9m while assets only every 44m



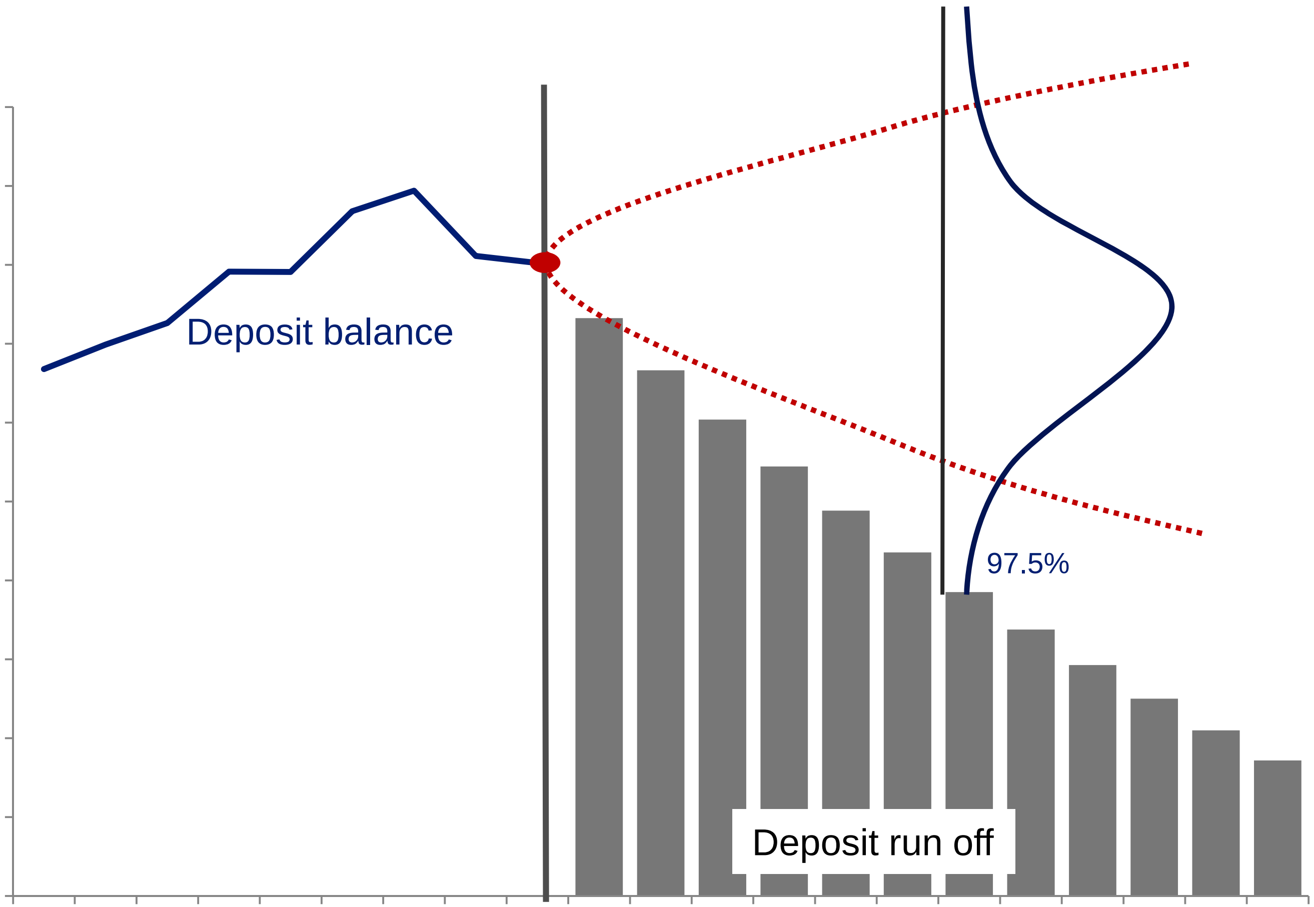
# Components of funds transfer pricing – fixed rate loans



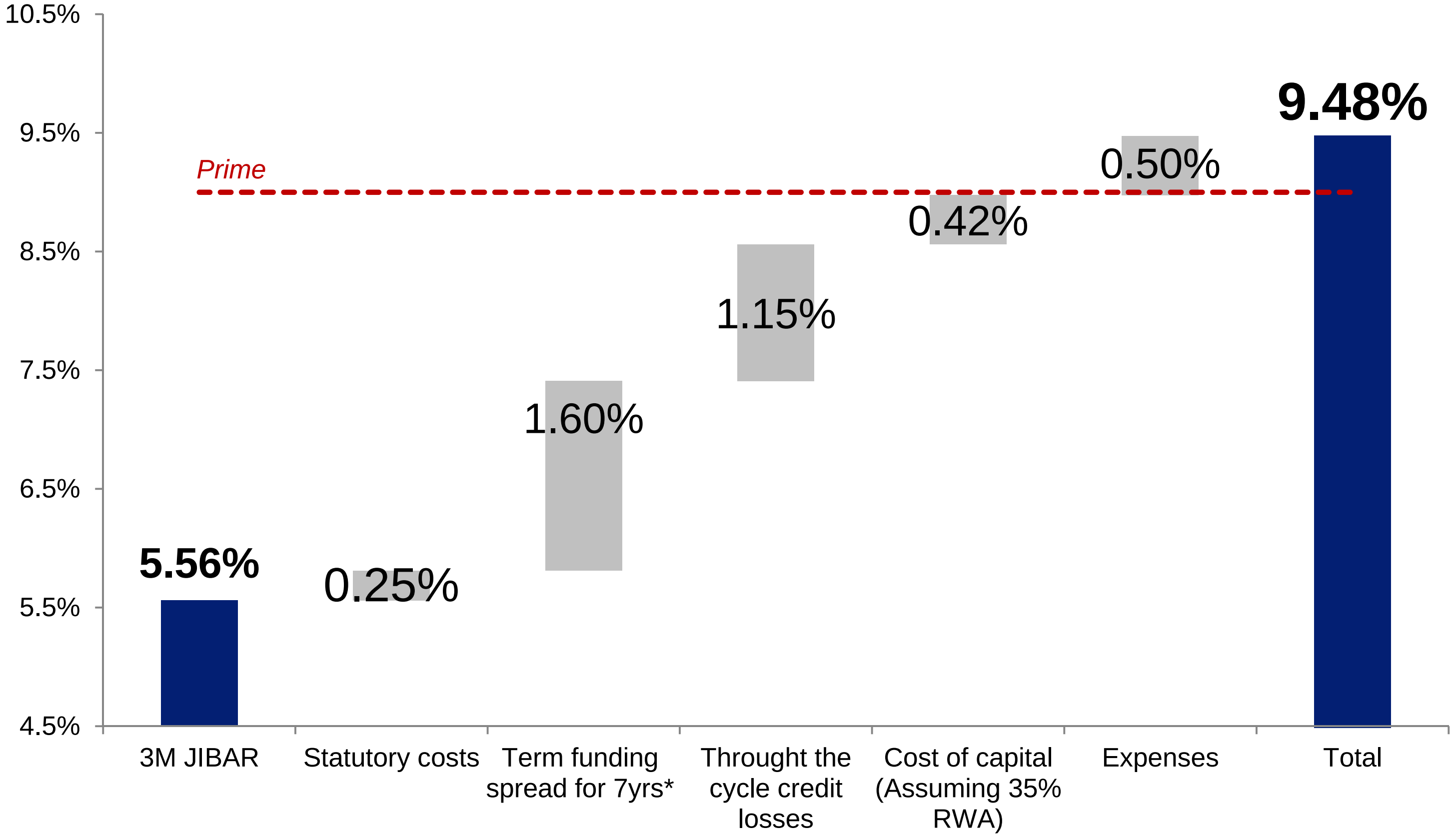
# Components of funds transfer pricing – demand deposit



# Evaluating cored core deposits and their value



# Estimation of mortgage funding costs



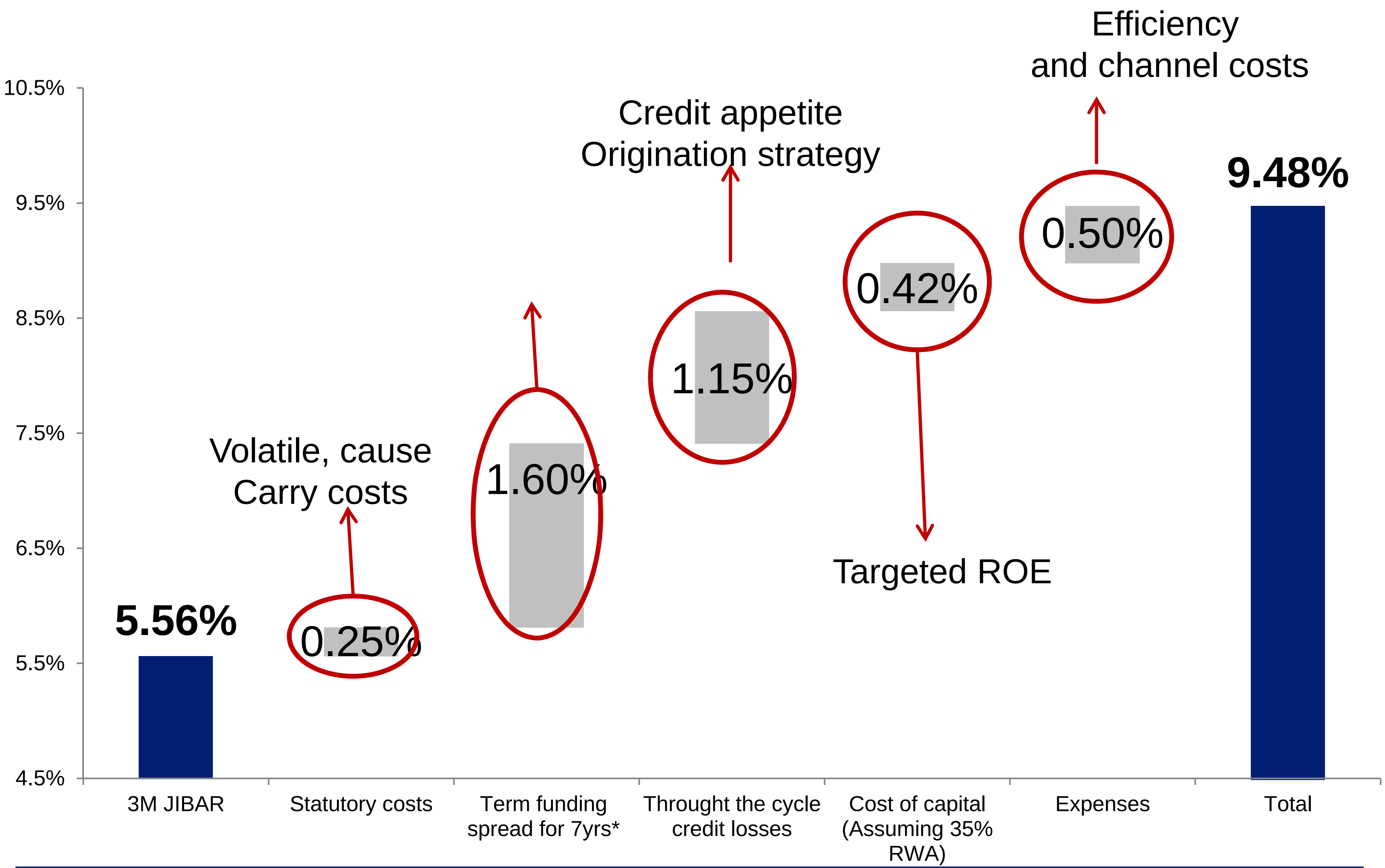

*On a portfolio-basis, rates of below prime were only possible from sustaining a liquidity mismatch*

*The benefit of this mismatch was given to borrowers*

*Notes*

**Match funded cost assumes amortisation profile with pre-payment, FirstRand NCD spreads*
*Assume cost of capital 15%*
*Assume Basel II standardised home loan risk weight 35%*
*Industry credit losses is based on impairment charge for largest 5 banks since 2006*

# Can you outperform the mortgage costs




The above all balanced against market pricing and competitors

# FTP conclusions

- There is no perfect approach
- The approach should create the correct incentives
- Align economic risks and incentives
- Support target balance sheet

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# funding strategy

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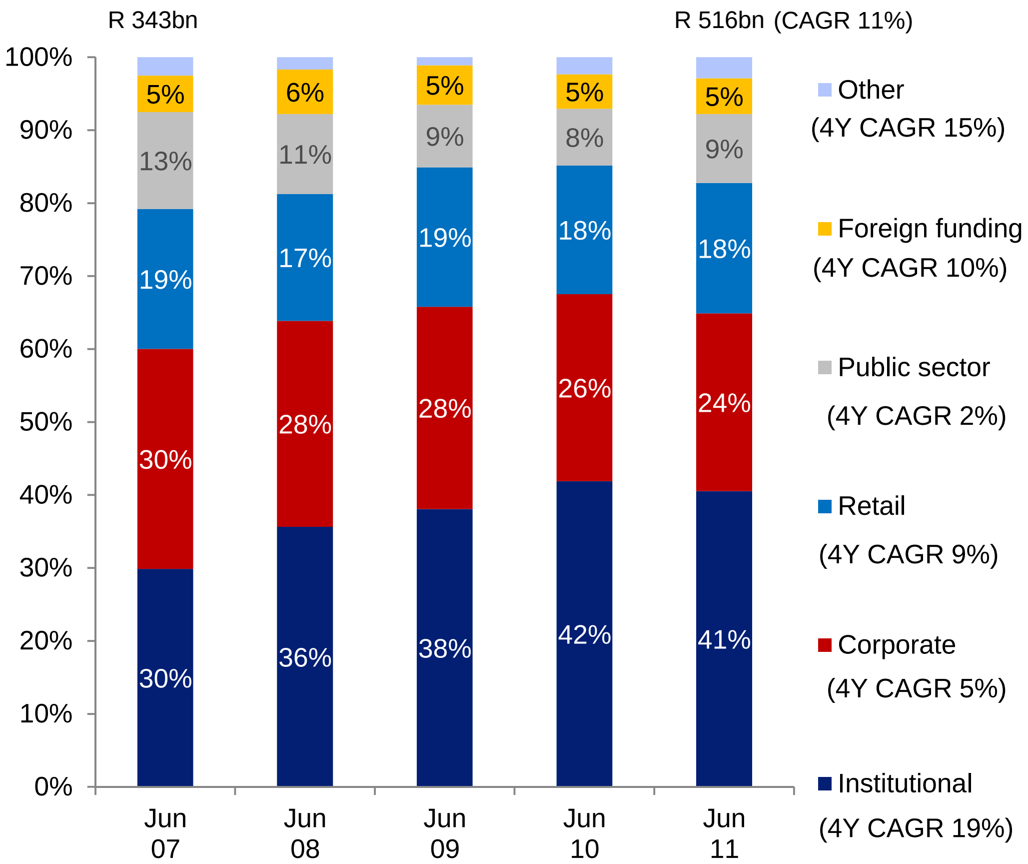
# The pillars of our funding strategy

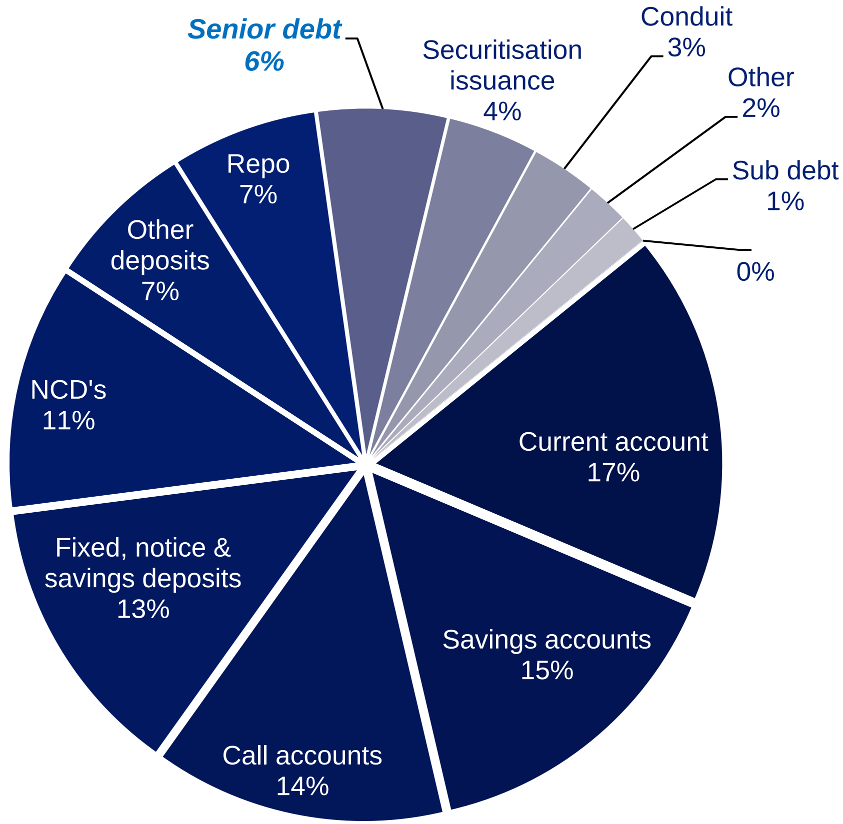
| Diversification | Efficiency | Flexibility | Counterparty relationships |
|---|---|---|---|
| Segments<br><br>Country and currency<br><br>Instrument type and maturity | Fund efficiently and with consideration of liquidity risk management framework, regulatory and rating agency requirements | Ensure flexibility in accessing funding opportunities | The Group places great value on its strong established relationships with investors |

# Strong focus on building a diversified funding base

## Sources of funding




## Funding instruments



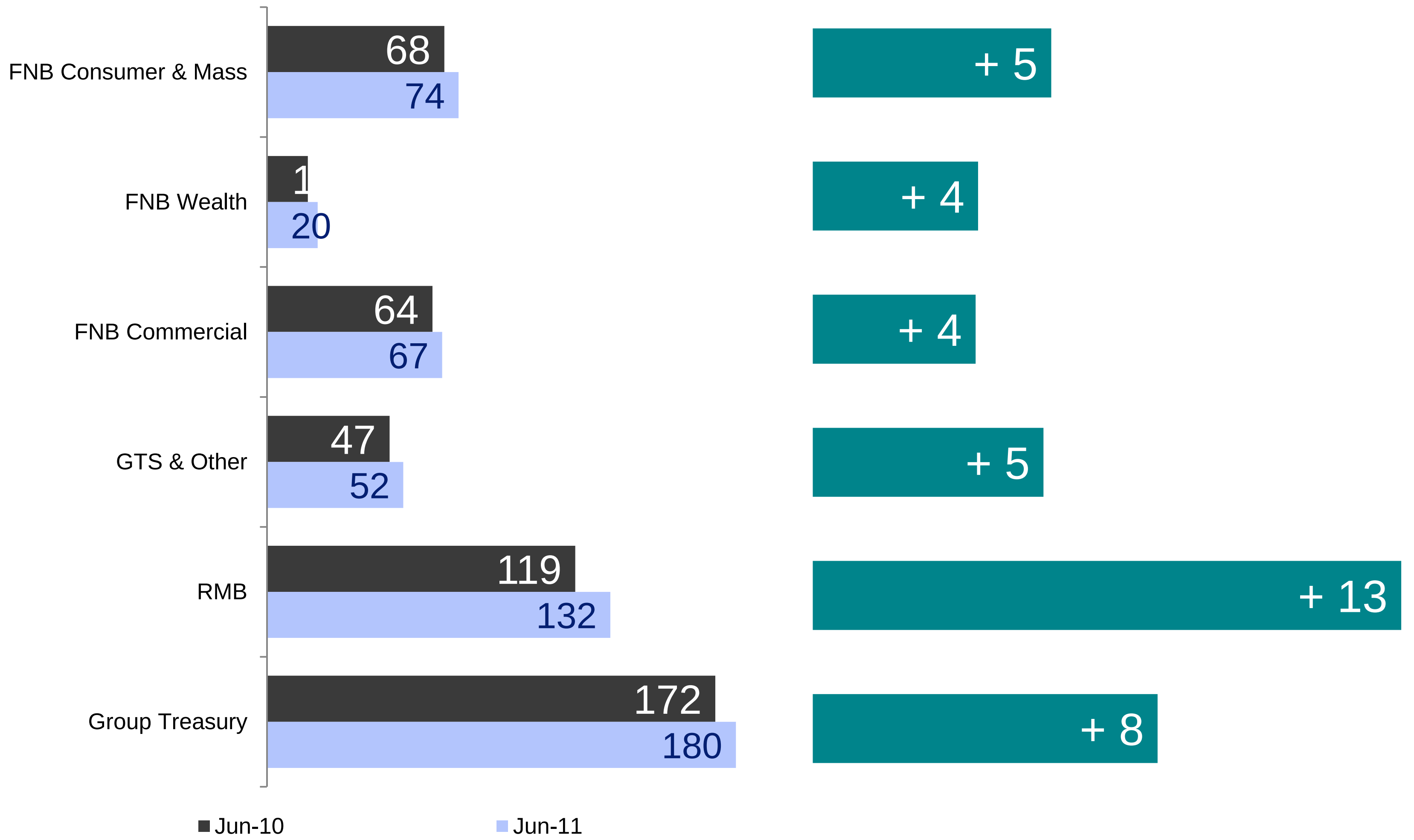

Incentivise building of deposit franchise

Source: SARB BA Returns, FirstRand Research, Jun 2011

# Franchises gaining traction with deposit growth

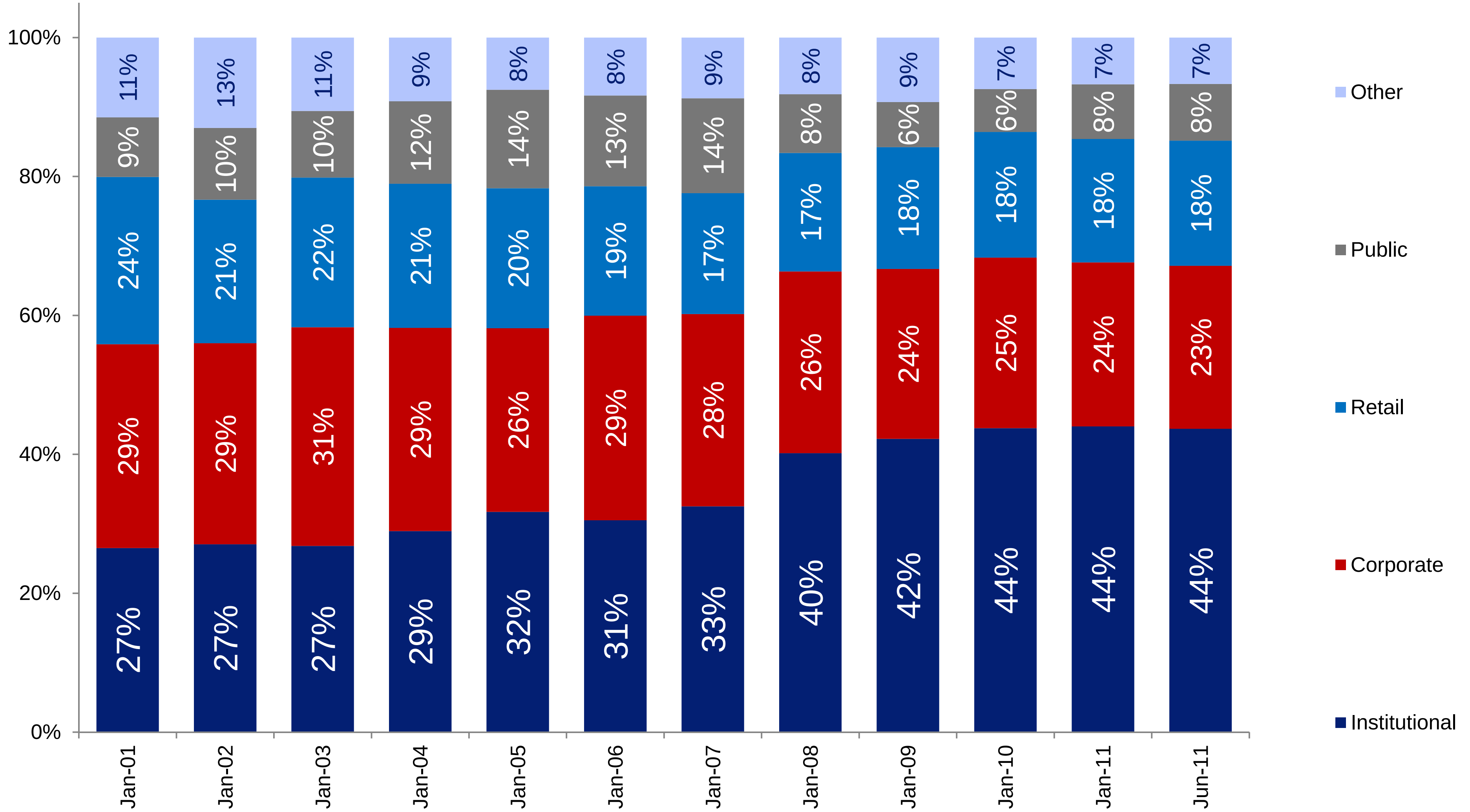
Funding by segment

Year on year growth




*Source: FirstRand, results, segmental reporting Jun 2011*

# South African banking sector – funding composition by counterparty

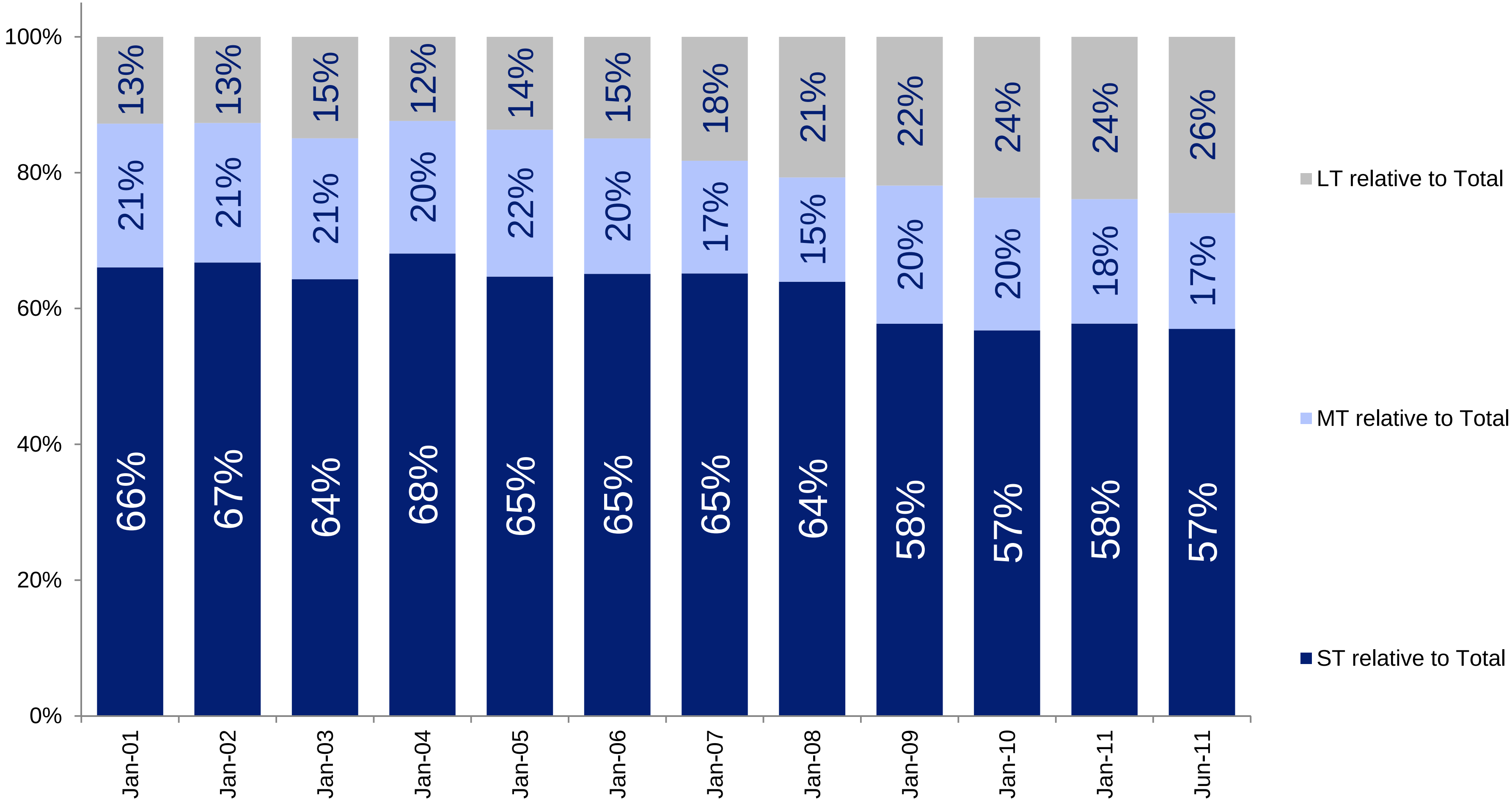



| | Jan-01 | Jan-02 | Jan-03 | Jan-04 | Jan-05 | Jan-06 | Jan-07 | Jan-08 | Jan-09 | Jan-10 | Jan-11 | Jun-11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Other | 11% | 13% | 11% | 9% | 8% | 8% | 9% | 8% | 9% | 7% | 7% | 7% |
| Public | 9% | 10% | 10% | 12% | 14% | 13% | 14% | 8% | 6% | 6% | 8% | 8% |
| Retail | 24% | 21% | 22% | 21% | 20% | 19% | 17% | 17% | 18% | 18% | 18% | 18% |
| Corporate | 29% | 29% | 31% | 29% | 26% | 29% | 28% | 26% | 24% | 25% | 24% | 23% |
| Institutional | 27% | 27% | 27% | 29% | 32% | 31% | 33% | 40% | 42% | 44% | 44% | 44% |

*Source: SARB BA900, June-2011, FirstRand*

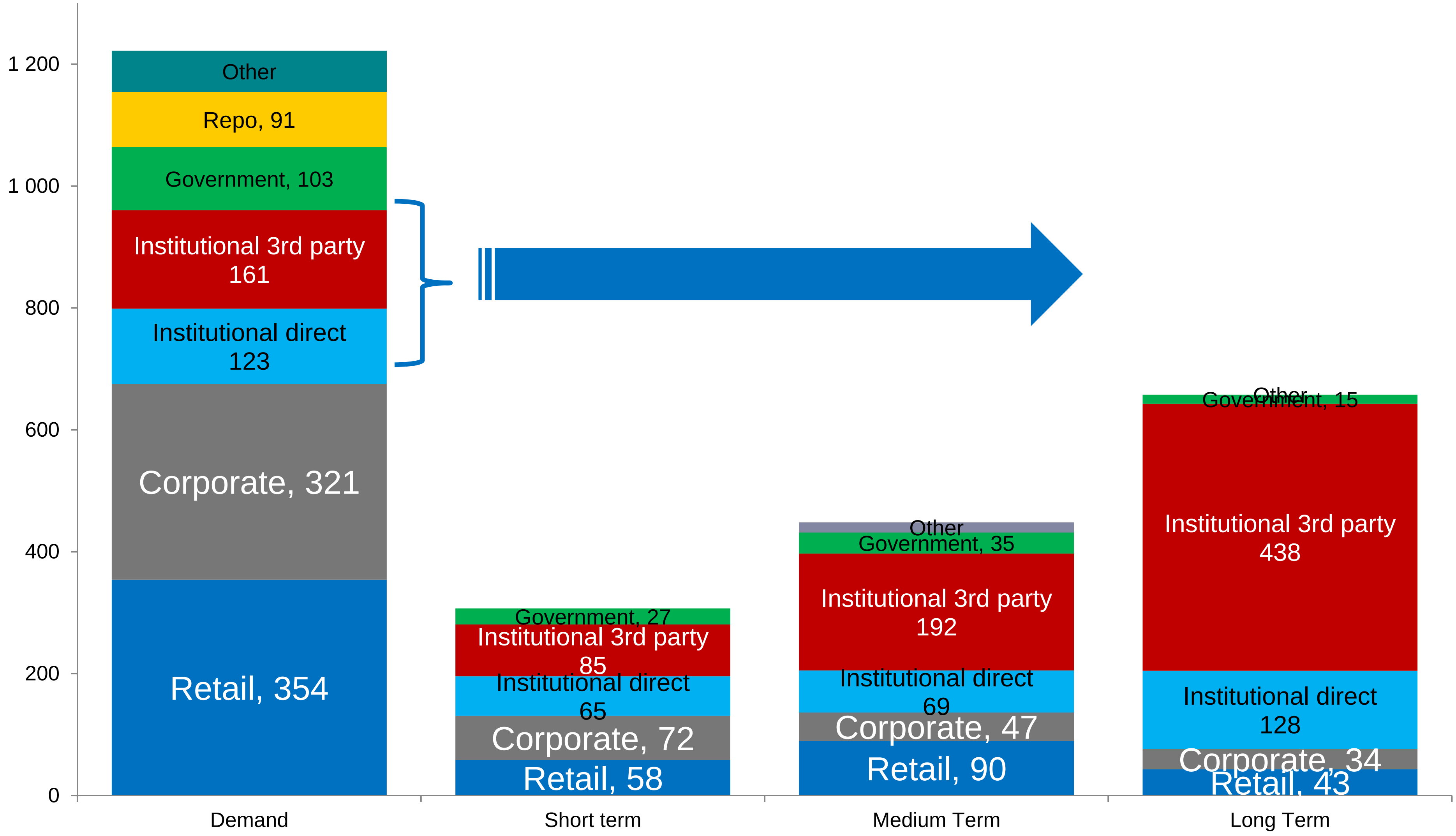
# Industry liquidity profile has been improving – however definitions do not align

Aggregate funding mix



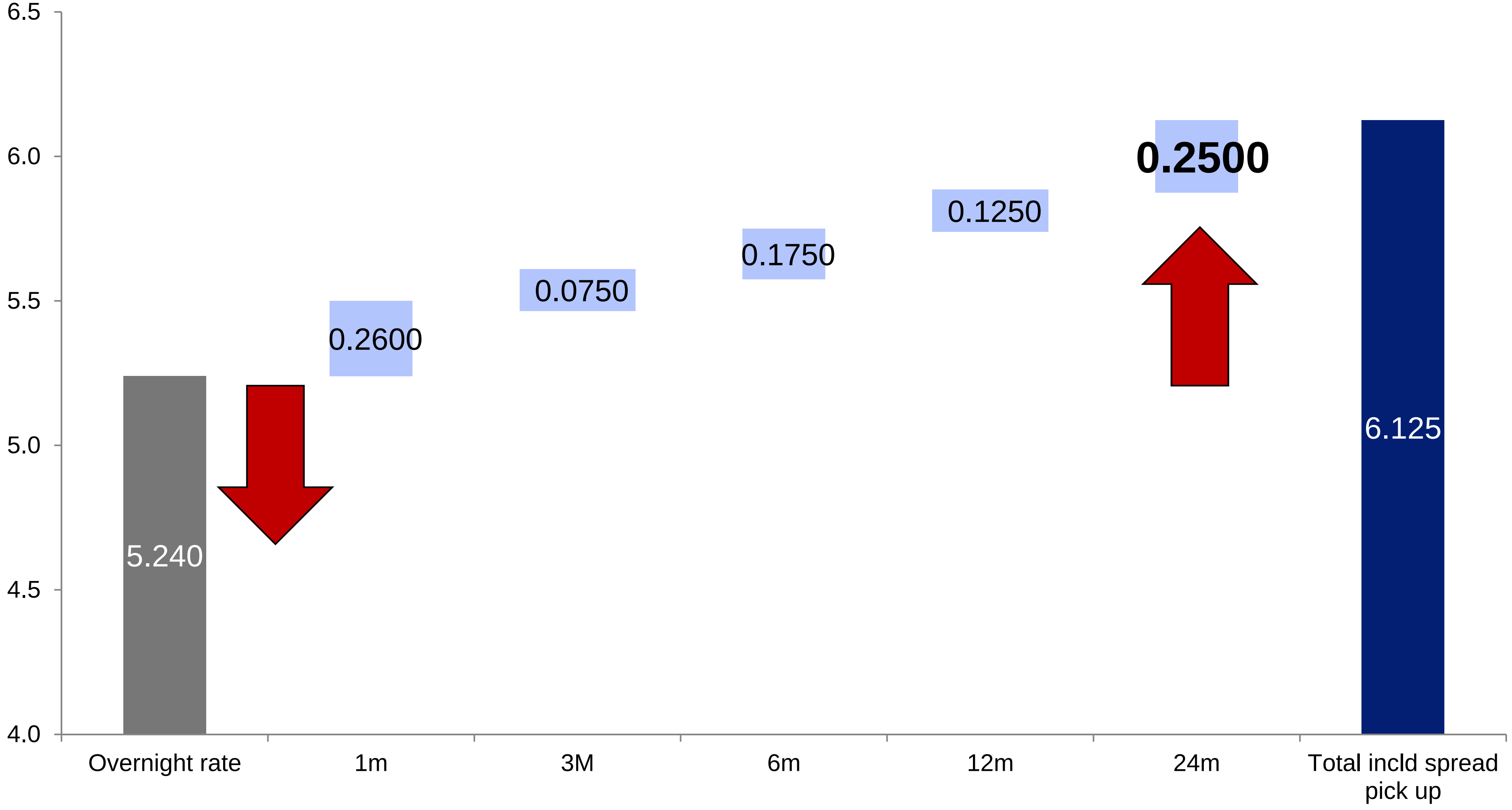

*Source: SARB BA900, Dec-2010, SA Banking Sector Aggregate*

# Industry funding and term profile by segment

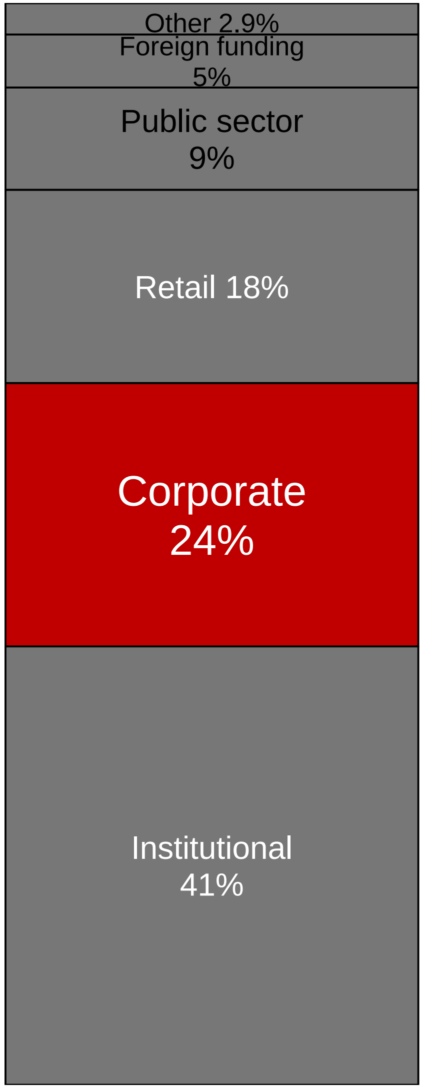



Source: SARB BA900, June-2011, SA Banking Sector Aggregate

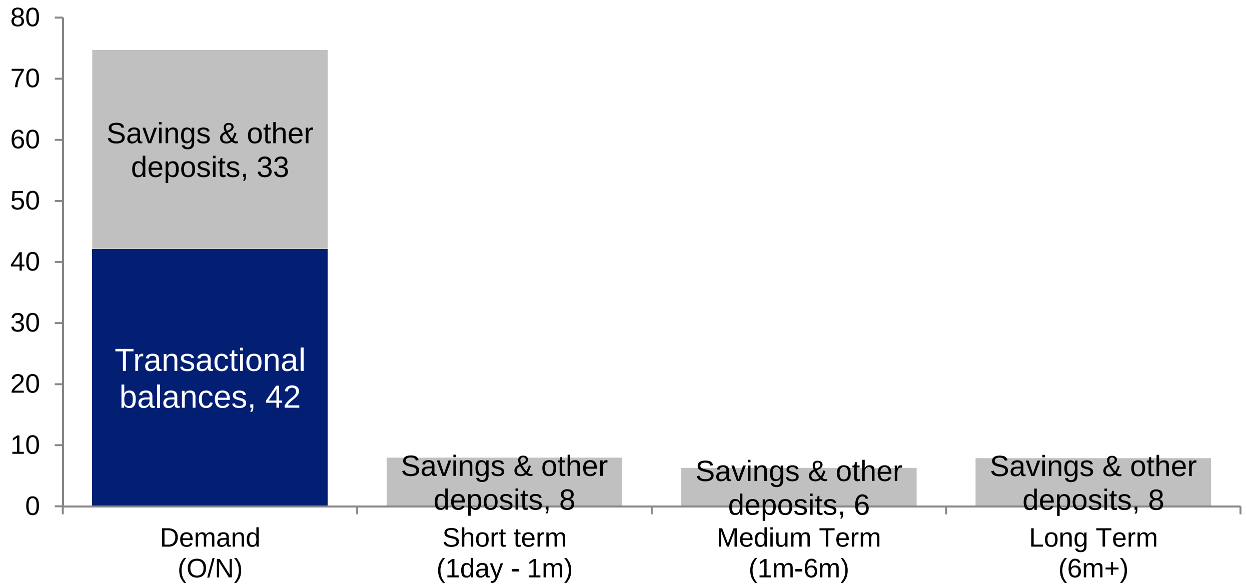
# Term yield pick-up is an insufficient incentive



# Corporate

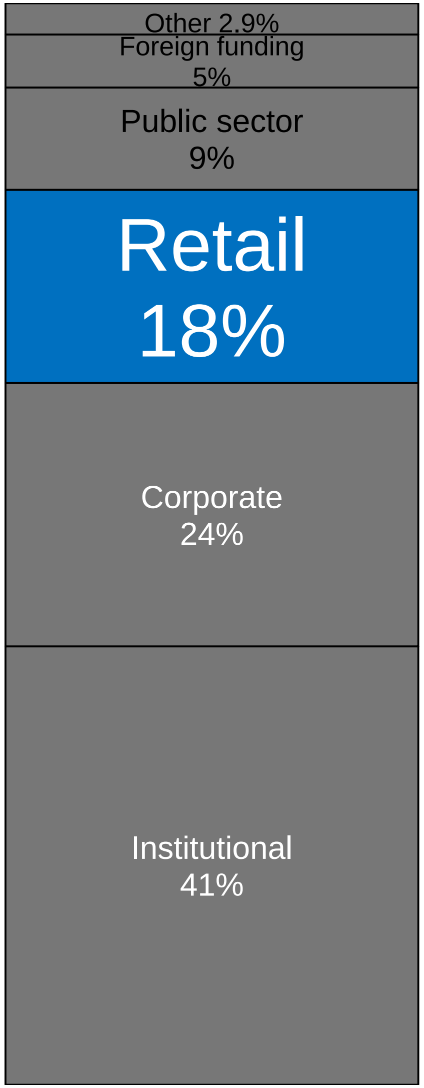



- To the extent we provide operational and cash management services this strengthens the funding relationship
- Banks are going to have to be innovative in order to attract and retain deposits

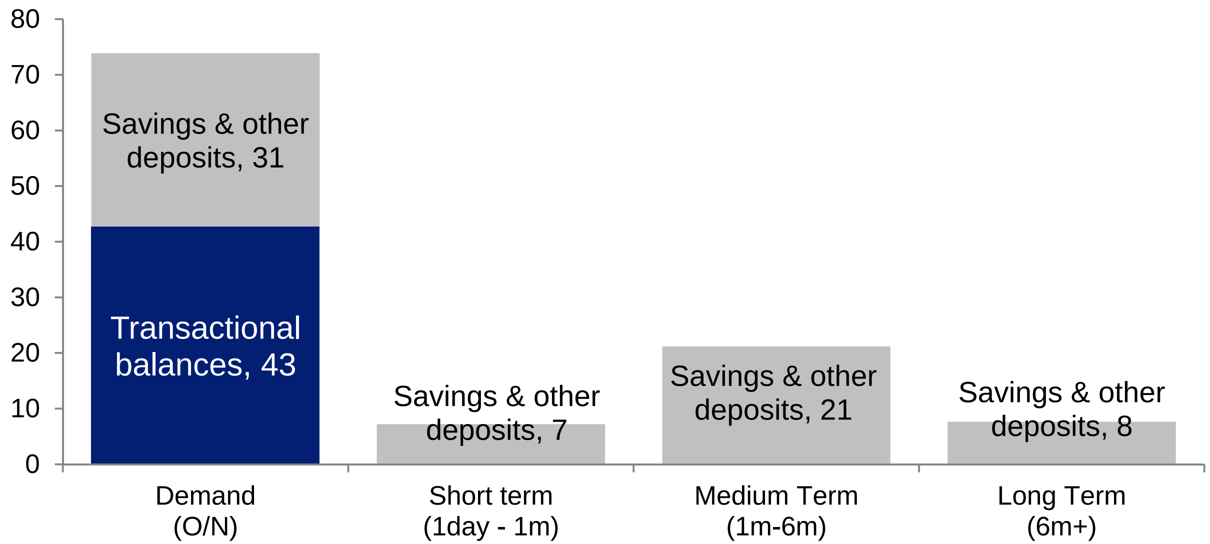



Source: SARB BA900, June-2011, FirstRand

# Retail

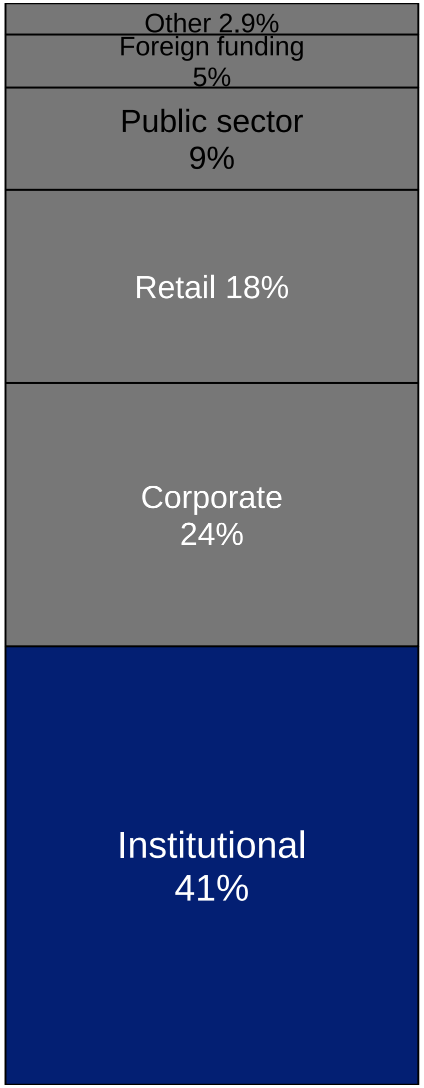



- The market for "*deposits*" is getting more competitive as banks price for their embedded value and try to re-intermediate to enhance their liquidity profile
- Banks are going to have to be innovative in order to attract and retain deposits
- FirstRand has launched two products
  - Money market maximizer
  - RMB Cash enhancer

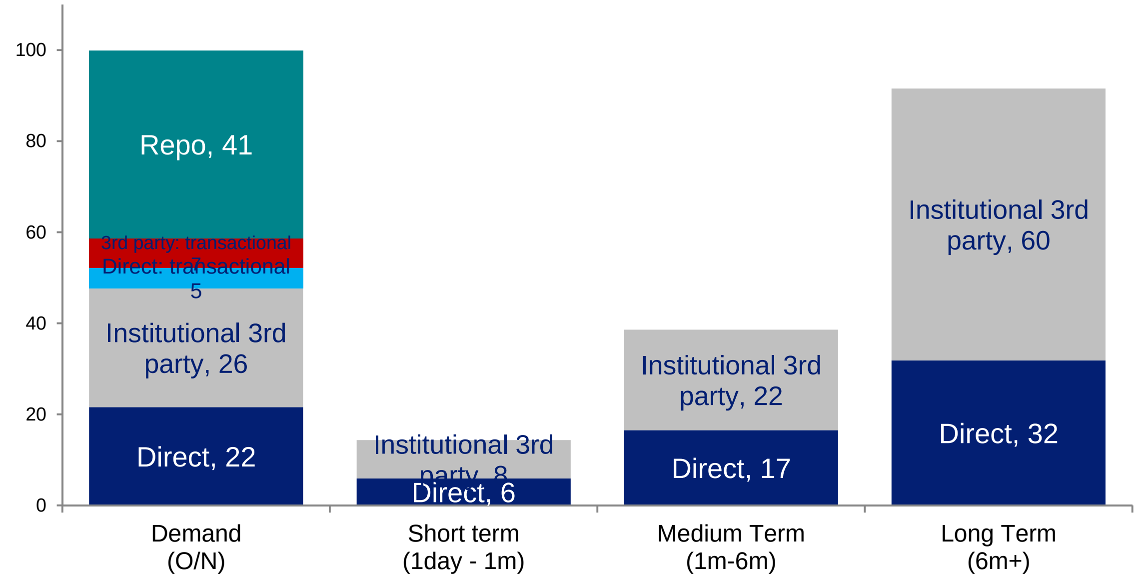



Source: SARB BA900, June-2011, FirstRand

# Institutional funding



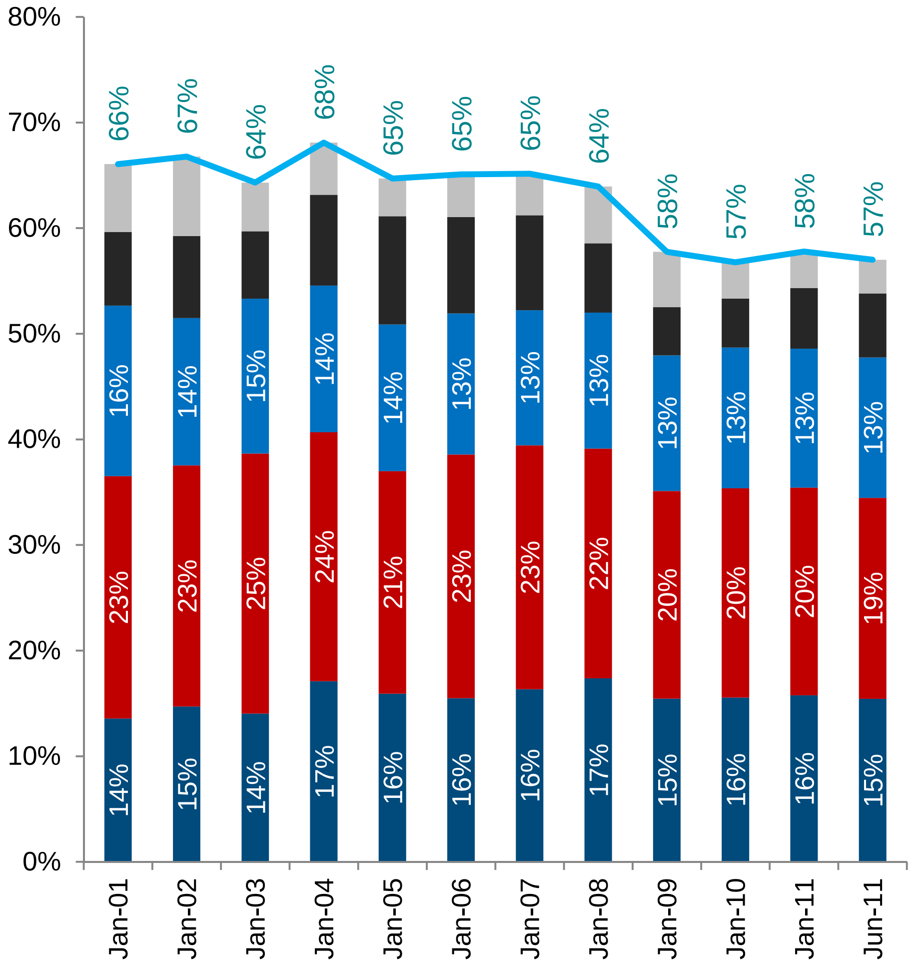

- FirstRand has historically been under represented in the capital markets.
- We are increasingly seeking long term fixed income investment appetite in the capital market and looking at alternative funding strategies including
- We would however like to see a change in the profile – a reduction in the short term portion of institutional funding
- Increasing the term of the institutional funding book does however come at a cost.



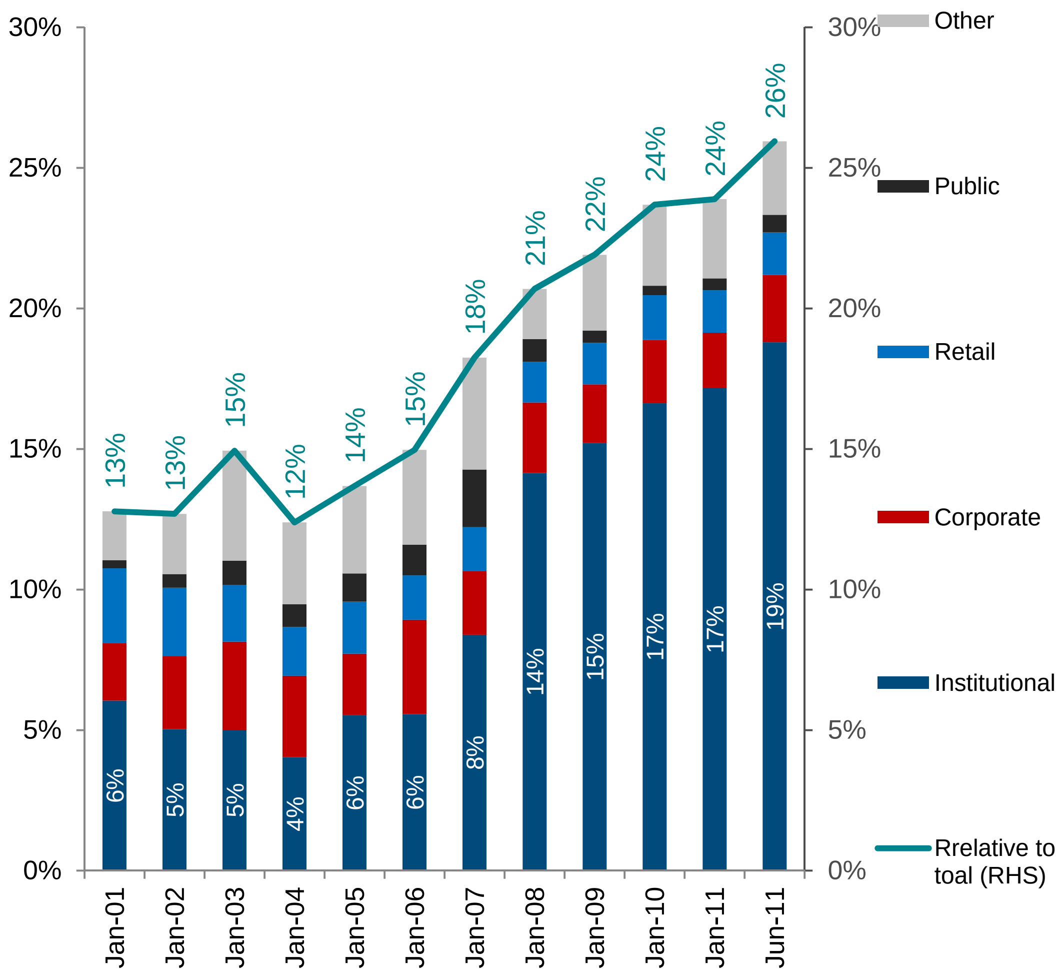

Source: SARB BA900, June-2011, FirstRand

# Industry liquidity profile has been improving – however definitions of long term do not align

Mix within short term funding (<"1m")

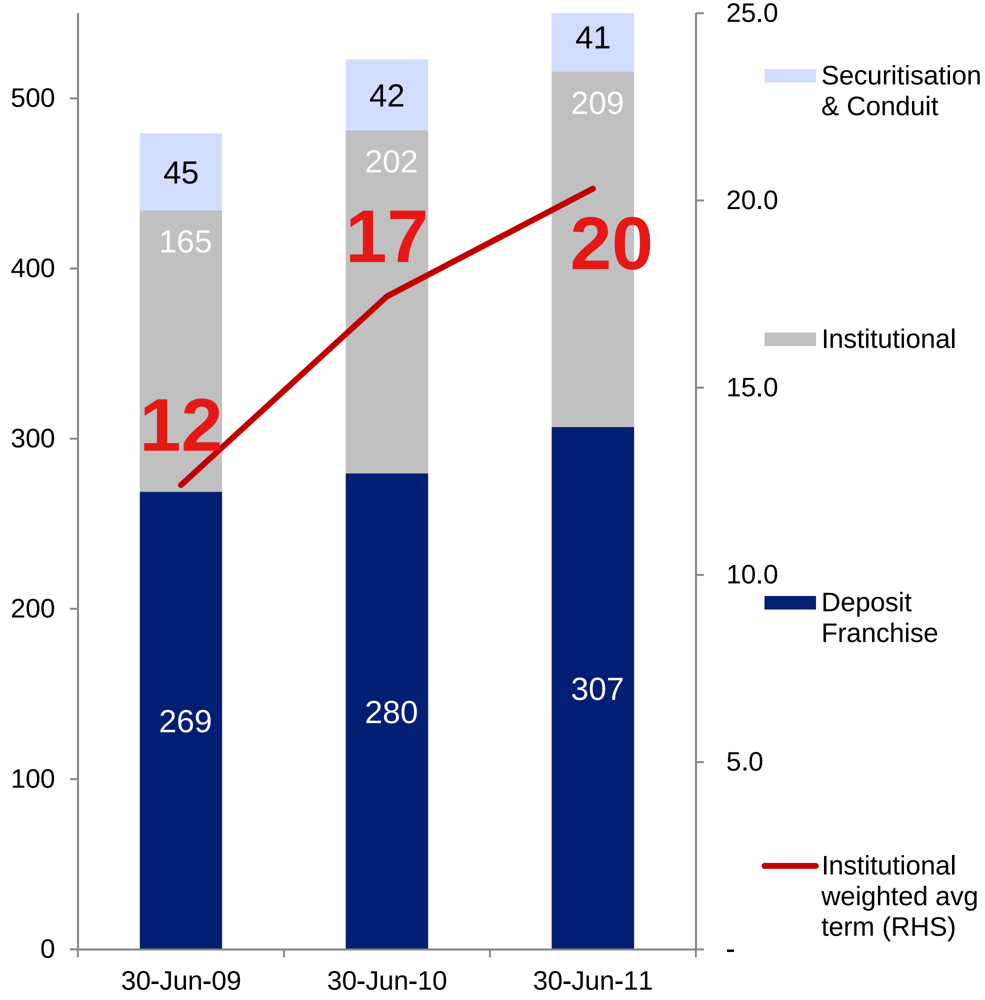



Mix within long term funding (">6m")



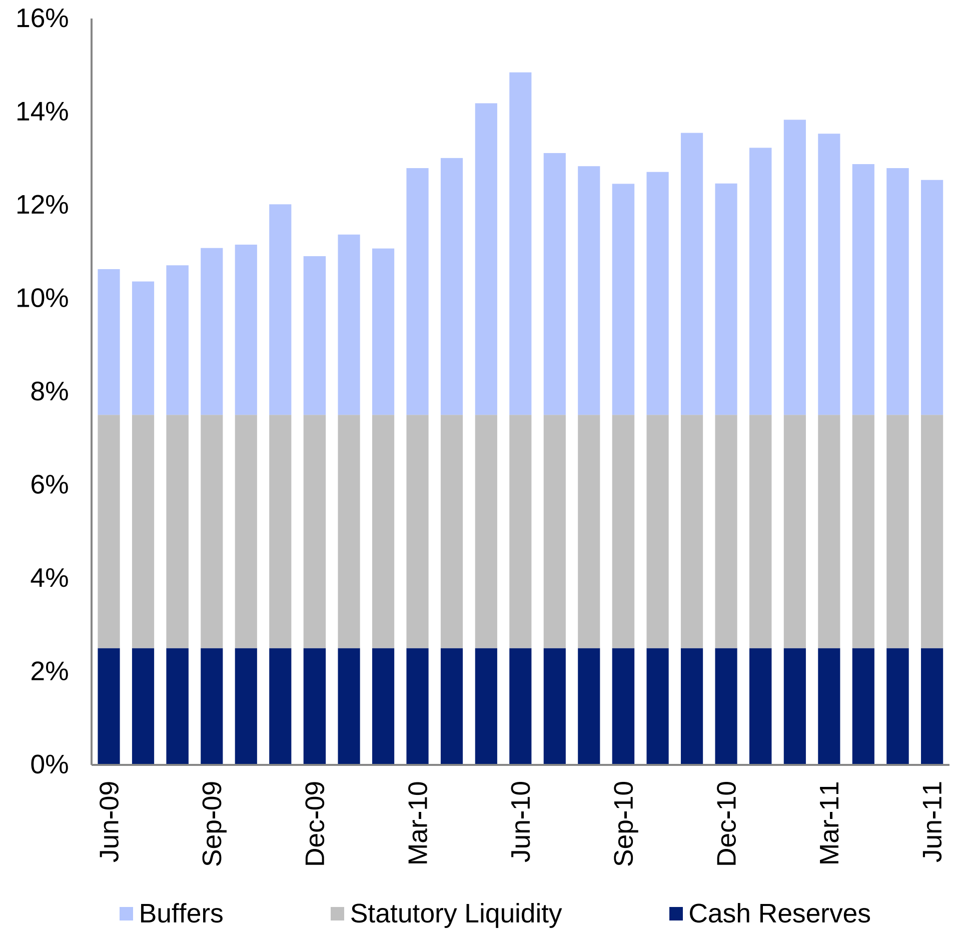

Source: SARB BA900, Dec-2010, SA Banking Sector Aggregate

# Actively lengthening the term profile and holding appropriate liquidity reserves



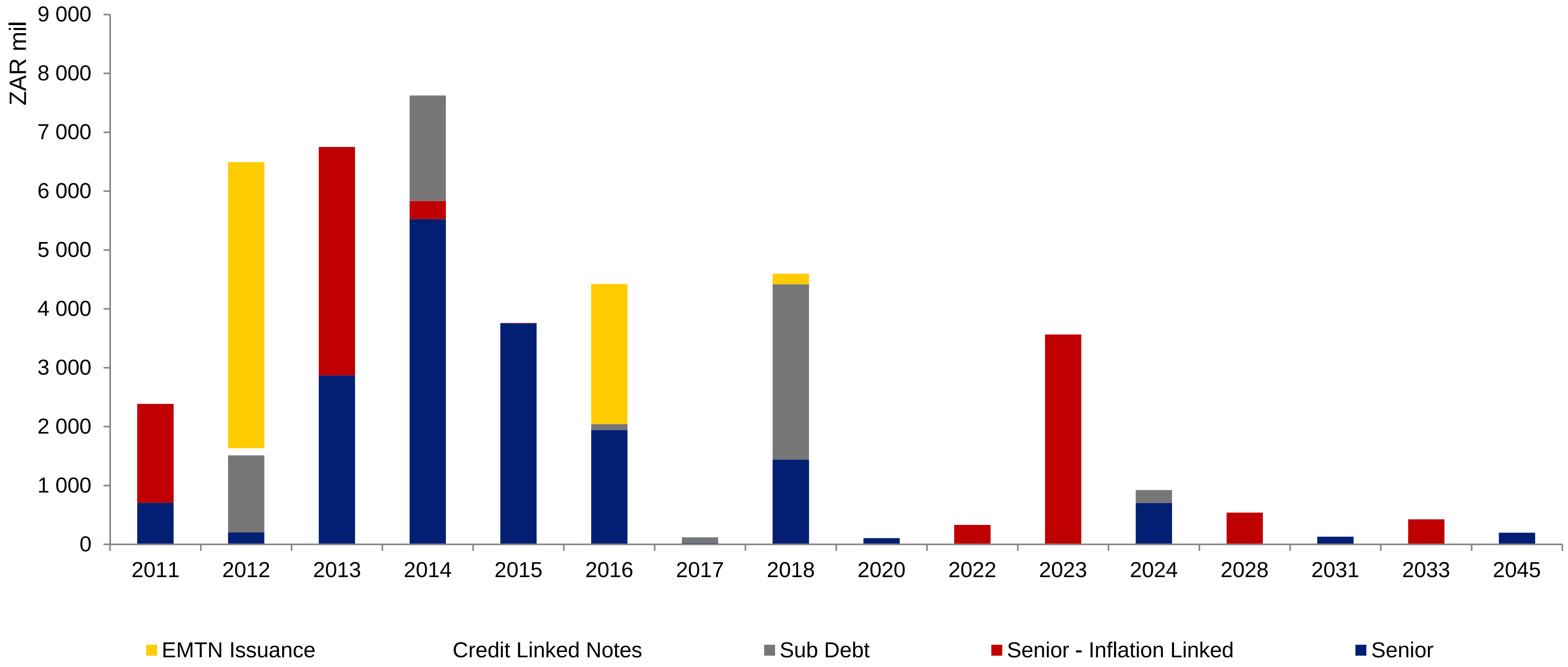

Source: FirstRand, Jun 2011

Liquidity reserves "%" of total liabilities




Source: SARB BA Returns, FirstRand Research, 30-Jun-11

# Diversified listed debt maturity profile




**April 2010 auction summary:**

| ZAR million | Nominal | Cash |
|---|---|---|
| Total bids | 4 296 | 5 813 |
| Allocation | 2 571 | 3 340 |

**Aug 2010 auction summary:**

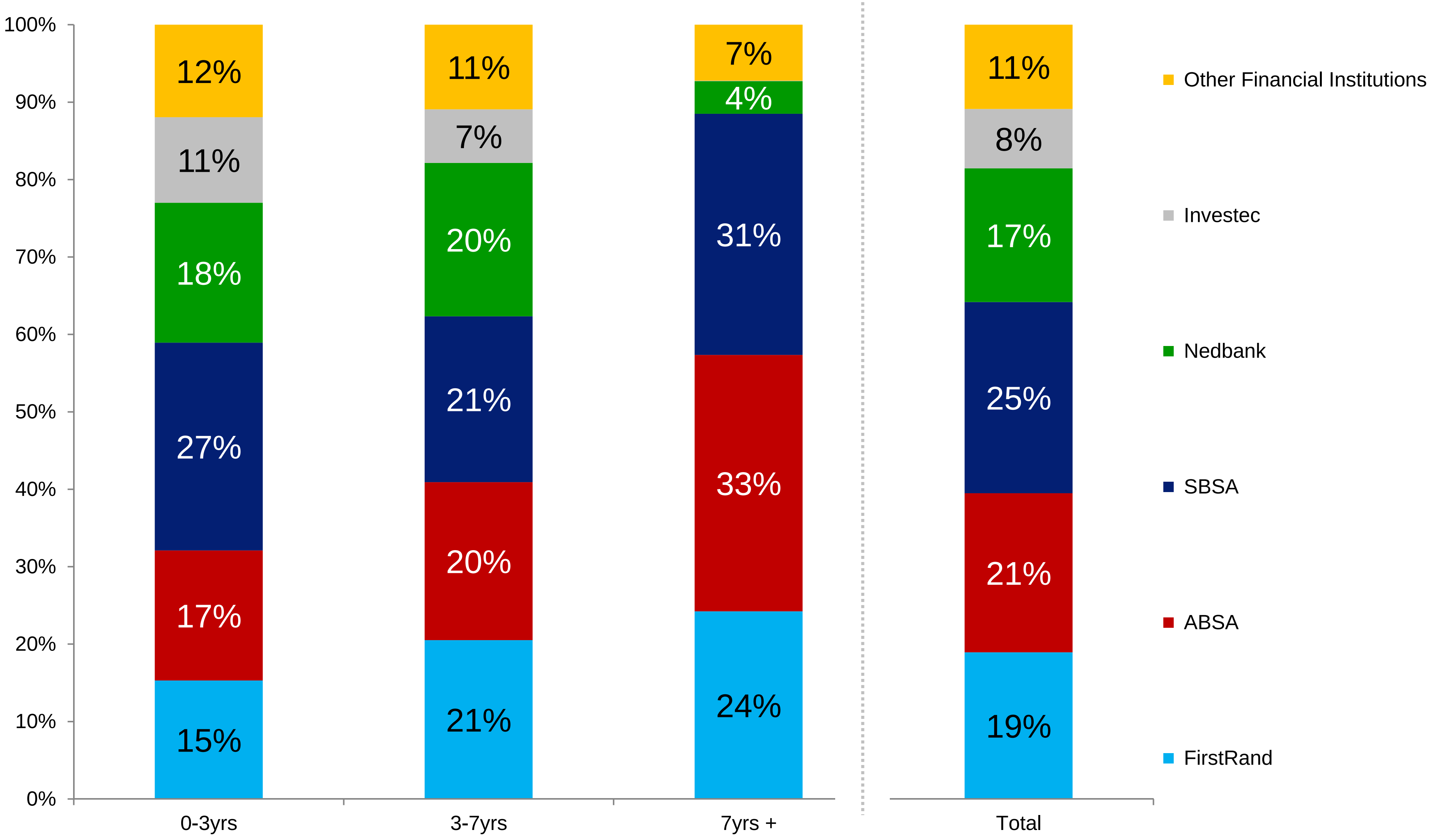
| ZAR million | Nominal | Cash |
|---|---|---|
| Total bids | 4 889 | 4 989 |
| Allocation | 4 199 | 4 309 |

**Feb 2011 auction summary:**

| ZAR million | Nominal | Cash |
|---|---|---|
| Total bids | 6 949 | 6 239 |
| Allocation | 4 623 | 4 682 |

*Source: FirstRand Research, JSE-BESA Bond Data, Jun 2011*

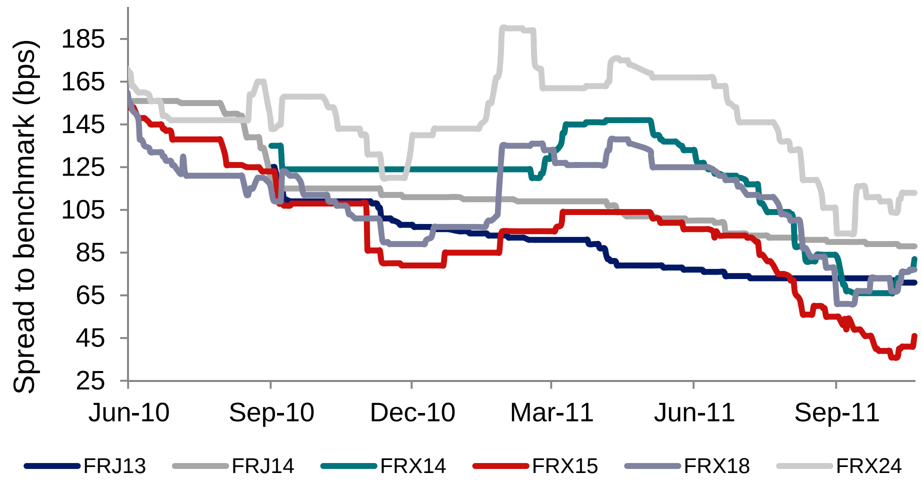
# Share of financial institutions debt issuance

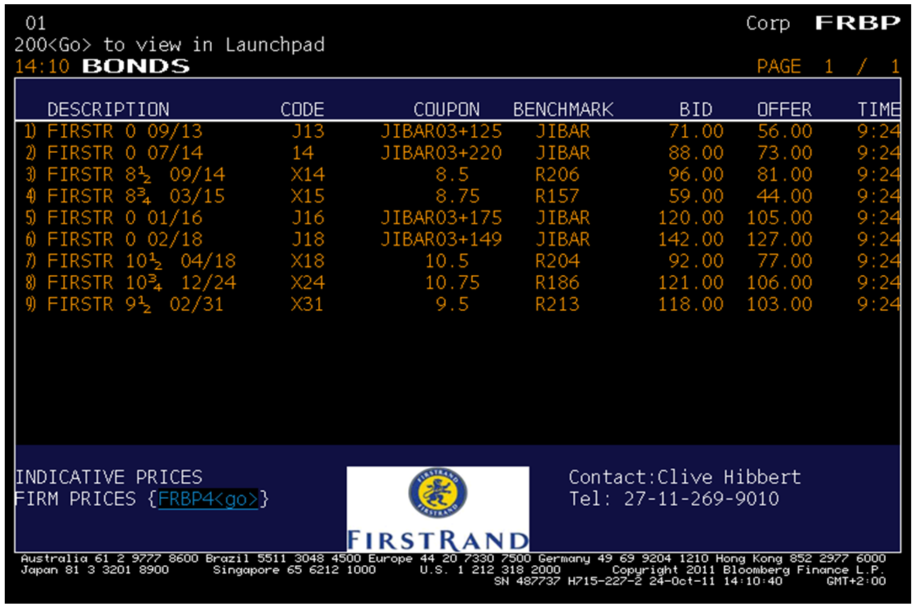



*Source: FirstRand Research, JSE-BESA Bond Data, Jun 2011*

# FirstRand bonds – market making support

- All pricing on Bloomberg
  - Bonds, NCD's, FRN's
  - <FRBP>, <RMBP>
- Provide market making support
- Facilitate secondary market trade
- Facilitate small portfolio adjustments
- Ensuring consistent valuation between FRN's & fixed rate bonds
- Ensure correct valuations on the JSE bond exchange



01 Corp **FRBP**
200<Go> to view in Launchpad
14:10 **BONDS** PAGE 1 / 1

| | DESCRIPTION | CODE | COUPON | BENCHMARK | BID | OFFER | TIME |
|---|---|---|---|---|---|---|---|
| 1) | FIRSTR 0 09/13 | J13 | JIBAR03+125 | JIBAR | 71.00 | 56.00 | 9:24 |
| 2) | FIRSTR 0 07/14 | 14 | JIBAR03+220 | JIBAR | 88.00 | 73.00 | 9:24 |
| 3) | FIRSTR 8½ 09/14 | X14 | 8.5 | R206 | 96.00 | 81.00 | 9:24 |
| 4) | FIRSTR 8¾ 03/15 | X15 | 8.75 | R157 | 59.00 | 44.00 | 9:24 |
| 5) | FIRSTR 0 01/16 | J16 | JIBAR03+175 | JIBAR | 120.00 | 105.00 | 9:24 |
| 6) | FIRSTR 0 02/18 | J18 | JIBAR03+149 | JIBAR | 142.00 | 127.00 | 9:24 |
| 7) | FIRSTR 10½ 04/18 | X18 | 10.5 | R204 | 92.00 | 77.00 | 9:24 |
| 8) | FIRSTR 10¾ 12/24 | X24 | 10.75 | R186 | 121.00 | 106.00 | 9:24 |
| 9) | FIRSTR 9½ 02/31 | X31 | 9.5 | R213 | 118.00 | 103.00 | 9:24 |

INDICATIVE PRICES
FIRM PRICES {FRBP4<go>}
FIRSTRAND
Contact:Clive Hibbert
Tel: 27-11-269-9010



*Source: Bloomberg page <FRBP> & JSE-BESA Bond Data, Jun 2011*

foreign currency
balance sheet

# FirstRand philosophy on foreign currency external debt

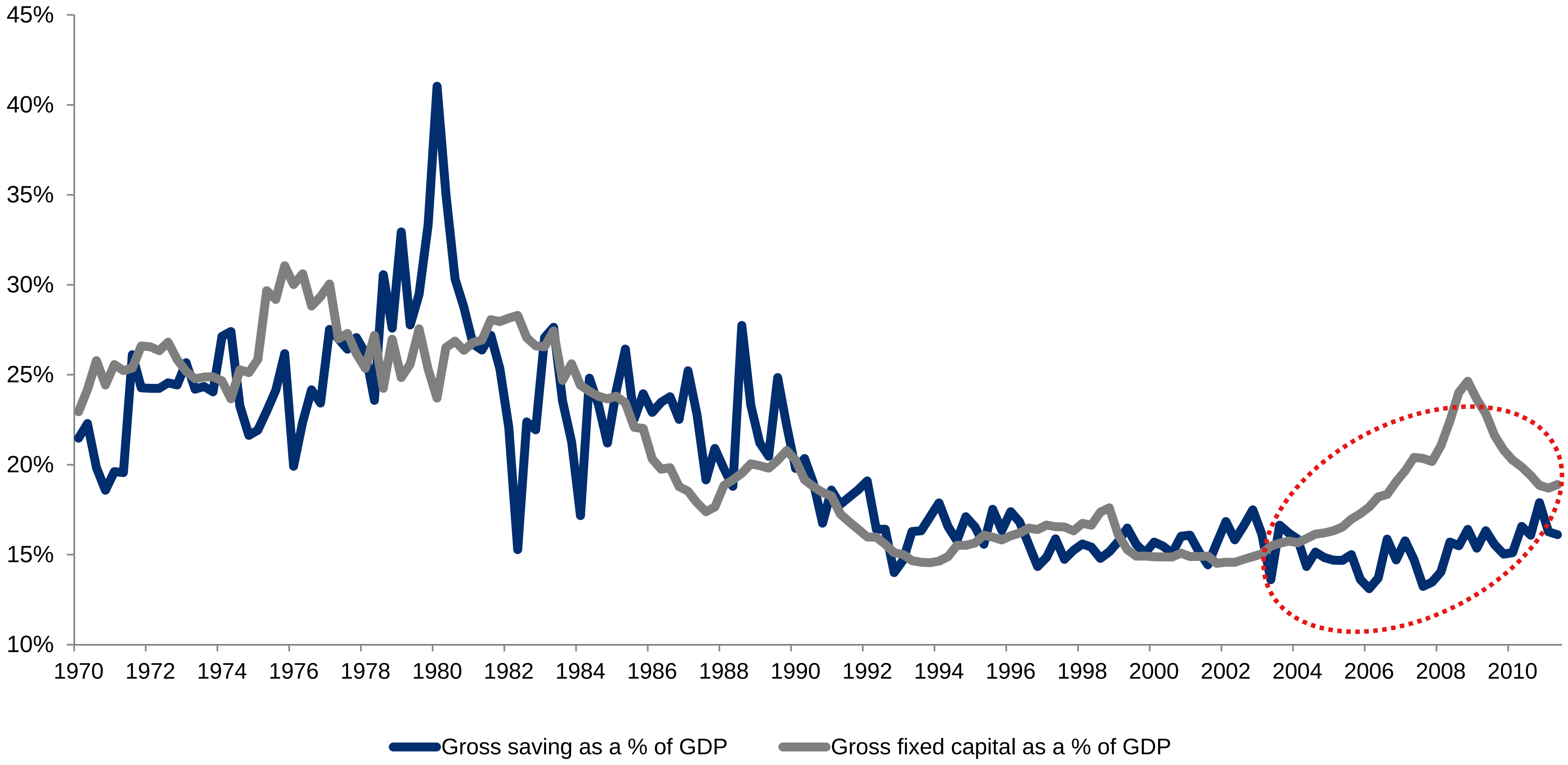
- Framework for the management of external debt  takes into account sources of sovereign risks[†]:
  - Unsustainable debt path (solvency) crisis
  - Liquidity crisis
  - Exchange rate and macroeconomic crisis
- We consider the external debt of all South African entities
  - private sector corporate
  - financial institutions and the
  - public sector

  As we all utilize from the same repayment capacity of SA Inc:
  - Confidence in the country, its credit quality, international standing and
  - export receipts
- Therefore a the following constraints:
  - US10bn Balance sheet
  - No mismatch, except for CFC balances

*Source: † "Rules of Thumb" for Sovereign Debt Crises, P Manasse and N Roubini, March 2005*

# Fixed capital formation funded by foreigners

Gross saving and gross capital formation (% of GDP)



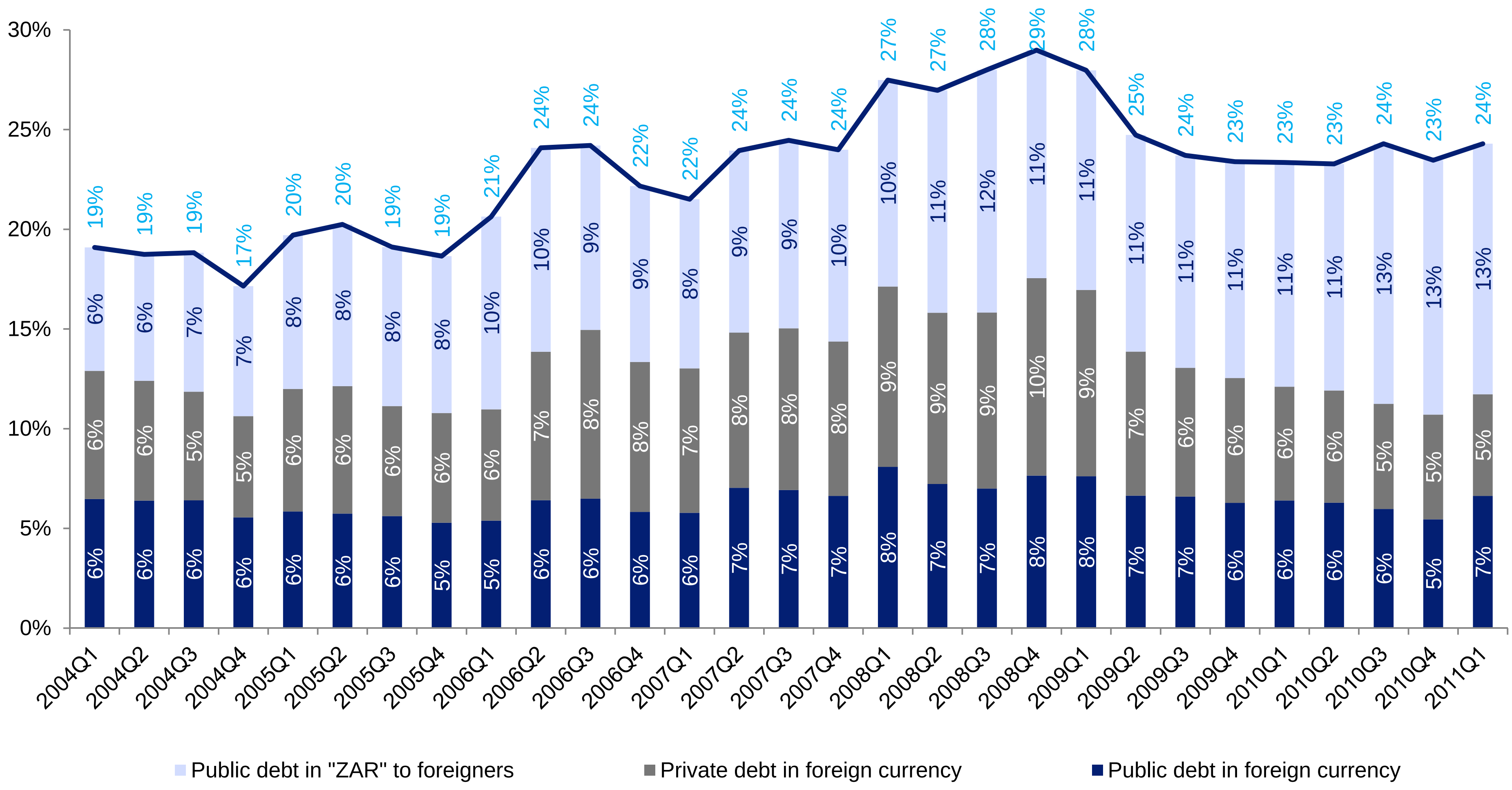

*Source: SARB Quarterly Bulletin, National Accounts*

# Application of RMS framework to SA

South Africa is in pretty good shape from a debt stock perspective SA's risk is a liquidity risk arising from external financing requirement

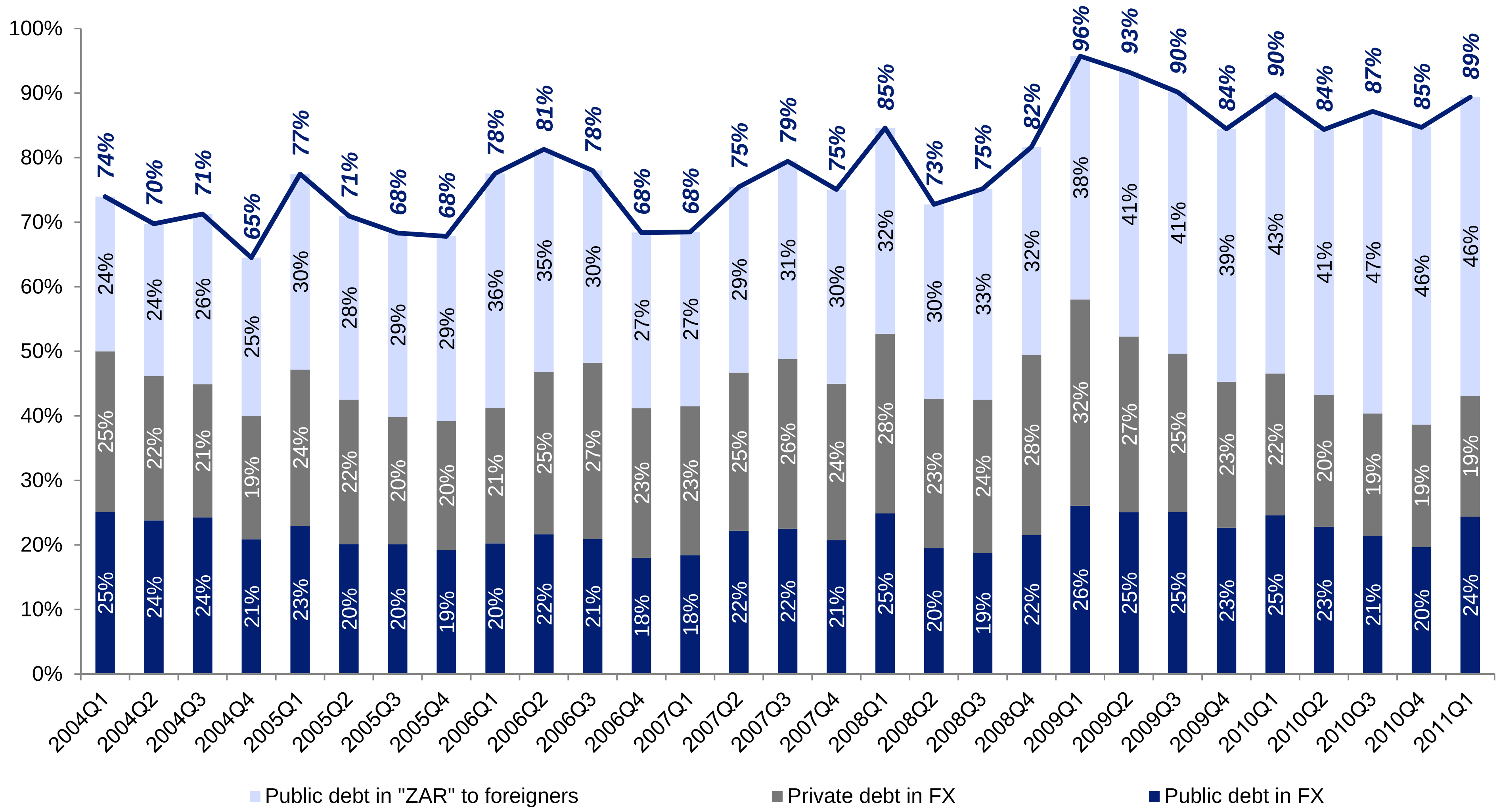
| RMS empirical thresholds | 1995 | 2000 | 2005 | 2008 | 2009 | RMS threshold |
|---|---|---|---|---|---|---|
| Total external debt/ GDP | 16% | 19% | 13% | 15% | 15% | < 50% |
| Short term external debt/ foreign reserves | 217% | 124% | 47% | 53% | 34% | < 134% |
| Long term - public sector external debt/(% of exports of goods, services, income) | 28% | 23% | 22% | 13% | 18% | < 215% |
| External Financing Requirement relative Foreign reserves | 319% | 160% | 98% | 120% | 67% | < 144% |
| Inflation | 6.9% | 7.0% | 3.6% | 9.5% | 6.3% | < 10.47% |
| Real GDP Growth | 3.1% | 4.2% | 5.3% | 3.6% | -1.7% | >-5.45% |
| Exchange Rate: Volatility | 4.3% | 7.8% | 17.2% | 19.8% | 29.5% | > 27% |

# Obligations to foreigners – relative to GDP



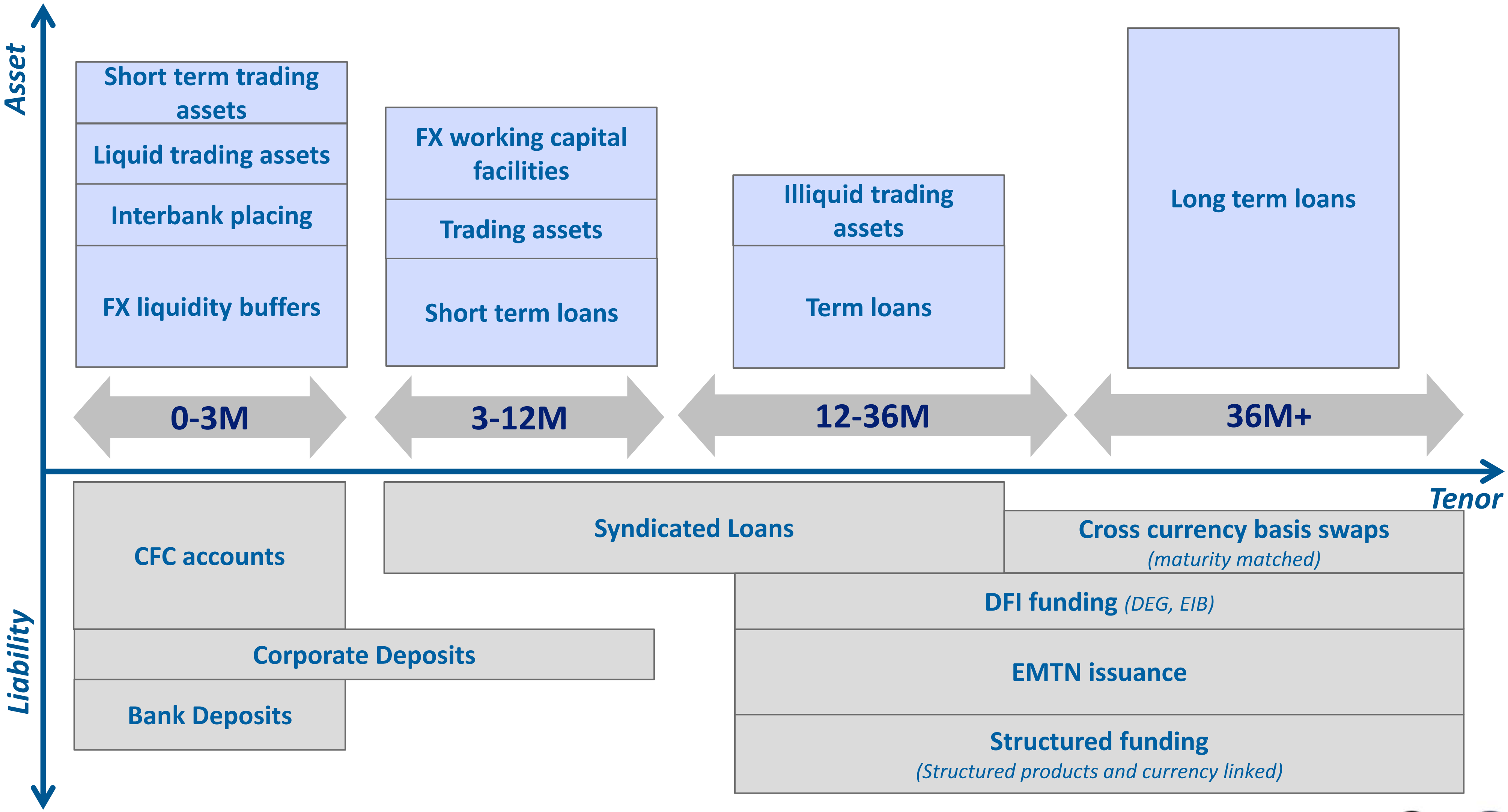

*Source: SARB Quarterly Bulletin, National Accounts*

# Obligations to foreigners – relative to exports

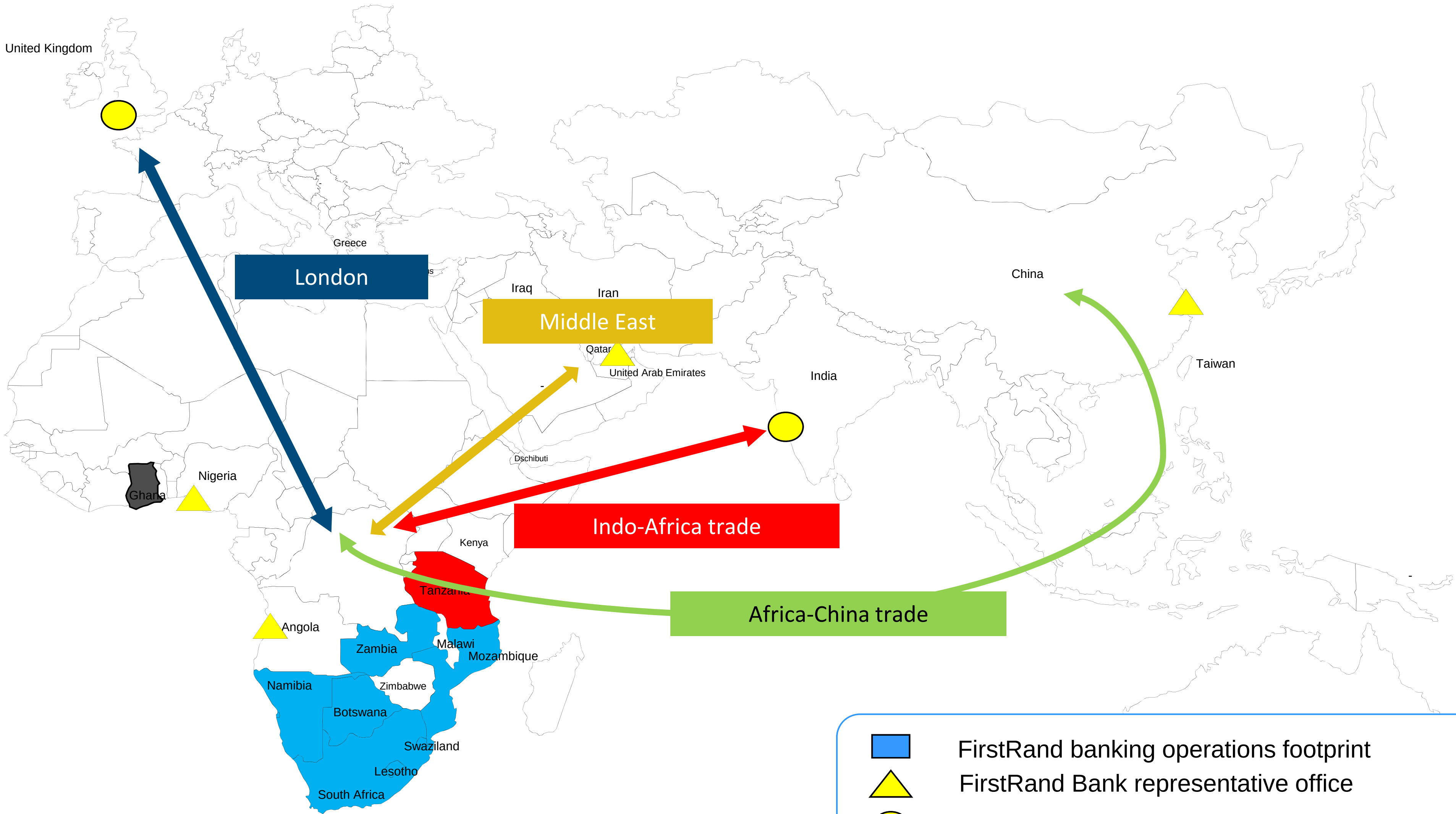



Source: SARB Quarterly Bulletin, National Accounts

# Foreign currency balance sheet – Approx. $4bn



# Funding platforms to support international strategy




FirstRand banking operations footprint
FirstRand Bank representative office
FirstRand Bank Branch

# International funding activities

## EMTN program

- Reg S only (*investigating 144A)*
- €500m 5-year bond due 2012
  - Conducted a public offer and bought back €267.5m
- US $350m 5-year bond due 2016
- Private placements

## Structured note program

- LSE listing
- Offers greater flexibility than benchmark program
- Can issue African currencies BWP, ZMK, NGN, and can settle in any Euroclear currency

## Carlyle Finance

- Turbo ABS securitisation
- Successful 1st issue
- Repeat issuance to follow

## Syndicated loans

- Lloyds TSB arranged $150m maturing 3 Dec 2012
- CCB arranged $150m maturing 25 March 2013

## DFI facilities

- EIB €40m maturing 30 Nov 2012
- DEG €85m & $55m maturing 15 Nov 2017
- EIB €50m maturing 6 Dec 2025

## Bilateral facilities

- ANZ
- Several other bilateral facilities in places
- EUR, USD, AUD, INR

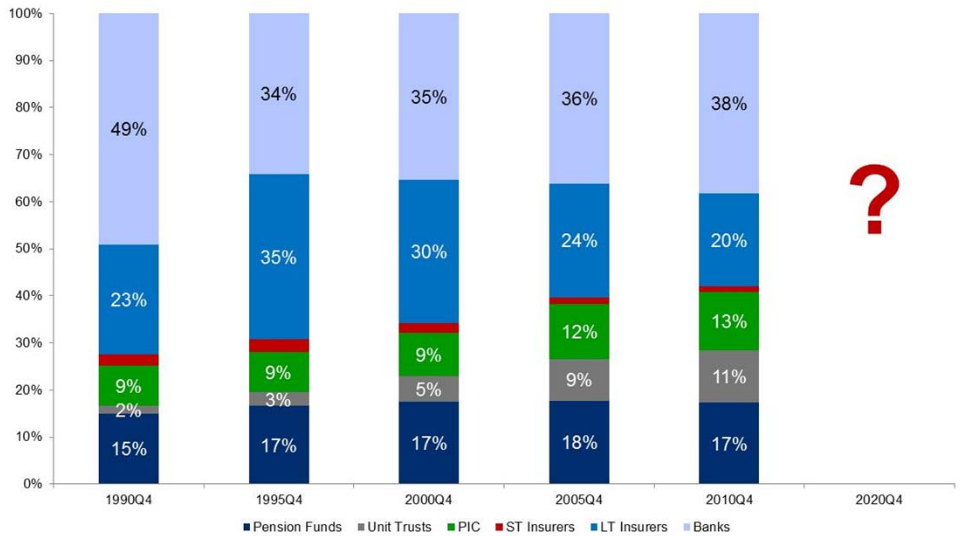
2011

# conclusion

# Conclusions

- Building and growing our deposit franchise
- Bank our clients end-to-end
  - Value operational relationships
- Selective capital market issuance
- Originate in security format

Asset under management for financial institutions



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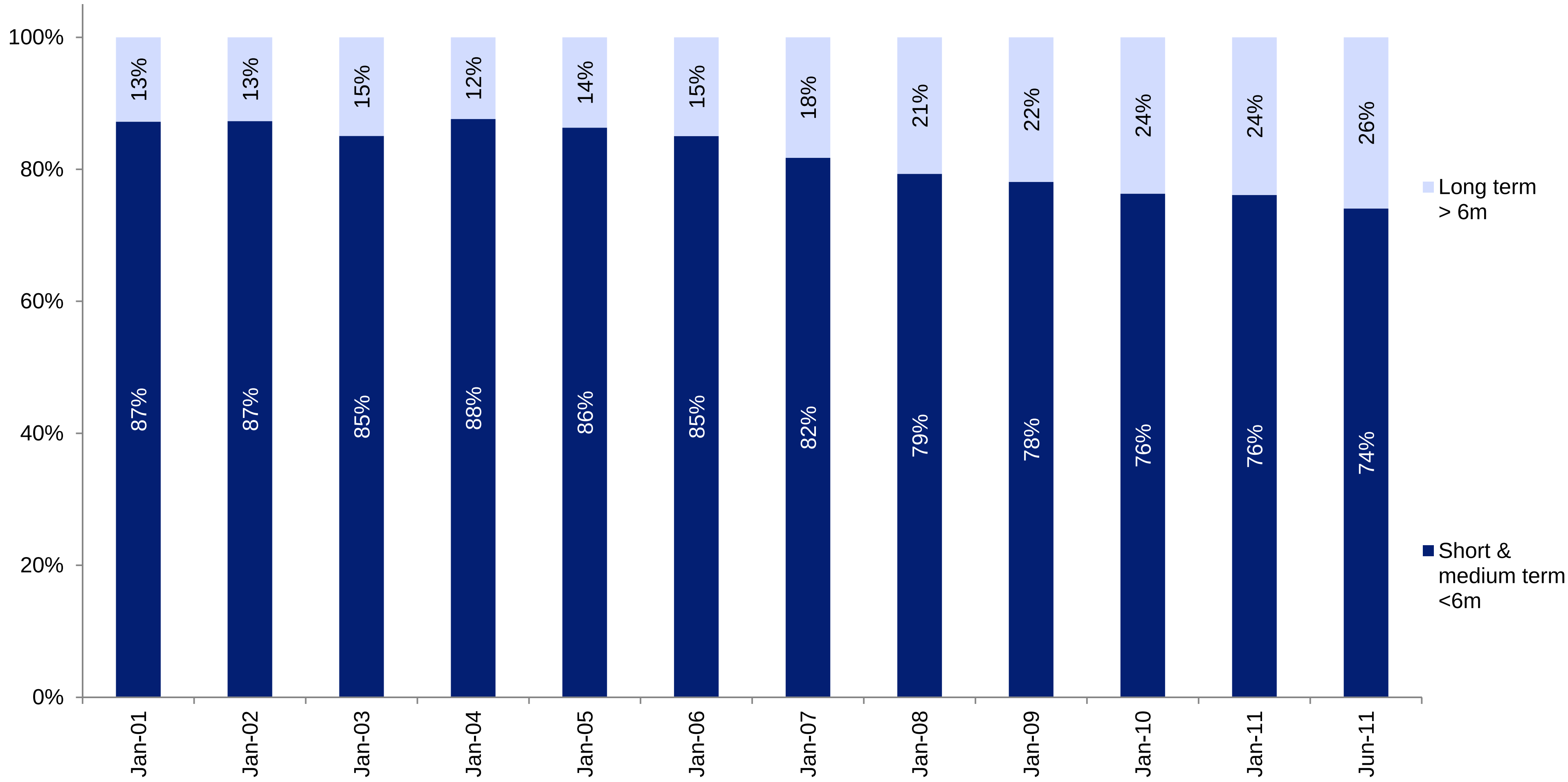
questions

2011

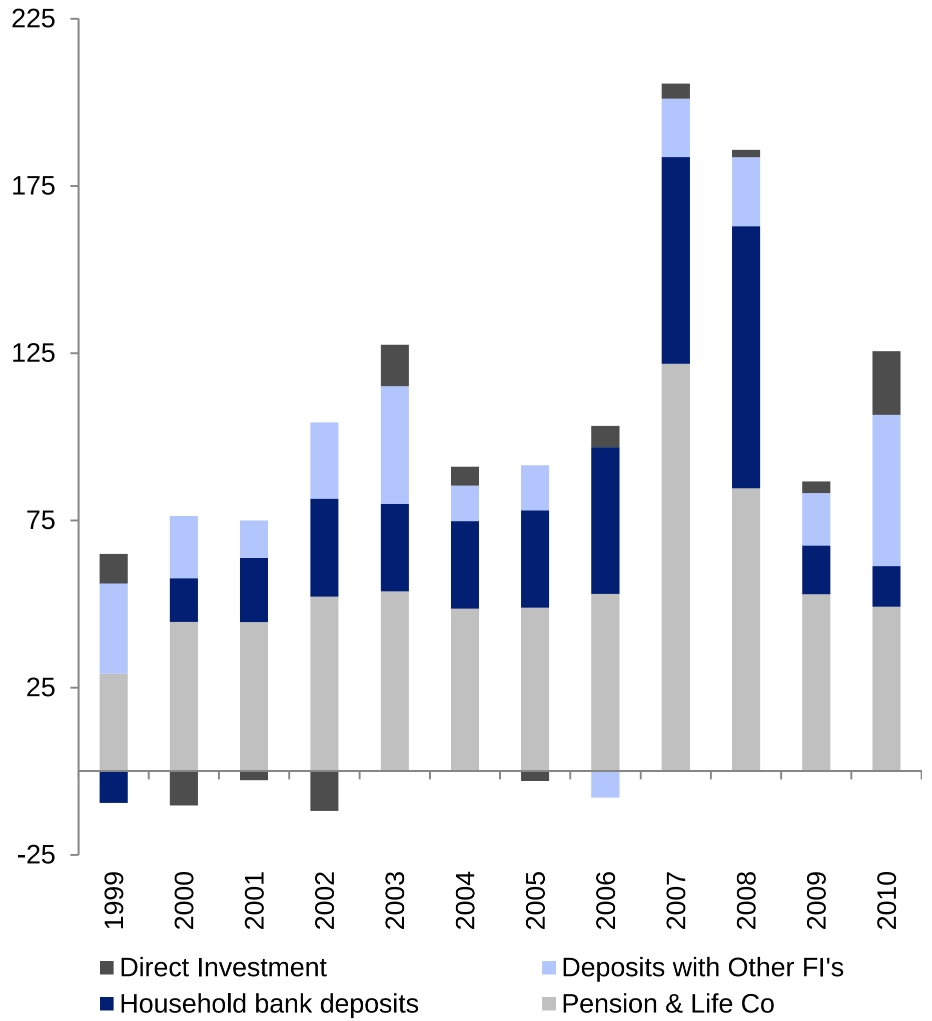
# appendix

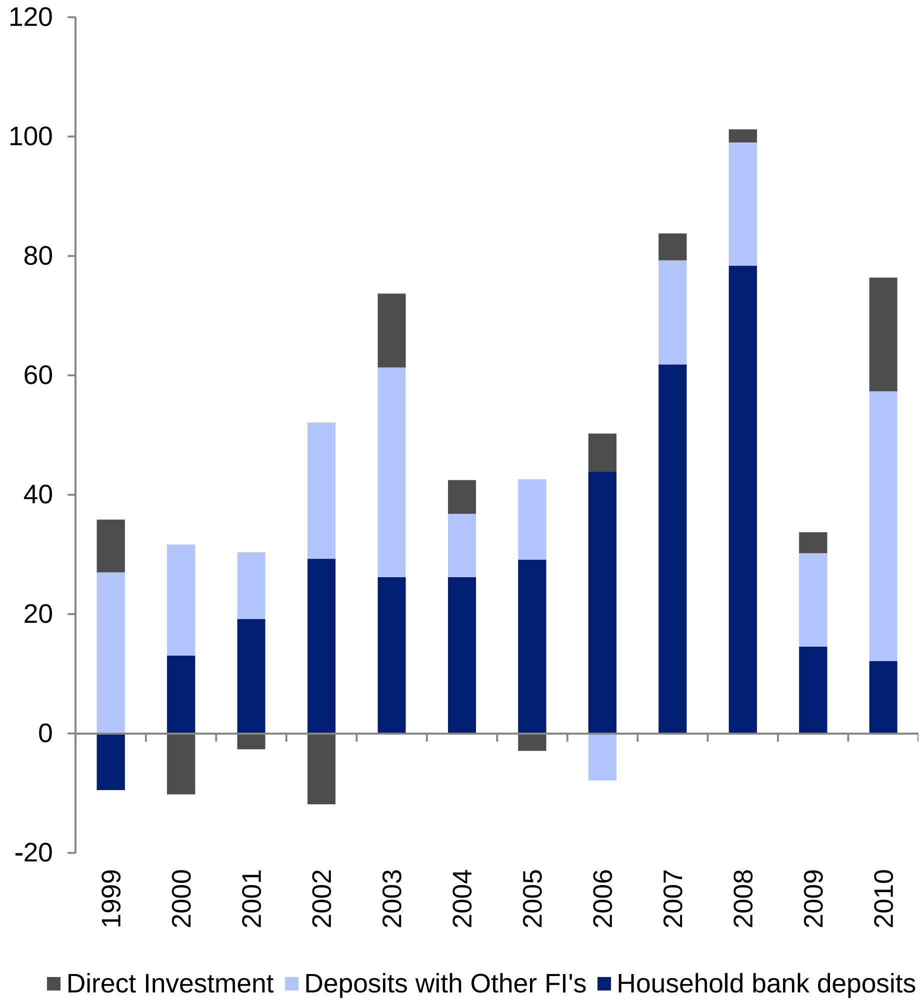
# Industry liquidity profile has been improving – however definitions do not align



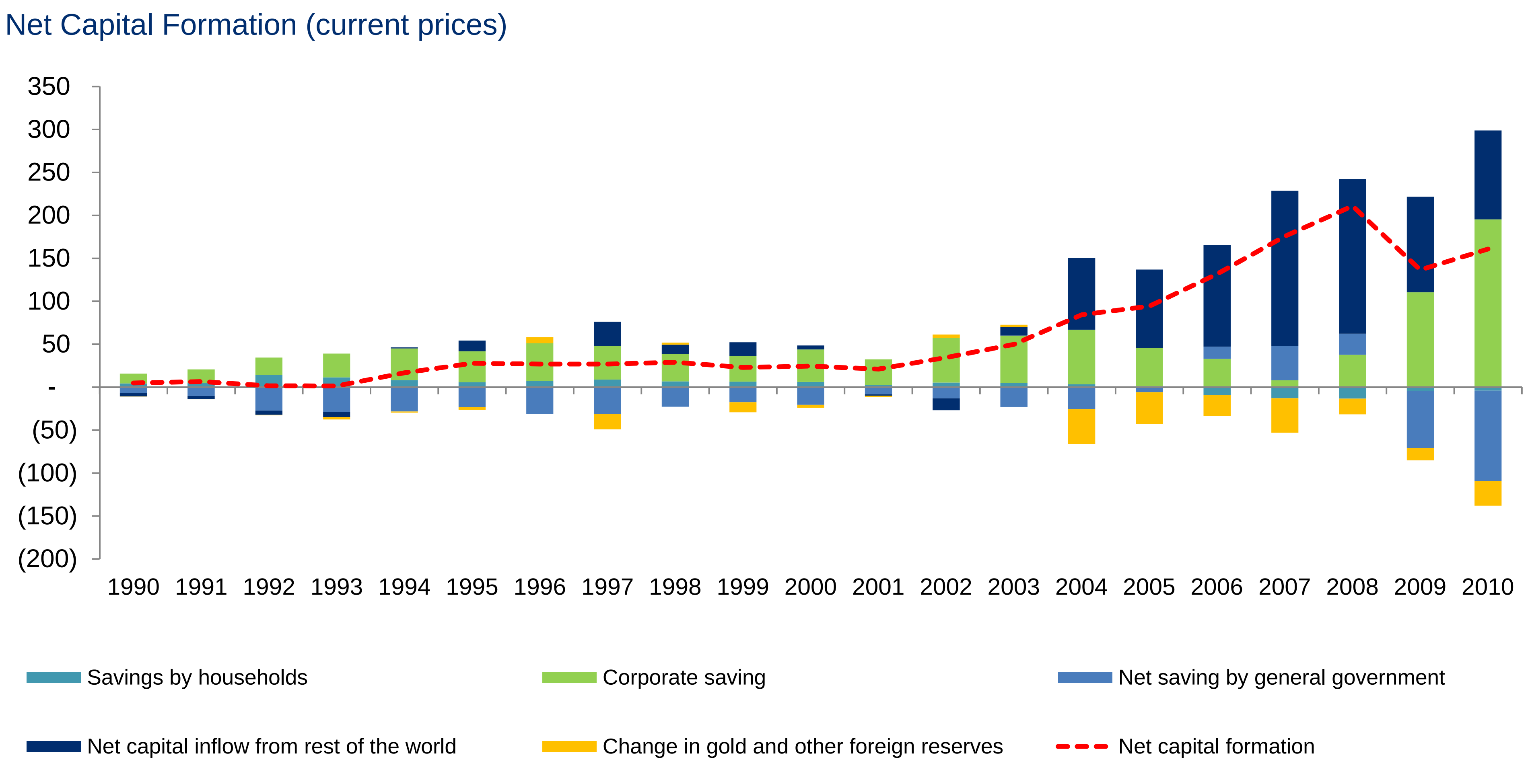

Source: SARB BA900, Dec-2010, SA Banking Sector Aggregate

# Household flows



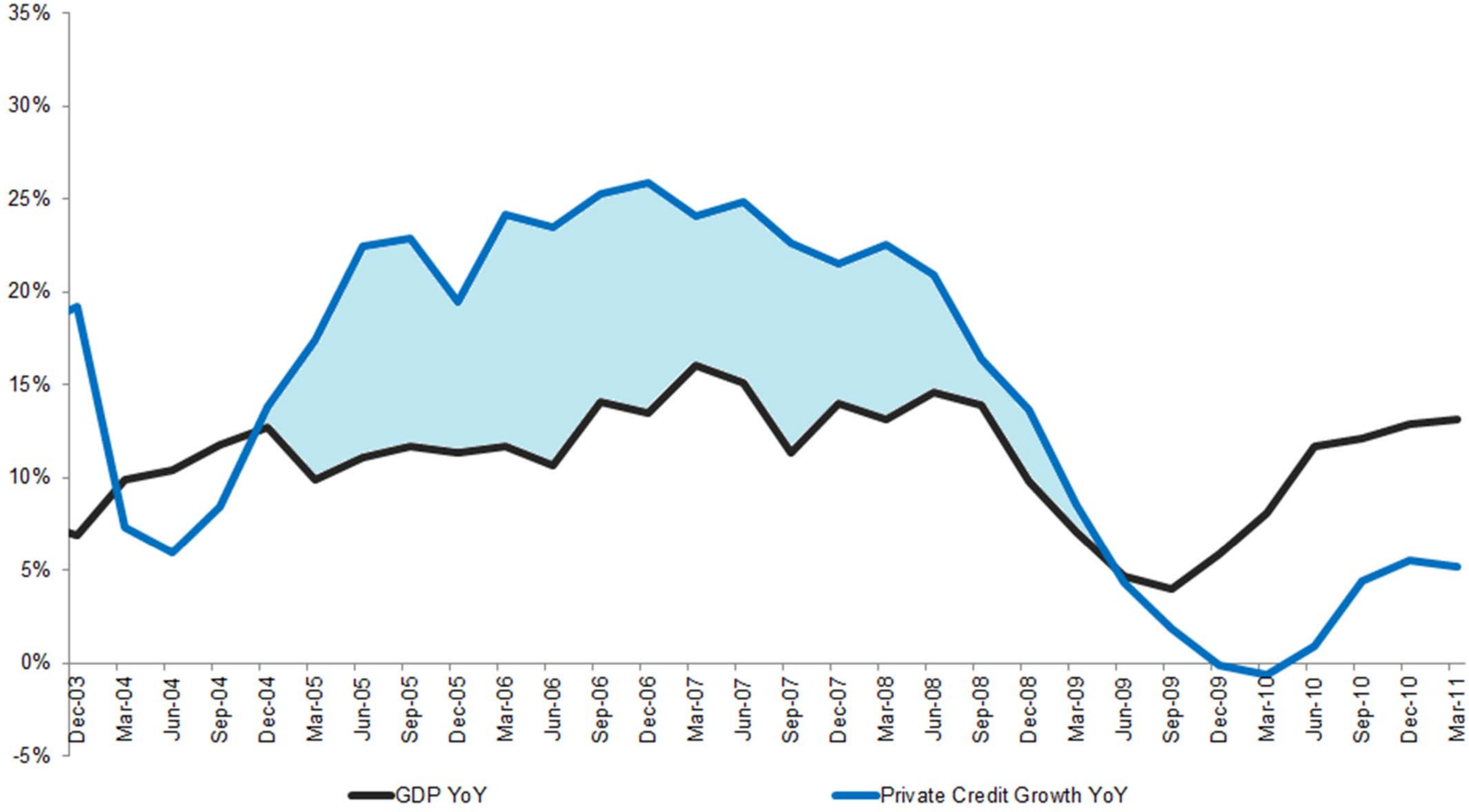



# Increasing dependence on foreign funding of fixed capital formation and corporate savings




*Source: SARB Quarterly Bulletin, National Accounts*

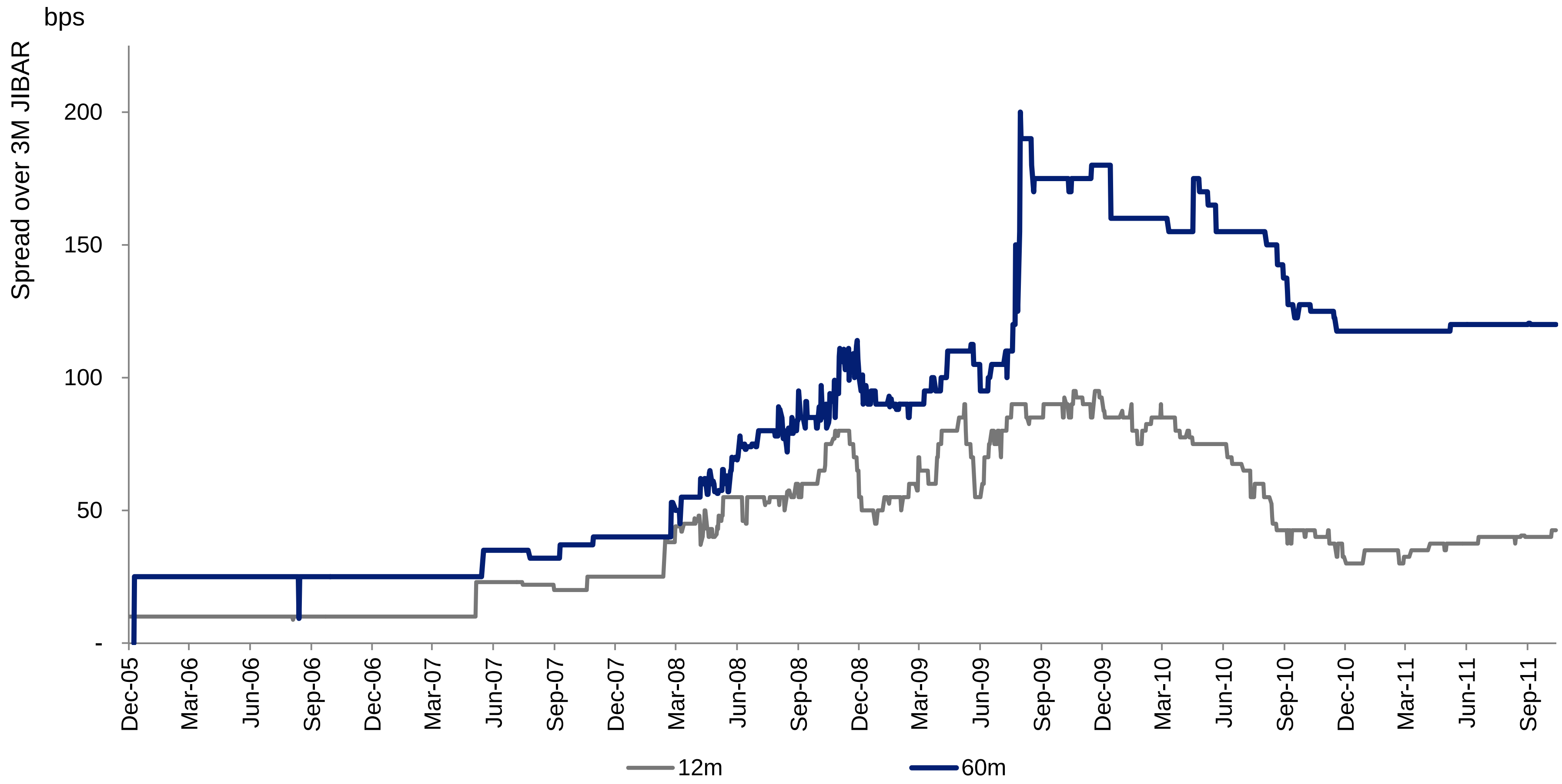
# Private credit growth year on year lags GDP change



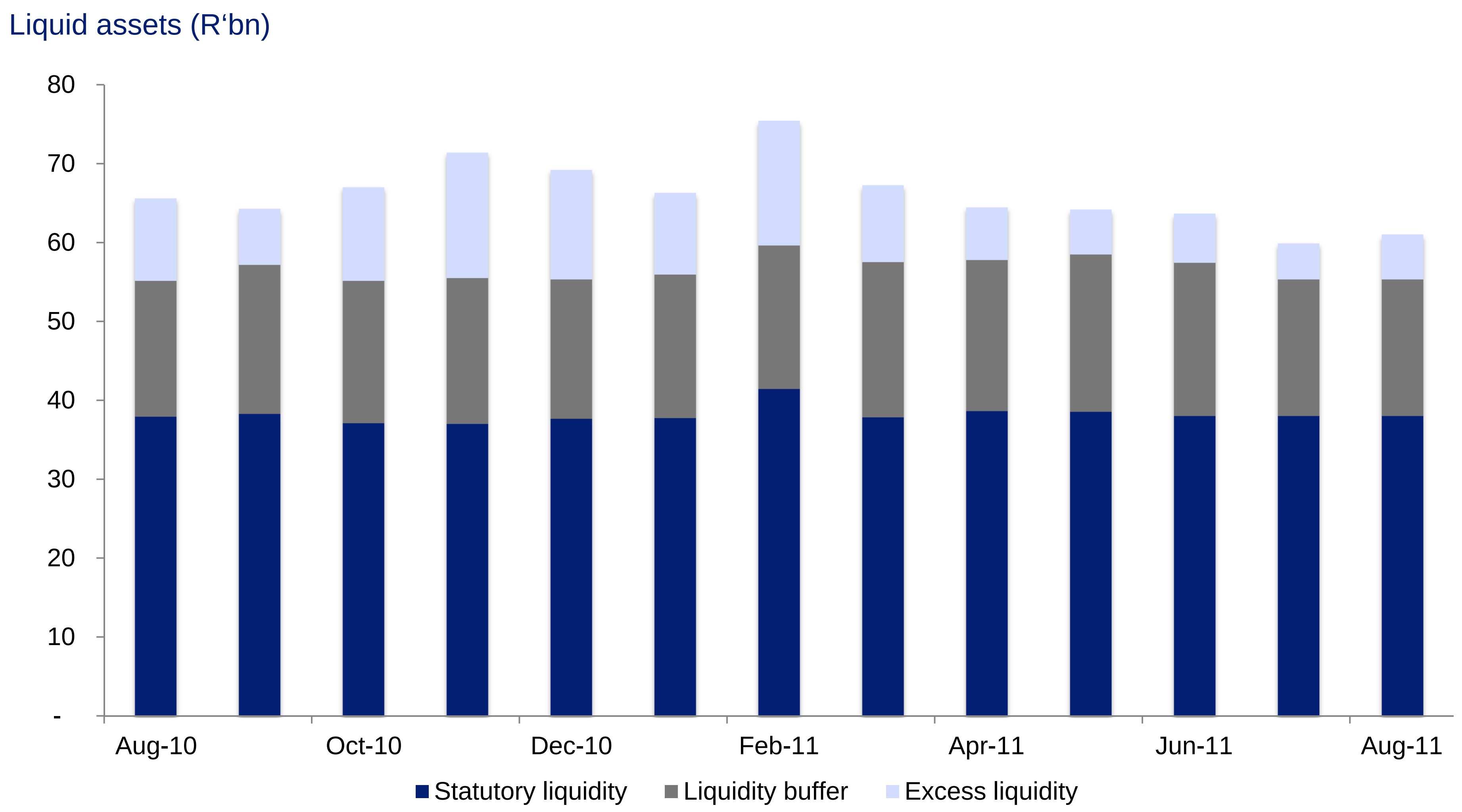

*Source: SARB Quarterly Bulletin, National Accounts*

# The significance of the liquidity component

Spread implied by FRB NCD's & FRN's



# Building appropriate liquidity buffers



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end