basel pillar 3 disclosure

6 MONTHS ENDED
31 DECEMBER 2012

FIRSTRAND

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FIRSTRAND

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Certain entities within the FirstRand Group are Authorised Financial Services and Credit Providers
This document is available on the Group's website:

www.firstrand.co.za

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OVERVIEW

Introduction

FirstRand Limited (FirstRand or the Group) believes that effective risk management is a key component of the delivery of sustainable returns to its shareholders. It is therefore deeply embedded in the Group's tactical and strategic decision making.

Risk taking is an essential part of the Group's business and FirstRand thus explicitly recognises risk identification, assessment, monitoring and management as core competencies and important differentiators in the competitive environment in which it operates. Through its portfolio of leading franchises, namely FNB, RMB and WesBank, FirstRand aims to be appropriately represented in all significant earnings pools across all chosen market segments and risk-taking activities. This entails building revenue streams that are diverse and creating long-term value through sustainable earnings pools managed within acceptable earnings volatility parameters.

Basel Pillar 3 disclosure

Regulation 43 of the revised Regulations of the Banks Act, 1990 (Act No. 94 of 1990), requires that a bank shall disclose in its annual financial statements and other disclosures to the public, reliable, relevant and timely qualitative and quantitative information that enables users of that information, amongst other things, to make an accurate assessment of the bank's financial condition, including its capital adequacy, financial performance, business activities, risk profile and risk management practice. This disclosure requirement is commonly known as Pillar 3 of the Basel Accord. This is the Basel Pillar 3 report of FirstRand and complies with the risk disclosure requirements of Basel Pillar 3.

The Group's financial performance for the six months ended 31 December 2012 is covered in the *Analysis of financial results for the six months ended 31 December 2012* and the *Unaudited interim results and cash dividend declaration for the six months ended 31 December 2012.*

FirstRand is the listed holding company and regulated bank-controlling company. The wholly-owned subsidiaries of FirstRand are FirstRand Bank Limited (the Bank or FRB), FirstRand EMA Holdings Limited (FREMA) and FirstRand Investment Holdings (Pty) Ltd (FRIHL), which are all regulated. Banking operations are included under the Bank, FREMA includes the banking operations in the rest of Africa and emerging markets, and all other activities are under FRIHL. A simplified diagrammatic representation of the Group structure is provided on page 82.

Some differences exist between the practices, approaches, processes and policies of the Bank and its wholly-owned subsidiaries and these are highlighted. However, no difference exists in the manner in which entities are consolidated for accounting and regulatory purposes. For certain equity accounted entities the Group does not apply International Financial Reporting Standards (IFRS) for regulatory purposes. For these entities a deduction or pro-rata consolidation method is applied.

This report has been internally verified by the Group's governance processes in line with the Group's public disclosure policy.

Managing the risk profile

The Group's focus areas to enable it to manage its risk profile to optimise its portfolio, are:

Earnings resilience and balance sheet strength

- strong earnings resilience through diversification, growth in client franchise businesses, improved margins and cost containment;
- maintaining balance sheet strength through an asset profile that reflects an appropriate balance between corporate and retail lending activities, an optimal retail asset mix and improved asset quality; and
- growth in the deposit franchise and maintaining ROEs;

Capital adequacy and liquidity profile

- funding the Group's activities in a sustainable, efficient and flexible manner, underpinned by strong counterparty relationships within prudential limits and requirements; and
- maintaining the Group's strong capital position post Basel III. Current targeted levels and ratios are summarised in the table below.

Capital adequacy position

	FirstRand		FRB*		Regulatory minimum
	Actual	**Target**	**Actual**	**Target**	
Capital adequacy ratio (%)	**14.9**	12.0 – 13.5	**14.6**	11.5 – 13.0	9.5**
Tier 1 ratio (%)	**13.4**	11.0	**12.7**	10.5	7.0
Core Tier 1 ratio (%)	**12.5**	9.5 – 11.0	**11.9**	9.0 – 10.5	5.25

* *Reflects solo supervision, i.e. FirstRand Bank excluding foreign branches.*
** *The regulatory minimum excludes the bank-specific (Pillar 2b) add-on and capital floor.*

Risk governance

- balancing the Group's overall risk capacity with a bottom-up and consolidated view of the planned risk profile for each business, in line with the Board risk appetite principles;
- strong risk governance with multiple points of control consistently applied throughout the organisation;

Top and emerging risks

- The crisis in Europe remains a source of tail risk for the Group's domestic operating environment;
- weakness of the South African economy due to labour unrest;
- weakening rand due to risk aversion which may put upward pressure on inflation;
- impact of macroeconomic conditions (possibility of stagflation type scenario with low growth coupled with high inflation) on credit risk mainly affecting the in-force portfolio;
- pressure on collateral values in the residential mortgage market;
- increased levels of non-performing loans (NPLs) in line with expectations in the unsecured lending portfolios;
- risk to the rand, inflation and domestic demand posed by South Africa's wide current account and fiscal deficits (twin deficit concerns) and the dependence on foreign capital to fund it;
- risk in the euro zone remains heightened, lengthening the liquidity profile to 18 months in the foreign currency balance sheet;
- impact of new Basel rules for liquidity, particularly the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR);
- the risk of sophisticated cyber crime and information security risk;
- anticipated implementation of a twin peaks model of financial regulation in South Africa and ongoing adjustments to the regulatory framework in terms of the implementation of the Basel III reforms; and
- impact on resources due to heightened regulatory scrutiny.

Recent and future regulatory changes

The amended Regulations relating to Banks (Regulations), which incorporated the Basel 2.5 reforms, were implemented with effect from 1 January 2012 and aims, inter alia, to strengthen the risk coverage of the capital framework, to strengthen board and senior management oversight and to increase public disclosure. In order to ensure that the regulatory framework for banks and banking groups in South Africa remains relevant and current, the Regulations were again amended during 2012, incorporating, inter alia, the minimum requirements contained in the Basel III framework, and became effective on 1 January 2013.

Ongoing amendments to the Regulations are expected to ensure that the South African regulatory framework for banks and banking groups remains aligned to internationally-agreed regulatory and supervisory standards.

The Financial Regulatory Reform Steering committee recently published, for public comment, a document which provides detailed information in respect of a wide-ranging set of reforms and proposals related to the implementation of a twin peaks model of financial regulation in South Africa, details of which were initially published in a policy document, A safer financial sector to serve South Africa better, during February 2011. The main objective of this policy is the development of institutions to deal with system-wide macro-prudential risks, which will be achieved by separating the oversight of market conduct regulation from prudential regulation and maintaining strong coordination by regulators.

Highlights

Details of highlights for the period and focus areas identified through risk management processes are discussed below.

HIGHLIGHTS FOR THE PERIOD	FOCUS
Capital management	
• the final Basel III capital framework for banks was released in October 2012 and the impact on the Group's Core Tier 1 capital is expected to be minimal with a more pronounced negative impact on Tier 1 and total capital adequacy ratios; and • as part of the Group's strategy to utilise regulatory limits to optimise its capital structure, FirstRand replaced the FRB06 and FRB07 subordinated debt instruments with the FRB11 bond. The FRB11 bond meets the Basel III entry criteria and will be included for grandfathering from 1 January 2013 with full recognition envisaged once the resolution regime is implemented in South Africa.	• maintaining strong capital levels, with particular focus on the capital quality; and • optimising the Group's risk-weighted assets (RWA) and capital mix during the transitional period of implementing Basel III requirements.
Credit risk	
• steady growth in retail advances attributable to affordable housing loans, card advances, personal loans, FNB Africa and vehicle and asset finance; • strong growth in commercial advances driven by owner-occupied commercial properties, leveraged finance products and agricultural loans; • growth in corporate advances underpinned by the mining, health and energy sectors; • HomeLoans continues to show improvement with the vintages at multi-year lows, although slow growth reflects continuing pressure in the property market; • impairments are at the bottom of the cycle however, given the level of consumer indebtedness, further rate increases would not positively impact impairments; • improvements in NPLs emanating from reductions in HomeLoans, driven by the low interest rate environment, which positively impacted customers' ability to service debt, lower levels of new inflows into NPLs and ongoing focus on enhanced collection processes across the Group; and • credit tightening actions taken in the unsecured loans portfolios are expected to result in continued slower growth in these portfolios going forward.	• monitoring credit concentration in industries affected by the recent labour unrest. **Retail credit portfolio:** • continued focus on credit strategy and consumer affordability to capture appropriate levels of new business utilising credit capacity calculation and risk appetite drivers; and • refining origination scorecards to ensure optimal credit quality of new business in the unsecured lending portfolios as well as the other retail portfolios. **Commercial credit portfolio:** • continued focus on credit strategy to capture appropriate levels of new business utilising credit capacity calculation and risk appetite drivers. **Wholesale credit portfolio:** • movements in facilities in line with origination strategy, i.e. predominantly to better-rated counterparties, to medium and low volatility industries and strong growth in African and Indian portfolios.

HIGHLIGHTS FOR THE PERIOD	FOCUS
Counterparty credit risk	
• implemented Basel II standardised approach for the calculation of counterparty credit default risk capital; a more risk-sensitive approach than the current exposure method (CEM) used previously; and • the improved risk sensitivity of this measure implies that capital now more accurately reflects the risk profile of the book.	• implementation of the Basel III credit value adjustment (CVA), asset value correlation multiplier (AVC) capital charges, and central clearing counterparty charges.
Market risk	
Market risk in the trading book	
• formation of a new Global Markets Division within RMB through the consolidation of business units resulting in increased diversification effects, overall reduced levels of market risk and a reduction in equity risk on the local balance sheet.	• continued incorporation of the African businesses into the overall market risk process.
Interest rate risk in the banking book	
• during the period under review, the average repo rate dropped by 45 basis points (bps), resulting in a negative endowment impact.	• enhancing the quality and frequency of interest rate risk analysis and standardising interest rate risk management throughout the Group by replicating the local process in the African subsidiaries.
Equity investment risk	
• regular portfolio churn with limited realisations during the period; and • several new equity investment acquisitions undertaken as part of the portfolio rebuilding drive.	• impact of Basel III regulations on the Group's equity investment portfolio's capital adequacy requirements, as the minority interests in consolidated subsidiaries no longer qualify as Core Tier 1 capital.
Foreign exchange and translation risk in the banking book	
• continued to strengthen principles regarding the management of foreign exchange positions, funding and support from FirstRand to the international entities; and • net open forward positions in foreign exchange (NOFP) limits were set for each of the foreign entities, together with a reporting and management framework and the foreign exchange market risk framework and limits.	• management of foreign exchange assets and foreign exchange exposures on the balance sheets of the Group's offshore entities (jurisdictions outside South Africa); and • review data accuracy and integrity related to the reporting and measurement of the daily foreign exchange exposure of the Group.
Funding and liquidity risk	
• the latest release of the Basel III liquidity coverage ratio has alleviated the requirement for the South African Reserve Bank (SARB) committed liquidity facility due to a reduction in the outflow factors and an increase in available assets.	• the Basel III liquidity regime continues to be a focus for the Group with emphasis on both funding and market liquidity risk management, and particular attention on the structural funding constraints of the South African market; and • optimising a risk-adjusted diversified funding profile in line with Basel III requirements relating to the LCR, which measures short-term liquidity stress, effective from January 2015 and the NSFR, which measures the stability of long-term structural funding, effective 1 January 2018.

HIGHLIGHTS FOR THE PERIOD	FOCUS
Operational risk	
• risk maturity assessments were conducted across the Group to identify key processes requiring improved levels of maturity in each division; and • approval of Group and divisional operational risk appetite figures enabling the Group and its divisions to measure and monitor operational risk profiles against approved operational risk appetite levels, and to set the boundaries for operational risk within which the business can achieve its strategic objectives.	• integration and automation of the Group's operational risk management tools onto a single platform to enhance operational risk management processes; • key themes identified during the risk maturity assessment initiative have resulted in the initiation and prioritisation of several projects across the Group which will also address identified operational risks.
Regulatory risk	
• the amended Regulations, which incorporated the Basel 2.5 reforms, were implemented with effect from 1 January 2012; and • the Regulations were again amended in 2012 and became effective on 1 January 2013 with the minimum requirements contained in the Basel III framework being phased in over the period.	• continued support for the SARB's objectives and endorsement of improvements in risk management and governance practices, and cooperation with other regulatory authorities.

DEFINITIONS

The Group is exposed to a number of risks that are inherent in its operations. Identifying, assessing, pricing and managing these risks appropriately are core competencies of the individual business areas. Individual risk types are commonly grouped into three broad categories, namely strategic and business risks, financial risks and operational risks.

Risk category reference	Risk components	Definition	Page reference
Strategic and business risks	Includes strategic risk, business risk, volume and margin risk, reputational risk, and environmental, social and governance (ESG) risks.	Strategic risk is the risk to current or prospective earnings arising from inappropriate business decisions or the improper implementation of such decisions.	16
		Business risk is the risk to earnings and capital from potential changes in the business environment, client behaviour and technological progress. Business risk is often associated with volume and margin risk and relates to the Group's ability to generate sufficient levels of revenue to offset its costs.	
		Volume and margin risk is the risk that the earnings and capital base is negatively impacted by a downturn in revenue due to market factors (e.g. margin compression), combined with the risk of an inflexible cost base.	
		Reputational risk is the risk of reputational damage due to compliance failures, pending litigations, underperformance or negative media coverage.	
		ESG risks focus on the environmental, social and governance issues which impact the Group's ability to successfully and sustainably implement business strategy.	
Financial risks	Capital management	The Group manages capital by allocating resources effectively in terms of its risk appetite and in a manner that maximises value for shareholders.	19
	Credit risk	Credit risk is the risk of loss due to the non-performance of a counterparty in respect of any financial or other obligation. For fair value portfolios, the definition of credit risk is expanded to include the risk of losses through fair value changes arising from changes in credit spreads. Credit risk also includes credit default risk, pre-settlement risk, country risk, concentration risk and securitisation risk.	27
	Securitisations and conduits	Securitisation is the structured process whereby loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities.	54
	Counterparty credit risk	Counterparty credit risk is defined as the risk of a counterparty to a contract, transaction or agreement defaulting prior to the final settlement of the transaction's cash flows.	60
	Market risk in the trading book	Market risk is the risk of adverse revaluation of any financial instrument as a consequence of changes in market prices or rates.	63
	Interest rate risk in the banking book (IRRBB)	IRRBB is defined as the sensitivity of a bank's financial position and earnings to unexpected, adverse movements in interest rates.	66
	Equity investment risk	Equity investment risk is the risk of an adverse change in the fair value of an investment in a company, fund or any other financial instrument, whether listed, unlisted or bespoke.	71
	Foreign exchange and translation risk in the banking book	Foreign exchange risk is the risk of losses occurring or a foreign investment's value changing from movements in foreign exchange rates. A bank is exposed to currency risk in its net open foreign currency positions and foreign investments. Translation risk is the risk associated with banks that deal in foreign currencies or hold foreign assets. The greater the proportion of asset, liability and equity classes denominated in a foreign currency, the greater the translation risk.	73
	Funding and liquidity risk	Funding liquidity risk is the risk that a bank will not be able to meet current and future cash flow and collateral requirements (expected and unexpected) without negatively affecting its reputation, daily operations and/or financial position. Market liquidity risk is the risk that market disruptions or lack of market liquidity will cause the bank to be unable (or able, but with difficulty) to trade in specific markets without affecting market prices significantly.	74
Operational risks	Operational risk	Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes and systems or from external events and human error. It includes fraud and criminal activity (internal and external), project risk, legal risk, business continuity, information and IT risk, process and human resources risk. Strategic, business and reputational risks are excluded from the definition.	77
	Regulatory risk	Regulatory risk is the risk of statutory or regulatory sanction and material financial loss or reputational damage as a result of failure to comply with any applicable laws, regulations or supervisory requirements.	80

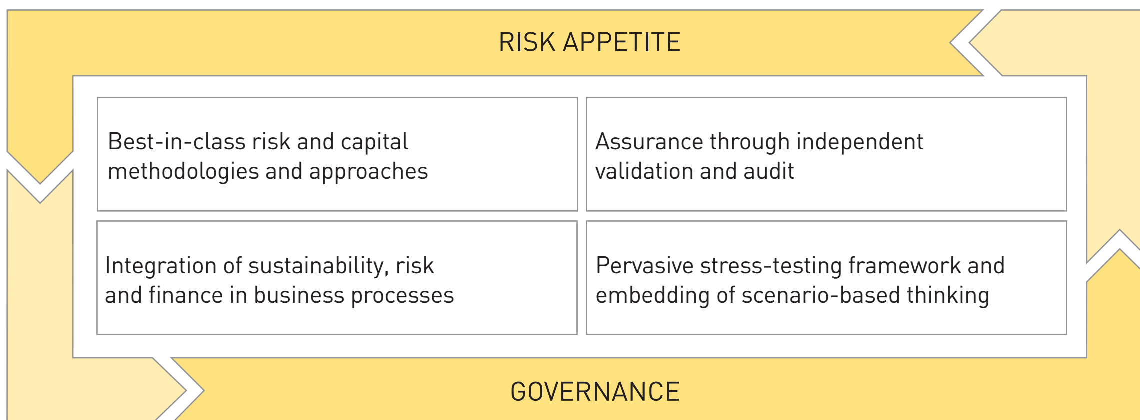
FIRSTRAND'S APPROACH TO RISK AND CAPITAL MANAGEMENT

The Group believes that effective risk management is of primary importance to its success and is a key component of the delivery of sustainable returns to its shareholders. It is therefore part of the Group's tactical and strategic decision making. The Group aligns its risk management approach to its strategy. Risk taking is an essential part of the Group's business. FirstRand recognises risk assessment, monitoring and management as core competencies and important differentiators in the competitive environment in which it operates.

The Group defines risk widely – as any factor that, if not adequately assessed, monitored and managed, may prevent it from achieving its business objectives or result in adverse outcomes, including damage to its reputation.

FirstRand follows a comprehensive approach to risk and capital management that comprises six core components, illustrated in the following chart.

Components of FirstRand's approach to risk and capital management



These core components are discussed further in this report:

- The Group's **risk appetite** frames all organisational decision making and forms the basis for the refinement of risk identification, assessment and management capabilities (see below).
- A strong **governance** structure and policy framework fosters the embedding of risk considerations in existing business processes and ensures that consistent standards exist across the Group's operating units (see page 13).
- Best practice **risk and capital management methodologies** have been developed in and for the relevant business areas (see page 8).
- An integrated approach to **sustainability and managing risk** was established to facilitate the proactive exchange of information between individual risk areas, and between risk and finance functions (see page 8).
- The Group employs a comprehensive, consistent and integrated approach to **stress testing** that is embedded as a business planning and management tool, emphasising scenario-based analyses in all its decision processes. Stress testing includes the quantification of potential volatility of earnings under various scenarios and due to event risk. (see page 9).
- Independent **oversight, validation and audit functions** ensure a high standard across methodological, operational and process components of the Group's risk and capital management processes (see page 12).

Risk appetite

The level of risk the Group is willing to take on – its risk appetite – is determined by the Board, which also assumes responsibility for ensuring that risks are adequately managed and controlled through the Risk, capital management and compliance (RCC) committee and subcommittees, as described in the Risk governance structure section on page 13.

The Group's risk appetite framework sets out specific principles, objectives and measures that link diverse considerations such as strategy, risk, target capitalisation levels and acceptable levels of earnings volatility. As each franchise is ultimately tasked with the generation of sustainable returns, risk appetite limits act as a constraint on the assumption of ever more risk in the pursuit of profits – both in quantum and in kind. For example, a marginal increase in return in exchange for disproportionately more volatile earnings is not acceptable. Similarly, certain types of risk, such as risks to its reputation, are incompatible with the business philosophy and thus fall outside its risk appetite.

In addition to these considerations, risk appetite finds its primary quantitative expression in two measures, namely:

- the level of earnings, growth and volatility the Group is willing to accept from certain risks that are core to its business; and
- the level of capitalisation to meet regulatory capital requirements, maintain a capital buffer for unforeseen events and business expansion, and the return achieved on capital allocated.

These two measures define the risk capacity and this expression of risk appetite is calibrated against broader financial targets.

The Board established risk appetite principles in which business is tracked against certain measures. These principles include:

- not excessively gearing the balance sheet;
- off-balance sheet exposure to be limited relative to own capital funding base;
- risk transfer to be about true risk transfer and not accounting or regulatory arbitrage;
- sources of income must be widely diversified across business entities, products, market segments, investments, financial and commodity markets and regions;
- the potential impact of severe downturn and stress conditions must be identified, measured, quantified, understood and contained in accordance with capital preservation and earnings volatility parameters;
- concentration in higher risk asset classes must be avoided;
- diversified sources of funding;
- sufficient buffers must be held for capital and liquidity purposes; and
- losses arising from operational process breakdowns must be contained.

As a function of the business environment and stakeholders' expectations together with the primary risk appetite measures, these provide firm boundaries for the organisation's chosen path of growth.

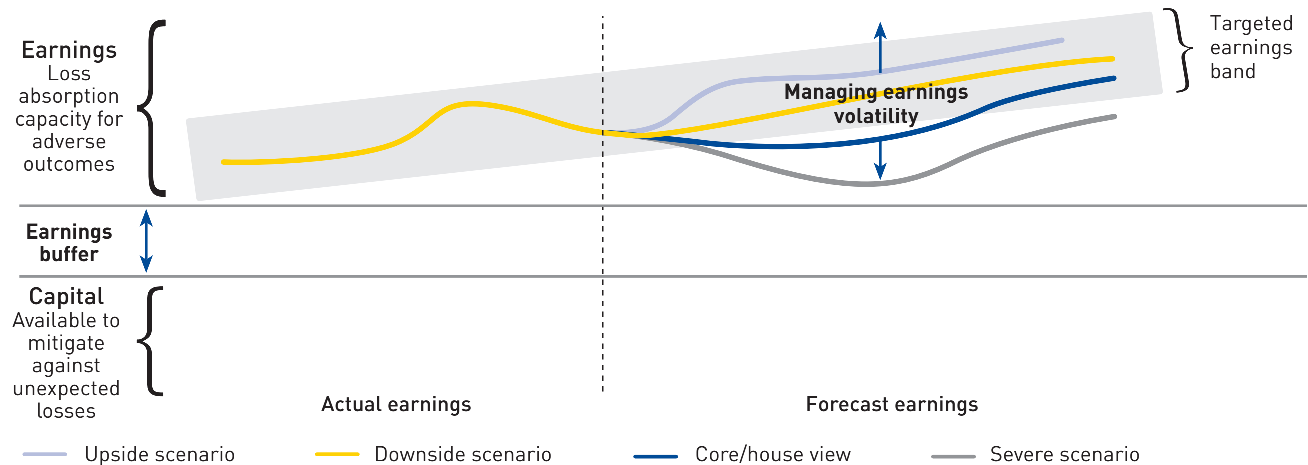
In setting the risk appetite, the Executive committee (Exco) and the Board balance the organisation's overall risk capacity with a bottom-up view of the planned risk profile for each business. It is in this process that the Group ultimately seeks to achieve an optimal trade-off between its ability to take on risk and the sustainability of the returns delivered to shareholders.

Risk appetite measures are included in risk and management reports across the businesses, as well as at board level. These measures are continually refined as more management information becomes available and stress test results are reported and discussed.

The Group views earnings as the primary defence against adverse outcomes. The earnings buffer and capital base provide protection against unexpected events for stakeholders. FirstRand's capacity to absorb earnings volatility and fluctuations is therefore supported by the generation of sustainable profits.

The chart below illustrates the strategy to manage earnings volatility through the cycle.

Managing earnings volatility through the cycle



Risk and capital methodologies

The detailed sections commencing on page 16 provide in-depth descriptions of the approaches, methodologies, models and processes used in the identification and management of each major risk. Each section also describes the applicable governance and policy framework and provides an analysis of the respective portfolios and the risk profile with respect to the type of risk under consideration and the capital position.

Focus on sustainability and integration of risk and finance

The Group considers the sustainability of its earnings within acceptable volatility as a core objective and key performance measure. The value of the franchises is ultimately supported by the Group's financial strength and a management approach is adopted that seeks to achieve an optimal deployed risk model.

The franchises are ultimately responsible for maximising risk-adjusted returns on a sustainable basis, within the limits of the Group's risk appetite. Shifts in the macro environment are also critical to any strategic adjustments. FirstRand manages its business based on the Group's house view which is used for budgeting, forecasting and credit origination strategies. The house view focuses on the key macroeconomic variables that impact the balance sheet and income statement. The macro outlook is reviewed on a monthly basis and spans a three-year forecast horizon for a core scenario and two risk scenarios. These scenarios are debated internally and communicated to the business units. A severe stress scenario is also generated for stress testing purposes.

The objective of the Group's financial resource management is to protect and enhance financial performance of the Group through the holistic management of the balance sheet and income streams within the context of the macroeconomic environment. At the core of FirstRand's approach is a belief that the balance sheet and income statement streams can be both protected and enhanced throughout the cycle to improve sustainability and predictability, by actively managing the investment and enterprise value risks which include:

- interest rate risk;
- credit portfolio risk;
- capital risks; and
- strategic funding risks.

To achieve this objective, the Group implements an integrated balance sheet management approach. This requires a detailed understanding of the economic cycle and the interplay between the risks created by the cycle and the levers within the business that can be used to mitigate those risks. Ultimately, the aim is to optimise the natural position of the balance sheet, look for natural hedges or implement appropriate macro hedges in the current structure and only make the balance sheet available to the origination businesses if the required risk-reward profile can be met.

FirstRand's integrated balance sheet management approach is aligned to the objectives of performance management in that it facilitates optimisation of the spread between ROE and cost of equity.

Group Treasury is responsible for capital management. The capital position provides the final buffer against adverse business performance under extremely severe economic conditions.

Group Treasury is also responsible for funding and liquidity management, exchange control, interest rate risk and capital and market risk in the banking book management.

The Group, through a combined initiative of its finance, treasury and risk functions, continues to integrate financial, treasury, capital and risk data and information on a common platform. This information, both actual and budgeted, is used as the basis for risk, capital and financial analysis and stress testing.

These practices are intended to ensure that capital and liquidity-related decisions can be taken in a well coordinated manner using a consistent, integrated view incorporating aspects of both finance and risk domains.

Internal capital adequacy assessment process (ICAAP)

The overall objective of capital management is to maintain sound capital ratios, a strong credit rating, ensure confidence in the solvency of the Group, comply with regulatory requirements and instil confidence during periods of uncertainty and turmoil in financial markets.

In order to achieve this objective the Group needs to:

- ensure that at least the minimum amount of regulatory capital is held at all times for the SARB to allow the Group to conduct business;
- hold sufficient capital that will instil confidence in the Group's ongoing solvency and status as a creditworthy counterparty for all stakeholders;
- allocate capital to businesses based on an understanding of the risk and reward drivers of the income streams and to ensure that appropriate returns are earned on capital deployed;
- ensure that the buffer over the minimum regulatory capital requirement is sufficient to cater for income and capital volatility and economic risk which may manifest through business disruption, regulatory intervention or credit downgrades, where applicable;
- consider the returns on a risk-adjusted basis to assess business performance; and
- ensure that FirstRand's capital adequacy ratios and other sublimits remain above appropriate (and approved) limits during different economic and business cycles.

The optimal level and composition of capital is determined after taking into account business units' organic growth plans as well as investor expectations, targeted capital ratios, future business plans, plans for the issuance of additional capital instruments, the need for appropriate buffers in excess of minimum requirements, rating agencies considerations and proposed regulatory changes.

Additionally, this requires that the Group develops and maintains a capital plan that incorporates, among others, the following:

- anticipated capital utilisation;
- planned issuance of capital instruments ;
- stress tests and scenario analysis;
- appropriation of profits and dividend payments;
- desired level of capital, inclusive of a buffer;
- expansion and strategic initiatives; and
- general contingency plan for dealing with divergences and unexpected events.

ICAAP is an integral tool in meeting the above objectives and is key to the Group's risk and capital management processes. ICAAP allows and facilitates:

- the link between business strategy, risk introduced and capital required to support the strategy;
- the establishment of frameworks, policies and procedures for the effective management of material risks;
- the embedding of a responsible risk culture at all levels in the organisation;
- the effective allocation and management of capital in the organisation;
- the development of plausible stress tests to provide useful information which serve as early warnings/triggers, so that contingency plans can be implemented; and
- the determination of the capital management strategy and how the Group will manage its capital including during periods of stress.

The overall objective of capital management is to maintain sound capital ratios, a strong credit rating, ensure confidence in the solvency of the Group, comply with regulatory requirements and instil confidence during periods of uncertainty and turmoil in financial markets.

Stress testing and scenario-based analyses

Stress testing and scenario-based analysis form an integral part of the overall governance and risk management culture of the Group and is an important risk management tool used to alert management of adverse unexpected outcomes related to a variety of risks and to provide an indication of how much capital is needed to absorb losses should these occur.

The evaluation of business plans and strategic options at a Group and business level, as well as the choice of tactical steps towards implementing these plans, are intrinsically linked to the evaluation and assessment of risk. Thinking through potential scenarios and how these might evolve based on changes in the economic environment, changes in competitors' strategies and potential stress events forms an integral part of the strategy setting, planning and budgeting processes.

Additionally, stress testing is used, among others, to:

- validate existing quantitative risk models in order to assess whether the output derived in a negative stress scenario is consistent with model outputs at a similar severity level;
- set risk limits; and
- evaluate emerging risks.

FirstRand's approach to planning, including the stress and scenario analysis, requires comprehensive involvement of the franchises and the various units within the Group's Corporate Centre. The Board, through the RCC committee, is ultimately responsible to critically evaluate:

- stress-test approach followed;
- scenario/s selected; and
- the impacts of the stress test results on the business and strategic direction of the Group.

From a business planning perspective, the business is managed in line with the core macroeconomic view (core scenario). Stress scenarios are overlaid on the core scenario to alert management of adverse unexpected outcomes which in turn impact management action considerations. The Group also recognises the fact that it is exposed to a number of risks that are difficult to anticipate and model and are, therefore, difficult to manage and mitigate economically. These risks are collectively denoted as event risks and are not necessarily strongly related to the economic environment or the Group's strategy. The planning and stress test provides for proactive and continuous identification of such potential events and establishes a process in which these are evaluated and discussed across the businesses.

From time-to-time, the regulator may call for the Group to run a supervisory stress test with prescribed assumptions and methodologies, which are also considered as part of the overall planning and stress test process.

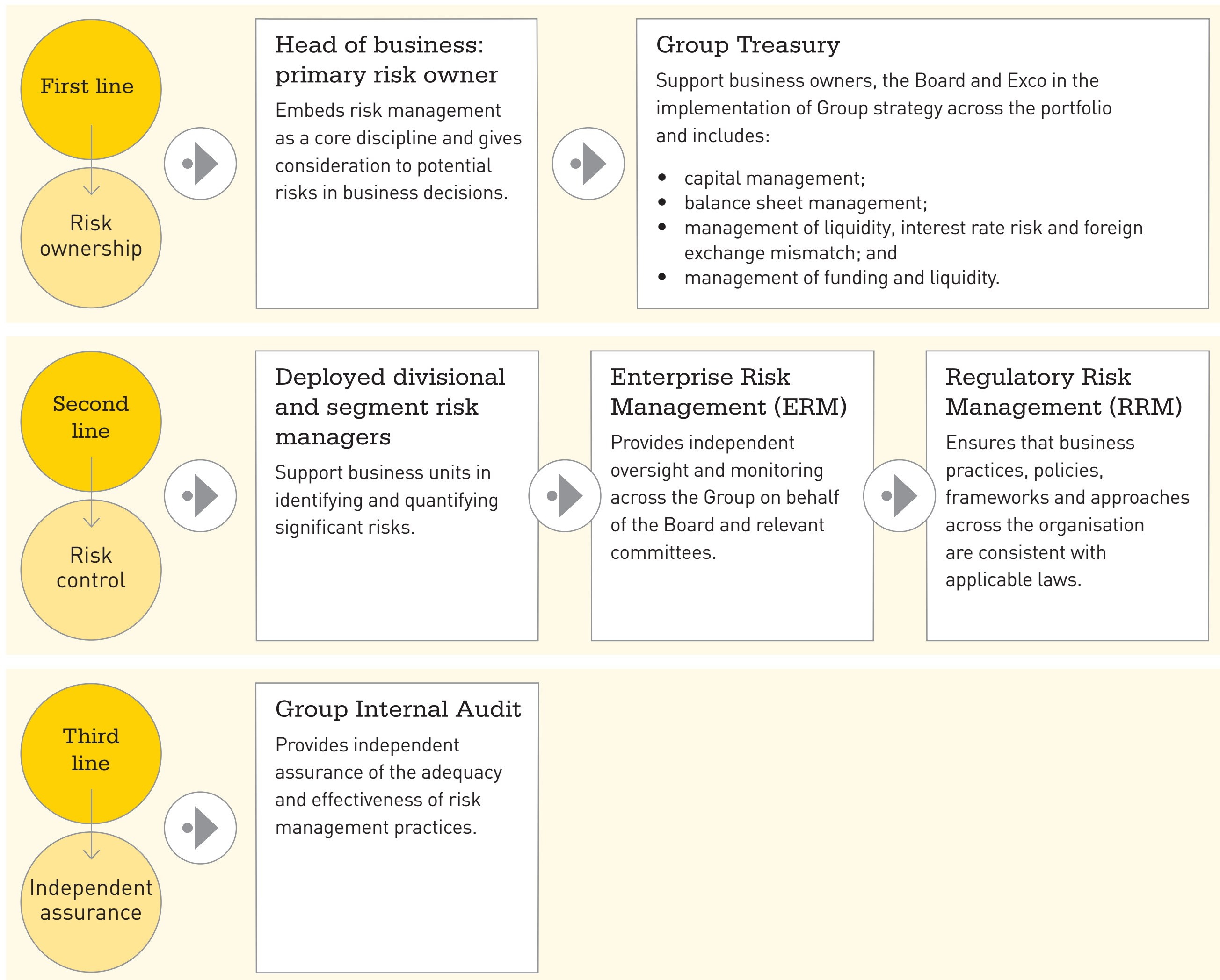
RISK MANAGEMENT FRAMEWORK AND GOVERNANCE

Risk governance framework

FirstRand's Board retains ultimate responsibility for ensuring that risks are adequately identified, measured, monitored and managed. The Group believes that effective risk management is based on a culture focused on risk paired with an effective governance structure.

Effective risk management also requires multiple points of control or safeguards that should be consistently applied at various levels throughout the organisation. There are three primary lines of control across the Group's operations illustrated in the chart below.

Lines of risk control



The risk management structure is set out in the Group's business performance and risk management framework (BPRMF). As a policy of both the Board and Exco, it delineates the roles and responsibilities of key stakeholders in business, support and control functions across the various franchises and the Group. The BPRMF explicitly recognises the three lines of control.

First line – risk ownership

Risk taking is inherent in the individual businesses' activities. Business management carries the primary responsibility for the risks in its business, in particular with respect to identifying and managing risk appropriately. In order to achieve this, the head of each business entity:

- ensures the entity acts in accordance with mandates approved by the Board or its delegated authority;
- identifies, quantifies and monitors key risks to business under normal and stress conditions;
- implements the strategic and business plans as applicable to the business entity within approved risk appetite parameters;
- designs business processes that will ensure that risks are appropriately managed;
- specifies the risk management processes whereby the key risks of the entity are managed;
- specifies and implements early warning measures, associated reporting, management and escalation processes;
- implements risk mitigation strategies;
- implements timeous corrective actions and loss control measures as required;
- reports risk information to Exco and the governance committee structure through to the Board; and
- ensures staff understand responsibilities in relation to risk management.

Business owners, the Board and Exco are supported in these responsibilities by Group Treasury and Financial Resource Mangement (FRM) within the Corporate Centre. The responsibilities of FRM and Group Treasury, including capital management, are described in the *Focus on sustainability and integration of risk and finance* section on page 8.

Second line – risk control

Business heads are supported in this by deployed divisional and segment risk management functions that are involved in all business decisions and are represented at an executive level across all franchises. Franchise heads of risk have a direct reporting line to the Group chief risk officer (CRO) and the relevant franchise CEO. Franchise and segment risk managers are responsible for risk identification, measurement and control. To this end, they:

- approve, coordinate and monitor risk assessment and risk management processes;
- ensure that board-approved risk policies and risk tools are implemented and adhered to;
- approve the design of business risk processes that will ensure that risks are appropriately managed;
- ensure that performance, risk exposures and corrective actions are reported in an appropriate format and frequency;
- monitor implementation of corrective action;
- identify process flaws and risk management issues and initiate corrective action;
- compile, analyse and escalate risk reports through governance structures; and
- ensure all risk management and loss containment activities are performed in a timely manner as agreed with Enterprise Risk Management (ERM).

Divisional and segment risk management activities are overseen by the independent, central risk control functions, ERM and Regulatory Risk Management (RRM).

ERM is headed by the Group CRO who is a member of Exco and provides independent oversight and monitoring across the Group on behalf of the Board and relevant committees. Furthermore ERM:

- takes ownership of and maintains risk frameworks;
- develops the Group's risk management strategy and communicates this strategy and requirements to appropriate stakeholders;
- challenges risk profiles through review of risk assessments, evaluation of risk management processes and monitoring of exposures and corrective actions;
- reports risk exposures and performance in relation to risk exposures to management and relevant committees;
- ensures appropriate risk skills throughout the Group alongside an appropriate risk management culture for risk taking;
- performs risk measurement validation and maintains risk governance structures;
- deploys a comprehensive and integrated approach to stress testing; and
- manages regulatory relationships with respect to risk matters.

RRM is an integral part of managing risks inherent in the business of banking and ensures that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws. The risks, responsibilities and processes of RRM are discussed in the *Regulatory risk* section on page 80.

Third line – independent assurance

The third major line of control involves internal audit and external advisors providing independent and objective assurance to the Board, Audit committee and regulators. The assurance is provided on the overall adequacy and effectiveness of governance, risk management and control within the Group as established by the first (management oversight) and second (management of risk) lines of control.

FirstRand has an established internal audit function, namely, Group Internal Audit (GIA).

GIA is an independent, objective assurance and consulting activity designed to add value and improve the operations of FirstRand and its subsidiaries, joint ventures, trusts, offshore operations and business interests. GIA assists executive management and the Audit committee to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes within the Group.

GIA is headed by the chief audit executive (CAE) and reports to the Board through the Audit committee chairman. The CAE has direct, unrestricted access to the Group CEO and executives, and respective

subsidiaries as well as to all FirstRand business unit functions, records, property and personnel. The CAE reports administratively to the CEO and functionally to the chairman of the Audit committee, which is in line with Institute of Internal Auditing standards and good corporate governance principles.

To achieve its objectives, GIA:

- assesses whether management establishes and monitors the adequacy and effectiveness of the internal control systems, internal risk management procedures and methodologies;
- assesses the adequacy and effectiveness of the organisation's corporate governance, risk management and internal control frameworks;
- assesses if governance processes and ethics are designed and operating in line with legislation and best practice guidelines;
- reviews the adequacy of manual and automated internal controls to ensure compliance with policies, plans, procedures, regulatory requirements and business objectives;
- assesses the adequacy of processes implemented to ensure that all tangible and intangible assets are safeguarded and accounted for;
- assesses if systems of fraud prevention and detection are functioning as intended; and
- escalates significant internal control weaknesses, together with practical recommendations to management and the Audit committee and follows up on recommendations to ensure effective remedial action has taken place.

GIA conducts work in accordance with globally recognised internal audit standards and practices and its activities are annually assessed by the external auditors.

Combined assurance

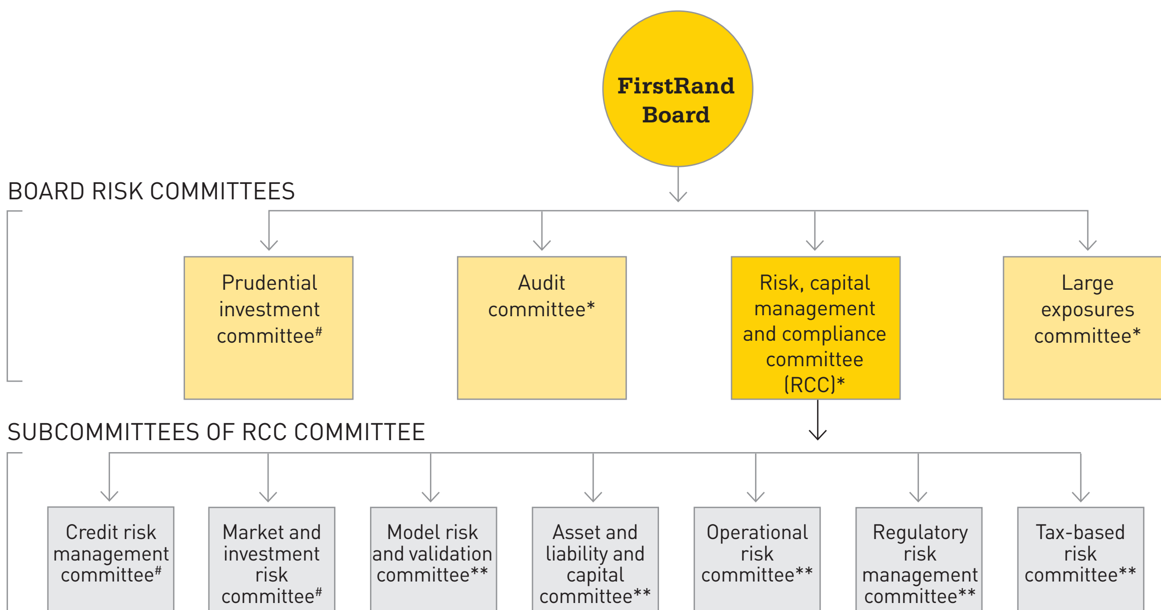
Formal enterprise-wide governance structures for enhancing the practice of combined assurance forums at Group and subsidiary level are overseen by the Audit committee. Through the assurance framework, GIA coordinates its work with senior management and ERM, RRM and external audit. The primary objective of the Group and assurance forums is for the assurance providers to work together with management to deliver the right assurance in the right areas by people with the best skills and experience as cost effectively as possible.

The outcomes of the combined assurance work indicate greater efficiency of the assurance processes through the elimination of duplication, more focused risk-based assurance against key control areas and heightened awareness of emerging issues resulting in the implementation of appropriate preventative and corrective actions plans.

Risk governance structure

In line with the Group's corporate governance framework, the Board retains ultimate responsibility for ensuring that risks are adequately identified, measured, managed and monitored across the Group. The Board discharges its duty through relevant policies and frameworks, as well as several board committees and subcommittees, as illustrated in the chart below.

Risk governance structure



* Chairperson is an independent non-executive board member.
** Chairperson is an external member.
\# Chairperson is a member of senior executive management. The Credit risk management committee has non-executive board representation.

The primary board committee overseeing risk matters across the Group is the RCC committee. It has delegated responsibility for a number of specialist topics to various subcommittees. The RCC committee submits its reports and findings to the Board and highlights control issues to the Audit committee. The responsibilities of the board committees and the subcommittees of the RCC committee are included in the table below.

Responsibilities of the board risk committees

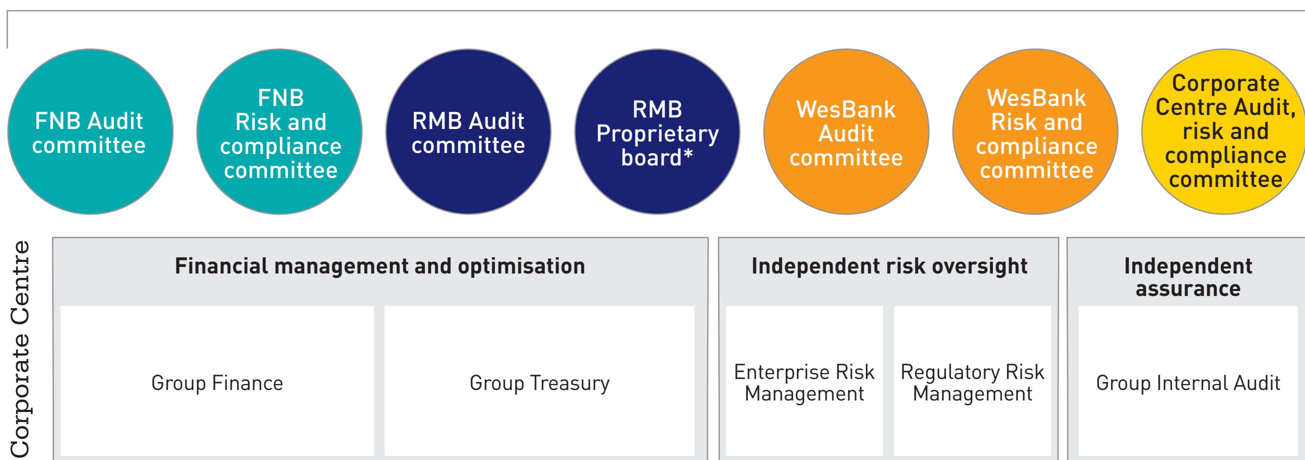
Committee	Responsibility
Large exposures committee (LEC)	• approves credit exposures in excess of 10% of the Group's capital; and • delegates the mandate for the approval of group and individual facilities to the FirstRand Wholesale credit committee, Commercial credit committee and Retail credit committee, as appropriate.
Audit committee	• considers the annual financial statements for approval by the Board; and • monitors the quality of the internal financial controls and processes of control in FirstRand and the implementation of corrective actions.
Risk, capital management and compliance (RCC) committee	• approves risk management policies, standards and processes; • monitors Group risk assessments; • monitors the effectiveness of risk management and high priority corrective actions; • monitors the Group's risk profile; • initiates corrective action, if required; • monitors compliance with the Regulations relating to Banks; and • approves regulatory capital models, risk and capital targets, limits and thresholds.
Prudential investment committee (PIC)	• ensures investment exposures comply with FirstRand's prudential investment guidelines.

Responsibilities of the subcommittees of the RCC committee

Committee	Responsibility
Credit risk management committee	• approves credit risk management policies, standards, processes and new business origination within risk appetite; • monitors effectiveness of credit risk management processes, credit risk profile and impairment charges; • monitors the quality of the credit risk profile, in-force business and new business origination, and underlying assets in the securitisation process; • monitors scenario and sensitivity analysis, stress tests, credit economic capital and credit concentrations; • ensures the uniform interpretation of the credit regulatory requirements and acceptable standards of credit reporting; and • reviews the credit economic conditions outlook from BSM and ensures that business units align credit origination strategies with the FirstRand view.
Market and investment risk committee (MIRC)	• approves market and investment risk management policies, standards and processes; • monitors the effectiveness of market and investment risk management processes; • monitors the market and investment risk profile; and • approves market and investment risk-related limits.
Model risk and validation committee (MRVC)	• considers and recommends for approval to the RCC committee all material aspects of model validation work including credit rating and estimation, internal models for market risk and advanced measurement operational risk models for the calculation of regulatory capital requirements.
Asset, liability and capital committee (ALCCO)	• approves and monitors effectiveness of management policies and processes for liquidity and funding risk, capital risk and market risk in the banking book (interest rate risk in the banking book, credit and counterparty credit risk, foreign exchange and translation risk, Corporate Centre macro hedges and investment risk); • monitors the management of funding of the Group's balance sheet; • provides governance and oversight of the level and composition of capital, and considers the supply and demand of capital across the Group; • approves buffers over regulatory capital and monitors capital adequacy ratios; and • approves frameworks and policies relating to internal funds transfer pricing (FTP) for the Group.

Committee	Responsibility
Operational risk committee (ORC)	• provides governance, oversight and coordination of relevant operational risk management practices; and • setting and approval of operational risk appetite.
Regulatory risk management (RRM) committee	• approves regulatory risk management principles, frameworks, plans, policies and standards; and • monitors the effectiveness of regulatory risk management, breaches and corrective action taken across the Group.
Tax risk committee	• monitors tax management processes, effectiveness of tax management process and corrective actions.
IT governance committee	• approves group-wide information and technology risk policies and standards to ensure the protection of information assets; and • ensures the effectiveness of information and technology systems and processes across the Group.

Franchise risk governance structure



* *The RMB Proprietary board is the Risk and regulatory committee of RMB.*

The roles of the RCC committee and its subcommittees are described with reference to the applicable governance structures and processes for each particular risk type in the major risk sections of this report. A number of the individual committee members are non-executive, further strengthening the Group's central, independent risk oversight and control functions.

Additional risk, audit and compliance committees exist in each franchise, the governance structures of which align closely with that of the Group, as illustrated in the chart above. The board committees are staffed by members of the respective committees of the individual franchise boards so as to ensure a common understanding of the challenges business faces and how these are addressed across the Group.

Regular risk reporting and challenge of current practices

As part of the reporting, challenge, debate and control process, ERM seeks to drive the implementation of more sophisticated risk assessment methodologies through the design of appropriate policies and processes, including the deployment of skilled risk management personnel in each of the franchises.

ERM, together with the independent review by GIA, ensure that all pertinent risk information is accurately captured, evaluated and escalated appropriately in a timely manner. This enables the Board and its designated committees to retain effective management control over the Group's risk position at all times.

STRATEGIC AND BUSINESS RISK

Introduction and objectives

Any business runs the risk of choosing an inappropriate strategy or failing to execute its strategy appropriately. The Group's objective is to minimise this risk in the normal course of business.

Business risk is considered in the strategic planning process and as a part of regular and pervasive stress testing and scenario analyses carried out across the Group. The objective is to develop and maintain a portfolio that delivers sustainable earnings thus minimising the chance of adverse outcomes occurring.

In an environment of continued weakness in the South African economy and the risks imposed by the continued weak global economy, FirstRand continues to focus on cost containment whilst pursuing growth opportunities both locally and in selected African markets. While the Group has negligible direct exposure to counterparties in the peripheral European countries, the risk lies in the growth impact on South Africa's economy as Europe is a major trading partner.

Organisational structure and governance

The development and execution of business level strategy is the responsibility of the Strategic executive committee (Stratco) and the individual business areas, subject to approval by the Board. This includes the approval of any subsequent material changes to strategic plans, budgets, acquisitions, significant equity investments and new strategic alliances.

Business unit and Group executive management, as well as functions within the Corporate Centre, review the external environment, industry trends, potential emerging risk factors, competitor actions and regulatory changes as part of strategic planning. Through this review, as well as regular scenario planning and stress-testing exercises, the risk to earnings and the level of potential business risk faced are assessed. Reports on the results of these exercises are discussed at various business, risk and board committees and are ultimately taken into account in the setting of risk appetite and in potential revisions to existing strategic plans.

Assessment and management

Strategic risk is not readily quantifiable and is, therefore, not a risk that an organisation can or should hold a protective capital buffer against. The risk to earnings on the other hand can be assessed, and this forms an explicit part of the Group's risk processes.

Volume and margin risk

Volume and margin risk is considered part of strategic planning and is regularly assessed through the Group's management and governance processes and ICAAP. Volume and margin risk could result in a situation where the operating income of the Group is insufficient to absorb the variability in income and operating costs.

Reputational risk

As a financial services provider, the Group's business is one inherently built on trust and close relationships with its clients. Reputational risk can arise from environmental, social and governance issues or as a consequence of financial or operational risk events.

The Group's reputation is built on the way in which it conducts business and it protects its reputation by managing and controlling these risks across its operations. It seeks to avoid large risk concentrations by establishing a risk profile that is balanced within and across risk types. In this respect, potential reputational risks are also taken into account as part of stress-testing exercises. The Group aims to establish a risk and earnings profile within the constraints of its risk appetite and seeks to limit potential stress losses from credit, market, liquidity or operational risks that may otherwise introduce an undesirable degree of volatility in its financial results and adversely affect its reputation.

Environmental, social and governance risk management

FirstRand has formal governance processes for managing ESG risks affecting the Group's ability to successfully implement business strategy. These processes involve the generation of ESG management reports at Group and franchise level, which detail ESG performance on a quarterly basis.

Each franchise defines tolerances for its principal ESG risks and action plans for addressing these in line with particular circumstances and risk appetite. Tolerances and mitigating actions are defined at Group and franchise level, and progress in respect of these is tracked through existing risk reporting structures. Provision is made for the escalation of significant ESG issues to the Board via Exco and the RCC and Audit committees.

The impact and likelihood of these risks are evaluated taking into account measures for management, mitigation and avoidance.

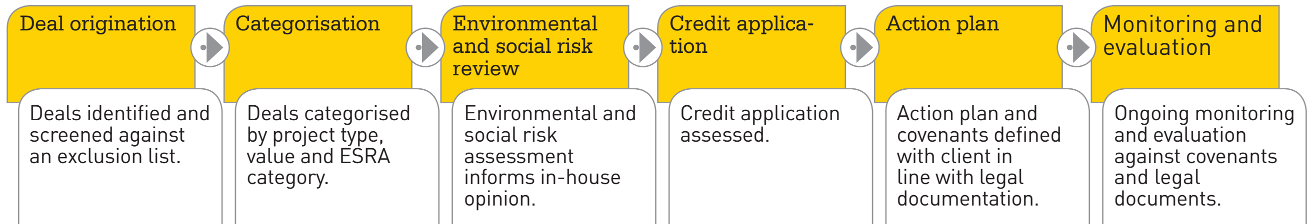
Equator Principles and environmental and social risk analysis (ESRA)

FirstRand became an Equator Principles (EP) finance institution in July 2009. Within FirstRand, the application of EP forms part of ESRA and is a specific credit risk management framework for determining, assessing and managing ESG risk in project finance transactions. EP transactions are all structured project finance activities, as defined by Basel II, where the capital costs associated with the project are US$10 million or above.

Each of the Group's operating franchises have formalised credit and compliance processes for the implementation of ESRA, with oversight provided by franchise risk and compliance officers, credit

committees throughout the Group and divisional social and ethics committees in cases of sensitivity. At a Group level oversight is provided by the RRM and RCC committees. Total ESRA performance statistics will be formally reported from 1 July 2013 once system improvements are implemented. The ESRA review process is illustrated in the chart below.

ESRA review process



ESRA transaction type

Transaction type	Threshold amount after which an ESRA review is triggered
Project finance transactions (subject to EP)	Total project capital costs at or above US$10 million.
Project finance advisory (subject to EP)	Total project capital costs at or above US$10 million.
Project finance transactions	All category A (high risk) and B (medium risk) transactions with a total project capital cost of less than US$10 million are subject to review.
Corporate loans	No threshold applied.
Equity investment deals	No threshold applied.
Affected commercial loans (inclusive of property finance)	Property finance or property securitised loans – no threshold is applied. Commercial loans (non-property related) – total facility amount above R7 million.
Asset finance for commercial or corporate purposes	Total facility amount above R50 million.
Commercial and corporate related working capital and overdraft loans	Total facility amount above R7 million.

2012 Equator Principles performance

The Group measures EP performance in line with the International Finance Corporation (IFC) performance standards as either Category A (high risk), Category B (medium risk) or Category C (low to no risk), per the definitions set out below.

Definition of EP performance categories

IFC/equator category	Risks/impacts
Category A (high risk)	Projects with potential significant adverse social or environmental impacts that are diverse, irreversible or unprecedented. Issues relating to these risks may lead to work stoppages, legal authorisations being withdrawn and reputational damage. Examples could include projects involving the physical displacement of the natural environment or communities.
Category B (medium risk)	Projects with potential limited adverse social or environmental impacts that are few in number, generally site specific, largely reversible and readily addressed through mitigation measures. Issues relating to these risks may lead to fines, penalties or legal non-compliance and reputational damage. Examples could include increased use of energy or increased atmospheric emissions.
Category C (low risk)	Projects with minimal or no social or environmental impacts.

EP transactions

EP category	**Six months ended 31 December 2012**		Year ended 30 June 2012	
	Projects screened for the first time during the period	**Projects that reached financial close during the period**	Projects screened for the first time during the year	Projects that reached financial close during the year
A (high risk)	**2**	**–**	2	1
B (medium risk)	**1**	**–**	9	8
C (low risk)	**8**	**8**	6	7
Total	**11**	**8**	17	16

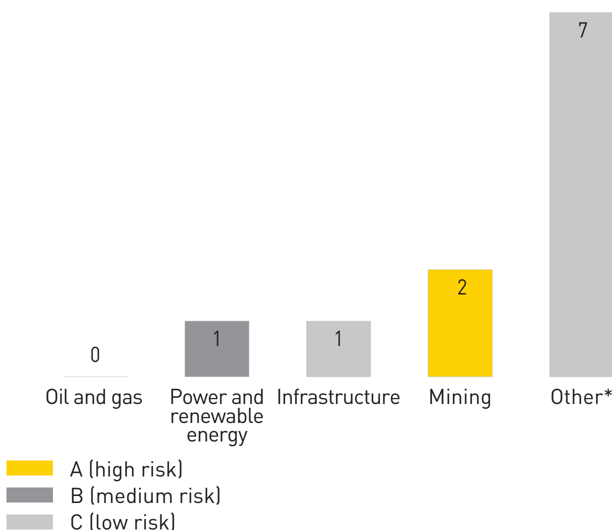
The projects screened are the structured EP-defined project finance deals, which were reviewed by an in-house environmental and social risk specialist. All category A and B transactions have been subjected to independent EP review to establish the environmental and social risks of the project for the first time during the reporting period. Financial close is assumed when all conditions precedent to initial drawing of the debt have been satisfied or waived.

EP reporting is externally assured for public disclosure by an independent third party per requirements set out by the EP Association. The auditor's report for the year ending 30 June 2012 can be viewed at http://www.firstrand.co.za/Sustainability/Pages/default.aspx

Analysis of EP transactions

EP transactions during the period under review were categorised into mining and other sectors, which generally involve commercial or retail property developments. All of the transactions noted are southern African based projects. The chart below illustrates the number of EP transactions screened per industry category for the period under review.

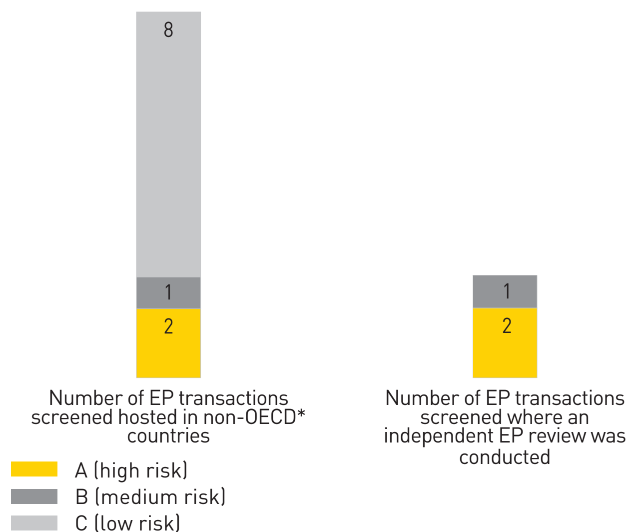
EP finance transactions screened per industry category (number of transactions)



* *Transactions in the other category are typically deals related to large commercial property developments.*

The chart below illustrates the number of EP transactions per EP category for the period under review.

Category of EP transactions (number of transactions)



* *Organisation for economic cooperation and development (OECD). During the period under review there were no EP transactions screened hosted in OECD countries.*

ESRA process going forward

FirstRand is currently in the fourth year of implementation of ESRA processes. Continued focus will be given to both awareness training and the effective implementation of the ESRA process.

Improvements during the period under review are the development of a more automated and efficient categorisation process which will be the first automated ESRA process at a financial institution in South Africa. This will embed the process into credit processes more effectively and allow for accurate performance reporting on all ESRA transactions.

The National Environment Management Act: Waste Act continues to be a focus area, particularly as it relates to the review of contamination of financed property or taken as security. The National Waste Management Strategy has identified the financial sector as a key stakeholder requiring guidance in relation to the identification and management of contaminated property.

For more detail on the EP and ESRA processes please visit www.firstrand.co.za/sustainability.

CAPITAL MANAGEMENT

Introduction and objectives

The Group seeks to establish and manage a portfolio of businesses and associated risks that will deliver sustainable returns to its shareholders by targeting a particular earnings profile that will generate returns within appropriate levels of volatility.

Sustainability also refers to the capacity to withstand periods of severe stress characterised by very high levels of unexpected financial and economic volatility, which cannot be mitigated by earnings alone. Capitalisation ratios appropriate to safeguarding operations and the interests of stakeholders are therefore maintained. In this respect, the overall capital management objective is to maintain sound capital ratios and a strong credit rating to ensure confidence in the solvency and quality of capital in the Group during calm and turbulent periods in the economy and financial markets.

The optimal level and composition of capital is determined after taking into account business units' organic growth plans – provided financial targets are met. Other factors taken into consideration include:

- targeted capital ratios;
- future business plans;
- issuance of capital instruments;
- the need for appropriate buffers in excess of minimum requirements;
- rating agencies' considerations;
- investor expectations; and
- proposed regulatory changes.

Allocating resources effectively, including capital and risk capacity, in terms of the risk appetite targets and in a manner that maximises value for shareholders is a core competence and key focus area. Sound capital management practices, therefore, form an important component of its overall business strategy.

The effectiveness of capital allocation decisions and the efficiency of its capital structure are important determinants of the ability to generate returns for shareholders. The Group seeks to hold limited excesses above the capital required to support its medium-term growth plans (including appropriate buffers for stresses and volatility) and future regulatory changes.

The total capital plan includes a dividend policy, which is set to ensure sustainable dividend cover based on sustainable normalised earnings. The plan also takes into account volatile earnings brought on by fair value accounting, anticipated earnings yield on capital employed, organic growth requirements and a safety margin for unexpected fluctuations in business plans.

Capital adequacy and planning

Period under review

The capital planning process ensures that the total capital adequacy and Core Tier 1 ratios remain within approved ranges or above target levels across economic and business cycles. The Group is appropriately capitalised under normal and severe scenarios as well as a range of stress events.

The board-approved capital plan is reviewed annually as part of the Group's ICAAP, with the stress-testing framework being an extension of the process. ICAAP assists in the attribution of capital in proportion to the risks inherent in the respective businesses with reference to normal economic circumstances and times of potential stress, which may lead to the realisation of risks not previously considered. These processes are under continuous review and refinement, and continue to inform the targeted buffer over the minimum capital requirement.

The Group aims to back all economic risk with Tier 1 capital, which offers the greatest capacity to absorb losses. Regular reviews of economic capital are carried out across the businesses and the Group remains well capitalised in the current environment, with levels of Tier 1 capital exceeding the level of economic capital required.

Throughout the period under review, the Group operated above its targeted capitalisation range, reporting a total capital adequacy ratio of 14.9% and a solid Core Tier 1 ratio of 12.5% at December 2012. Similarly the Bank, excluding foreign branches, operated comfortably above its target ranges with a total capital adequacy of 14.6% and Core Tier 1 ratio of 11.9%. The Group continues to follow a conservative approach to capital levels and prefers to maintain capital ratios at the upper end of its targeted capitalisation range, particularly given ongoing regulatory developments and Africa expansion initiatives.

The targeted capital levels as well as the ratios at 31 December 2012 are summarised in the table below.

Capital adequacy position

	FirstRand		FRB*		Regulatory minimum
	Actual	**Target**	**Actual**	**Target**	
Capital adequacy ratio (%)	**14.9**	**12.0 – 13.5**	**14.6**	**11.5 – 13.0**	**9.5****
Tier 1 ratio (%)	**13.4**	**11.0**	**12.7**	**10.5**	**7.0**
Core Tier 1 ratio (%)	**12.5**	**9.5 – 11.0**	**11.9**	**9.0 – 10.5**	**5.25**

* *Reflects solo supervision, i.e. FirstRand Bank excluding foreign branches.*
** *The regulatory minimum excludes the bank-specific (Pillar 2b) add-on and capital floor.*

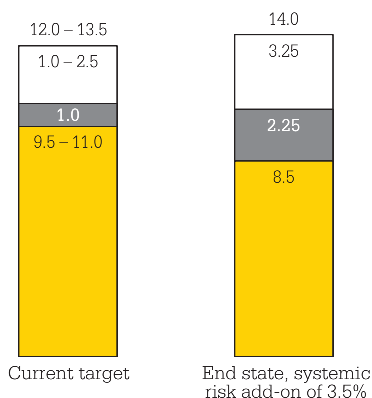
Basel III

The final Basel III framework "A global regulatory framework for resilient banks and banking systems," issued in December 2010, will be phased in from 1 January 2013 with full compliance of capital levels (including buffers) required by 1 January 2019.

The final capital framework for banks operating in South Africa was released in October 2012. It aligns the implementation dates with the Basel III framework. The Basel III impact on the Group's Core Tier 1 ratio is expected to be minimal. There is, however, a more pronounced negative impact on the Tier 1 ratio and total capital adequacy ratio as the current non-cumulative non-redeemable (NCNR) preference share capital and subordinated debt instruments do not meet the new loss absorbency criteria.

The graph below shows the current internal targets and the end state minimum capital requirements (excluding the bank-specific individual capital requirement (ICR), or Pillar 2b add-on). The internal target levels will be reassessed under Basel III.

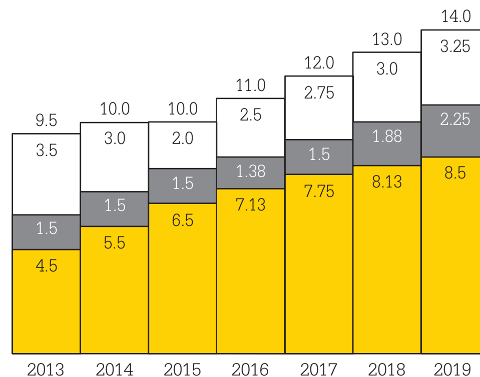
Current internal target and end state minimum capital requirements (%)



Tier 2
Other/Additional Tier 1
Core Tier 1/Common Equity Tier 1

Given the transitional period to comply with the final capital framework, the Group remains focused on meeting the end state Common Equity Tier 1 (CET1) requirement, while looking at ways to optimise the overall capital mix. The graph opposite shows the minimum capital requirements (excluding the ICR add-on) during the transitional period until 2019.

Minimum capital requirements (%)



Tier 2
Additional Tier 1
Common Equity Tier 1

The regulations allow for the inclusion of disclosable reserves (i.e. share-based payment reserve, foreign currency translation reserve and available-for-sale reserve) in CET1. This is partly offset by the exclusion of certain minority interests, as well as additional regulatory deductions. The grandfathering of qualifying capital instruments diminishes the total capital supply further.

RWA are expected to increase mainly for counterparty credit risk. The SARB issued a directive in December 2012 delaying the additional capital requirement on ZAR over-the-counter (OTC) derivatives and local counterparties until 1 January 2014.

The Group continues to participate in the SARB's bi-annual quantitative impact studies to assess the influence of Basel III on capital adequacy ratios, as well as to monitor the impact of leverage for the industry. The simple, transparent non-risk based leverage ratio is calibrated to act as a credible supplementary measure to the risk-based capital requirements. The SARB has proposed a minimum Tier 1 capital leverage ratio of 4%, which the Group continues to comfortably exceed.

Supply of capital – Tier 1

Tier 1 capitalisation ratios benefited from stronger internal capital generation through earnings growth. All profits were appropriated at 31 December 2012.

Supply of capital – Tier 2

During the period under review, FirstRand replaced the FRB06 and FRB07 subordinated debt instruments with a Basel III instrument that references a resolution regime. The FRB11 bond meets the Basel III entry criteria and will be included for grandfathering from 1 January 2013 with full recognition envisaged once the resolution regime is implemented in South Africa.

Demand for capital

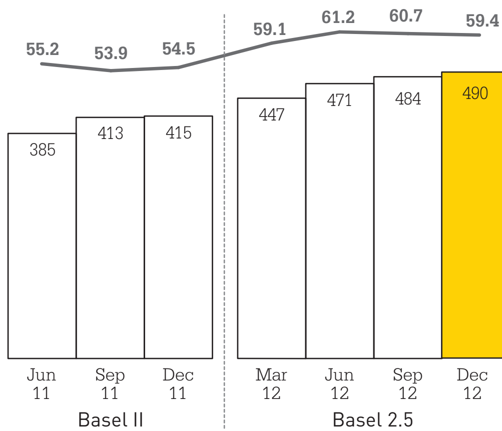
Basel 2.5 implemented on 1 January 2012 has resulted in an increase in the following risk types:

- credit and equity investment risk – a 6% scalar applied to the exposures on the advanced internal ratings-based (AIRB) approach; and
- market risk – stressed Value-at-Risk (VaR) requirements and incremental risk charge.

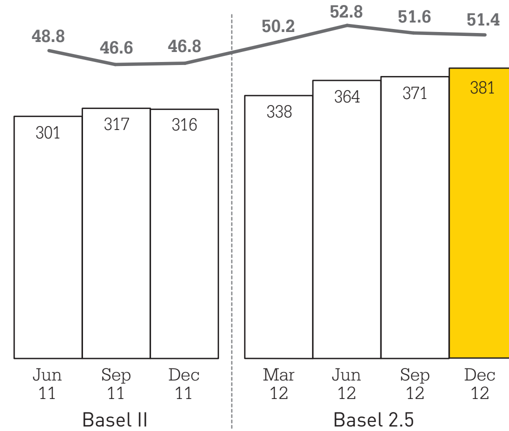
The overall RWA increase was also driven by credit risk volume growth and recalibrations, offset by decreased market risk positions. Effective 1 July 2011, the SARB also required equity investment risk exposures be risk weighted under the simple risk weighted method, with a phasing in of the higher capital requirement.

The following graphs show the increase in the demand for capital, taking into account regulatory changes over time.

FirstRand RWA history



FRB RWA history



Capital adequacy

The following table shows the composition of regulatory capital for FirstRand.

Composition of qualifying capital

	FirstRand		
R million	**December 2012**	December 2011	June 2012
Ordinary shareholders equity as per IFRS	**66 274**	57 506	62 521
Less: non-qualifying reserves	**(4 343)**	(3 577)	(3 983)
Cash flow reserve	**842**	649	753
Available-for-sale reserve	**(1 068)**	(412)	(626)
Share-based payment reserve	**(2 959)**	(3 054)	(3 247)
Foreign currency translation reserve	**(1 363)**	(1 080)	(1 052)
Other reserves	**205**	320	189
Ordinary shareholders equity qualifying as capital	**61 931**	53 929	58 538
Ordinary share capital and share premium	**5 442**	5 222	5 271
Reserves	**56 489**	48 707	53 267
Non-controlling interest	**2 705**	3 074	2 767
Less: total impairments	**(3 260)**	(3 092)	(3 419)
Excess of expected loss over eligible provisions (50%)	**(231)**	(844)	(400)
First loss credit enhancements in respect of securitisation structures (50%)	**(652)**	(284)	(508)
Goodwill and intangibles	**(1 557)**	(1 647)	(1 743)
Other impairments*	**(820)**	(317)	(768)
Total Core Tier 1 capital	**61 376**	53 911	57 886
Total Other Tier 1 capital	**4 119**	4 119	4 119
NCNR preference share capital	**4 519**	4 519	4 519
Less: impairments*	**(400)**	(400)	(400)
Total Tier 1 capital	**65 495**	58 030	62 005
Upper Tier 2 instruments	**1 047**	1 044	1 045
Tier 2 subordinated debt instruments	**7 181**	5 784	6 973
Other reserves	**201**	208	215
Less: total impairments	**(883)**	(1 128)	(908)
Excess of expected loss over eligible provisions (50%)	**(231)**	(844)	(400)
First loss credit enhancements in respect of securitisation structures (50%)	**(652)**	(284)	(508)
Total Tier 2 capital	**7 546**	5 908	7 325
Total qualifying capital and reserves	**73 041**	63 938	69 330

* *December 2011 restated to include investment in other regulated financial entities (previously included under Core Tier 1 capital).*

The table below provides more detail on the Group's capital instruments at 31 December 2012.

Characteristics of capital instruments

Capital type	Instrument	Nominal R million	Actual R million	Rate type	First call date
Core Tier 1	Ordinary share capital and premium	5 442	5 442		Perpetual
Other Tier 1	NCNR preference share capital	4 519	4 519	Floating	Perpetual
Upper Tier 2	FRBC21	628	606	Fixed	21 Dec 2018
	FRBC22	440	441	Floating	21 Dec 2018
Subordinated debt	FRB03	1 740	1 829	Fixed	15 Sep 2014
	FRB05	2 110	2 046	Fixed	21 Dec 2018
	FRB08	100	100	Floating	10 Jun 2016
	FRB09	100	100	Floating	10 Jun 2017
	FRB10	1 000	1 013	Floating	25 Jan 2017
	FRB11	1 500	1 507	Floating	11 Dec 2017
	FNBB002	120	170	Floating	1 Dec 2016
	FNBB003	27	27	Fixed	1 Dec 2016
	FNBX22	110	113	Fixed	29 Mar 2017
	FNBJ22	280	280	Floating	29 Mar 2017

The table below provides a detailed breakdown of the RWA numbers and capital requirement per current SARB regulations for each risk type of FirstRand.

RWA and capital requirements

	FirstRand					
	December 2012				December 2011	June 2012
	RWA					
R million	**Advanced approach**	**Standardised approach**	**Total**	**Capital requirement***	RWA	
Credit risk						
Corporate, banks and sovereigns	**115 325**	**10 556**	**125 881**	**11 959**	104 868	117 561
Small and medium enterprises (SMEs)	**40 286**	**14 320**	**54 606**	**5 188**	49 434	45 493
Residential mortgages	**50 462**	**4 086**	**54 548**	**5 182**	47 165	55 932
Qualifying revolving retail	**15 319**	**118**	**15 437**	**1 467**	9 611	12 661
Other retail	**55 658**	**7 095**	**62 753**	**5 962**	53 814	63 710
Securitisation exposure	**8 239**	**263**	**8 502**	**808**	9 013	9 588
Other	**–**	**15 174**	**15 174**	**1 441**	8 443	12 904
Total credit risk	**285 289**	**51 612**	**336 901**	**32 007**	282 348	317 849
Operational risk**	**59 747**	**14 048**	**73 795**	**7 011**	63 745	72 963
Market risk	**10 735**	**2 456**	**13 191**	**1 253**	12 621	15 868
Equity investment risk	**42 110**	**–**	**42 110**	**4 000**	30 236	40 640
Other assets	**–**	**24 376**	**24 376**	**2 316**	26 171	24 148
Total RWA	**397 881**	**92 492**	**490 373**	**46 587**	415 121	471 468
Pillar 1 (8%)				**39 231**	33 208	37 717
Pillar 2 (1.5%)				**7 356**	6 227	7 072
Total capital requirement*				**46 587**	39 435	44 789

** Capital requirement calculated at 9.5% (Pillar 1 of 8% and Pillar 2a of 1.5%) of RWA.*
*** Exposures subject to basic indicator approach included under the standardised method.*

The following table shows the composition of regulatory capital for the Bank.

Composition of qualifying capital

R million	FRB*		
	December 2012	December 2011	June 2012
Ordinary shareholders equity as per IFRS	**48 290**	42 187	45 956
Less: non-qualifying reserves	**(645)**	(1 406)	(364)
Cash flow reserve	**842**	649	753
Available-for-sale reserve	**(1 046)**	(518)	(695)
Share-based payment reserve	**(441)**	(369)	(422)
Unappropriated profits		(1 168)	
Ordinary shareholders equity qualifying as capital	**47 645**	40 781	45 592
Ordinary share capital and share premium	**15 308**	14 608	15 308
Reserves	**32 337**	26 173	30 284
Less: total impairments	**(2 156)**	(2 859)	(2 526)
Excess of expected loss over eligible provisions (50%)	**(231)**	(844)	(400)
First loss credit enhancements in respect of securitisation structures (50%)	**(45)**	(45)	(45)
Qualifying capital in branches	**(1 732)**	(1 732)	(1 732)
Intangibles	**(148)**	(224)	(332)
Other impairments		(14)	(17)
Total Core Tier 1 capital	**45 489**	37 922	43 066
Total Other Tier 1 capital	**3 000**	3 000	3 000
NCNR preference share capital	**3 000**	3 000	3 000
Total Tier 1 capital	**48 489**	40 922	46 066
Upper Tier 2 instruments	**1 047**	1 044	1 045
Tier 2 subordinated debt instruments	**6 595**	5 364	6 392
Less: total impairments	**(276)**	(889)	(445)
Excess of expected loss over eligible provisions (50%)	**(231)**	(844)	(400)
First loss credit enhancements in respect of securitisation structures (50%)	**(45)**	(45)	(45)
Total Tier 2 capital	**7 366**	5 519	6 992
Total qualifying capital and reserves	**55 855**	46 441	53 058

* *Reflects solo supervision, i.e. FirstRand Bank excluding foreign branches.*

RWA and capital requirements

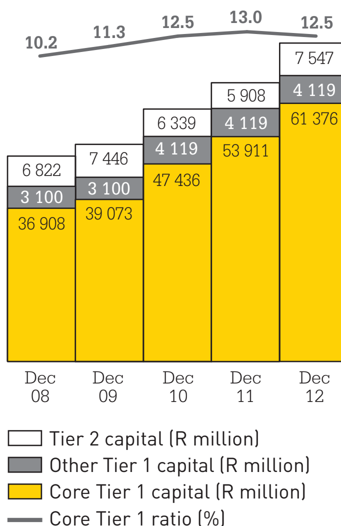
R million	FRB*					
	December 2012				December 2011	June 2012
	RWA			**Capital require-ment****	RWA	
	Advanced approach	**Standardised approach**	**Total**			
Credit risk						
Corporate, banks and sovereigns	**115 325**	**–**	**115 325**	**10 956**	96 663	108 719
SMEs	**40 286**	**–**	**40 286**	**3 827**	39 648	34 134
Residential mortgages	**50 462**	**–**	**50 462**	**4 794**	43 464	52 224
Qualifying revolving retail	**15 319**	**–**	**15 319**	**1 455**	9 611	12 564
Other retail	**55 658**	**–**	**55 658**	**5 288**	45 186	55 311
Securitisation exposure	**8 239**	**–**	**8 239**	**783**	8 673	9 207
Total credit risk	**285 289**	**–**	**285 289**	**27 103**	243 245	272 159
Operational risk	**56 390**	**–**	**56 390**	**5 357**	42 268	54 099
Market risk	**10 735**	**–**	**10 735**	**1 020**	5 125	12 511
Equity investment risk	**13 513**	**–**	**13 513**	**1 284**	10 570	10 391
Other assets	**–**	**15 492**	**15 492**	**1 472**	14 545	15 275
Total RWA	**365 927**	**15 492**	**381 419**	**36 236**	315 753	364 435
Pillar 1 (8%)				**30 515**	25 261	29 154
Pillar 2 (1.5%)				**5 721**	4 736	5 467
Total capital requirement*				**36 236**	29 997	34 621

* *Reflects solo supervision, i.e. FirstRand Bank excluding foreign branches.*
** *Capital requirement calculated at 9.5% (Pillar 1 of 8% and Pillar 2a of 1.5%) of RWA.*

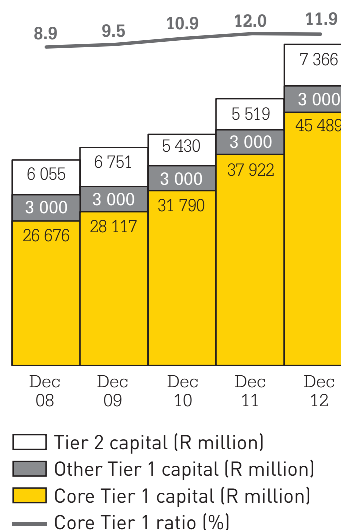
Historical overview of capital adequacy

The graphs below provide a historical overview of the capital adequacy for FirstRand and the Bank.

Capital adequacy – FirstRand



Capital adequacy – FRB



Note: Comparative info prior to December 2010 relates to the previously regulated entity FirstRand Bank Holdings Limited.

Capital adequacy position for FirstRand and its subsidiaries/foreign branches

The registered banking subsidiaries of FirstRand must comply with the SARB regulations and those of the respective in-country regulators, with primary focus placed on Tier 1 capital and total capital adequacy ratios. Based on the outcome of detailed stress testing, each entity targets a capital level in excess of the regulatory minimum. Adequate controls and processes are in place to ensure that each entity is adequately capitalised to meet local regulatory requirements. Capital generated by subsidiaries in excess of targeted levels is returned to FirstRand, usually in the form of dividends. During the period under review, no significant restrictions were experienced on the repayment of such dividends or capital to the Group.

The capital adequacy position of FirstRand and its subsidiaries/foreign branches is set out below.

RWA and capital adequacy position for FirstRand and its subsidiaries/foreign branches

	December 2012			December 2011	June 2012
	RWA R million	**Tier 1 %**	**Total capital adequacy %**	Total capital adequacy %	Total capital adequacy %
Basel II/2.5					
FirstRand	**490 373**	**13.4**	**14.9**	15.4	14.7
FirstRand Bank South Africa	**381 419**	**12.7**	**14.6**	14.7	14.6
FirstRand Bank London	**7 362**	**17.0**	**17.2**	11.7	18.0
FirstRand Bank India	**1 570**	**33.7**	**34.0**	33.9	30.4
RMB Australia	**10 706**	**12.8**	**12.8**	15.1	14.2
FNB Namibia*	**14 590**	**11.0**	**16.1**	16.7	17.6
Basel I*					
FNB Botswana	**10 639**	**12.8**	**20.2**	18.0	16.6
FNB Lesotho	**453**	**15.7**	**20.6**	19.5	17.4
FNB Mozambique	**1 138**	**14.9**	**15.0**	10.7	11.9
FNB Swaziland	**1 596**	**25.2**	**26.5**	28.8	29.4
FNB Zambia	**1 404**	**10.8**	**20.2**	14.6	18.0
FNB Tanzania	**99**	**89.4**	**89.4**	107.2	77.8

* *Ratios based on local rules.*

CREDIT RISK

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CREDIT RISK

Introduction and objectives

Credit risk is managed as part of the broader financial resource management process and is aligned with the Group's macroeconomic view.

Credit risk management is split into three distinct portfolios, namely, retail credit, commercial credit and wholesale credit, which are aligned to customer profiles. Credit risk management includes credit origination strategy, risk appetite, risk quantification and measurement, collection and recovery of delinquent accounts, and extends across the franchises. Activities that give rise to credit risk in each of the portfolios are described below.

Retail credit

Secured products in Retail credit in FNB include mortgage finance with property as security for the loan and pension-backed loans with a portion of a pension fund as security to purchase or improve a property. Secured retail credit at WesBank mainly relates to instalment sale agreements for the financing of motor vehicles.

Unsecured products in both FNB and WesBank include:

- personal loans ranging from small short-term loans to larger loans with a repayment terms of up to 60 months;
- student loans to finance studies at approved tertiary institutions;
- revolving overdraft facilities linked to the transactional demand deposit accounts; and
- credit cards with revolving credit limits and either straight or budget period repayment facilities.

Commercial credit

The Commercial credit portfolio strategy is focused on providing tailored credit products to commercial customers. These credit products are originated under both of the FNB (primary relationship owner) and WesBank (vehicle and asset-based finance (VAF)) brands. These products include:

- revolving overdraft facilities linked to transactional demand deposit accounts;
- traditional vehicle and asset-based finance (VAF) and fleet petrol cards;
- dealer funding solutions to selected vehicle dealerships secured by trade stock;
- guarantees and letters of credit to assist in the facilitation of transactions;
- forward exchange contracts and interest rate swaps;
- secured term loans;
- property finance includes owner-occupied and multi-tenanted properties as well as finance for residential developments secured by the properties;
- leveraged finance provides specialised business financing to fund, amongst others, business acquisitions, management buy-outs, management buy-ins, BEE transactions and balance sheet re-structuring over a maximum period of five years; and
- working capital facilities secured against debtors books and selective invoice discounting.

Wholesale credit

Wholesale credit offered by RMB to large corporate multi-banked customers includes the following products:

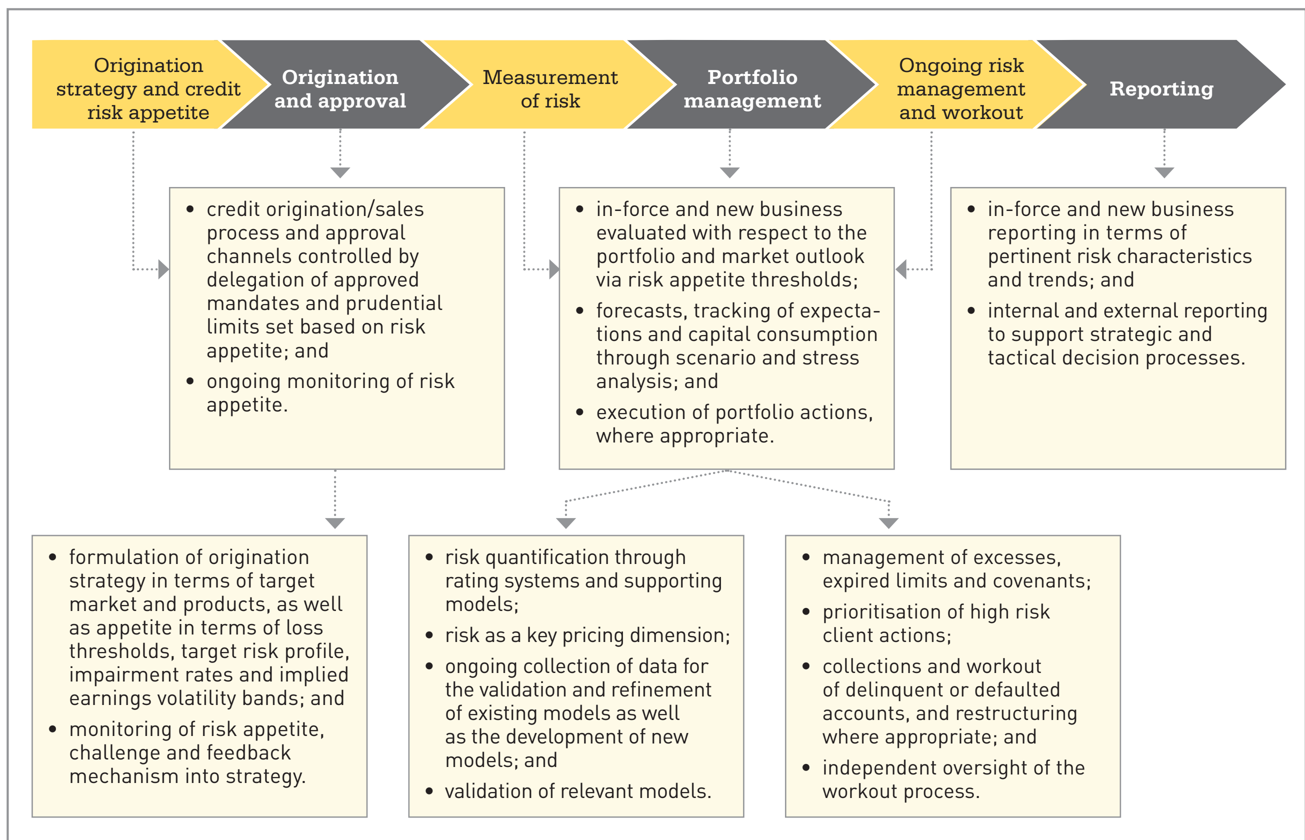
- structured asset finance for client funding requirements in local and cross-border strategic African jurisdictions;
- funding of corporate businesses, government and parastatals through debt capital market instruments;
- all inclusive financing packages for investment banking clients;
- structuring, raising and underwriting of equity capital and structured equity solutions;
- infrastructure and project finance;
- leveraged finance;
- real estate investment banking; and
- resource finance.

Credit risk is one of the core risks assumed in pursuit of the Group's business objectives. It is the most significant risk type in terms of regulatory and economic capital requirements. The objectives of its credit risk management practices are two-fold:

- Risk control: Appropriate limits are placed on the assumption of credit risk and steps are taken to ensure the accuracy of credit risk assessments and reports. Deployed and central credit risk management teams fulfil this task.
- Management: Credit risk is taken within the constraints of the risk appetite framework. The credit portfolio is managed at an aggregate level to optimise the exposure to this risk. Business units and deployed risk functions, overseen by the Group Credit Risk Management function within ERM and relevant board committees fulfil this role.

The scope of credit risk identification and management practices across the Group thus spans the entire credit value chain, as illustrated in the chart below.

Scope of credit risk management and identification practices



Organisational structure and governance

The RCC committee and franchise Exco's regularly receive and review reports on the adequacy and robustness of credit risk identification, management and control processes, as well as on the current and projected credit risk profile across the Group. The credit risk management governance structures, related roles and responsibilities as well as lines of accountability are set out in the credit risk management framework (CRMF). Approved by the RCC committee and the FirstRand Credit risk management committee (a subcommittee of the RCC committee), the CRMF is a policy of the Board and a subframework of the BPRMF (see page 12).

The credit-focused board committees, the Large exposures committee (a board committee) and the FirstRand Credit risk management committee support the RCC committee in its tasks. The Model risk and validation committee (MRVC, also a subcommittee of the RCC committee), support the RCC committee in its tasks relating specifically to models. For a description of the role and responsibilities of these committees refer to the Risk g*overnance structure* section on page 13.

The Group Credit Risk Management (GCRM) function

The GCRM function in ERM provides independent oversight of credit risk management practices in the deployed risk management functions to ensure an effective credit risk management process. It owns the CRMF and related policies and monitors the implementation of credit risk-related frameworks. In addition, its responsibilities include:

- active participation in the formulation of credit and origination strategies, in particular with a view to the implementation and management of the Group's credit risk appetite across the business units;
- aggregation of credit risk-related stress testing and scenario analysis;
- monitoring the credit components of the risk appetite framework;
- monitoring and reporting the credit risk profile and credit performance;
- aggregation and quantification of credit economic capital, including the credit risk assessment employed for ICAAP;
- reviewing all credit rating systems and independent revalidation of credit rating systems;
- management of relationships with external stakeholders such as relevant regulators with respect to credit matters;
- oversight of the credit impairment process;
- consolidated regulatory reporting; and
- the assessment, analysis and reporting of impairments and consolidated credit risk reporting to stakeholders such as the RCC committee.

The GCRM function is supported by deployed, portfolio level credit functions that are responsible for the implementation of relevant credit risk frameworks and policies in the various businesses, including the implementation of adequate credit risk controls, processes and infrastructure required to allow for the efficient management of credit risk. Responsibilities specifically include:

- formulation of credit strategy and assessment of business level credit risk appetite (together with Group Treasury within the constraints of the overall credit risk appetite);
- maintaining and monitoring implementation of methodologies, policies, procedures and credit risk management standards;
- validation of credit rating systems and associated processes as well as other decision support tools, such as economic capital, stress testing and impairment models;
- portfolio ownership of the credit regulatory reporting process;
- maintaining the credit governance structure; and
- monitoring of corrective actions.

Assessment and management

Calculation of internal ratings and rating process

The assessment of credit risk across the Group relies heavily on internally-developed quantitative models for regulatory purposes under Basel II, as well as for addressing business needs.

Credit risk models are widely employed in a number of activities such as the assessment of capital requirements, pricing, impairment calculations and stress testing of the portfolio. All of these models are built on a number of client and facility rating models, in line with Basel II AIRB approach requirements and the Bank's model building frameworks. The Group was granted regulatory approval under Basel II for the approaches shown in the table below.

Basel approach	FirstRand Bank	Remaining FirstRand subsidiaries
AIRB	✓	
Standardised approach		✓

Even though the remaining subsidiaries do not have regulatory approval to use the AIRB approach, the same or similar models are applied for the internal assessment of credit risk in these subsidiaries on the standardised approach. The models are used for the internal assessment of the following three primary credit risk components discussed in the following sections:

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

Management of the credit portfolio is heavily reliant on these three credit risk measures. PD, EAD and LGD are inputs into the portfolio and Group-level credit risk assessment where the measures are combined with estimates of correlations between individual counterparties, industries and portfolios to reflect diversification benefits across the portfolio of credit risks.

Probability of default

PD is defined as the probability of a counterparty defaulting on any of its obligations over the next year and is a measure of the counterparty's ability and willingness to repay facilities granted to it. A default, in this context, is defined along two dimensions:

- time-driven: the counterparty is in arrears for more than 90 days or three instalments as appropriate; and
- event-driven: there is reason to believe that the exposure will not be recovered in full and has been classified as such.

This definition of default is consistently applied across all credit portfolios as well as in the recognition of NPLs for accounting purposes.

For communication and reporting purposes, the Group employs a granular, 100-point, master-rating scale, which has been mapped to the continuum of default probabilities, as illustrated in the table below.

Mapping of FirstRand (FR) grades to rating agency scales

FR rating	Midpoint PD	International scale mapping*
FR 1 – 15	0.07%	AAA, AA, A
FR 16 – 25	0.32%	BBB
FR 26 – 32	0.77%	BB+, BB
FR 33 – 40	1.48%	BB-
FR 41 – 55	2.78%	B+
FR 56 – 86	7.95%	B
FR 87 – 91	15.47%	B-
FR 92 – 99	59.11%	Below B-
FR 100	100%	D (defaulted)

* *Indicative mapping to the international rating scales of Standard & Poor's. These mappings are reviewed and updated on a regular basis.*

FR rating of 1 is the lowest PD and a FR rating of 100 is the highest. External ratings have also been mapped to the master-rating scale for reporting purposes.

In line with international best practice, the Group distinguishes between the two measures of PD, both used for the management of exposure to credit risk:

- Through-the-cycle (TTC) PD measures reflect long term, average default expectations over the course of the economic cycle. TTC PDs are an input to economic and regulatory capital calculations.
- Point-in-time (PIT) PD measures reflect default expectations in the current economic environment and thus tend to be more volatile than TTC PDs. PIT PDs are used in credit portfolio management, including credit risk appetite and portfolio monitoring.

Exposure at default

The EAD of a particular facility is defined as the expected exposure to a counterparty through a facility, should the counterparty default over the next year. It reflects commitments made and facilities granted that have not been paid out and that may be drawn over the period under consideration (i.e. off-balance sheet exposures). It is also a measure of potential future exposure on derivative positions.

Tailored to the respective portfolios and products employed, a number of EAD models are in use across the Group. These have been developed internally and are calibrated to the historical default experience.

Loss given default

LGD is the third major credit risk component estimated on the basis of internal models. It is defined as the economic loss on a particular facility upon default of the counterparty. It is expressed as a percentage of exposure outstanding at the time of default. In most portfolios, LGD is strongly dependent on:

- type, quality, and level of subordination;
- value of collateral held compared to the size of overall exposure; and
- effectiveness of the recovery process and the timing of cash flows received during the workout or restructuring process.

A number of models are used to assess LGDs across various portfolios. These models were developed internally and the outputs are calibrated to reflect both the internal loss experience, where available, and external benchmarks, where appropriate.

Typically, a distinction is made between the long-run expected LGDs and LGDs reflective of downturn conditions. The latter is a more conservative assessment of risk, which incorporates a degree of interdependence between PD and LGD that can be found in a number of portfolios (i.e. instances where deteriorating collateral values are also indicative of higher default risk). It is this more conservative measure of LGD applicable to downturns which is used in the calculation of regulatory capital estimates.

Expected loss (EL)

EL, the product of the primary risk measures PD, EAD and LGD, is a forward-looking measure of portfolio or transaction risk. It is used for a variety of purposes across the Group alongside other risk measures.

Slotting approach

Slotting approach relates mainly to project and commodity finance. In terms of the slotting approach, the exposure is rated after assessing the risks and mitigations applied to reduce/eliminate the risk and mapped to one of four supervisory categories. This will apply where the Group finances an entity created to finance and/or operate physical assets, where the primary source of repayment of the obligations is the income generated by the assets (i.e. specialised lending specifically in project and commodity finance).

Rating process

A consistent rating process is employed across the Group, differentiated by the type of counterparty and the type of model employed for rating purposes. For example, retail portfolios are segmented into homogeneous pools in an automated process. Based on the internal product level data, PDs are then estimated (and continuously updated) for each pool. The following table summarises the processes and approaches employed and provides an overview of the types of exposures within each of the portfolios.

Credit portfolio rating process

Portfolio and type of exposures	Description of rating system
Large corporate portfolios (Wholesale: RMB,WesBank Corporate and Corporate Centre) Exposures to private sector counterparties including corporates and securities firms and public sector counterparties. A wide range of products give rise to credit exposure, including loan facilities, structured finance facilities, contingent products and derivative instruments.	The default definitions applied in the rating systems are aligned to Basel requirements. **Rating process:** • rating assignment to corporate credit counterparties is based on a detailed individual assessment of the counterparty's creditworthiness; • this assessment is performed through a qualitative analysis of the business and financial risks of the counterparty and is supplemented by internally developed statistical rating models; • rating models were developed using internal and external data covering more than ten years. Qualitative analysis is based on the methodology followed by international rating agencies; • the rating assessment is reviewed by the FirstRand Wholesale credit committee or delegated subcommittee and the rating (and associated PD) is approved by these committees; • no overrides of the ratings or the PDs are possible after approval by these committees; and • LGD and EAD estimates are based on modelling of a combination of internal and suitably adjusted international data.
Low default portfolios: sovereign and bank exposures (Wholesale: RMB and Corporate Centre) Exposures to sovereign and bank counterparties.	The default definitions applied in the rating systems are aligned to Basel requirements. **Rating process:** • expert judgement models are used in combination with external rating agency ratings as well as structured peer group analyses which form a key input in the ratings process. The analysis is supplemented by internally developed statistical models; • the calibration of PD and LGD ratings is based on a mapping to external default data as well as credit spread market data; • the rating assessment is reviewed by the FirstRand Wholesale credit committee or delegated subcommittee and the rating (as well as the associated PD) is approved by these committees; and • no overrides of the ratings or the PDs are possible after approval by these committees.
Specialised lending portfolios (Wholesale: RMB, FNB Commercial and Wealth, (RMB Private Bank and FNB Private Clients)) Exposures to private-sector counterparties for the financing of income-producing real estate.	The default definitions applied in the rating systems are aligned to Basel requirements. **Rating process:** • rating system is based on hybrid models using a combination of statistical cash flow simulation models and qualitative scorecards calibrated to a combination of internal data and external benchmarks; • the rating assessment is reviewed by the FirstRand Wholesale credit committee or delegated subcommittee and the rating (as well as the associated PD) is approved by these committees; and • no overrides of the ratings or the PDs are possible after approval by these committees.

<table>
<tr><th>Portfolio and type of exposures</th><th>Description of rating system</th></tr>
<tr><td>Commercial portfolio
(SMEs corporate and SMEs retail counterparties in FNB Commercial and WesBank)
Exposures to SME clients.
A wide range of products give rise to credit exposure, including loan facilities, contingent products and term lending products.</td><td>The default definitions applied in the rating systems are aligned to Basel requirements.
SME retail rating process:
• the SME retail portfolio is segmented into homogeneous pools and subpools through an automated scoring process using statistical models that incorporate product type, customer behaviour and delinquency status;
• PDs are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools; and
• LGD and EAD estimates are applied on a portfolio level, estimated from internal historical default and recovery experience.
SME corporate rating process:
• PD: Counterparties are scored using Moody's RiskCalc™, in addition to other internal risk drivers, the output of which is calibrated to internal historical default data;
• LGD: Recovery rates are largely determined by collateral type and these have been set with reference to internal historical loss data, external data (Fitch) and Basel II guidelines; and
• EAD: Portfolio level credit conversion factors are estimated on the basis of the Group's internal historical experience and benchmarked against international studies.</td></tr>
<tr><td>Residential mortgages
(Retail portfolios in FNB HomeLoans, Wealth (RMB Private Bank and FNB Private Clients) and mortgage exposures in the FNB Smart segment)
Exposures to individuals for the financing of residential properties.</td><td rowspan="3">The default definition applied in the rating systems is aligned to the requirements of Basel.
Rating process and approach:
• retail portfolios are segmented into homogeneous pools and subpools through an automated scoring process using statistical models that incorporate product type, loan characteristics, customer behaviour, application data and delinquency status;
• PDs are estimated for each subpool based on internal product level history associated with the respective homogeneous pools and subpools;
• no overrides of the PDs are possible. The only potential override is not that of the PD, but rather of the automated decision to lend or not. Such overrides may be done on the basis of the credit manager's judgement in a structured process supported by pertinent business reasons; and
• LGD and EAD estimates are based on subsegmentation with reference to the collateral or product type as well as associated analyses and modelling of historical internal loss data.
Additional notes on qualifying revolving retail exposures:
• these exposures are unsecured and, therefore, only the efficiency of recovery processes impacts on the level of LGD; and
• EAD measurement plays a significant role in the assessment of risk due to the typically high level of undrawn facilities that are characteristic of these product types. EAD estimates are based on actual historic EAD, segmented appropriately (e.g. straight versus budget in the case of credit cards).</td></tr>
<tr><td>Qualifying revolving retail exposures
(Retail portfolios in FNB Card, FNB Core Banking Solutions and Wealth)
Exposures to individuals providing a revolving limit through a credit card or overdraft facility.</td></tr>
<tr><td>Other retail exposures
(Retail portfolios in FNB Loans, FNB Smart segment, WesBank VAF and WesBank Loans)</td></tr>
</table>

Model validation

Rating models are recalibrated and independently validated on an annual basis to ensure validity, efficacy and accuracy. Rating models used across the credit portfolios incorporate an appropriate degree of conservatism, achieved through the prudent choice of model parameters and the inclusion of downturn periods such as 2001 and 2007-2009 in the calibration.

Independent validation of rating systems is carried out by the GCRM function in ERM. It is responsible for reviewing all rating systems, and an annual comprehensive revalidation of all material rating systems. An audit team in GIA carries out sample revalidations of the rating systems. The results of these analyses are reported to MRVC and ultimately approved by the RCC committee (designated model approval committee). As part of this process, extensive documentation covering all steps of the model development lifecycle from inception through to validation is maintained. This includes:

- developmental evidence, detailing processes followed and data used to set parameters for the model. These documents are updated at least annually by the model-development teams;
- independent validation reports, documenting the process followed during the annual validation exercise as well as results obtained from these analyses; and
- model build and development frameworks are reviewed and, where required, updated annually by GCRM. These frameworks provide guidance, principles and minimum standards which the model development teams are required to adhere to.

Credit risk mitigation

Since the taking and managing of credit risk is core to its business, the Group aims to optimise the amount of credit risk it takes to achieve its return objectives. Mitigation of credit risk is an important component of this process, beginning with the structuring and approval of facilities for only those clients and within those parameters that fall within risk appetite.

In addition, various instruments are used to reduce exposure in the case of a counterparty default. These include, amongst others, financial or other collateral, netting agreements, guarantees and credit derivatives. The type of security used depends on the portfolio, product or customer segment. For example:

- mortgages and instalment sale finance are secured by the assets financed;
- personal loans, overdrafts and credit card exposures are unsecured or secured by guarantees and suretyships;
- FNB Commercial credit facilities are secured by the assets of the SMEs counterparties and commercial property transactions are supported by the financed property and associated cash flows;
- working capital facilities are often not secured by claims on specific assets, but risk in structured facilities granted by RMB is mitigated by financial or other collateral such as guarantees or credit derivatives; and
- credit risk in RMB's FICC business is mitigated through the use of netting agreements and financial collateral.

The Group employs strict policies governing the valuation and management of collateral across all business areas. Collateral is managed internally to ensure that title is retained over collateral taken over the life of the transaction. All items of collateral are valued at inception of a transaction and at various points throughout the life of the transaction, either through physical inspection or indexation methods, as appropriate. For wholesale and commercial portfolios, valuation of collateral is reassessed as part of the annual facility review. For mortgage portfolios, collateral valuations are updated on an ongoing basis through statistical indexation models. For all retail portfolios, collateral is also revalued by physical inspections in the event of default and at the start of the workout process.

Management of concentration risk

Aggregated monitoring of concentration risk takes place at Group level through the GCRM function in ERM. Concentration risk is managed in the respective credit portfolios as outlined below.

Wholesale credit portfolio:

- single name limits for large exposures;
- evaluation of country and industry concentrations;
- a sophisticated, simulation-based portfolio model;
- securitisation structures; and
- credit derivatives.

Commercial portfolios:

- maintaining an appropriate balance of exposures across industries with a view to mitigating residual risks at Group level, where appropriate and economically feasible; and
- reliance on a small number of collateral types.

Retail portfolios:

- monitoring and management in the respective business segments (e.g. exposure to geographical areas and loan-to-value (LTV) bands for mortgage portfolios).

Monitoring of weak exposures

Credit exposures are actively monitored throughout the life of transactions. As indicated above, the management of credit risk is largely carried out at a business unit level, and, therefore, the processes for the identification and management of weak exposures differ slightly across the various franchises.

Wholesale credit portfolios:

- watch lists of high risk clients;
- specific and detailed action plans for each client are actively monitored and updated at least monthly;
- restructuring of facilities where appropriate;
- use of credit derivatives;
- efficient workout; and
- realisation of collateral value in the event of default.

Retail credit portfolios:

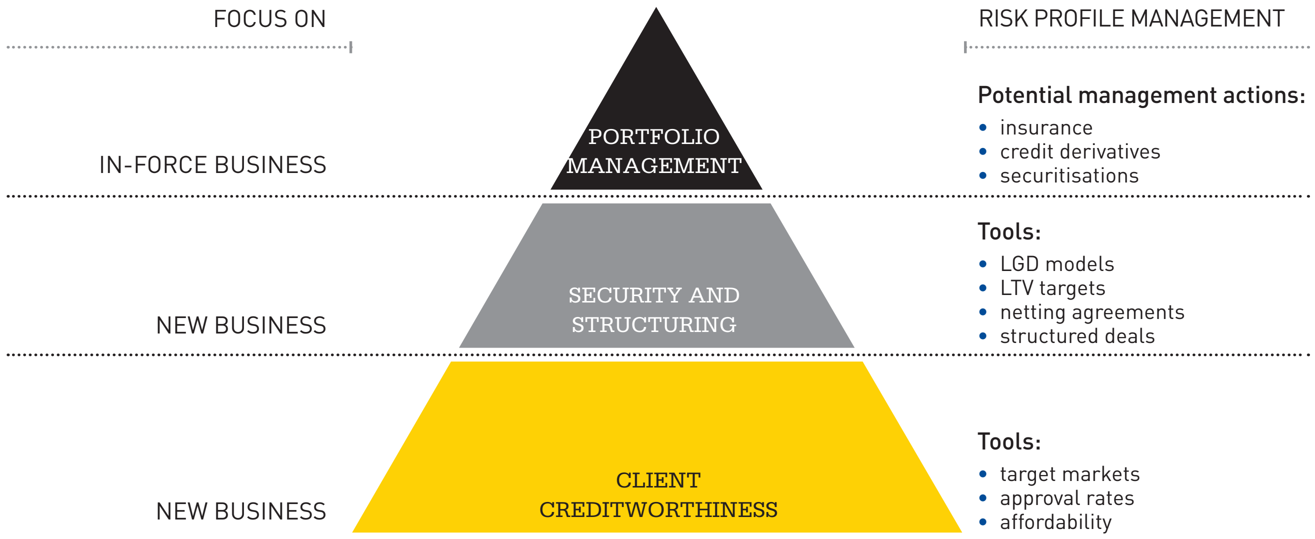
- monitoring on a (homogeneous) portfolio basis;
- restructuring of weak exposures to increase the projected realised value;
- reduction or removal of undrawn facilities in areas such as HomeLoans and Card; and
- revaluation of properties before approval of additional facilities.

Commercial and other portfolios of clients that fall between the corporate and retail segments are treated in a hybrid manner, dependent on the number of exposures and the size of individual transactions. Reports on the overall quality of the portfolio are monitored closely at a business unit as well as at a Group level.

Use of credit risk tools and measures

Credit risk measures are used in a large number of business processes, including pricing and setting impairments, in determining capitalisation levels and business strategy, risk appetite and the establishing of appropriate return targets. Credit risk tools and measures are used extensively in the determination of its current credit risk profile and credit risk appetite (see chart below).

Use of credit risk tools and measures



The following table describes the use of credit risk concepts and measures across a number of key areas and business processes related to the management of the credit portfolio.

Use of credit measures in the credit lifecycle

	WHOLESALE	RETAIL
Determination of portfolio and client acquisition strategy	• assessment of overall portfolio credit risk determined by PD, EAD and LGD; and • acquisition and overall strategy set in terms of appropriate limits and Group credit risk appetite.	• see wholesale; and • credit models determine loss thresholds used in setting of credit risk appetite.
Determination of individual and portfolio limits	• industry and geographical concentrations; • ratings; • risk-related limits on the composition of the portfolio; and • Group credit risk appetite.	• see wholesale; and • modelled versus actual experience are evaluated in setting of risk appetite.
Profitability analysis and pricing decisions	• PD, EAD and LGD used to determine pricing; and • economic profit used for profitability.	• see wholesale.
Credit approval	• consideration of applicant's ratings; • credit risk appetite limits; and • projected risk-adjusted return on economic capital (PD, EAD and LGD are key inputs into these measures).	• automated based on application scorecards (scorecards are reflective of PD, EAD and LGD); and • assessment of client's affordability.
Credit monitoring and risk management	• risk assessment based on PD, EAD and LGD; • counterparty FR grades updated based on risk assessment; and • portfolio model apportion additional capital to large transactions that will increase concentration risk.	• see wholesale; and • monthly analysis of portfolio and risk movements used in portfolio management and credit strategy decisions.
Impairments	• PD and LGD used in the assessment of impairments and provisioning; and • judgmental assessment to determine adequacy of provisions.	• loss identification period (LIP) PD, LGD and roll rates used for specific, portfolio and incurred but not reported (IBNR) provisions.
Regulatory and economic capital calculation	• primary credit risk measures – PD, EAD and LGD are the most important inputs.	• primary credit risk measures – PD, EAD and LGD are the most important inputs.
Reporting to senior management and the Board	• portfolio reports discussed at business and deployed risk committee meetings; and • quarterly portfolio reports submitted to Credit risk management and RCC committees.	• portfolio reports discussed at business and deployed risk committee meetings; and • quarterly portfolio reports submitted to Credit risk management and RCC committees.

Credit risk portfolio

Credit strategy is managed as part of the broader balance sheet management process and is aligned with the Group's view of trends in the wider economy. The current origination strategies are resulting in improving credit quality across all retail portfolios (as evidenced in the vintage analyses for the large retail portfolios on page 52).

The advances portfolio grew by 13% during the period under review. Growth in investment banking and commercial loans to the property and agriculture sectors underpinned the corporate advances increase. Retail advances benefited from strong growth in the VAF portfolio. Unsecured lending growth is similar to that of the previous December, however, credit extension review actions are continuously applied. Growth in the Africa book is consistent.

The level of NPLs has been trending downwards since the peak in June 2009. Facilitated by the favourable credit environment, retail defaults have continued to decline and retail NPLs as a percentage of advances also continued to decline. Increases in some unsecured portfolios have materialised, as expected. Overall, the corporate portfolios experienced a slight increase in NPLs as a result of the investment banking book.

Retail credit portfolios

Vehicle and asset finance growth was particularly robust for the period under review. Residential mortgages growth remains flat, the focus on improving the risk profile. Impairments in this portfolio declined noticeably as a result. The growth in the unsecured lending portfolios was within the defined credit risk appetite.

The Group's strategies to reduce NPLs continued to yield favourable results. The reduction in NPLs was driven by the slower inflow into NPLs in HomeLoans. Increased NPLs in most of the unsecured portfolios is in line with expectations and risk appetite, and has been appropriately priced for.

The higher impairment charge in the retail secured portfolios was due to increased impairments in VAF. Impairments have also increased in the unsecured portfolios (except Card), in line with expectations.

Corporate credit portfolios

The RMB core advances book grew due to investment banking related lending, particularly in mining, renewable energy and pharmaceuticals, while the FNB Commercial portfolio achieved growth mainly attributed to the leverage finance, property term loan and agriculture portfolios.

NPLs in the Corporate portfolio increased modestly over the prior period, reflecting a reduction in NPLs in the WesBank Corporate portfolio. In contrast, RMB NPLs increased as a result of new impaired loans. Impairment charges have remained stable over the period under review.

Credit assets

The following table provides a breakdown of the Group's credit assets by segment, including off-balance sheet exposures.

Credit assets by type and segment

R million	**December 2012**	December 2011	June 2012
Cash and short-term funds	**44 631**	30 213	33 587
– Balances with central banks	**16 453**	14 835	15 434
– Money at call and short notice	**28 178**	15 378	18 153
Gross advances	**572 236**	506 165	533 347
– FNB*	**257 076**	236 124	245 994
-FNB Retail	**188 982**	178 386	184 614
-FNB Commercial	**39 300**	32 617	35 960
-FNB Africa	**28 794**	25 121	25 420
– WesBank	**129 941**	110 713	119 389
– RMB Investment Banking*	**177 350**	145 447	160 217
– RMB Corporate Banking*	**3 512**	3 655	2 669
– Other	**4 357**	10 226	5 078
Derivatives	**56 502**	57 721	52 913
Debt investment securities (excluding non-recourse investments)	**81 168**	88 749	82 020
Accounts receivable	**6 400**	7 894	6 007
Reinsurance assets	**846**	855	898
Credit risk not recognised in the balance sheet	**108 639**	97 495	104 158
– Guarantees	**22 363**	21 747	22 741
– Acceptances	**285**	267	293
– Letters of credit	**8 688**	7 020	7 886
– Irrevocable commitments	**73 059**	65 180	69 348
– Credit derivatives	**4 244**	3 281	3 890
Total	**870 422**	789 092	812 930

* *The comparative information for certain portfolios have been restated to reflect the current segmentation of the business.*

Credit quality

Advances are considered past due in the following circumstances:

- loans with a specific expiry date (e.g. term loans) and consumer loans repayable by regular instalments (for example mortgage loans and personal loans) are treated as overdue where one full instalment is in arrears for one day or more and remains unpaid as at the reporting date; or
- loans payable on demand (e.g. overdrafts) are treated as overdue where a demand for repayment was served on the borrower but repayment has not been made in accordance with the stipulated requirements.

In these instances, the full outstanding amount is considered overdue even if part is not yet due.

A past due analysis is performed for advances with specific expiry or instalment repayment dates. The analysis is not applicable to overdraft products or products where no specific due date is determined. The level of risk on these types of products is assessed and reported with reference to the counterparty ratings of the exposures.

The following tables provide the age analyses of loans and advances for the Group.

Age analysis of advances

R million	December 2012					
			Past due but not impaired			
	Neither past due nor impaired	Re-negotiated but current	One instalment past due	Two instalments past due	Impaired	Total
- FNB Retail	176 202	294	2 072	1 135	9 279	188 982
- FNB Commercial	37 559	1	36	19	1 685	39 300
- FNB Africa	26 605	–	1 379	344	466	28 794
FNB	240 366	295	3 487	1 498	11 430	257 076
WesBank	121 702	–	3 122	1 081	4 036	129 941
RMB Investment Banking*	175 851	–	51	79	1 369	177 350
RMB Corporate Banking*	3 504	–	–	–	8	3 512
Other	4 357	–	–	–	–	4 357
Total	**545 780**	**295**	**6 660**	**2 658**	**16 843**	**572 236**

* *Impaired advances for RMB are net of cumulative credit fair value adjustments on the non-performing book.*

R million	December 2011					
			Past due but not impaired**			
	Neither past due nor impaired	Renegotiated but current	One full instalment past due	Two full instalments past due	Impaired	Total
- FNB Retail	159 434	215	7 092	1 364	10 281	178 386
- FNB Commercial	30 731	–	193	50	1 643	32 617
- FNB Africa	23 725	9	907	98	382	25 121
FNB*	213 890	224	8 192	1 512	12 306	236 124
WesBank	102 873	–	3 634	84	4 122	110 713
RMB Investment Banking*	144 174	–	59	73	1 141	145 447
RMB Corporate Banking*	3 640	–	–	–	15	3 655
Other	10 226	–	–	–	–	10 226
Total	474 803	224	11 885	1 669	17 584	506 165

* *Certain portfolios have been restated to reflect the current segmentation of the business. Impaired advances for RMB are net of cumulative credit fair value adjustments on the non-performing book.*
** *The past due but not impaired ageing analysis has changed from a day count to an instalment count classification in line with the impairment methodology.*

R million	June 2012					
			Past due but not impaired			
	Neither past due nor impaired	Renegotiated but current	One full instalment past due	Two full instalments past due	Impaired	Total
- FNB Retail	170 475	288	2 604	1 307	9 940	184 614
- FNB Commercial	34 240	–	38	17	1 665	35 960
- FNB Africa	24 467	45	259	174	475	25 420
FNB*	229 182	333	2 901	1 498	12 080	245 994
WesBank	111 680	–	2 612	956	4 141	119 389
RMB Investment Banking*	158 400	–	147	17	1 653	160 217
RMB Corporate Banking*	2 660	–	–	–	9	2 669
Other	5 078	–	–	–	–	5 078
Total	507 000	333	5 660	2 471	17 883	533 347

* *Certain portfolios have been restated to reflect the current segmentation of the business. Impaired advances for RMB are net of cumulative credit fair value adjustments on the non-performing book.*

Renegotiated advances

Financial assets that would otherwise be past due or impaired that have been renegotiated, are separately classified as neither past due nor impaired assets.

Renegotiated advances are advances where, due to deterioration in the counterparty's financial condition, the Bank granted a concession where the original terms and conditions of the facility were amended and the counterparty is within the new terms of the advance.

Advances are only classified as renegotiated if the terms of the renegotiated contract have not yet expired and remain classified as such until the terms of the renegotiated contract expire. Where the advances are reclassified as neither past due nor impaired the adherence to the new terms and conditions is closely monitored. Renegotiated advances exclude advances which are extended or renewed as part of the ordinary course of business on similar terms and conditions as the original advances.

Non-performing advances cannot be reclassified as renegotiated unless the arrears balance has been repaid. Renegotiated but current financial assets are considered as part of the collective evaluation of impairment where financial assets are grouped on the basis of similar credit risk characteristics.

As part of the risk management and recoveries approach, the Group enters into arrangements with clients where concessions are made on payment terms (for example, a reduction in payments for a specified period, changes in the payment profile or debt counselling payment plans). There are formally defined eligibility criteria appropriate for individual products to determine when clients are eligible for such arrangements. These accounts are monitored in a separate portfolio in each product segment and the performance is tracked for management and impairment purposes. For retail accounts classified as NPLs however, these cannot be reclassified to performing until all arrears have been paid up as per the Group's policy.

Past due but not impaired

The classification of advances as past due but not impaired follows the standards set out in applicable accounting policies. Advances past due but not impaired in the tables above include accounts in arrears by one or two full repayments. For the six months ended 31 December 2012 exposures to technical and partial arrears of R5.2 billion (June 2012: R5.4 billion and December 2011: R3.5 billion) were classified as neither past due nor impaired in accordance with FirstRand impairment methodology, primarily driven by retail exposures.

Policy for impairment of financial assets

General

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount.

Assets carried at amortised cost

The Group assesses at each reporting date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event(s) has an adverse impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following events:

- significant difficulty of the issuer or debtor;
- a breach of contract, such as a default or delinquency in payments;
- it becomes probable that the issuer or debtor will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties; or
- observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be allocated to the individual financial assets in the Group, including:
  - adverse changes in the payment status of issuers or debtors in the Group; or
  - national or local economic conditions that correlate with defaults on the assets in the Group.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and a collective assessment for impairment is performed. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the financial asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit and loss. If a financial asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is elected.

For the purposes of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics (i.e. on the basis of FirstRand's grading process that considers asset type, industry, geographical location, collateral type, past due status and other relevant factors). Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated.

Future cash flows of a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently.

Estimates of changes in future cash flows for groups of assets reflect and are directionally consistent with changes in related observable data from period to period (for example, changes in unemployment rates, property prices, payment status or other factors indicative of changes in the probability of losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are regularly reviewed to reduce any differences between loss estimates and actual loss experience.

When a loan is uncollectible, it is written off against the related allowance account. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairments in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively related to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss is reversed by adjusting the allowance account. The amount of the reversal is recognised in profit or loss.

Analysis of movement in impairment of advances

R million	**December 2012**	December 2011	June 2012
Opening balance	**5 522**	5 812	5 812
Reclassifications and transfers	**35**	(46)	(31)
Acquisitions	**(3)**	17	35
Exchange rate difference	**7**	13	12
Unwinding and discounted present value on NPLs	**(105)**	(71)	(131)
Bad debts written off	**(2 439)**	(2 501)	(5 454)
Net new impairments created	**2 519**	2 193	5 279
Closing balance – specific impairments	**5 536**	5 417	5 522
Closing balance – portfolio impairments	**3 662**	2 490	3 318
Total impairments	**9 198**	7 907	8 840

NPLs and impaired advances

Adequacy of impairments is assessed through the ongoing review of the quality of the credit exposures. Although credit management and workout processes are similar for amortised cost advances and fair value advances, impairments for these differ.

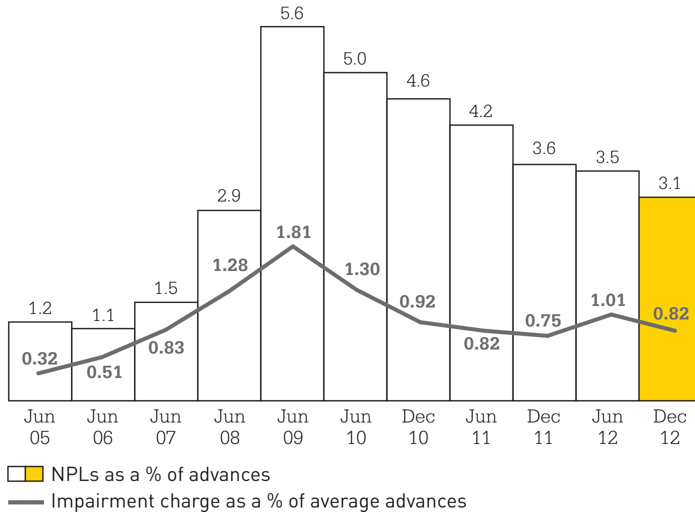
For amortised cost advances, impairments are recognised through the creation of an impairment reserve and an impairment charge in the income statement. For fair value advances, the credit valuation adjustment is charged to the income statement through trading income and recognised as a change to the carrying value of the asset.

Specific impairments are created for non-performing advances where there is objective evidence that an incurred loss event will have an adverse impact on the estimated future cash flows from the asset. Potential recoveries from guarantees and collateral are incorporated into the calculation of the impairment figures.

All assets not individually impaired, as described, are included in portfolios with similar credit characteristics (homogeneous pools) and collectively assessed. Portfolio impairments are created with reference to these performing advances based on historical patterns of losses in each part of the performing book. Points of consideration for this analysis are the level of arrears, arrears roll rates, PIT PDs, LGDs and the economic environment. Loans considered uncollectable are written off against the reserve for loan impairments. Subsequent recoveries against these facilities decrease the credit impairment charge in the income statement in the year of recovery.

The graph shows the history of the credit losses reflected by the impairment charge and NPLs percentages.

NPLs and impairment history
(%)



Impairment charges are reflected before insurance proceeds where applicable.

The following tables provide an analysis of NPLs by class, sector and geographical area respectively.

NPLs by class

	NPLs as a % of advances			NPLs		
%/R million	**December 2012**	December 2011	June 2012	**December 2012**	December 2011	June 2012
FNB*	**4.45**	5.21	4.91	**11 430**	12 306	12 080
FNB Retail	**4.91**	5.76	5.38	**9 279**	10 281	9 940
FNB Commercial	**4.29**	5.04	4.63	**1 685**	1 643	1 665
FNB Africa	**1.62**	1.52	1.87	**466**	382	475
WesBank	**3.11**	3.72	3.47	**4 036**	4 122	4 141
RMB Investment Banking*	**1.31**	1.34	1.52	**2 323**	1 945	2 436
RMB Corporate Banking*	**0.23**	0.41	0.34	**8**	15	9
Total NPLs	**3.11**	3.63	3.50	**17 797**	18 388	18 666

* *The comparative information for certain portfolios has been restated to reflect the current segmentation of the business.*

NPLs by sector

	NPLs as a % of advances			NPLs		
%/R million	**December 2012**	December 2011	June 2012	**December 2012**	December 2011	June 2012
Agriculture	**3.3**	4.36	3.45	**568**	533	571
Banks and financial services	**0.51**	0.09	0.50	**401**	56	371
Building and property development	**8.12**	9.60	8.01	**2 460**	2 308	2 342
Government, Land Bank and public authorities	**0.30**	0.27	0.25	**46**	42	40
Individuals	**4.16**	4.46	4.59	**12 591**	12 747	13 089
Manufacturing and commerce	**1.54**	1.37	1.79	**969**	585	1 003
Mining	**0.50**	0.62	2.59	**91**	78	422
Transport and communication	**1.32**	1.61	1.65	**220**	240	246
Other	**1.51**	5.34	2.29	**451**	1 799	582
Total NPLs	**3.11**	3.63	3.50	**17 797**	18 388	18 666

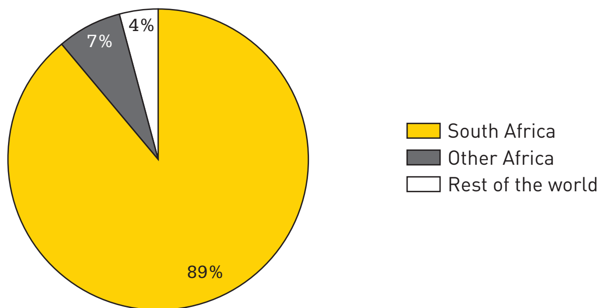
NPLs by geographical area

%/R million	NPLs as a % of advances			NPLs		
	December 2012	December 2011	June 2012	**December 2012**	December 2011	June 2012
South Africa	**3.27**	3.88	3.64	**16 744**	17 562	17 386
Other Africa	**1.23**	1.36	1.63	**471**	418	509
UK	**0.32**	0.11	0.43	**44**	13	68
North America	**–**	–	77.11	**–**	–	219
South America	**89.58**	>100	71.00	**301**	342	290
Australasia	**6.23**	0.85	3.54	**237**	53	194
Total NPLs	**3.11**	3.63	3.50	**17 797**	18 388	18 666

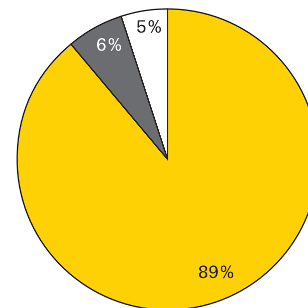
Geographic and industry concentration risk

Geographically, most of the Group's exposures are originated in South Africa. The following charts provide the geographical and industry split of gross advances after deduction of interest in suspense.

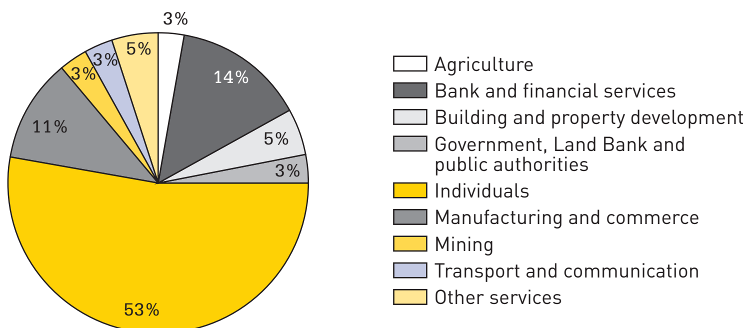
Geographical split by exposure 2012



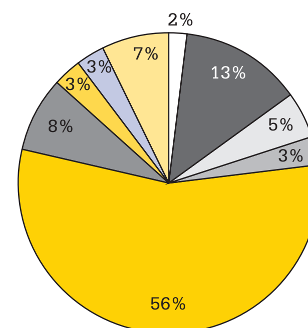
Geographical split by exposure 2011



Industry split by exposure 2012



Industry split by exposure 2011



The Group seeks to establish a balanced portfolio profile and closely monitors credit concentrations. The following tables provide a breakdown of credit exposure across geographies.

Concentration of significant credit exposure

	December 2012							
R million	**South Africa**	**Other Africa**	**United Kingdom**	**Other Europe**	**North America**	**South America**	**Other#**	**Total**
Advances	**511 974**	**38 189**	**13 936**	**3 793**	**201**	**336**	**3 807**	**572 236**
Derivatives	**34 909**	**99**	**16 645**	**3 553**	**1 230**	**–**	**66**	**56 502**
Debt investment securities*	**68 758**	**6 023**	**481**	**–**	**5 315**	**–**	**591**	**81 168**
Guarantees, acceptances and letters of credit**	**27 159**	**3 469**	**–**	**106**	**–**	**–**	**602**	**31 336**
Irrevocable commitments**	**65 261**	**6 708**	**454**	**184**	**168**	**23**	**261**	**73 059**

* *Excludes non-recourse investments.*
** *Significant off-balance sheet exposures.*
# *Other includes Australasia and Asia.*

	December 2011							
R million	South Africa	Other Africa	United Kingdom	Other Europe	North America	South America	Other#	Total
Advances	452 851	30 696	12 243	3 719	290	112	6 254	506 165
Derivatives	36 155	73	10 400	9 231	1 675	–	187	57 721
Debt investment securities*	79 008	4 790	991	2 149	814	–	997	88 749
Guarantees, acceptances and letters of credit**	24 231	3 740	8	839	–	–	216	29 034
Irrevocable commitments**	58 376	4 993	465	1 083	53	–	210	65 180

* *Excludes non-recourse investments.*
** *Significant off-balance sheet exposures.*
# *Other includes Australasia and Asia.*

	June 2012							
R million	South Africa	Other Africa	United Kingdom	Other Europe	North America	South America	Other#	Total
Advances	478 204	31 271	15 747	2 266	284	102	5 473	533 347
Derivatives	33 808	88	11 925	5 568	1 424	–	100	52 913
Debt investment securities*	71 152	5 456	1 525	–	1 636	–	2 251	82 020
Guarantees, acceptances and letters of credit**	23 912	5 674	–	529	7	2	796	30 920
Irrevocable commitments**	63 073	4 941	814	148	66	–	306	69 348

* *Excludes non-recourse investments.*
** *Significant off-balance sheet exposures.*
# *Other includes Australasia and Asia.*

Average advances per major risk type

R million	**December 2012**	December 2011	June 2012
Retail credit	**272 261**	247 175	259 574
Africa	**26 631**	22 861	24 722
Wholesale credit	**157 473**	136 778	146 197
Commercial credit	**36 264**	30 660	33 299

Basel disclosure

Credit rating systems and processes used for Basel

The Group uses the AIRB approach for the exposures of the Bank and the standardised approach for all other legal entities and offshore branches in the Group for regulatory capital purposes. Due to the relatively smaller size of the subsidiaries and the scarcity of relevant data, the Group plans to continue using the standardised approach for the foreseeable future for these portfolios.

The following table provides a breakdown of credit exposure by type, segment and Basel II approach. The figures are based on IFRS accounting standards and differ from the exposure figures used for regulatory capital calculations, which reflect the recognition of permissible adjustments such as the netting of certain exposures.

Credit exposure by type, segment and Basel II approach

		AIRB	Standardised approach	
R million	**December 2012**	FirstRand Bank (SA)	Regulated bank entities within FNB Africa	Other subsidiaries
Cash and short-term funds	**44 631**	37 506	4 433	2 692
– Balances with central banks	**16 453**	13 439	2 994	20
– Money at call and short notice	**28 178**	24 067	1 439	2 672
Gross advances	**572 236**	518 990	28 794	24 452
– FNB	**257 076**	228 170	28 794	112
– FNB Retail	**188 982**	188 982	–	–
– FNB Commercial	**39 300**	39 188	–	112
– FNB Africa	**28 794**	–	28 794	–
– WesBank	**129 941**	115 676	–	14 265
– RMB Investment Banking	**177 350**	167 275	–	10 075
– RMB Corporate Banking	**3 512**	3 512	–	–
– Other	**4 357**	4 357	–	–
Derivatives	**56 502**	55 776	26	700
Debt investment securities (excluding non-recourse investments)	**81 168**	70 960	6 039	4 169
Accounts receivable	**6 400**	3 260	685	2 455
Loans due by holding company and fellow subsidiaires	**–**	21 033	5 698	(26 731)
Reinsurance assets	**846**	–	–	846
Credit risk not recognised on the balance sheet	**108 639**	98 956	7 993	1 690
– Guarantees	**22 363**	19 580	2 270	513
– Acceptances	**285**	285	–	–
– Letters of credit	**8 688**	8 249	434	5
– Irrevocable commitments	**73 059**	66 598	5 289	1 172
– Credit derivatives	**4 244**	4 244	–	–
Total	**870 422**	806 481	53 668	10 273

For portfolios using the standardised approach, rating scales from Fitch Ratings, Moody's and Standard & Poor's are used. External ratings are not available for all jurisdictions and for certain parts of the portfolio other than corporate, bank and sovereign counterparties. Where applicable, the Group uses its internally developed mapping between FR grade and rating agency grades.

The following table provides the breakdown of exposures rated through the standardised approach in FNB Africa by risk bucket after taking risk mitigation into account.

FNB Africa exposures by risk bucket

Risk bucket	Exposure R million
0%	–
10%	–
20%	5 289
35%	10 649
50%	3 617
75%	3 981
100%	29 966
Specific impairments	166
Total	53 668

PD, EAD and LGD profiles

A summary of credit risk parameters as reported for regulatory capital purposes is shown below for each significant AIRB asset class. The parameters reflect through-the-cycle PDs and downturn LGDs. The Bank uses EAD-weighted PDs based on the FirstRand master-rating scale (see page 30) which are then mapped to Basel rating buckets (1 – 25) for regulatory reporting purposes.

The tables provide a summary of the EAD distribution by prescribed counterparty risk bands (Basel risk buckets). The EAD-weighted downturn LGD and the EAD-weighted PD for the performing and total book are also shown as well as comparatives for the prior year.

Year-on-year trends will be impacted by the risk migration in the existing book (reflecting changes in the economic environment), quality of new business originated and any model recalibrations implemented during the course of the period.

The performance of the credit portfolio was in line with that of the industry over the period under review.

The risk profile reflects the revised credit origination strategy that selectively targets segments providing an appropriate risk/return profile in the current economic environment.

The following tables include the EAD% distribution per Basel risk bucket for the different asset classes.

Risk profile per asset class: EAD% distribution per Basel risk bucket

	FRB*			Corporate**		
	EAD%			EAD%		
Basel PD risk buckets	**Dec 2012**	June 2012	Dec 2011	**Dec 2012**	June 2012	Dec 2011
1 – 5	**8.3**	9.1	13.8	**0.5**	0.6	0.5
6 – 10	**15.7**	15.2	14.9	**33.0**	36.4	37.1
11 – 15	**37.1**	39.5	34.8	**53.6**	51.2	46.1
16 – 20	**32.0**	28.3	28.4	**11.4**	9.3	13.7
21 – 25	**4.4**	5.2	5.1	**1.3**	2.0	2.0
NPLs	**2.4**	2.6	2.7	**0.2**	0.5	0.6

** The movement in FRB from December 2011 to December 2012 are explained in each separate asset class.*
*** The distributions of corporate, sovereign, specialised lending and banks indicate no significant movement from December 2011 to December 2012.*

	SME corporate*			SME retail**		
	EAD%			EAD%		
Basel PD risk buckets	**Dec 2012**	June 2012	Dec 2011	**Dec 2012**	June 2012	Dec 2011
1 – 5	**0.1**	–	–	**–**	–	–
6 – 10	**0.8**	–	–	**15.0**	12.4	3.1
11 – 15	**53.5**	54.0	31.6	**24.6**	27.9	41.9
16 – 20	**40.0**	41.2	58.9	**53.3**	51.4	46.6
21 – 25	**3.2**	3.4	7.9	**3.9**	4.6	4.0
NPLs	**2.4**	1.4	1.6	**3.2**	3.7	4.4

** SME corporate :The main contributor to the movement from December 2011 to December 2012 is the implementation of the updated PD model, which now includes more recent benign default experiences and represents a full economic cycle resulting in a reduction in PDs.*
*** SME retail: The main contributor to the movement is the implementation of the updated PD model, which now includes more recent benign default experiences and represents a full economic cycle resulting in a reduction in PDs.*
 # The distributions of retail mortgages and retail revolving indicate no significant movement from December 2011 to December 2012.
† Other retail: The movement in the other retail segment is due to signficant growth in the unsecured loans portfolio and the implementation of updated PD models.

Distribution of PD%, LGD% and EL/EAD per asset class

	December 2012					
%	FRB	Corporate	Sovereign	Specialised lending	Banks	SMEs corporate
Average performing PD	2.56	1.12	0.18	2.03	0.28	2.62
Average performing LGD	28.31	35.10	24.40	22.09	32.24	29.31
Performing EL/EAD	0.85	0.46	0.05	0.52	0.09	0.72
Average total book PD	4.92	1.28	0.34	8.01	0.28	4.92
Average total book LGD	28.59	35.16	24.46	23.28	32.24	29.99
Total book EL/EAD	1.71	0.58	0.15	2.95	0.09	2.04

Sovereign**			Specialised lending**			Banks**		
EAD%			EAD%			EAD%		
Dec 2012	June 2012	Dec 2011	**Dec 2012**	June 2012	Dec 2011	**Dec 2012**	June 2012	Dec 2011
78.8	78.5	87.0	**0.2**	0.2	0.4	**4.3**	7.8	12.9
15.5	16.9	9.0	**17.7**	19.7	22.3	**71.0**	73.3	64.9
4.1	3.0	3.0	**42.8**	40.2	35.3	**19.2**	15.5	16.6
0.8	1.2	–	**32.5**	31.8	32.9	**0.5**	0.6	0.5
0.3	0.3	–	**0.8**	1.0	1.1	**0.7**	0.1	–
0.4	–	–	**6.1**	7.1	7.9	**–**	–	–

Retail mortgages#			Retail revolving#			Other retail†		
EAD%			EAD%			EAD%		
Dec 2012	June 2012	Dec 2011	**Dec 2012**	June 2012	Dec 2011	**Dec 2012**	June 2012	Dec 2011
–	–	–	**–**	–	–	**–**	–	0.1
0.5	–	–	**22.9**	22.8	25.4	**–**	1.7	2.0
55.3	55.9	54.1	**32.1**	32.0	33.4	**7.1**	21.9	21.9
35.9	34.6	35.8	**34.0**	34.2	31.3	**75.8**	55.5	55.2
4.7	5.3	5.7	**9.0**	8.9	7.8	**13.0**	16.8	16.5
3.6	4.1	4.5	**2.0**	2.1	2.1	**4.0**	4.1	4.3

December 2012			
SMEs retail	Retail mortgages	Retail revolving	Other retail
2.70	2.98	3.79	6.24
31.23	14.18	65.07	33.34
0.81	0.48	2.47	2.67
6.26	6.46	5.73	10.03
31.75	14.51	65.26	34.22
1.99	1.29	3.78	4.45

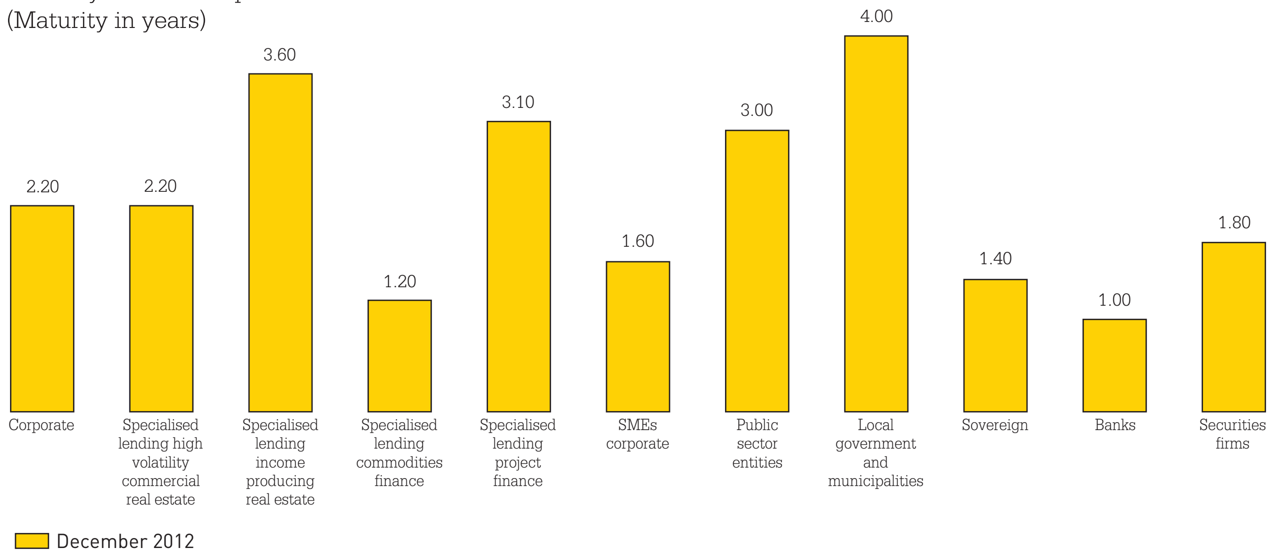
Maturity breakdown

Maturity is defined as the average time at which a bank will receive its contractual payments (cash flows), calculated for each account or exposure weighted by the size of each of the cash flows.

Maturity is used as an input in the AIRB regulatory capital calculation for wholesale portfolios. These are aggregated on an asset class basis for review and reporting purposes. The longer the maturity of a deal, the greater the uncertainty, and all else being equal, the larger the regulatory capital requirement.

Maturity breakdown of AIRB asset classes within the wholesale credit portfolio is disclosed in the chart below.

Maturity breakdown per wholesale AIRB asset class
(Maturity in years)



Actual versus expected loss analysis

To provide a meaningful assessment of the effectiveness of internal ratings-based models, expected loss is compared against actual losses during the calendar year. This is performed for all significant AIRB asset classes.

Expected loss here refers to regulatory expected loss. This provides a one-year forward looking view, based on information available at the beginning of the year (i.e. 31 December 2011).

Risk parameters include:

- PDs, which are calibrated to long-run default experience to avoid regulatory models being skewed to a specific part of the credit cycle;
- LGDs, which are calibrated to select downturn periods to reflect depressed asset prices during economic downturns; and
- EADs.

Actual losses during the period consist of the level of specific impairments at the start of the period (31 December 2011) and the net specific impairment charge recorded through the income statement for the period as determined by IFRS. It excludes the effect of post-write off recoveries which would reduce the actual loss number. The calculation is based on the assumption that the specific provisions raised are a fair estimate of what final losses on defaulted exposures would be, although the length of the workout period creates uncertainty in this assumption.

The measure of actual losses includes specific impairments raised for exposures which defaulted during the year, but which did not exist at 31 December 2011. These exposures are not reflected in the expected loss value described below.

The table overleaf provides the comparison of actual loss to regulatory expected loss for each significant AIRB asset class of the Bank. PDs used for regulatory capital purposes are based on long run experience and are expected to underestimate actual defaults at the top of the credit cycle and overestimate actual defaults at the bottom of the credit cycle, under normal circumstances.

It should also be noted that the regulatory expected loss shown is based on the expected loss derived from the regulatory capital models that were applied as at 31 December 2011.

This comparison is supplemented with more detailed analyses on the following page, comparing actual and expected outcomes for each risk parameter (PD, LGD and EAD) over the period under review.

Expected values are based on regulatory capital models applied as at 31 December 2011. For PDs, this is applied to the total performing book as at 31 December 2011. For LGDs and EADs, it is applied to all facilities that defaulted over the subsequent 12 months.

Actual values are based on actual outcomes over the year January 2012 to December 2012. Due to the length of the workout period, there is uncertainty in the measure provided for actual LGDs as facilities that default during the year would only have had between one and twelve months to recover to date – depending on when the default event occurred.

The EAD-estimated to actual ratio is derived as the ratio of expected nominal exposure at default (for all accounts that defaulted during the 2012 calendar year) to the actual nominal exposure at default for the same accounts. A ratio above 100% indicates an overestimation.

Actual versus expected loss per portfolio segment for the Bank

R million	For the year ended*			
	December 2012		December 2011	
	Expected loss	**Actual loss**	Expected loss*	Actual loss*
Corporate (corporate, banks and sovereigns)**	**1 488**	**324**	1 146	23
SMEs (SME corporate and SME retail)#	**1 345**	**1 116**	1 374	1 079
Residential mortgages	**2 628**	**2 880**	2 871	3 322
Qualifying revolving retail#	**1 021**	**961**	939	907
Other retail†	**1 177**	**2 153**	760	1 168
WesBank†	**3 059**	**3 431**	3 163	3 522
Total	**10 718**	**10 865**	10 253	10 021

* *The composition used above differs slightly from that used in the remainder of this section due to impairment charges at business unit level as opposed to AIRB asset class level. The expected and actual losses for the year ended December 2011 were restated to reflect the correct expected and actual losses as at 1 January 2011 and 31 December 2011 respectively.*

** *The expected losses for the corporate portfolio are higher than the actual losses due to it being a low default portfolio. As a result, the models use conservative data inputs.*

SMEs and qualifying revolving retail actual losses are below expected losses which is expected, given the current point in the economic cycle and the fact that the expected loss parameters are based on long run and downturn conditions.

† *The other retail and WesBank portfolios have experienced accelerated growth during the year ended December 2012, although this is not reflected in the expected losses which are based on accounts that are in-force at the start of the period. However, these new accounts will contribute to the actual losses as a result of additional provisions that will be raised. As a result, the actual losses are expected to exceed the expected losses.*

R million	For the year ended*			
	June 2012		June 2011	
	Expected loss*	Actual loss	Expected loss	Actual loss
Corporate (corporate, banks and sovereigns)	1 499	313	847	16
SMEs (SME corporate and SME retail)	1 507	1 094	1 354	1 189
Residential mortgages	2 793	2 961	3 102	3 773
Qualifying revolving retail	1 179	808	1 168	1 122
Other retail	904	1 990	790	1 013
WesBank	3 160	3 371	3 142	3 663
Total	11 042	10 537	10 403	10 776

* *The composition used above differs slightly from that used in the remainder of this section, due to impairment charges reflected at business unit level as opposed to AIRB asset class level. The expected losses for the year ended June 2012 were restated to reflect the correct expected losses as at 1 July 2011.*

Risk parameters used to determine regulatory expected loss for the Bank

	December 2012				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate, banks and sovereigns*	0.62	0.08	35.21	11.40	111.41
Specialised lending – property finance	2.11	1.61	31.13	22.08	105.43
SMEs – corporate	4.54	1.95	26.92	24.23	126.31
SMEs – retail	3.11	3.01	28.82	22.88	108.36
Residential mortgages	3.29	2.45	15.54	10.74	104.16
Qualifying revolving retail	3.38	2.67	67.17	62.03	100.82
Other retail	6.26	5.81	47.06	45.37	105.84
Total	2.57	1.86	32.76	28.69	106.20

* *Corporate, banks and sovereigns are shown as one asset class to align with the respective asset class in the actual versus expected loss table.*

	December 2011				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate, banks and sovereigns*	0.73	0.18	25.37	16.15	103.20
Specialised lending – property finance	1.76	1.80	34.95	39.19	96.70
SMEs – corporate	4.28	2.42	33.59	22.93	136.04
SMEs – retail	3.12	3.38	36.16	27.68	118.85
Residential mortgages	3.20	3.11	15.92	10.78	103.98
Qualifying revolving retail	3.02	2.96	71.23	66.49	102.76
Other retail	6.13	5.15	33.36	32.24	104.73
Total	2.51	2.03	26.89	22.38	106.57

* *Corporate, banks and sovereigns are shown as one asset class to align with the respective asset class in the actual versus expected loss table.*

	June 2012				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate, banks and sovereigns*	0.73	0.11	37.33	10.86	194.54
Specialised lending – property finance	2.70	2.31	21.82	28.84	116.04
SMEs – corporate	4.85	2.33	26.97	28.98	144.33
SMEs – retail	3.21	2.96	28.83	20.87	113.27
Residential mortgages	3.57	2.92	15.30	11.53	104.43
Qualifying revolving retail	3.02	2.46	72.37	68.53	98.94
Other retail	5.99	5.07	45.99	43.66	102.91
Total	2.72	1.96	30.55	27.52	107.98

* *Corporate, banks and sovereigns are shown as one asset class to align with the respective asset class in the actual versus expected loss table.*

The analysis is based on regulatory capital models that were applied at 31 December 2011. PDs used for regulatory capital purposes are based on long run experience and are anticipated to underestimate actual defaults at the top of the credit cycle and overestimate actual defaults at the bottom of the credit cycle. Expected LGDs are anticipated to overestimate actual LGDs as expected LGDs are based on downturn experience. This explains the majority of the differences. Additional explanations are provided below.

The corporate, banks and sovereign regulatory capital models remain conservative as these are low default portfolios with actual default rates remaining lower than expected. Movements in expected LGDs from period-to-period are as a result of low defaults on the portfolio and varying degrees of collateral for defaulted counterparties in each period. Depending on the specific exposures in default, the numbers can vary substantially.

SMEs corporate asset class EAD models applied for regulatory capital at December 2011 overestimated EADs and reflect the model in use at the time. The updated model predicts EADs at a more appropriate level although still with a degree of conservative data inputs.

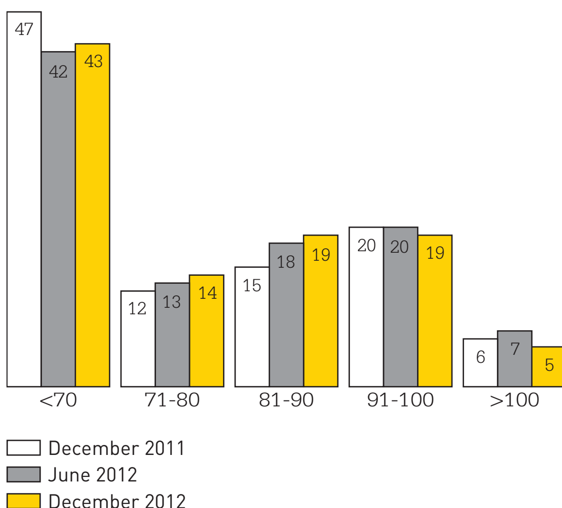
Selected risk analyses

This section provides further information on selected risk analyses of the credit portfolios.

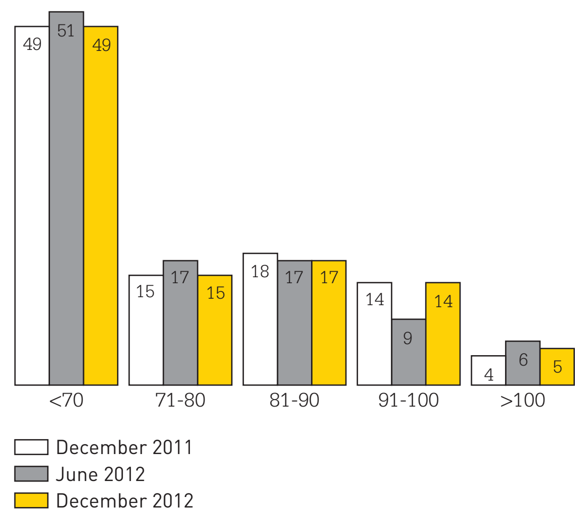
The graphs below provide the balance-to-value distributions and the ageing of the residential mortgages portfolios. The recent focus on the loan-to-value ratios for new business resulted in an improvement in the balance-to-original value although the broader strategy is to place more emphasis on the counterparty creditworthiness as opposed to only the underlying security. Pressures on property market values have, however, negatively impacted the balance-to-market value distribution.

The age distribution is reflective of the low growth in the residential mortgages portfolio over the three reporting periods.

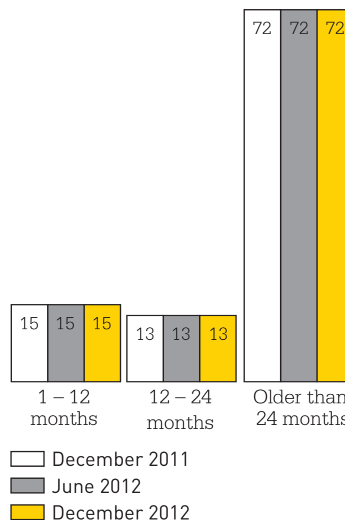
Residential mortgages balance-to-original value (%)



Residential mortgages balance-to-market value (%)

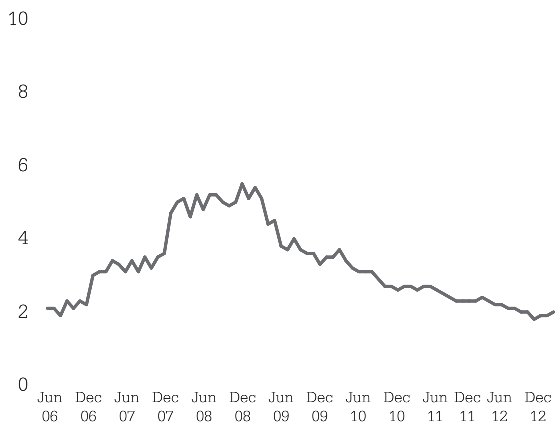


Residential mortgages age distribution (%)



The following graph shows the arrears in the FNB HomeLoans portfolio. It includes advances where more than one full payment is in arrears expressed as a percentage of the total advances balance.

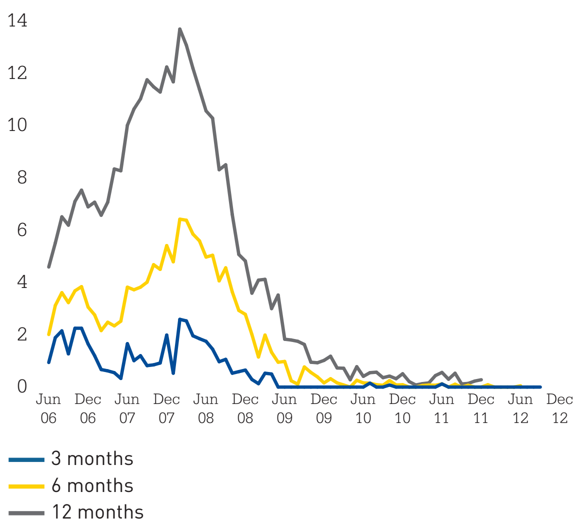
FNB HomeLoans arrears (%)



The following graphs provide the vintage analysis for FNB HomeLoans and WesBank retail. Vintage graphs provide the default experience three, six and twelve months after each origination date, indicating the impact of origination strategies and the macroeconomic environment.

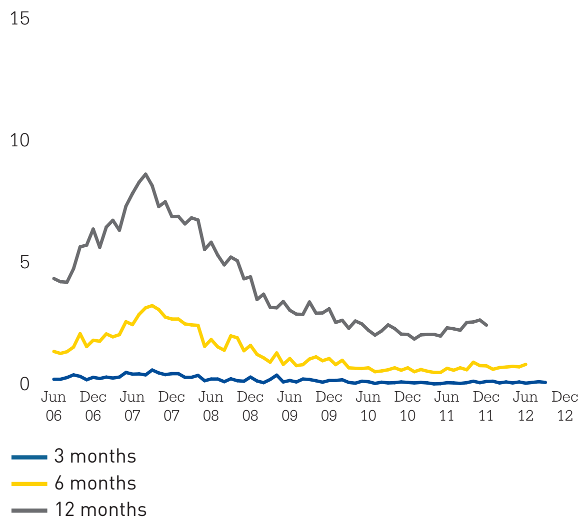
For FNB HomeLoans, the three, six and twelve month cumulative vintage analysis illustrates a marked improvement in the quality of business written since mid-2008 despite further deterioration in macro conditions in the succeeding period.

FNB HomeLoans vintage analysis (%)



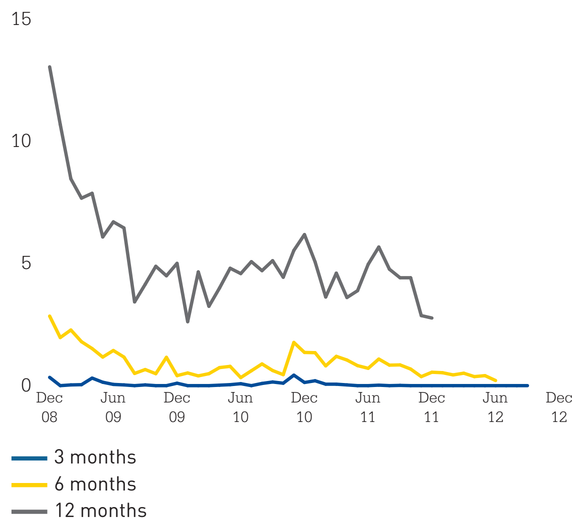
The more recent decreases in the default experience reflect the effect of credit origination strategies. This has resulted in an improved risk profile.

WesBank retail vintage analysis (%)



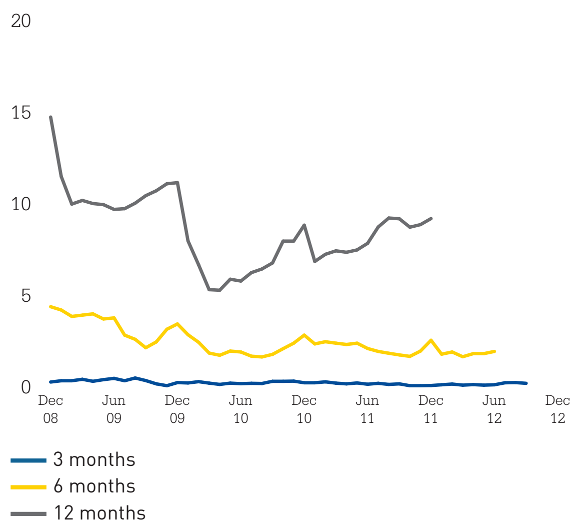
The WesBank retail six and twelve month cumulative vintage analysis continues to show a noticeable improvement in the quality of business written since mid-2007. This is due to improved customer profiles and enhanced collection strategies.

FNB Card vintage analysis (%)



The level of inflows into NPLs continues to decrease.

Unsecured vintage analysis (excluding FNB Card) (%)



The default experience of the FNB and WesBank unsecured portfolios is within risk appetite.

The increasing trend in the twelve-month vintage analysis above is expected to moderate given a more conservative credit origination strategy during the period.

Continued actions are undertaken to ensure these portfolios remain within risk appetite.

The Group's repossessed properties are shown below.

	Properties in possession			
	As at 31 December		% change	As at 30 June
	2012	2011		2012
Number of properties	**401**	935	(57)	594
Value (R million)	**62**	198	(69)	103

SECURITISATIONS AND CONDUITS

Introduction and objectives

Securitisation is the structured process whereby interests in loans and other receivables are packaged, underwritten and sold in the form of asset-backed securities.

Asset securitisations enable the Group to access funding markets at debt ratings higher than its overall corporate rating, which generally provides access to broader funding sources at more favourable rates. By removing the assets and supporting debt from the balance sheet, the Group is able to save some of the costs of on-balance sheet financing and manage potential asset-liability mismatches and credit concentrations.

The Group uses securitisation as a tool to achieve one or more of the following objectives:

- enhance the Group's liquidity position through the diversification of funding sources;
- match the cash flow profile of assets and liabilities;
- reduce balance sheet credit risk exposure;
- reduce capital requirements; and
- manage credit concentration risk.

Traditional and synthetic securitisations

The following tables show the traditional and synthetic securitisations currently in place, the rating distribution of any exposures retained and a breakdown of the various roles performed by the Group. Whilst national scale ratings have been used in this table, global scale equivalent ratings are used for internal risk management purposes.

Securitisation transactions for FirstRand

R million	Asset type	Year initiated	Expected close	Rating agency	Assets securitised
Traditional securitisations**					20 993
Nitro 4	Retail: Auto loans	2011	2016	Moody's	3 982
Ikhaya 1	Retail: Mortgages	2007	2011	Fitch	1 900
Ikhaya 2	Retail: Mortgages	2007	2012	Fitch	2 884
Turbo Finance 1	Retail: Auto loans	2011	2013	Moody's and Fitch	3 620
Turbo Finance 2	Retail: Auto loans	2012	2015	Moody's and Fitch	4 037
Turbo Finance 3	Retail: Auto loans	2012	2015	Moody's and Fitch	4 570
Synthetic securitisations**					20 000
Fresco 2	Corporate receivables	2007	2013	Fitch	20 000
Total					40 993

** Does not include cash reserves.*
*** Includes transactions that have been structured by the Group and therefore excludes third-party transactions.*

Rating distribution of retained and purchased securitisation exposures

R million	AAA(zaf)	AA(zaf)	AA-(zaf)	A+(zaf)	A(zaf)	BBB+(zaf)
Traditional						
At 31 December 2012	**1 073**	**–**	**–**	**81**	**–**	**–**
At 31 December 2011	1 952	–	–	81	–	59
At 30 June 2012	2 000	–	–	81	–	59
Synthetic						
At 31 December 2012	**–**	**–**	**12 840**	**–**	**–**	**–**
At 31 December 2011	–	–	17 840	–	–	–
At 30 June 2012		–	17 839	–	–	–
Third party						
At 31 December 2012	**503**	**–**	**–**	**–**	**–**	**–**
At 31 December 2011	625	–	–	–	51	–
At 30 June 2012	188	–	–	–	51	–

While national scale ratings have been used in this table, global-scale equivalent ratings are used for internal risk management purposes.
This table includes the rating distribution of transactions retained by FirstRand and those purchased from third parties.

	Assets outstanding*			Notes outstanding			Retained exposure		
	December 2012	December 2011	June 2012	**December 2012**	December 2011	June 2012	**December 2012**	December 2011	June 2012
	8 900	6 935	7 491	**9 925**	7 354	8 130	**2 368**	3 213	3 407
	1 966	3 227	2 573	**2 360**	3 687	3 007	**1 034**	1 824	1 366
	–	–	–	**–**	–	–	**–**	55	–
	–	1 498	–	**–**	1 439	–	**–**	159	–
	–	2 210	1 487	**–**	2 228	1 486	**–**	1 175	1 208
	2 798	–	3 431	**2 976**	–	3 637	**893**	–	833
	4 136	–	–	**4 589**	–	–	**441**	–	–
	15 000	20 000	20 000	**15 000**	20 000	20 000	**13 262**	18 263	18 262
	15 000	20 000	20 000	**15 000**	20 000	20 000	**13 262**	18 263	18 262
	23 900	26 935	27 491	**24 925**	27 354	28 130	**15 630**	21 476	21 669

	BBB(zaf)	BB(zaf)	B+(zaf)	Not rated	Total
	–	**–**	**–**	**1 214**	**2 368**
	–	–	–	1 121	3 213
	442	–	–	825	3 407
	–	**180**	**52**	**190**	**13 262**
	–	180	53	190	18 263
	–	180	53	190	18 262
	–	**–**	**–**	**–**	**503**
	–	–	–	–	676
	–	–	–	–	239

The Group's role in securitisation transactions

Transaction	Originator	Sponsor	Services	Investor	Liquidity provider	Credit enhance-ment provider	Swap counter-party
Fresco 2	✓	✓		✓		✓	
Nitro 4	✓	✓	✓	✓			✓
Turbo Finance 2	✓	✓	✓	✓			
Turbo Finance 3	✓	✓	✓	✓			

Third party securitisations

Transaction	Originator	Sponsor	Servicer	Investor	Liquidity provider	Credit enhance-ment provider	Swap provider
Homes Obligor Mortgage Enhanced Securities					✓		
Private Residential Mortgages 2					✓		
Superdrive Investments				✓			
Torque Securitisation					✓		

Resecuritisations

A resecuritisation exposure is a securitisation exposure in which the risk associated with an underlying pool of exposures is tranched and at least one of the underlying exposures is a securitisation exposure. Securitisation paper is on occasion acquired by the conduit structures and managed as part of the underlying portfolio. This makes up a minimal portion of the total portfolio (<1% at December 2012) and are accounted for as resecuritisation exposure for capital.

Oversight and credit risk mitigation

The Group monitors retained securitisation exposures in a number of ways:

- proposed securitisations follow a rigorous internal approval approach and are reviewed for approval by ALCCO, RCC committee and the Board;
- off-balance sheet transactions are discussed and approved at a bi-monthly meeting of the off-balance sheet forum;
- changes to retained exposures (ratings, redemptions, losses) reflect in the monthly BA 500 regulatory reporting; and
- transaction investor reports, alignment with special purpose vehicle (SPV) financial reporting and the impact of underlying asset performance are reviewed on the quarterly BA501 regulatory reporting.

The Group does not employ credit risk mitigation techniques to hedge credit risk on retained securitisation tranches. The Group determines the applicable capital requirements for retained exposures according to the Basel securitisation framework; further detail hereon is provided below.

Securitisation accounting policies

From an accounting perspective, traditional securitisations are treated as sales transactions. At inception, the assets are sold to a special purpose vehicle at carrying value and no gains or losses are recognised. For synthetic securitisations, the credit derivatives used in the transaction are recognised at fair value, with any fair value adjustments reported in profit or loss.

The securitisation entities are subsequently consolidated into FRIHL for financial reporting purposes. Retained traditional securitisation notes are accounted for as available-for-sale investment securities within the banking book.

The Group does not currently employ any form of warehousing prior to structuring a new securitisation.

Summary of securitisation activity

Maturity of Turbo Finance 1

Launched on 2 February 2012, Turbo Finance plc (Turbo Finance 1), represented the Group's first securitisation of offshore assets originated by its UK vehicle finance business, MotoNovo Finance. Strong asset performance together with good prepayment levels resulted in the full redemption of the investor held Class A tranche in September 2012. With the Group holding the remaining notes, the decision was taken to repurchase all the outstanding assets and thereby terminate the securitisation. The legal process to repurchase the outstanding assets was completed in early October 2012, with all notes fully redeemed on 22 October 2012.

Issuance of Turbo Finance 3

The introduction of the Bank of England's Funding for Liquidity Scheme (FLS) in July 2012, offered asset creators in the UK the opportunity to access cheaper funding for net new credit extension. The result of this was an expectation of a reduced supply of asset-backed securities (ABS) paper in the sterling market and, as a consequence, the spreads on primary issuance and secondary market trades tightened substantially. The Group saw this as a good opportunity to revisit the term market to lock in additional sterling funding at favourable rates.

In November 2012, the Group closed its third UK traditional auto loan securitisation, Turbo Finance 3 plc (Turbo Finance 3). Turbo Finance 3 is a cash securitisation of fixed rate auto loans extended to obligors by MotoNovo Finance, a division of the Bank (London branch). The note issuance of £332.7 million is rated by both Fitch and Moody's. The performance of the existing Turbo Finance transactions has helped to improve the rating assumptions used by the rating agencies, allowing for a reduction in the level of subordination required for the Aaa/AAA Class A note (18% compared to 28% for Turbo Finance 1). The following table provides further detail regarding the notes issued.

Turbo Finance 3 notes issued

Tranche	Rating (Moody's/ Fitch)	Amount (£ million)	Credit enhancement* (%)	Coupon
A	Aaa(sf)/ AAA(sf)	273.40	17.82	1mLibor + 60
B	A1(sf)/A(sf)	27.80	9.47	1mLibor + 140
C	NR/NR	26.20	1.59	7.00%
D	NR/NR	5.30	0.00	20.00%
Total		332.70		

* *Calculated including the class D notes/cash component.*

Unlike the previous two Turbo Finance transactions, excess demand for high quality credit assets allowed the marketing of the Class B tranche as well. FirstRand, acting through its London branch, continues to act as servicer for the transaction. The transaction is compliant with Article 122a of the EU Capital Requirement Directive where the Bank chose to use the on-balance sheet retention method to meet the 5% retained interest requirements of Article 122a.

Scheduled amortisation of Fresco 2

Scheduled amortisation of the Fresco 2 has commenced, with R5 billion amortised by December 2012. Targeted maturity is 2 August 2013. The transaction's performance since closing is in line with expectations.

Rating downgrade of Nitro Securitisation 4 Issuer Trust (Nitro 4)

In September 2012, Moody's Investor Services downgraded the South African government debt rating from A3 to Baa1, effectively lowering the local currency country ceiling to A1. Consequently, the rating of Nitro 4 class A tranche was downgraded from Aa2(sf) to A1(sf) on a local currency international scale basis.

Based on a realignment of the national scale to international scale mapping, the Class A notes remain rated Aaa(sf).za. The transaction was structured to obtain matched term funding for the Bank and is currently performing in line with expectations.

Conduit programmes and fixed-income funds

The Group's conduit programmes are debt capital market vehicles, which provide investment-grade corporate South African counterparties with an alternative source of funding to directly accessing capital markets via their own domestic medium-term debt programmes or traditional bank funding. It also provides institutional investors with highly-rated short-term alternative investments. The fixed income fund is a call-loan bond fund, which offers overnight borrowers and lenders an alternative to traditional overnight bank borrowings or overnight deposits.

All the assets originated for the conduit programmes are rigorously evaluated as part of the Group's credit approval processes applicable to any other corporate exposure held by the Group.

The conduit programmes have proved resilient during difficult financial market conditions and have experienced a tightening of credit spreads in line with the corporate debt market. Supply of assets and demand for notes issued by the conduits remain healthy, albeit within the constraints of newly introduced collective investment scheme (CIS) regulations.

The following tables show the programmes currently in place, the ratings distribution of the underlying assets and the role played by the Bank in each of these programmes. All of these capital market vehicles continue to perform in line with expectations.

Conduits and fixed income funds

Transaction R million	Underlying assets	Year initiated	Rating agency	Programme size	Non-recourse investments			Credit enhancement*		
					December 2012	December 2011	June 2012	**December 2012**	December 2011	June 2012
Conduits										
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	**5 736**	7 806	6 687	**–**	–	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	**3 579**	6 277	4 487	**673**	740	670
Total				30 000	**9 315**	14 083	11 174	**673**	740	670
Fixed income fund										
iNkotha	Overnight corporate loans	2006	GCR	10 000	**3 088**	3 571	2 654	**–**	–	–
Total				10 000	**3 088**	3 571	2 654	**–**	–	–

* *Includes programme-wide credit enhancements either funded by way of notes or unfunded by way of guarantee.*

Rating distribution of conduits and fixed income funds

R million	F1+(zaf)	AAA(zaf)	AA+(zaf)	AA(zaf)	AA-(zaf)	A+(zaf)	A(zaf)	A-(zaf)	Total
Conduits									
At 31 December 2012	**–**	**–**	**958**	**1 700**	**3 283**	**855**	**1 680**	**839**	**9 315**
At 31 December 2011	–	492	201	4 596	4 474	1 483	1 775	1 062	14 083
At 30 June 2012	–	121	730	2 628	3 778	1 071	1 765	1 081	11 174
Fixed income fund									
At 31 December 2012	**–**	**–**	**–**	**1 073**	**468**	**428**	**158**	**961**	**3 088**
At 31 December 2011	–	–	–	1 277	823	97	1 302	72	3 571
At 30 June 2012	–	–	–	1 097	479	519	–	559	2 654

The Bank's role in the conduits and the fixed income fund

Transaction	Sponsor	Originator	Investor	Servicer	Liquidity provider	Credit enhancement provider	Swap counterparty
iNdwa	✓			✓	✓		✓
iNkotha				✓			
iVuzi	✓			✓	✓	✓	✓

All of the above programmes continue to perform in line with expectations.

Liquidity facilities

The table below provides a summary of the liquidity facilities provided by the Bank.

Liquidity facilities

R million	Transaction type	Exposure		
		December 2012	December 2011	June 2012
Own transactions		**6 481**	10 548	8 157
iNdwa	Conduit	**4 151**	5 863	4 713
iVuzi	Conduit	**2 330**	4 685	3 444
Third party transactions	Securitisations	**1 536**	860	558
Total		**8 017**	11 408	8 715

All liquidity facilities granted to the transactions in the table above rank senior in terms of payment priority in the event of a drawdown. Economic capital is allocated to the liquidity facility extended to iNdwa and iVuzi as if the underlying assets were held by the Bank. The conduit programmes are consolidated into FRIHL for financial reporting purposes.

Additional information

The following table provides the securitisation exposures retained or purchased as well as associated capital requirements per risk band. The Group applies a number of methodologies in determining the capital requirements for securitisation and conduit exposures.

For domestic transactions, the Group applies the internal ratings based approach, supervisory formula and standardised approach, the choice of which is determined by the most efficient use of capital.

Retained or purchased securitisation exposure and the associated regulatory capital charges

	Exposure			Capital*			Capital deduction		
R million	**December 2012**	December 2011	June 2012	**December 2012**	December 2011	June 2012	**December 2012**	December 2011	June 2012
Risk weighted bands									
=<10%	**4 701**	7 511	7 443	**66**	53	55	**–**	–	–
>10% =<20%	**765**	1 111	810	**9**	14	11	**–**	–	–
>20% =<50%	**523**	729	1 235	**27**	36	42	**–**	–	–
>50% =<100%	**1 356**	81	81	**84**	6	6	**–**	–	–
>100% =<650%	**–**	59	59	**–**	24	26	**–**	–	–
1 250%/deduction	**1 777**	1 311	1 457	**–**	–	46	**1 404**	1 311	1 015
Look through	**15 402**	23 497	22 745	**644**	741	797	**–**	–	–
Total	**24 524**	34 299	33 830	**830**	874	983	**1 404**	1 311	1 015

* *Capital is calculated at the Basel II 9.75% requirement and includes a 6% capital scalar.*

The table below provides a summary of the deductions from securitisation exposures.

Deductions from securitisation exposures

R million	Corporate receivables	Retail mortgages	Retail: instalment sales and leasing	Total
Traditional	–	–	1 214	1 214
Synthetic	190	–	–	190
Total	190	–	1 214	1 404

The Group did not securitise any exposures that were impaired or past due at the time of securitisation. None of the securitisations transactions are subject to early amortisation treatment.

COUNTERPARTY CREDIT RISK

Introduction and objectives

Counterparty credit risk is a counterparty's ability to satisfy its obligations under a contract that has a positive economic value to a bank at any point during the life of the contract. It differs from normal credit risk in that the economic value of the transaction is uncertain and dependent on market factors that are typically not under the control of the bank or the client.

Counterparty credit risk is a risk taken mainly in the Group's trading and securities financing businesses. The objective of counterparty credit risk management is to ensure that risk is appropriately measured, analysed and reported on, and is only taken within specified limits in line with the Group's risk appetite framework as mandated by the Board.

During the period under review the Group implemented the Basel II standardised approach for the calculation of counterparty credit default risk capital. This measure is more risk-sensitive than the CEM used previously. The improved risk sensitivity of the measure implies that capital now more accurately reflects the risk profile of the book. In the current financial year the Group is focusing on the implementation of the Basel III CVA, AVC capital charges and central clearing counterparty changes.

FirstRand is and will continue to be an active participant in processes to implement legislative and structural reforms in the local derivatives market. Changes to international regulations relating to derivative market reforms are regularly monitored.

The risk to bilateral OTC counterparties is reduced by restricting transactions to higher rated counterparties and collateralising all mark-to-market movements in the majority of cases. The risk to clients in securities financing is reduced by improved margining and restricting exposure to higher quality underlying assets.

Organisational structure and governance

RMB's credit department is responsible for the overall management of counterparty credit risk. It is supported by RMB's derivative counterparty risk department which is responsible for ensuring that market and credit risk methodologies are consistently applied in the quantification of risk.

Counterparty credit risk is managed on the basis of the principles, approaches, policies and processes set out in the credit risk management framework for wholesale credit exposures.

In this respect, counterparty credit risk governance aligns closely with the Group's credit risk governance framework, with mandates and responsibilities cascading from the Board through the RCC committee to the respective credit committees and subcommittees as well as deployed and central risk management functions. Refer to the *Risk management framework* and *governance section*, (page 11), and the Credit risk governance section (page 29) for more details.

The Derivative counterparty risk committee supports the Credit risk management committee and its subcommittees with analysis and quantification of counterparty credit risk for traded product exposures.

Assessment and management

Quantification of risk exposure

The measurement of counterparty credit risk aligns closely with credit risk measurement practices and is focused on establishing appropriate limits at counterparty level and on ongoing portfolio risk management.

To this end, appropriate quantification methodologies of potential future exposure over the life of a product, even under distressed market conditions, are developed and approved at the relevant technical committees.

Individual counterparty risk limit applications are prepared using the approved risk quantification methodologies, and assessed and approved at the dedicated counterparty credit committee, which has appropriate executive and non-executive representation.

All counterparty credit risk limits are subject to annual review, while counterparty exposures are monitored by the respective risk functions on a daily basis. Overall counterparty risk limits are allocated across a number of products. Desk level reports are used to ensure sufficient limit availability prior to executing additional trades with a counterparty.

Business and risk management functions share the following responsibilities in this process:

- quantification of exposure and risk, as well as management of facility utilisation within approved credit limits;
- ongoing monitoring of counterparty creditworthiness to ensure early identification of high risk exposures and predetermined facility reviews at certain intervals;
- collateral management;
- management of high risk (watch list) exposures;
- collections and workout process management for defaulted assets; and
- counterparty credit risk reporting.

Limit breaches are dealt with in accordance with the approved excess mandate. Significant limit breaches necessitate reporting to the head of the business unit, the head of risk for the affected business unit and the derivative counterparty risk management function. Any remedial actions are agreed amongst these parties and failure to remedy such a breach is reported to the RMB Proprietary board, ERM and the RCC committee.

As part of the ongoing process of understanding the drivers of counterparty credit risk, regular analysis is carried out on OTC derivative and securities financing portfolios on a look-through basis. This portfolio review process seeks to identify concentrations, the hypothetical impact of stress scenarios and to better understand the interaction of underlying market risk factors and credit exposure. The benefits gained include clearer insight into potential collateral, earnings and capital volatility, and potentially unduly risky trading behaviour by counterparties.

Advanced monitoring of the creditworthiness of developed market counterparty banks is conducted through the real-time analysis of the spreads on listed securities that have been issued by or referencing these banks.

Counterparty credit risk mitigation

Where appropriate, various instruments are used to mitigate the potential exposure to certain counterparties. These include financial or other collateral in line with common credit risk practices, as well as netting agreements, guarantees and credit derivatives.

The Group uses International Swaps and Derivatives Association (ISDA) and International Securities Market Association agreements for the purpose of netting derivative transactions and repurchase transactions respectively. These master agreements as well as associated credit support annexes (CSA) set out internationally accepted valuation and default covenants, which are evaluated and applied on a daily basis, including daily margin calls based on the approved CSA thresholds.

For regulatory purposes, the net exposure figures are employed in capital calculations, whilst for accounting purposes netting is only applied where a legal right to set off and the intention to settle on a netted basis exist.

Collateral to be provided in the event of a credit rating downgrade

In some instances, FirstRand has signed ISDA agreements where both parties would be required to post additional collateral in the event of a rating downgrade. The additional collateral to be provided by the Group in the event of a credit rating downgrade is not material and would not adversely impact its financial position.

When assessing the portfolio in aggregate, the collateral that would need to be provided in the hypothetical event of a rating downgrade is subject to many factors, not least of which are market moves in the underlying traded instruments and netting of existing positions.

While these variables are not quantifiable, the table below, in addition to showing the effect of counterparty credit risk mitigation, provides a guide to the order of magnitude of the netted portfolio size and collateral placed with the Group. In aggregate, all of the positive mark-to-market values shown below would need to reverse before the Group would be a net provider of collateral.

Counterparty credit risk profile

The following table provides an overview of the counterparty credit risk arising from the Group's derivative and structured finance transactions.

Composition of counterparty credit risk exposure

R million	**December 2012**	December 2011	June 2012
Gross positive fair value	**115 244**	130 160	97 704
Netting benefits	**(15 953)**	(57 376)	(8 444)
Netted current credit exposure before mitigation	**99 291**	72 784	89 260
Collateral value	**(87 464)**	(60 873)	(73 415)
Netted potential future exposure	**3 213**	11 496	3 194
Exposure at default*	**15 378**	23 407	21 174

* *EAD is calculated under the standardised method. EAD under the standardised method is quantified by scaling either the current credit exposure less collateral or the net potential future exposure by a factor of 1.4. The latter explains why the summation of the netted current exposure, collateral value and netted potential future exposure in the table above differs from the EAD computed.*

The Group employs credit derivatives primarily for the purposes of protecting its own positions and for hedging its credit portfolio, as indicated in the following tables.

Credit derivatives exposure

	December 2012			
R million	**Credit default swaps**	**Total return swaps**	**Other**	**Total**
Own credit portfolio				
– protection bought	**18**	**–**	**–**	**18**
– protection sold	**1 845**	**–**	**–**	**1 845**
Intermediation activities				
– protection bought	**3 186**	**–**	**–**	**3 186**
– protection sold	**4 207**	**–**	**–**	**4 207**

	December 2011			
R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	14	–	–	14
– protection sold	3 454	–	–	3 454
Intermediation activities				
– protection bought	665	–	–	665
– protection sold	3 259	–	–	3 259

	June 2012			
R million	Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	–	–	–	18
– protection sold	1 900	–	–	3 259
Intermediation activities				
– protection bought	3 149	–	–	46
– protection sold	3 865	–	–	1 091

MARKET RISK

Market risk in the trading book	63
Interest rate risk in the banking book	66
Equity investment in the banking book	71
Foreign exchange and translation risk in the banking book	73

MARKET RISK IN THE TRADING BOOK

Introduction and objectives

Substantially all market risk in the Group is taken and managed by RMB. The relevant businesses within RMB function as the centre of expertise for all trading and market risk-related activities and seek to take on, manage and contain market risk within guidelines set out as part of the Bank's risk appetite.

Towards the end of the 2012 financial year, RMB conducted a strategic review of its business and a decision to cease outright proprietary trading activities ensued. A new Global Markets Division was formed, with focus directed towards client-centric business activities and an asset management initiative. Substantially the Bank's market risk now emanates from the provision of hedging solutions for clients, market making activities and term-lending products.

In aggregate, the consolidation of the remaining businesses resulted in increased diversification effects and reduced levels of market risk for the period under review, with a sharp reduction in equity risk on the local balance sheet.

Following the successful implementation of VaR plus stressed VaR in January 2012, the performance of market risk-taking activities is measured as the higher of the Bank's internal expected tail loss (ETL) measure (as a proxy for economic capital) and regulatory capital based on VaR plus stressed VaR.

Interest rate risk in the banking book is managed by Group Treasury and disclosed as part of the *Interest rate in the banking book* section of this report.

Organisational structure and governance

In terms of the market risk framework, a subframework of the BPRMF, responsibility for determining market risk appetite vests with the Board, which also retains independent oversight of market risk-related activities through the RCC committee and its Market and investment risk subcommittee (MIRC).

Separate governance forums, such as RMB's Proprietary board, take responsibility for allocating these mandates further, whilst deployed and central risk management functions provide independent control and oversight of the overall market risk process.

Assessment and management

Quantification of risk exposures

Market risk exposures are primarily measured and managed using an ETL measure and ETL limits. The ETL measure used by RMB is a historical simulation measure assessing the average loss beyond a selected percentile. RMB's ETL is based on a confidence interval of 99% and applicable holding periods. Since ETL is adjusted for the trading liquidity of the portfolio, it is referred to as liquidity-adjusted ETL. Holding periods, ranging between 10 to 90 days, are used in the calculation and are based on an assessment of distressed liquidity of portfolios. Historical data sets are chosen to incorporate periods of market stress such as data from the 2008/2009 global financial crisis included during the period under review.

VaR calculations over holding periods of 1 day and 10 days are used as an additional tool in the assessment of market risk. VaR triggers and absolute loss thresholds are used to highlight positions to be reviewed by management.

The Group's VaR number should be interpreted in light of the limitations of the methodology used, as follows:

- historical simulation VaR may not provide an accurate estimate of future market moves. It can only provide a prediction of the future based on events that occurred in the specific historic time sources referenced for the VaR calculation. Therefore, events that are more extreme than those in the historical data series cannot be predicted;
- the use of a 99% confidence level does not reflect the extent of potential losses beyond that percentile. The ETL is a better measure to quantify losses beyond that percentile (but still subject to similar limitations as stated for VaR);
- the use of a 1-day time horizon will not fully capture the profit and loss implications of positions with insufficient trading liquidity from either a desirability or size perspective to be closed out or hedged within one day; and
- positions and risk factors may change substantially intraday, whilst VaR is only calculated at the end of the trading day with reference to closing positions and risk factors.

These limitations mean that the Group cannot guarantee that losses will not exceed the VaR.

Risk concentrations in the market risk environment are controlled by means of appropriate ETL sublimits for individual asset classes and the maximum allowable exposure for each business unit. In addition to the general market risk limits described above, limits covering obligor specific risk were introduced and utilisation against these limits is monitored continuously based on the regulatory building block approach.

Stress testing

Stress testing provides an indication of potential losses that could occur under extreme market conditions. The ETL assessment provides a view of risk exposures under stress conditions.

Additional stress testing, to supplement the ETL assessment, is conducted using historical market downturn scenarios and includes the use of what-if hypothetical and forward-looking simulations. The calibrations of the stress tests are reviewed regularly to ensure that the results are indicative of the possible impact of severely distressed and event-driven market conditions. Stress and scenario analyses are reported to and considered regularly by the relevant governance bodies frequently.

Back testing

Back testing is performed in order to verify the predictive ability of the VaR model and ensure ongoing appropriateness thereof. The regulatory standard for back testing is to measure daily profits and losses against daily VaR at the 99th percentile. The number of breaches over a period of 250 trading days is calculated, and, should the number exceed that which is considered appropriate, the model is recalibrated.

Regulatory and economic capital for market risk

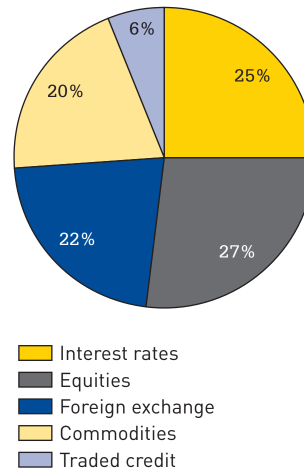
The internal VaR model for general market risk was approved by the SARB for local trading units and is consistent with the methodologies as stipulated under the Basel 2.5 framework. For all international legal entities, the standardised approach is used for regulatory market risk capital purposes.

Economic capital for market risk is calculated using liquidity-adjusted ETL plus an assessment of specific risk.

Trading book market risk profile

The chart shows the distribution of exposures per asset class across the Group's trading activities at 31 December 2012 based on the VaR methodology. Substantially, the equity component VaR relates to listed equity exposures in RMB Australia Holdings. These exposures are predominantly to the junior resources sector and are booked on the RMB Australia Holdings balance sheet.

Composition of VaR exposure per asset class



VaR analysis by risk type

The table below reflects the VaR over a 1-day holding period at a 99% confidence level. Results for the interim period reflect the derisking that has taken place with regards to outright proprietary trading, predominantly in the listed equity asset class. The lower period end results also reflect an overall lower level of risk maintained through the December month.

1-day 99% VaR analysis by instrument

	December 2012				December	June 2012
R million	**Min***	**Max***	**Average**	**Period end**	2011	Period end
Risk type						
Equities	**16.5**	**34.7**	**23.8**	**18.1**	17.4	30.6
Interest rates**	**16.0**	**52.8**	**29.9**	**16.8**	17.9	45.8
Foreign exchange	**11.4**	**35.2**	**18.8**	**14.2**	11.4	15.8
Commodities	**9.1**	**35.2**	**24.9**	**13.5**	8.9	24.6
Traded Credit	**2.9**	**10.8**	**6.4**	**3.7**	4.6	10.3
Diversification effect				**(25.5)**	(35.7)	(44.2)
Diversified total	**37.0**	**71.8**	**54.8**	**37.0**	19.9	72.6

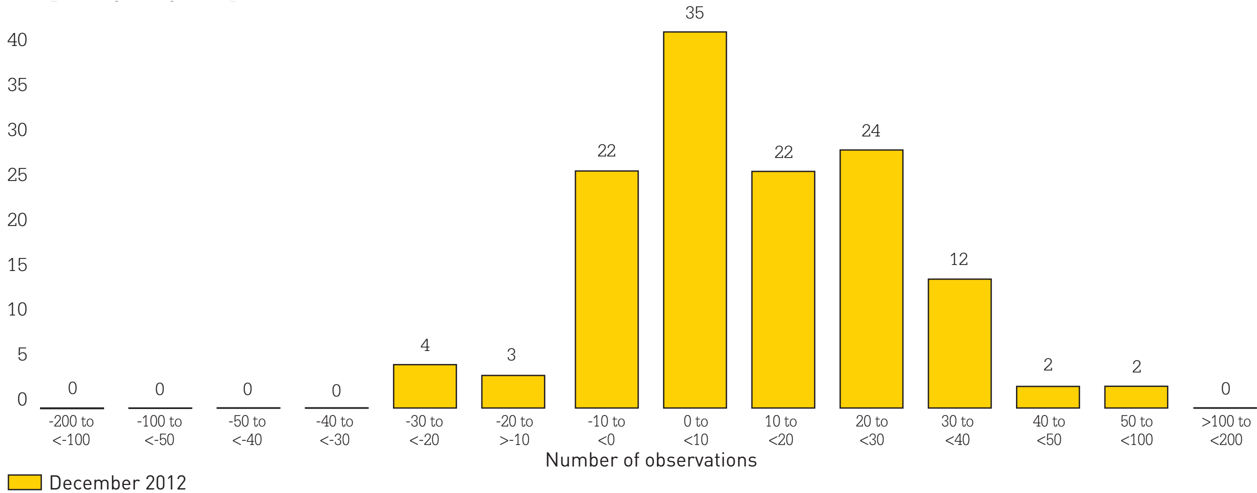
* *The maximum and minimum VaR figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above table.*

** *Banking book exposures are managed by Group Treasury and are reported under the banking book interest rate risk section.*

Distribution of daily trading earnings from trading units

The histogram below shows the daily revenue for the local trading units in FirstRand for the period under review.

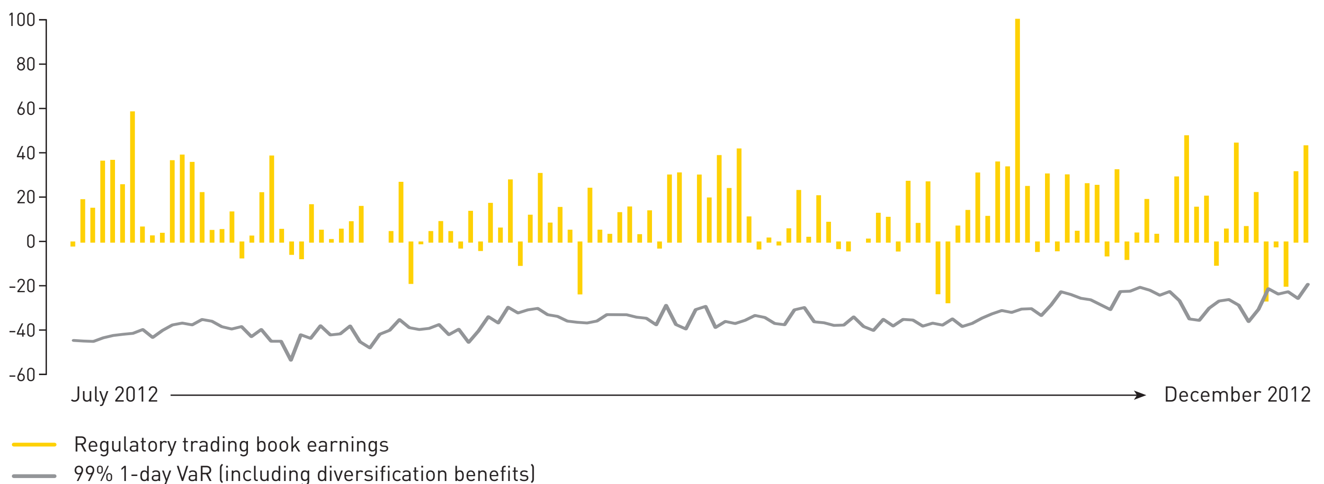
Distribution of daily earnings
Frequency (days in period)



Back testing: daily regulatory trading book earnings and VaR

The Group tracks its daily local earnings profile as illustrated in the chart below. The earnings and 1-day VaR relate to the Bank's internal VaR model. Exposures were contained within risk limits during the trading period and the earnings profile is skewed towards profitability.

Back testing: daily regulatory trading book earnings versus 1-day 99% VaR
(R million)



Trading book earnings exceeded 1-day VaR on one occasion during the six month period under review, indicating a reasonably accurate quantification of market risk provided by the Group's internal model.

International

RMB Australia Holdings and the Bank's India branch hold the highest exposure to market risk amongst the international operations. The same approach is employed for the measurement and management of market risk as in the local portfolio. During the period under review, market risk was contained within acceptable limits.

FRIHL

VaR analysis by risk type

The table below reflects the VaR over a 1-day holding period at a 99% confidence level for FRIHL. Market risk in FRIHL relates to the trading activities taking place in RMB Australia Holdings Limited and RMB Securities Trading (Pty) Ltd, and represents a subset of the VaR analysis by asset class reflected above for the Group.

The table below reflects the derisking that has taken place with regard to outright proprietary trading in the listed equity asset class, particularly as it relates to RMB Securities Trading (Pty) Ltd.

1-day 99% VaR analysis by instrument for FRIHL

	December 2012				December 2011**	June 2012
R million	**Min***	**Max***	**Average**	**Period end**	Period end	Period end
Diversified total	**14.7**	**25.6**	**18.7**	**17.8**	41.8	27.2

* *The maximum and minimum VaR figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above tables.*
** *As 1-day VaR is reported this year, the 2011 period end numbers have been restated to reflect 1-day VaR.*

FNB Africa subsidiaries

Market risk for the African subsidiaries is measured using the same ETL and VaR methodologies as described above and supplemented with a stress loss measure per asset class. During the period under review, market risk was contained within acceptable limits and was effectively managed in the FNB African subsidiaries.

INTEREST RATE RISK IN THE BANKING BOOK

Introduction and objectives

Interest rate risk is the sensitivity of the balance sheet and income statement to unexpected, adverse movements in interest rates. Activities in the Group that give rise to interest rate risk are the endowment effect and interest rate mismatch. The endowment effect, which results from a large proportion of endowment liabilities (including stagnant deposits and equity) that fund variable-rate assets (e.g. prime-linked mortgages), remains the primary driver of interest rate risk in the banking book (IRRBB) and results in bank earnings being vulnerable to interest rate cuts. For its interest rate mismatch, the Group also hedges its residual fixed-rate position, which has been adjusted for optionality.

In the Group, interest rate risk arises in trading and non-trading/banking book activities. In the trading book, interest rate risk is primarily quantified and managed using ETL measures and limits, VaR calculations are performed over a 1- and 10-day holding period as an additional risk measure. This is covered in the *Market risk in the trading book* section of this report.

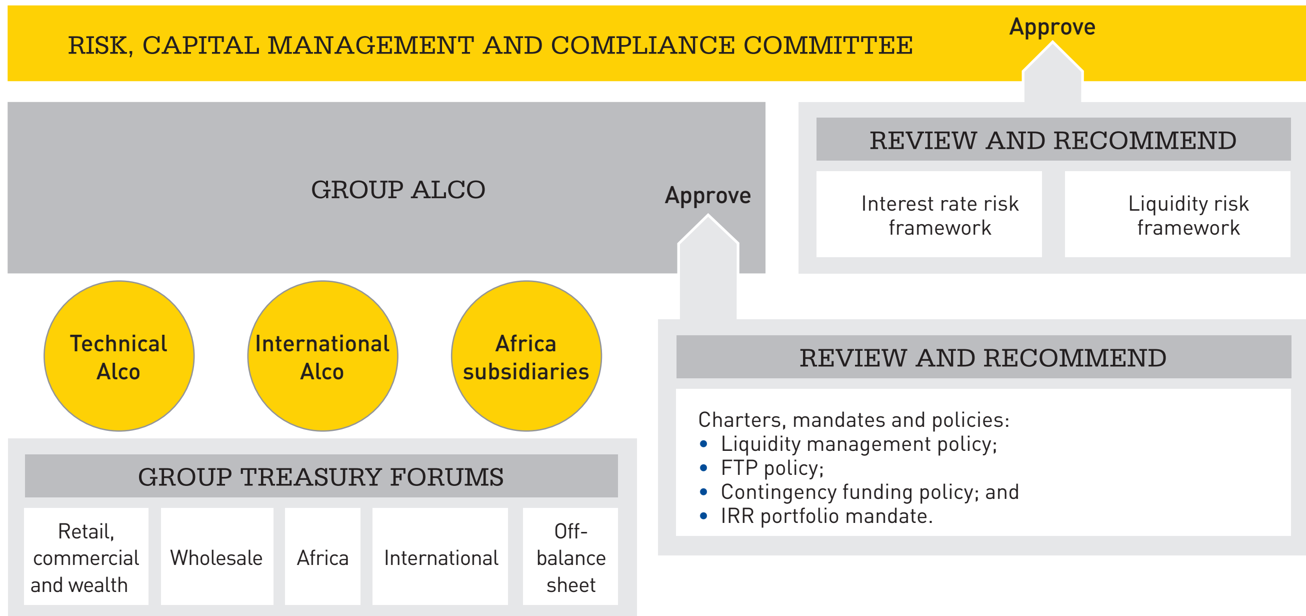
IRRBB originates from the differing repricing characteristics of balance sheet instruments, yield curve risk, basis risk and client optionality embedded in banking book products. It is an inevitable risk associated with banking and can be an important source of profitability and shareholder value. IRRBB continues to be managed from an earnings approach, with the aim to protect and enhance the Group's earnings and economic value within approved risk limit and appetite levels.

Organisational structure and governance

The control and management of IRRBB is governed by the framework for the management of IRRBB, which is a subframework of the BPRMF. Ultimate responsibility for determining risk limits and appetite for the Group vests with the Board. Independent oversight for monitoring is done through the RCC committee, who, in turn, has delegated the responsibility for IRRBB to the FirstRand ALCCO. ALCCO also maintains responsibility on behalf of the Board for the allocation of sublimits and remedial action to be taken in the event of any limit breaches.

Individual ALCCOs exist in each of the African subsidiaries and international branches which monitor and manage in-country IRRBB. Material issues from individual ALCCO are reported through to FirstRand ALCCO. The IRRBB management and governance structure is illustrated on the next page.

Interest rate risk management and governance structure



Assessment and management

FirstRand Bank

Management and monitoring of the FirstRand domestic banking book is split between the RMB book and the remaining domestic banking book. RMB manages the banking book under its market risk framework; as such, risk is measured and monitored in conjunction with the trading book with management oversight provided by MIRC. The RMB banking book interest rate risk exposure was R14.1 million on a 10-day ETL basis at 31 December 2012 (December 2011: R27 million and June 2012: R79.7 million). (Refer to *Market risk in the trading book* section on page 63). Any reference in future relating to the banking book excludes the RMB book.

The remaining banking book consists predominantly of retail balances from FNB and WesBank and the Corporate Centre balance sheet. This is managed centrally by Group Treasury with oversight from Corporate Centre risk management. The Group Treasury investment committee meets regularly to discuss and propose strategies and to ensure that management action is within the Group's risk limit and appetite levels.

The internal FTP process is used to transfer interest rate risk from the franchises to Group Treasury, where risk can be managed holistically in line with the Group's macroeconomic outlook. This is achieved by balance sheet optimisation, or alternatively through the use of derivative transactions. Derivative instruments used are mainly interest rate swaps, for which there is a liquid market. Hedge accounting is used where possible to minimise accounting mismatches, thus ensuring that amounts deferred in equity are released to the income statement at the same time as movements attributable to the underlying hedged asset/liability.

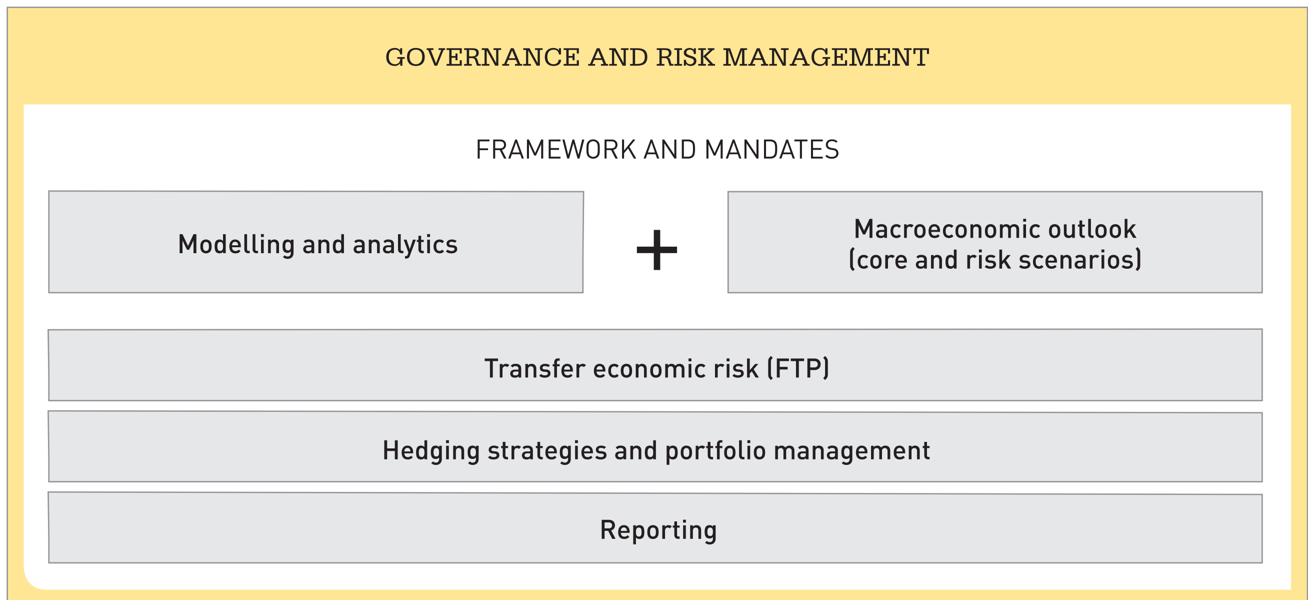
A number of measurement techniques are used to measure IRRBB. These focus on the net interest income (NII) sensitivity/earnings risk and the overall impact on economic value of equity (EVE) and daily PV01 (present value of 1bps increase in rates) measures.

The interest rate risk from the fixed book is managed to low levels with remaining risk stemming from timing and basis risk. The primary driver of NII sensitivity relates to the non- and low-rate products in the balance sheet, the endowment book. This has an adverse impact on the Group's NII margin in a cutting cycle as the decrease in NII from assets repricing to lower rates is not offset by a corresponding interest saving from liabilities. In the current rate cycle, the average repo rate for the period dropped by 45 bps, resulting in a negative impact to the Bank's margin.

International subsidiaries and branches

Management of the African subsidiaries and international branches is performed by in-country management teams with oversight provided by Group Treasury and Corporate Centre risk management. For subsidiaries, NII measures are used to measure, monitor and manage interest rate risk in line with the Group's appetite.

Interest rate risk management and assessment



Current repricing profile

In calculating the repricing gap, all banking book assets, liabilities and derivative instruments are placed in gap intervals based on their repricing characteristics. Non-maturing deposits and transmission accounts for which rates are administered by the Group are considered to reprice overnight. No prepayment assumptions are applied. The change in the repricing gap from December 2011 is due to growth in administered products and improvements in the modelling process. The overall balance sheet continues to be sensitive to rate cuts.

Repricing schedules for the Group's banking book

R million	December 2012				
	Term to repricing				
	< 3 months	> 3 but ≤ 6 months	> 6 but ≤ 12 months	> 12 months	Non-rate sensitive
FirstRand Bank					
Net repricing gap	**(8 475)**	**(15 746)**	**33 531**	**16 671**	**(25 982)**
Cumulative repricing gap	**(8 475)**	**(24 221)**	**9 310**	**25 982**	**–**
FNB Africa					
Net repricing gap	**5 714**	**(1 426)**	**(1 463)**	**(1 111)**	**(1 715)**
Cumulative repricing gap	**5 714**	**4 289**	**2 826**	**1 715**	**–**
Total cumulative repricing gap	**(2 761)**	**(19 933)**	**12 136**	**27 696**	**–**

R million	December 2011				
	Term to repricing				
	< 3 months	> 3 but ≤ 6 months	> 6 but ≤ 12 months	> 12 months	Non-rate sensitive
FirstRand Bank					
Net repricing gap	13 828	(612)	(10 925)	14 496	(16 787)
Cumulative repricing gap	13 828	13 216	2 291	16 787	–
FNB Africa					
Net repricing gap	5 366	(471)	(1 416)	456	(3 935)
Cumulative repricing gap	5 366	4 895	3 479	3 935	–
Total cumulative repricing gap	19 194	18 111	5 770	20 722	–

R million	June 2012				
	Term to repricing				
	< 3 months	> 3 but ≤ 6 months	> 6 but ≤ 12 months	> 12 months	Non-rate sensitive
FirstRand Bank					
Net repricing gap	23 422	(4 164)	(5)	15 650	(34 903)
Cumulative repricing gap	23 422	19 258	19 253	34 903	–
FNB Africa					
Net repricing gap	2 555	(1 398)	(484)	1 558	(2 231)
Cumulative repricing gap	2 555	1 157	673	2 231	–
Total cumulative repricing gap	25 977	20 415	19 926	37 134	–

This repricing gap analysis excludes the banking books of RMB and the Bank's India and London branches, which are separately managed on a fair value basis.

Sensitivity analysis

NII sensitivity

NII models are run on a monthly basis to provide a measure of the NII sensitivity of the existing balance sheet to shocks in interest rates. Different scenarios are modelled including parallel and key rate shocks as well as yield curve twists and inversions as appropriate. Underlying transactions are modelled on a contractual basis, assuming a constant balance sheet size and mix. No adjustments are made for prepayments in the underlying book, however, prepayment assumptions are factored into the calculation of hedges for fixed rate lending. Roll-over assumptions are not applied to off-balance sheet positions.

The tables below show the 12-month NII sensitivity for a 200 bps downward parallel shock to interest rates. The decreased sensitivity in December 2012 from December 2011 is attributable to an increase in the use of derivative positions to manage interest rate risk in line with the macroeconomic outlook. In the prior year, the book was positioned for rate hikes. However, due to the rising threat of a crisis in Europe and growing global growth concerns, hedges have been put in place to provide greater NII margin stability in the event of further rate reductions.

Assuming no change in the balance sheet and no management action in response to interest rate movements, an instantaneous and sustained parallel decrease in interest rates of 200 bps would result in a reduction in projected 12-month NII of R1 558 million, a similar increase in interest rates would result in an increase in projected 12-month NII of R1 442 million.

Sensitivity of the Group's projected NII

	December 2012		
	Change in projected 12-month NII		
R million	**FirstRand Bank**	**FNB Africa**	**FirstRand**
Downward 200 bps	**(1 318)**	**(240)**	**(1 558)**
Upward 200 bps	**1 201**	**241**	**1 442**

	December 2011		
	Change in projected 12-month NII		
R million	FirstRand Bank	FNB Africa	FirstRand
Downward 200 bps	(1 336)	(214)	(1 550)
Upward 200 bps	1 448	214	1 662

	June 2012		
	Change in projected 12-month NII		
R million	FirstRand Bank	FNB Africa	FirstRand
Downward 200 bps	(1 514)	(244)	(1 758)
Upward 200 bps	1 562	240	1 802

Economic value of equity (EVE)

EVE sensitivity measures are calculated on a monthly basis. The impact on equity is as a result of the net open position after hedging used to manage IRRBB. The impact on equity occurs either as a result of fair value movements on these positions being recognised in the income statement, or movements deferred to the available for sale/cash flow hedging reserves.

The table below shows the EVE measures for a -200 bps and +200 bps instantaneous, parallel shock to rates on open positions run in Group Treasury. This is shown as a percentage of total Tier 1 and Tier 2 capital for the Group. The change in the current period is attributable to growth in the retail fixed book.

Sensitivity of the Group's reported reserves to interest rate movements

R million/%	**December 2012**	December 2011	June 2012
Downward 200 bps			
Available-for-sale	**965**	1 066	1 008
Cash flow	**(1 542)**	(1 032)	(1 006)
Total sensitivity	**(577)**	34	2
As % of Tier 1 and Tier 2 capital	**(1.0327%)**	0.0733%	0.0037%
Upward 200 bps			
Available-for-sale	**(832)**	(946)	(871)
Cash flow	**1 417**	955	916
Total sensitivity	**584**	9	45
As % of Tier 1 and Tier 2 capital	**1.0458%**	0.0203%	0.0645%

The NII sensitivity analysis excludes the banking books of RMB and the international balance sheet, both of which are managed separately on a fair value basis.

EQUITY INVESTMENT RISK IN THE BANKING BOOK

Introduction and objectives

Portfolio investments in equity instruments are primarily undertaken in RMB, but certain equity investments have been made by WesBank, FNB and the Corporate Centre. Positions in unlisted investments in RMB are taken mainly through its Private Equity, Resources and Investment Banking divisions, while listed investments are primarily made through the Resources division.

The Group actively monitors regulatory developments, including amendments to current Basel capital requirements and the impact of Basel III. Basel III regulation has indirectly impacted the Group's equity investment portfolio's capital adequacy requirements in that part of the minority interest in the consolidated subsidiaries no longer qualifies as Core Tier 1 capital.

The overall quality of the investment portfolio remains acceptable and is within risk appetite. During the period under review, there have been few realisations and several new equity investment undertaken as part of a portfolio rebuilding drive. This trend is expected to continue in the private equity market in line with RMB's approved business strategy and risk appetite.

Organisational structure and governance

The responsibility for determining equity investment risk appetite vests with the Board. The following structures have been established in order to assess and manage equity investment risk:

- the Prudential investment committee (Investment committee) chaired by the RMB chief investment officer and its delegated subcommittees are responsible for the approval of all portfolio investment transactions in equity, quasi-equity or quasi-debt instruments;
- where the structure of the investments also incorporate significant components of senior debt, approval authority will rest with the respective credit committees and the Large exposures committee, as appropriate;
- the RCC and MIRC committees are responsible for the oversight of investment risk measurement and management across the Group;
- the bi-annual investment risk oversight committee assesses the quality, size and performance of the investment portfolio across RMB and reviews movements in light of risk appetite;
- the RMB CRO, in consultation with the Group CRO and with support from the deployed and central risk management functions, provides independent oversight and reporting of all investment activities in RMB to the RMB Proprietary board, as well as MIRC. FNB and WesBank executive management monitor and manage investments through the financial reporting process.

Assessment and management

Management of exposures

The equity investment risk portfolio is managed through a rigorous evaluation and review process from inception to exit of a transaction. All investments are subject to a comprehensive due diligence, during which a thorough understanding of the target company's business, risks, challenges, competitors, management team and unique advantage or value proposition is developed.

For each transaction, an appropriate structure is put in place which aligns the interests of all parties involved through the use of incentives and constraints for management and the selling party. Where appropriate, the Group seeks to take a number of seats on the company's board and maintains close oversight through monitoring of operations.

The investment thesis, results of the due diligence process and investment structure are discussed at the Investment committee before final approval is granted. In addition, normal semi-annual reviews of each investment are carried out and crucial parts of these reviews, such as valuation estimates, are independently peer reviewed.

Recording of exposures – accounting policies

IAS 39 requires equity investments to be classified as:

- financial assets at fair value through profit and loss; or
- available-for-sale financial assets.

The consolidated financial statements include the assets, liabilities and results of operations of all equity investments in which the Group, directly or indirectly, has the power to exercise control over the operations for its own benefit.

Equity investments in associates and joint ventures are included in the consolidated financial statements using the equity accounting method. Associates are entities where the Group holds an equity interest of between 20% and 50%, or over which it has the ability to exercise significant influence, but does not control. Joint ventures are entities in which the Group has joint control over the economic activity of the joint venture through a contractual agreement.

Measurement of risk exposures

Risk exposures are measured as the potential loss under stress conditions. A series of standardised stress tests are used to assess potential losses under current market conditions, adverse market conditions, as well as severe stress/event risk. These stress tests are conducted at individual investment and portfolio levels.

The Group targets an investment portfolio profile that is diversified along a number of pertinent dimensions, such as geography, industry, investment stage and vintage (i.e. annual replacements of realisations).

Stress testing

Economic and regulatory capital calculations are complemented with regular stress tests of market values and underlying drivers of valuation e.g. company earnings, valuation multiples and assessments of stress resulting from portfolio concentrations.

Regulatory and economic capital

The Basel II simple risk weighted method (300% or 400%) under the market based approach is applied for the quantification of regulatory capital.

Effective from 30 November 2012 the SARB required that the underlying equity assets in the Employee Liability Insurance (ELI) cell captive be included in the Bank's equity risk investment portfolio on a look-through basis. These were previously allocated to other assets in the credit risk portfolio and risk weighted at 100%.

For economic capital purposes, an approach using market value shocks to the underlying investments is used to assess economic capital requirements for unlisted investments after taking any unrealised profits not taken to book into account.

Where price discovery is reliable, the risk of listed equity investments is measured based on a 90-day ETL calculated using RMB's internal market risk model. The ETL risk measure is supplemented by a measure of the specific (idiosyncratic) risk of the individual securities per the specific risk measurement methodology.

Equity investment risk profile

Market prices in selected industries continue to present the Group with opportunities to build its private equity portfolio. Unrealised profits for the investment portfolio continue to remain resilient. RMB's strategic business review conducted towards the end of the 2012 financial year resulted in significantly reduced listed equity investment exposures following the cessation of outright proprietary trading activities. However, the private equity portfolio has been subject to a portfolio rebuilding initiative that is likely to continue for the remainder of the financial year.

Investment risk exposure and sensitivity of investment risk exposure

R million	**December 2012**	December 2011	June 2012
Listed investment risk exposure included in the equity investment risk ETL process*	**474**	1 493	687
ETL on above equity investment risk exposures*	**176**	696	377
Estimated sensitivity of remaining investment balances**			
Sensitivity to 10% movement in market value on investment fair value	**535**	364	502
Cumulative gains realised from sale of positions in the banking book during the period	**195**	831	1 642

* *The decline in both exposure and ETL from December 2011 to December 2012 is largely due to the cessation of all outright proprietary trading activities in the FICC and Equities businesses as well as the further run down of legacy assets.*
** *These are the investment balances not subject to the equity investment risk ETL process.*

The following table provides information relating to equity investments in the banking book of the Group.

Investment valuations and associated regulatory capital requirements

	December 2012		
R million	**Publicly quoted invest-ments**	**Privately held**	**Total**
Carrying value disclosed in the balance sheet	**2 936**	**9 314**	**12 249**
Fair value*	**2 960**	**11 844**	**14 803**
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement**	**–**	**72**	**72**
Latent revaluation gains not recognised in the balance sheet**	**24**	**2 530**	**2 554**
Capital requirement#	**837**	**3 539**	**4 376**

* *The fair values of listed private equity investments were not considered to be materially different from the quoted market prices.*
** *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*
# *Capital requirement calculated at 9.5% of RWA (excluding the bank-specific Pillar 2b add on).*

	December 2011		
R million	Publicly quoted investments	Privately held	Total
Carrying value disclosed in the balance sheet	3 988	7 806	11 794
Fair value*	3 988	10 711	14 699
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement**	28	198	226
Latent revaluation gains not recognised in the balance sheet**	–	2 905	2 905
Capital requirement#	649	2 299	2 948

* *The fair values of listed private equity investments were not considered to be materially different from the quoted market prices.*
** *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*
# *Capital requirement calculated at 9.5% of RWA (excluding the bank-specific Pillar 2b add on). Effective 1 July 2011, the SARB requested that all equity investment risk exposures be risk weighted under the simple risk weighted method (previously non-bank entities were risk weighted under the standardised approach). This has increased the capital requirement for the Group.*

Investment valuations and associated regulatory capital requirements

R million	June 2012 Publicly quoted investments	Privately held	Total
Carrying value disclosed in the balance sheet	2 509	10 064	12 573
Fair value*	2 509	13 087	15 596
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement**	55	44	99
Latent revaluation gains not recognised in the balance sheet**	–	3 054	3 054
Capital requirement#	715	3 824	4 540

* *The fair values of listed private equity investments were not considered to be materially different from the quoted market prices.*
** *These unrealised gains or losses are not included in Tier 1 or Tier 2 capital.*
# *Capital requirement calculated at 9.5% of RWA (excluding the bank-specific Pillar 2b add on).*

FOREIGN EXCHANGE AND TRANSLATION RISK IN THE BANKING BOOK

Introduction and objectives

Foreign exchange risk arises from on- and off-balance sheet positions whose valuation in Rand is subject to currency movements. Key activities giving rise to these positions are foreign currency placements, lending and investing activities, the raising of foreign currency funding and from trading and client facilitation activities in foreign currencies. The objective of foreign exchange risk management is to ensure that currency mismatches are managed within the Group's risk appetite and to ensure that it is overseen and governed in keeping with the risk governance structures.

Translation risk is the risk to the rand-based South African reported earnings brought about by fluctuations in the exchange rate when applied to the value, earnings and assets of foreign operations. Translation risk is, at present, seen as an unavoidable risk which results from having offshore operations. The Group does not actively hedge this risk.

Organisational structure and governance

Foreign exchange risk results from activities of all the franchises, but management and consolidation of all these positions occur in one of two business units. Client flow and foreign exchange trading, including daily currency mismatch, are consolidated under and executed by RMB Global Markets. Foreign currency funding, foreign asset as well as foreign currency exposure and liquidity and term mismatch are consolidated under and managed by Group Treasury.

Market risk, foreign exposure and mismatch limits are approved by the Board and the primary governance body is the RCC committee. Trading risk and the net open forward position on foreign exchange (NOFP) are overseen by MIRC, a subcommittee of the RCC committee and mismatch risk is governed through the FirstRand ALCCO and International ALCCO processes. In addition to the committee structures, business units charged with frontline management of these risks have deployed risk managers within their units who assess and report on these risks on an ongoing basis.

Assessment and management

In addition to the regulatory prudential limit on foreign asset exposure (25% of local liabilities), the Board has set internal limits on FirstRand's total foreign currency exposure, within the regulatory limit but allowing opportunity for expansion and growth. Internal limits are also set per franchise, taking into account existing foreign asset exposure and future growth plans. Internal limits and utilisation are continuously monitored and reviewed when necessary.

The Group's NOFP position is well within the regulatory limit of US$650 million. Senior management implemented various levels of internal prudential limits, taking into account the fluctuating exchange rates and the Group's capital position, again below the regulatory limit but large enough to cater for the hedging, settlement and execution positions of business units. Group Treasury is the clearer of all currency positions in FirstRand and is therefore tasked with the responsibility for managing the Group's position within all internal and prudential limits. Any breaches are reported through the risk management structures and corrective action is monitored by both the deployed risk manager and ERM.

Foreign exchange and translation risk profile

Over the past year no significant foreign exchange positions have been run, apart from translation risk in strategic foreign investments. Mismatches have been well contained within regulatory limits at all times. The NOFP internal management limit was recently adjusted upwards to cater for increased (unhedged) currency risk related to foreign investment positions held directly by the Group and to cater for increased buffer trading for RMB and Group Treasury trading positions. Allowances were also made for newly established foreign entities of the Group, giving them slightly higher internal management triggers so as not to constrain growth in the start-up phase. The standard management triggers are applied to the mature foreign entities. The macro foreign asset exposure of the Group remained below both regulatory and board limits and there is significant headroom for expansion into foreign assets.

FUNDING AND LIQUIDITY RISK

Introduction and objectives

The Group distinguishes three types of liquidity risk:

- funding liquidity risk is the risk that a bank will not be able to effectively meet current and future cash flow and collateral requirements without negatively affecting the normal course of business, financial position or reputation;
- market liquidity risk is the risk that market disruptions or lack of market liquidity will cause the bank to be unable (or able, but with difficulty) to trade in specific markets without significantly affecting market prices; and
- mitigation of market and funding liquidity risks is achieved via contingent liquidity risk management. Buffer stocks of highly liquid assets are held either to be sold into the market or provide collateral for loans to cover any unforeseen cash shortfall that may arise.

The Group's principal liquidity risk management objective is to optimally fund itself under normal and stressed conditions.

Funding structure

The banking sector in South Africa is characterised by certain structural features, such as a low discretionary savings rate and a higher degree of contractual savings that are captured by institutions such as pension funds, provident funds and providers of asset management services. A portion of these contractual savings translate into institutional funding for banks which has higher liquidity risk than retail deposits. Limited yield incentivisation and corporate liquidity needs mean that South African banks are funding seekers. The structural liquidity risk is therefore higher in South Africa than in most other markets. This risk is however, to some extent mitigated by the following factors:

- the closed rand system where all rand transactions have to be cleared and settled in South Africa through registered banks and clearing institutions domiciled in South Africa;
- the prudential exchange control framework in place in South Africa; and
- the low dependency of South African banks on foreign currency funding.

In the light of the structural funding issues focus is currently placed on a risk-adjusted diversified funding profile in line with Basel III requirements. The release of the updated Basel III LCR will reduce the reliance on the SARB committed liquidity facility. The increase in the ratio is driven by lower outflow factors for non-operational cash flows, increased availability of qualifying high quality liquid assets and reduced contingent outflows. In addition, the time for compliance has been adjusted to a phase in approach beginning with a 60% requirement in 2015 and increasing in 10% annual increments through to 2019.

Surplus liquidity buffers for cash flow management are amended in line with available liquidity in government debentures, treasury bills and bonds. The current level is considered sufficient relative to current market conditions.

Organisational structure and governance

Liquidity risk management is governed by the liquidity risk management framework (LRMF), which provides relevant standards in accordance with regulatory requirements and international best practices. As a subframework to the BPRMF, the LRMF is approved by the Board and sets out consistent and comprehensive standards, principles, policies and procedures to be implemented throughout the Group to effectively identify, measure, report and manage liquidity risk.

The Board retains ultimate responsibility for the effective management of liquidity risk. The Board has delegated its responsibility for the assessment and management of this risk to the RCC committee, which in turn delegated this task to FirstRand ALCCO. FirstRand ALCCO's primary responsibility is the assessment, control and management of both liquidity and interest rate risk for the Bank, FNB Africa and international subsidiaries and branches, either directly or indirectly, through providing guidance, management and oversight to the asset and liability management functions and ALCCOs in these subsidiaries and branches.

FirstRand Bank (SA)

Liquidity risk for the Bank SA (RMB, FNB, Corporate Centre and WesBank) is centrally managed by a dedicated liquidity and funding team in Group Treasury. Governance is provided by an independent risk team responsible for ensuring that the liquidity risk management framework is implemented appropriately.

The Group's liquidity position, exposures and auxiliary information are reported weekly to the funding and liquidity portfolio management committee and monthly at the funding executive committee. In addition, management aspects of the liquidity position are reported to and debated by Group Treasury. The liquidity risk management team also provide regular reports to FirstRand ALCCO.

FNB Africa

Individual ALCCOs have been established in each of the FREMA businesses which manage liquidity risk on a decentralised basis, in line with the principles under delegated mandates from the respective boards. Reports from these committees are regularly presented to FirstRand ALCCO and the management and control of liquidity risk in the subsidiaries follows the guidance and principles that have been set out and approved by FirstRand ALCCO.

International subsidiaries

Similarly, liquidity risk for international subsidiaries is managed on a decentralised basis in line with the Group's LRMF. Each international subsidiary and branch reports into International ALCCO, which is a subcommittee of FirstRand ALCCO, and meets quarterly to review and discuss region-specific liquidity and interest rate risk issues.

FirstRand has been granted renewable dispensation by the Financial Services Authority (FSA) for a waiver on a "Whole-firm Liquidity Modification application" basis where the FSA considers local risk reporting and compliance of the parent bank sufficient to waive FSA requirements for FirstRand Bank (London branch). FSA reporting commenced from January 2011.

Liquidity risk management

The Group explicitly acknowledges liquidity risk as a consequential risk that may be caused by other risks as demonstrated by the reduction in liquidity in many international markets as a consequence of the recent credit crisis. The Group is, therefore, focused on continuously monitoring and analysing the potential impact of other risks and events on the funding and liquidity position of the organisation to ensure business activities preserve and enhance funding stability. This ensures the Group is able to operate through a period of stress when the access to funding is constrained.

The approach to liquidity risk management distinguishes between structural, daily and contingency liquidity risk, and various approaches are employed in the assessment and management of these on a daily, weekly and monthly basis as illustrated in the chart below.

Aspects of liquidity risk management

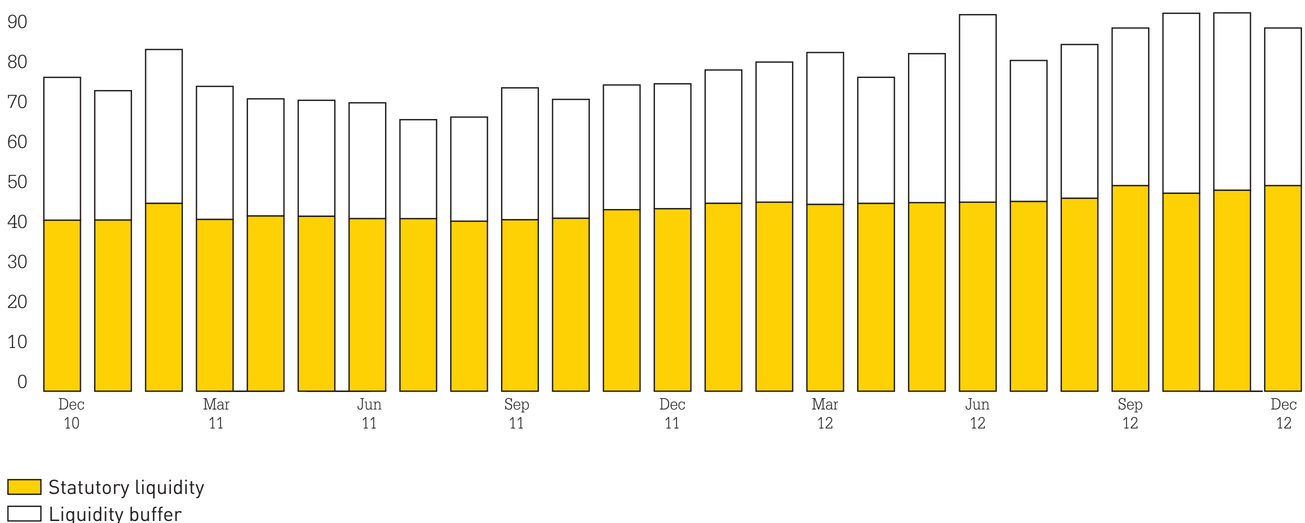
Structural LRM	Daily LRM	Contingency LRM
The risk that structural, long-term on-and-off balance sheet exposures cannot be funded timeously or at reasonable cost.	Ensuring that intraday and day-to-day anticipated and unforeseen payment obligations can be met by maintaining a sustainable balance between liquidity inflows and outflows.	Maintaining a number of contingency funding sources to draw upon in times of economic stress.
• liquidity risk tolerance; • liquidity strategy; • ensuring substantial diversification over different funding sources; • assessing the impact of future funding and liquidity needs taking into account expected liquidity shortfalls or excesses; • setting the approach to managing liquidity in different currencies and from one country to another; • ensuring adequate liquidity ratios; • ensuring an adequate structural liquidity gap; and • maintaining a funds transfer pricing methodology and processes.	• managing intraday liquidity positions; • managing the daily payment queue; • monitoring the net funding requirements; • forecasting cash flows; • perform short-term cash flow analysis for all currencies individually and in aggregate; • management of intragroup liquidity; • managing central bank clearing; • managing the net daily cash positions; • managing and maintaining market access; and • managing and maintaining collateral.	• managing early warning and key risk indicators; • performing stress testing including sensitivity analysis and scenario testing; • maintaining the product behaviour and optionality assumptions; • ensuring that an adequate and diversified portfolio of liquid assets and buffers are in place; and • maintaining the contingency funding plan.

Available liquidity

Liquidity buffers are actively managed via high quality, highly liquid assets that are available as protection against unexpected events or market disruptions. The buffer methodology has been defined and linked to regular stress testing and scenario analysis. The methodology is adaptive and will be responsive to Basel III changes on the LCR.

The chart below shows the liquidity buffer and statutory liquidity requirements for the Bank.

Bank's liquidity buffer and statutory liquidity requirements
(R billion)



In addition to the measurement and management of the liquidity profiles, various key risk indicators are defined that highlight potential risks within defined thresholds. Two levels of severity are defined for each indicator. Monitored on a daily and monthly basis, the key risk indicators may trigger immediate action where required. Their current status and relevant trends are reported to the FirstRand ALCCO and the RCC committee quarterly.

Stress testing and scenario analysis

Regular and rigorous stress tests are conducted on the funding profile and liquidity position as part of the overall stress-testing framework with a focus on:

- quantifying the potential exposure to future liquidity stresses;
- analysing the possible impact of economic and event risks on cash flows, liquidity, profitability and solvency position; and
- proactively evaluating the potential secondary and tertiary effects of other risks on the Group.

Liquidity contingency planning

Frequent volatility in funding markets and the fact that financial institutions can and have experienced liquidity problems even during good economic times have highlighted the relevance of quality liquidity risk and contingency management processes.

The Bank's ability to meet all of its daily funding obligations and emergency liquidity needs is of paramount importance and in order to ensure that this is always adequately managed, the Bank maintains a liquidity contingency plan (LCP).

The objective of the LCP is to achieve and maintain funding sufficiency in a manner that allows the Group to emerge from a potential funding crisis with the best possible reputation and financial condition for continuing operations. The plan is expected to:

- support effective management of liquidity and funding risk under stressed conditions;
- establish clear roles and responsibilities in the event of a liquidity crisis; and
- articulate clear invocation and escalation procedures.

The LCP provides a pre-planned response mechanism to facilitate a swift and effective response to contingency funding events. These events may be triggered by financial distress in the market (systemic) or a bank-specific event (idiosyncratic) which may result in the loss of funding sources.

It is reviewed, annually and tested bi-annually via a Bank-wide liquidity stress simulation exercise to ensure the document remains up to date, relevant and familiar to all key personnel within the Bank that have a role to play should the Bank ever experience an extreme liquidity stress event.

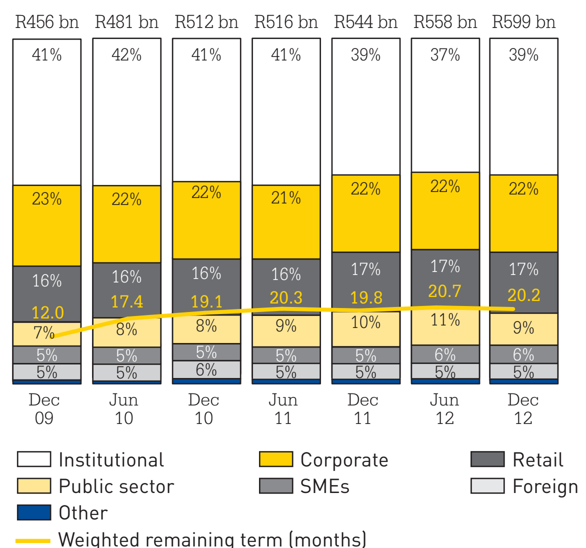
Funding strategy

The Group's objective is to fund its activities in a sustainable, diversified, efficient and flexible manner, underpinned by strong counterparty relationships within prudential limits and requirements. The objective is to maintain natural market share, but also to outperform at the margin, which will provide the Group with a natural liquidity buffer.

The Group seeks to diversify funding sources across segments, countries, instrument types and maturities. Where structural restrictions exist such as South Africa's reliance on wholesale funding, the risk is mitigated through term profile and liquidity buffers.

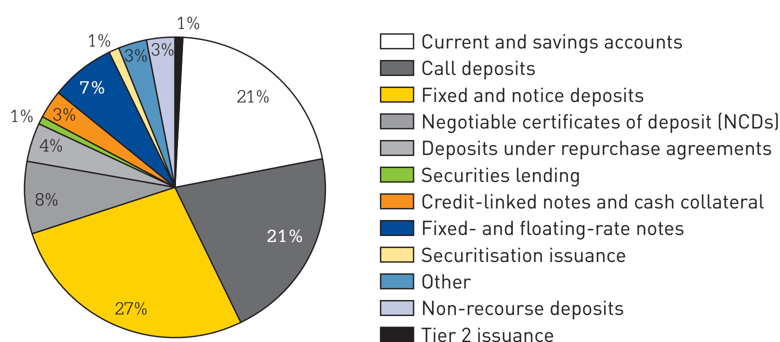
The table below illustrates the Group's sources of funding by counterparty.

The Bank's funding analysis by source (%) and total deposit base (R billion)



The chart below illustrates the Group's funding instruments by instrument type including senior debt and securitisation.

The Bank's funding instruments by instrument type at 31 December 2012 (%)



The business is incentivised to preserve and enhance funding stability via the funds transfer pricing framework, which ensures the pricing of assets is in line with liquidity risk, liabilities in accordance with funding maturity and contingents in respect of the potential funding draws on the Group.

OPERATIONAL RISK

Introduction and objectives

The Group processes large volumes of simple and complex transactions on a daily basis. The ability to process these transactions effectively is impacted by failure of IT systems and infrastructure, internal or external fraud, litigation, business disruption or process failure. Disruption in power supply, complex systems and inter-connectivity with other financial institutions and exchanges increase the risk of operational failure. Operational risk can also cause reputational damage, and, therefore, efforts to identify, manage and mitigate operational risk are equally sensitive to reputational risk as well as the risk of financial loss.

The overall objective of operational risk management is to enhance the level of operational risk maturity across the FirstRand Group by implementing and embedding process-based risk and control identification and assessments and integrating all the operational risk management advanced measurement approach (AMA) elements for a more comprehensive view of the operational risk profile.

The Group uses a variety of approaches and tools in the assessment, measurement and management of operational risk. ERM, independent of the revenue-producing units, is responsible for developing and ensuring the implementation of the operational risk management framework (ORMF) and its supporting policies to manage operational risks, and provides regular reports of operational risk exposures to the Board via the Group's risk governance structures. ERM is supported in its tasks by deployed segment and divisional risk managers, using Group-wide control standards endorsed by senior management and through the training of staff in a process of identifying, measuring, monitoring and reporting operational risk.

The period under review has strengthened the Group's view that the management of operational risk is an ongoing process that must be routinely defined, refined and re-examined. Existing policies, methodologies, processes, standards, systems and infrastructure are frequently evaluated for relevance to ensure that the discipline remains at the forefront of operational risk management and in line with regulatory developments and emerging best practices.

The Group recognises that managing operational risk effectively is not only a key capability but also provides a competitive advantage when addressing the balance between risk and reward. Embedding operational risk appetite levels and measuring actual operational risk exposure against the defined operational risk appetite at Group and divisional levels is a key operational risk strategic objective for the next six months ahead.

The period under review

Risk maturity assessments were conducted across the Group to identify key processes requiring greater levels of risk maturity in each division. Key themes identified during the risk maturity assessment initiative have resulted in the initiation and prioritisation of several projects across the divisions which will also address identified operational risks.

Work is underway to integrate and automate the Group's operational risk management tools onto a single platform to enhance operational risk management processes.

Operational risk appetite at Group and divisional levels were approved in the six months under review and represent an important step forward in enhancing the operational risk management discipline at FirstRand. It enables the Group and its divisions to measure and monitor operational risk profiles against their respective approved operational risk appetite levels and to set the boundaries for operational risk within which the business can achieve its strategic objectives.

Organisational structure and governance

The Board has delegated its responsibility for the governance and oversight over the management of operational risk to the Operational risk committee (ORC), a subcommittee of the RCC committee. The ORC provides governance, supervision, oversight and coordination of relevant operational risk processes as set out in the board-approved ORMF, a subframework of the BPRMF. Members of the ORC include a non-executive board member and an independent specialist advisory member, franchise heads of operational risk, the head of operational risk of the Group. In addition, senior personnel of the central ERM function attend the ORC.

In addition, governance committees at all levels of the Group (business unit, segment and franchise) and specialist Group sub-committees of the ORC (covering IT risk, business resilience, fraud risk, etc.) support the ORC and RCC committees in the execution of risk management duties and responsibilities.

The central operational risk management team in ERM is responsible for embedding the governance structure across the Group.

The management of operational risk is governed by the board-approved ORMF The ORMF prescribes the authorities, governance and monitoring structures, duties and responsibilities, processes, methodologies and standards which have to be implemented and adhered to when managing operational risk.

Measurement

Basel – advanced measurement approach

FirstRand began applying AMA under Basel from 1 January 2009 for the Group's domestic operations. Offshore subsidiaries and operations continue to utilise the standardised approach for operational risk and all previously unregulated entities that are now part of the FRIHL Group utilise the basic indicator approach.

Under AMA, FirstRand is allowed to use a sophisticated statistical model for the calculation of capital requirements, which enables more accurate risk-based measures of capital for all business units on AMA.

Operational risk scenarios (covering key risks that, although low in probability, may result in severe losses) and internal loss data are the inputs into this model.

Scenarios are derived through an extensive analysis of the Group's operational risks in consultation with business and risk experts from the respective business areas. Scenarios are cross referenced to external loss data, internal losses, risk and control self assessments and other pertinent information about relevant risk exposures. To ensure the ongoing accuracy of risk and capital assessments, all scenarios are reviewed, supplemented or updated semi-annually, as appropriate.

The loss data used for risk measurement, management and capital calculation is collected for all seven Basel event types across various internal business lines. Data collection is the responsibility of the respective business units and is overseen by the operational risk management team in ERM.

The modelled operational risk scenarios are combined with modelled loss data in a simulation model to derive the annual, aggregate distribution of operational risk losses. Basel Pillar 1 minimum capital requirements are then calculated (for the Group and each franchise) as the operational VaR at the 99.9th percentile of the aggregate loss distribution, excluding the effects of insurance, expected losses and correlation/ diversification.

Capital requirements are calculated for each franchise using the AMA capital model and then allocated to the legal entities within the Group based on gross income contribution ratios. This split of capital between legal entities is required for internal capital allocation, regulatory reporting and performance measurement purposes.

Business practices continuously evolve and the operational risk control environment is therefore constantly changing as a reflection of the underlying risk profile. The assessment of the operational risk profile and exposures and associated capital requirements take the following into account:

- changes in the operational risk profile, as measured by the various operational risk tools;
- material effects of expansion into new markets, new or substantially changed products or activities as well as the closure of existing operations;
- changes in the control environment – the organisation targets a continuous improvement in the control environment, but deterioration in effectiveness is also possible due to, for example, unforeseen increases in transaction volumes; and
- changes in the external environment, which drives certain types of operational risk.

Assessment and management

Operational risk assessment approaches and tools

The Group obtains assurance that the principles and standards in the ORMF are being adhered to by the three lines of control model integrated in operational risk management. In this model, business units own the operational risk profile as the first line of control. In the second line of control ERM is responsible for consolidated operational risk reporting, policy ownership and facilitation and coordination of operational risk management and governance processes. GIA, as the third line of control, provides independent assurance of the adequacy and effectiveness of operational risk management processes and practices.

In line with international best practice, a variety of tools and approaches are employed and embedded in the assessment and management of operational risk. The most pertinent of these are outlined in the following chart.

Operational risk assessment approaches and tools

<table>
<tr><th colspan="2">OPERATIONAL RISK TOOLS AND APPROACHES</th></tr>
<tr><th>Risk control self assessments (RCSA)
Process-based and control assessments (PRCIA)</th><th>Key risk indicators (KRI)</th></tr>
<tr><td>• integrated in the day-to-day business and risk management processes;
• used by business and risk managers to identify and monitor key risk areas and assess the effectiveness of existing controls; and
• PRCIA (currently being rolled out) is the risk and control assessment per product/service based on key business processes.</td><td>• used across the Group in all businesses as an early warning measure;
• highlight areas of changing trends in exposures to specific key operational risks; and
• inform operational risk profiles which are reported periodically to the appropriate management and risk committees and are monitored on a continuous basis.</td></tr>
<tr><th>Internal/external loss data</th><th>Risk scenarios</th></tr>
<tr><td>• the capturing of internal loss data is well entrenched within the Group.
• internal loss data reporting and analyses occur at all levels with specific focus on the root cause and process analysis and corrective action; and
• external loss databases are used to learn from the loss experience of other organisations and as an input to the risk scenario process.</td><td>• risk scenarios are widely used to identify and quantify low frequency extreme loss events;
• senior executives of the business actively participate in the bi-annual reviews; and
• the results are tabled at the appropriate risk committees and used as input to the capital modelling process.</td></tr>
</table>

As the PRCIA is rolled out across the Group over a period, it will replace the RCSA to ensure that a comprehensive assessment of risks and controls across end-to-end business processes is conducted.

FirstRand uses an integrated and reputable operational risk system which is well positioned as the core operational risk system and provides a solid platform for automation of all the operational risk tools. The automation and integration of all the operational risk tools on the operational risk system is currently a key focus area for the operational risk management function.

Operational risk losses

As operational risk cannot be avoided or mitigated entirely, frequent operational risk events resulting in small losses are expected as part of business operations (e.g. external fraud) and are budgeted for. Business areas minimise these losses through continuously monitoring and improving relevant business and control practices and processes. Operational risk events resulting in substantial losses occur much less frequently and the Group strives to minimise these and contain frequency and severity within its risk appetite limits.

Internal validation

In order to ensure consistency in the application and output of the various operational risk tools, a Group internal validation is undertaken annually. This process involves a robust challenge of all the operational risk tools at all levels within the Group. A report is issued on the final results of the internal validation exercise to the business for action where necessary.

Internal audit findings

GIA acts as the third line of risk control across the Group and provides an independent view on the adequacy of existing controls and their effectiveness in mitigating risks associated with key and supporting processes. Audit findings are tracked, monitored and reported on through the risk management and governance processes and structures.

Risk management processes

Within operational risk, a number of key risks exist in respect of which specialised teams, frameworks, policies and processes have been established and integrated into the broader operational risk management and governance processes as described below.

Business resilience management

Business resilience management (BRM) focuses on ensuring that the Group's operations are resilient to the risk of severe disruptions caused by internal failures or external events. The Business resilience steering committee, a subcommittee of the ORC, has oversight of BRM.

The business continuity practices of the Group are documented in the Group's business resilience policy and supporting standards, which are approved at the ORC. The policy, a subframework of the ORMF, requires the development and maintenance of business continuity strategies and plans. It also requires regular business continuity assessments and testing to be carried out in all business units and the results reported to the Business resilience steering committee.

The Group carries out regular reviews of BRM practices and any disruptions or incidents are assessed and regularly reported to the relevant risk committees.

Legal risk

The legal risk management framework, a subframework of the ORMF, addresses and seeks to guide the operations of the Group in areas such as the creation and ongoing management of contractual relationships, the management of disputes, which do or might lead to litigation, the protection and enforcement of property rights

(including intellectual property) and failure to account for the impact of the law or changes in the law brought about by legislation or the decisions of the courts. Whilst compliance with law is a major element of legal risk, RRM, through the regulatory risk management governance framework and attendant programme manages this aspect of legal risk. Added to these substantive and direct risks is the management of risk around the procurement of external legal resources.

A legal risk management programme is in place to work towards an ultimate goal of ensuring that comprehensive, sound operational risk governance practices and solutions are adopted in respect of legal risk management which represent best practice and which align to the Group's overall risk management programme. The Legal risk committee, a subcommittee of the ORC, has oversight of legal risk management.

Information risk

Information risk is concerned with the quality and protection of information and information systems against unauthorised access, destruction, modification, use and disclosure. The goal is to ensure the confidentiality, availability and integrity of all information and the systems that maintain, process and disseminate this information.

The Group's information and technology governance framework, acceptable use of information resources policy and information security policy provide the basis for the management of IT risk and information security within the Group.

The IT risk management framework, a subframework of the ORMF, defines the objectives of IT risk management and the processes that are to be embedded, managed and monitored across the Group for the effective management of IT risk.

During the reporting period the Group's Information Governance and IT Governance functions have been reviewed and restructured to allow for better alignment with the Group's ERM function. This integration with ERM will ensure that information and technology risks are identified and managed as part of the management of operational risks in the end-to-end business processes.

Fraud and security risks

Fraud risk is defined as the risk of loss resulting from unlawfully making, with intent to defraud, a misrepresentation which causes actual prejudice or which is potentially prejudicial to another. Fraud incorporates both internal (staff) criminal activities as well as those that emanate from an external source.

Fraud risk is governed by the fraud risk management framework, which is a subframework of the ORMF. The Group utilises a deployed fraud risk management model that requires businesses to institute processes and controls specific and appropriate to its operations within the constraints of a consistent governance framework that is overseen by the fraud risk management function reporting to the Group CRO.

The Group is committed to creating an environment that safeguards customers, staff and assets against fraud or security risks by continually investing in people, systems and processes for both preventative and detective measures.

Risk insurance

The Group has a structured insurance risk financing programme in place which has been developed over many years to protect the Group against unexpected material losses arising from non-trading risks. The insurance risk programme is continuously refined and enhanced through ongoing assessment of the changing risk profiles, organisational strategy and growth and the monitoring of international insurance markets. The levels and extent of the various insurance covers are reviewed and benchmarked annually.

The Group's insurance-buying philosophy is to carry as much risk on its own account as is economically viable and to only protect itself against catastrophic risks through the use of third party insurance providers. Accordingly, the majority of cover is placed into the Group's wholly-owned first party dedicated insurance company, FirstRand Insurance Services Company Limited (FRISCOL). All cover on the main programme is placed with reinsurers with a minimum credit rating of A-. The insurance programme includes, *inter alia,* cover for operational risk exposures such as professional indemnity, directors and officers liability, crime bond, public and general liability, etc. The Group, however, does not consider insurance as a mitigant in the calculation of capital for operational risk purposes.

REGULATORY RISK

Introduction and objectives

In FirstRand, the Group's RRM function plays an integral part in managing the risks inherent in banking. The Group fosters a compliance culture in its operations that contributes to the overall objective of prudent regulatory compliance and risk management by observing both the spirit and the letter of the law as an integral part of its business activities. The compliance culture also embraces broader standards of integrity and ethical conduct which concerns all employees.

Non-compliance may potentially have serious consequences, which could lead to both civil and criminal liability, including penalties, claims for loss and damages or restrictions imposed by regulatory bodies.

The objective of the RRM function is to ensure that business practices, policies, frameworks and approaches across the organisation are consistent with applicable laws and that regulatory risks are identified and managed proactively throughout the Group. This objective culminates in the maintenance of an effective and efficient regulatory risk management framework with sufficient operational capacity throughout the Group to promote and oversee compliance with legislative and best practice requirements.

It is of paramount importance that the Group ensures compliance with, among others, the provisions of the Banks Act, 1990 (Act No. 94 of 1990 – the Act) and the Regulations relating to Banks and ensures that all compliance issues identified in this context are effectively and expeditiously resolved by senior management with the assistance of RRM. Similarly, compliance with other important legislative and regulatory requirements such as Anti-Money Laundering legislation and Combating Terrorist Financing measures requires close cooperation with and interaction between RRM, other functions within the Group and the various regulatory authorities.

In order to achieve the Group's regulatory risk management objectives, staff members are being trained and made aware of compliance requirements in order to ensure a high level of under-standing and awareness of the applicable regulatory framework.

The period under review

The most notable future developments and focus area in respect of regulatory reforms is the current proposed shift to a twin peaks system of financial regulation in South Africa and expected ongoing adjustments to the regulatory framework, including those relating to the implementation and phase-in of the Basel III reforms and requirements.

The new Regulations relating to Banks became effective on 1 January 2013. It incorporates, among others, the requirements contained in the Basel III framework which are being phased in. Ongoing amendments to the Regulations are expected in order to ensure that the South African regulatory framework for banks and banking groups remains relevant and current in accordance with the latest internationally agreed regulatory and supervisory standards.

Organisational structure and governance

Responsibility for ensuring compliance with all relevant laws, related internal policies, regulations and supervisory requirements rests with the Board. In order to assist board members to make informed judgements on whether the Group is managing its regulatory and compliance risks effectively, the head of RRM has overall responsibility for coordinating the management of the Group's regulatory risk, including monitoring, assessing and reporting on the level of compliance to senior management and the Board. RRM complies with the prescribed requirements in terms of regulation 49 of the Regulations and its mandate is formalised in the Group's compliance risk management framework.

Governance oversight of the RRM function is conducted by a number of committees such as the RRM committee, the RCC committee and the Audit committee, all of which receive regular detailed reports on the level of compliance and instances of material non-compliance from RRM.

In addition to the centralised RRM function, each of the operating franchises have dedicated compliance officers responsible for implementing and monitoring compliance policies and procedures related to their respective franchises.

FirstRand has a formal social and ethics committee to exercise oversight over the governance and functioning of the Group-wide ethics programme. The FirstRand Group code of ethics is the cornerstone of FirstRand's ethics management framework.

RRM retains an independent reporting line to the Group CEO as well as to the Board through its designated committees.

Assessment and management

RRM's board mandate is to ensure full compliance with statutes and regulations. To achieve this, RRM has implemented appropriate structures, policies, processes and procedures to identify regulatory and supervisory risks. RRM monitors the management of these risks and reports on the level of compliance risk management to both the Board and the Registrar of Banks. These include:

- risk identification through documenting which laws, regulations and supervisory requirements are applicable to FirstRand;
- risk measurement through the development of risk management plans;
- risk monitoring and review of remedial actions;
- risk reporting; and
- providing advice on compliance-related matters.

Although independent of other risk management and governance functions, the RRM function works closely with GIA, ERM, external audit, internal and external legal advisors and the company secretary's office to ensure the effective functioning of the compliance processes.

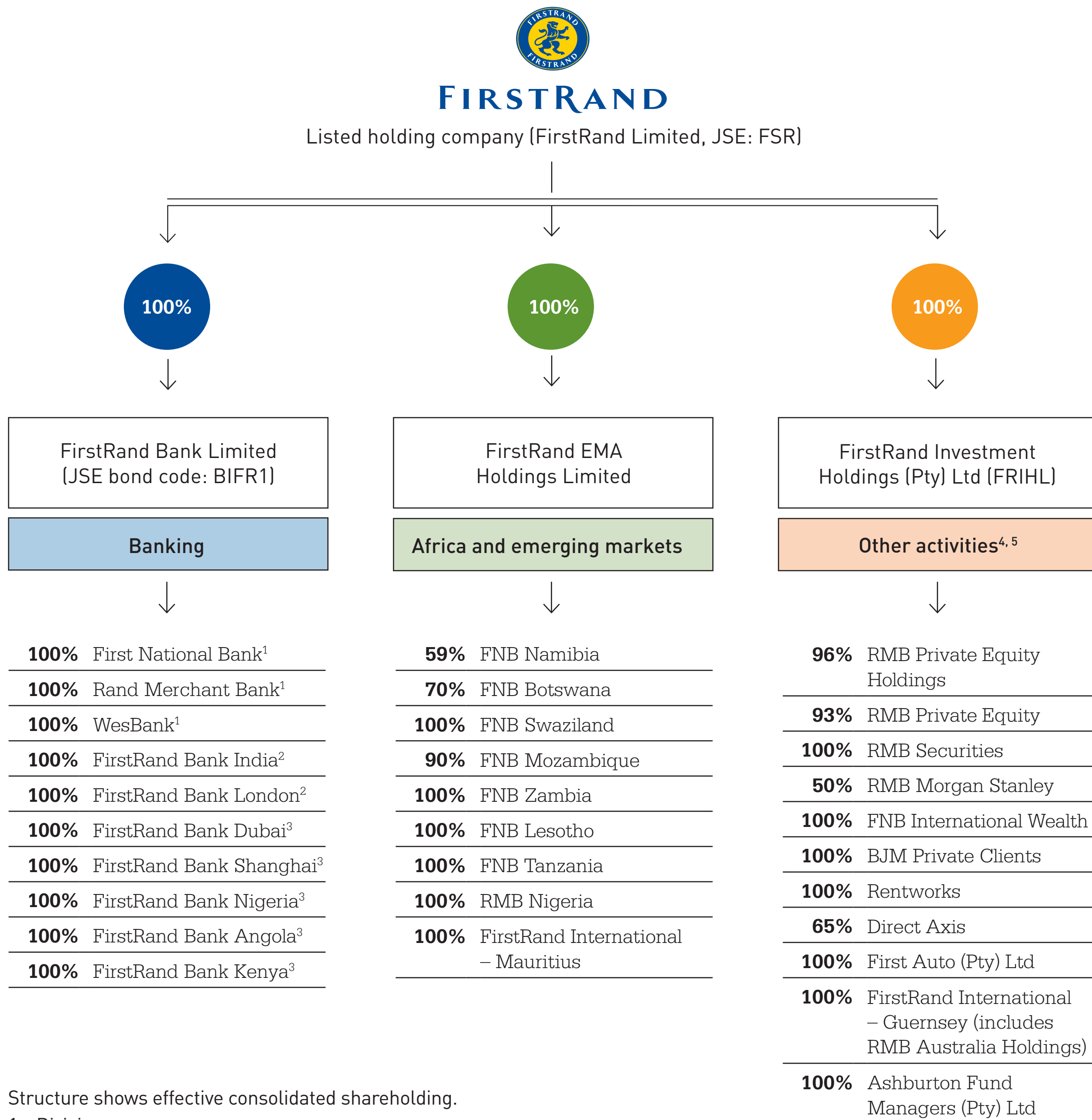
Public Policy and Regulatory Affairs Office

The Group's Public Policy and Regulatory Affairs Office (PPRAO) provides the Group with a central point of engagement, representation and coordination in respect of relevant regulatory and public policy related matters, at a strategic level. The PPRAO's function is differentiated from the existing and continuing engagement with regulators at an operational level (i.e. regulatory reporting, compliance and audit) with its main objective to ensure that executives across the Group and the franchises are aware of key developments relating to public policy, legislation and regulation which are considered pertinent to the Group's business activities and to support executives in developing the Group's position on issues pertaining to government policy, proposed and existing legislation and regulation.

REMUNERATION AND COMPENSATION

FirstRand's compensation policies and practices observe international best practice and comply with the requirements of the Banks Act, 1990 (Act No. 94 of 1990), and the Financial Stability Board's Principles for Sound Compensation Practices. In accordance with the requirements of regulation 43 of the revised Regulations of the Bank's Act and the Basel 2.5 requirements, full disclosures in respect of the Group's compensation policies, practices and performance are made annually in the Group's annual integrated report, which is publically available at:
www.firstrand.co.za.

Simplified group structure



Structure shows effective consolidated shareholding.

1. Division
2. Branch
3. Representative office
4. For segmental analysis purposes entities included in FRIHL are reported as part of the results of the managing franchise
5. The Group's securitisations and conduits are in FRIHL

Abbreviations

ABS	Asset-backed securities
AIRB	Advanced internal ratings-based approach
ALCCO	Asset, liability and capital committtee
ALM	Asset and liability management
AMA	Advanced measurement approach
AVC	Asset value correlation multiplier
BCBS	The Basel Committee on Banking supervision
BPRMF	Business performance and risk management framework
bps	basis points
BRM	Business resilience management
BSM	Balance Sheet Management
CAE	Chief audit executive
CDS	Credit default swap
CEM	Current exposure method
CEO	Chief executive officer
CET1	Common Equity Tier 1
CIS	Collective investment scheme
CRMF	Credit risk management framework
CRO	Chief risk officer
CSA	Credit support annexes
CVA	Credit valuation adjustment
EAD	Exposure at default
EL	Expected loss
ELI	Employee liability insurance
EP	Equator principles
ERM	Enterprise Risk Management
ESG	Environmental, social and governance risks
ESRA	Environmental and social risk analysis
ETL	Expected tail loss
EVE	Economic value of equity
Exco	Executive committee
FICC	Fixed income, currency and commodities division
FLS	Funding for Liquidity Scheme
FNB	First National Bank
FRB	FirstRand Bank Limited
FREMA	FirstRand EMA Holdings Limited
FRIHL	FirstRand Investment Holdings (Pty) Limited
FRISCOL	FirstRand Insurance Services Company Limited
FRM	Financial Resource Management
FR	FirstRand
FSA	Financial Services Authority
FTP	Funds transfer pricing
GCRM	Group Credit Risk Management
GIA	Group Internal Audit
GTS	Global Transational Services
IBD	RMB Investment Banking division
IBNR	Incurred but not reported
ICAAP	Interal capital adequacy assessment process
ICR	Individual capital requirement
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
iKhaya 1	iKhaya 1 RMBS Limited
iKhaya 1	iKhaya 2 RMBS Limited
IRRBB	Interest rate risk in the banking book
ISDA	International Swaps and Derivative Association
LCP	Liquidity contingency planning
LCR	Liquidity coverage ratio
LEC	Large exposures committee
LGD	Loss given default
LIP	Loss identification period
LRMF	Liquidity risk management framework
LTV	Loan-to-value
MIRC	Market and investment risk committee
MRVC	Model risk and validation committee
NCNR	Non-cummulative non-redeemable
NII	Net interest income
Nitro 4	Nitro Issuer Trust
NMD's	Non-maturity deposits and transmission account balances
NOFP	Net open forward position in foreign exchange
NPLs	Non-performing loans
NSFR	Net stable funding ratio
OECD	Organisation for economic cooperation and development
ORC	Operational risk committee
ORMF	Operational risk management framework
OTC	Over-the-counter
PD	Probability of default
PIT	Point-in-time
RCC	Risk, capital management and compliance committee
RCSA	Risk and control self assessments
Remco	Remuneration committee
RMB	Rand Merchant Bank
RMBS	Residential mortgage-backed securities
PPRAO	Public policy and regulatory affairs office
PRCIA	Process-based and control assessments
RCSA	Risk control self assessments
ROE	Return on equity
RRM	Regulatory Risk Management
RWA	Risk-weighted assets
RWN	Rating watch negative
SARB	South African Reserve Bank
S&P	Standard & Poors
SMEs	Small and medium enterprise
Stratco	Strategic executive committee
Turbo 3	Turbo Finance 3 plc
TTC	Through-the-cycle
UK	United Kingdom
US	United States
VAF	Vehicle and asset-based finance
VaR	Value-at-Risk