basel II pillar 3 disclosure

for the six months ended 31 December 2011

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 our website:

www.firstrand.co.za

email questions to: investor.relations@firstrand.co.za

Overview

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 position, financial performance, business activities, risk profile and risk management practice. This disclosure requirement is commonly known as Pillar 3 of the Basel II Accord.

This is the Basel II Pillar 3 report of FirstRand Limited (FirstRand or the Group). This report complies with the risk disclosure requirements of Basel II Pillar 3. The Group's financial performance for the six months ended 31 December 2011 is covered in the *analysis of financial results on the six months ended 31 December 2011 and the unaudited interim results and cash dividend declaration for the six months ended 31 December 2011.*

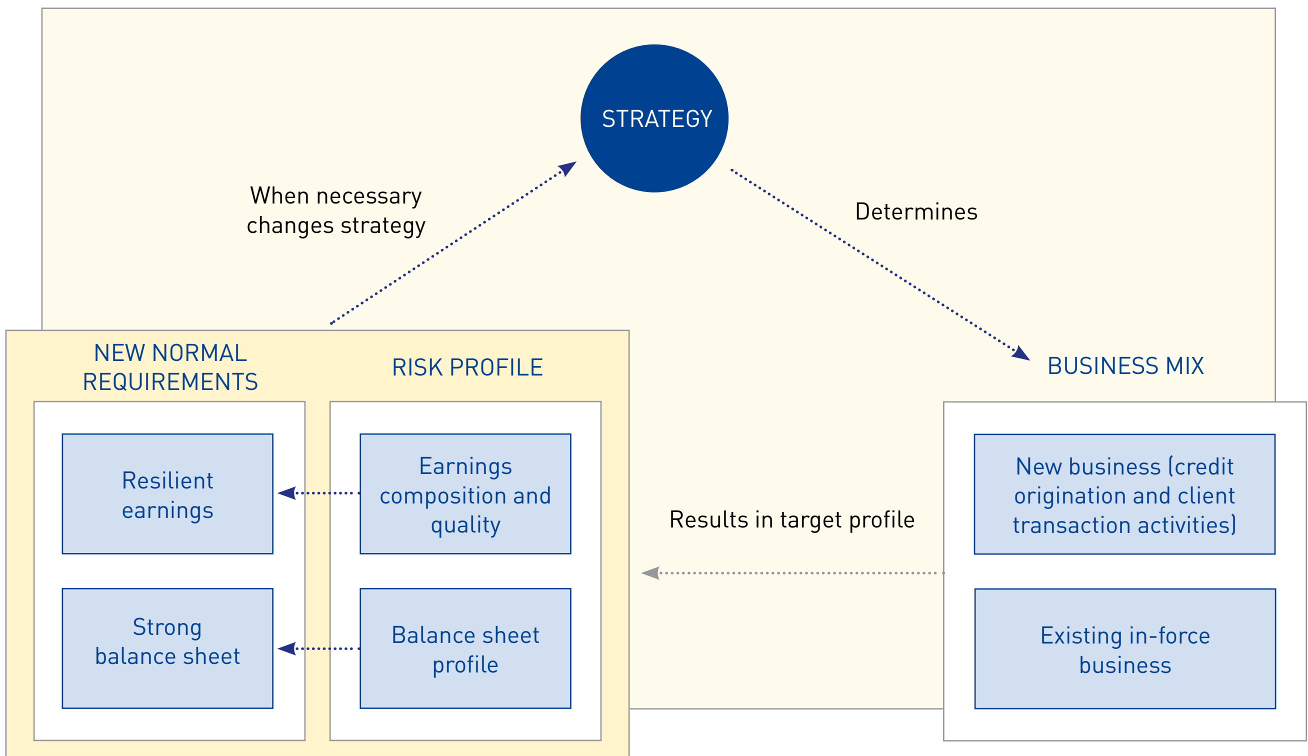
FirstRand is the listed holding company and regulated bank-controlling company. The wholly-owned subsidiaries of FirstRand are FirstRand Bank Limited (the Bank or FRB), FirstRand EMA Holdings Limited (FREMA) and FirstRand Investment Holdings (Pty) Limited (FRIHL) and are all regulated. Banking operations are included under the Bank, FREMA includes Africa and emerging markets and all other activities are under FRIHL. A simplified diagrammatic representation of the Group structure is provided on page 84.

Some differences between the practices, approaches, processes and policies of the Bank and its fellow wholly-owned subsidiaries exist and these are highlighted by a reference to the appropriate entity, where necessary. For fully consolidated entities in the Group, no difference in the manner in which entities are consolidated for accounting and regulatory purposes exist. All information in this report has been internally verified by the Group's governance processes.

STRATEGY AND RISK PROFILE ALIGNED

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 deeply embedded in the Group's tactical and strategic decision making.

The Group's strategic planning process



Risk taking is an essential part of the Group's business. FirstRand explicitly recognises risk assessment, monitoring and management as core competencies and important differentiators in the competitive environment in which it operates.

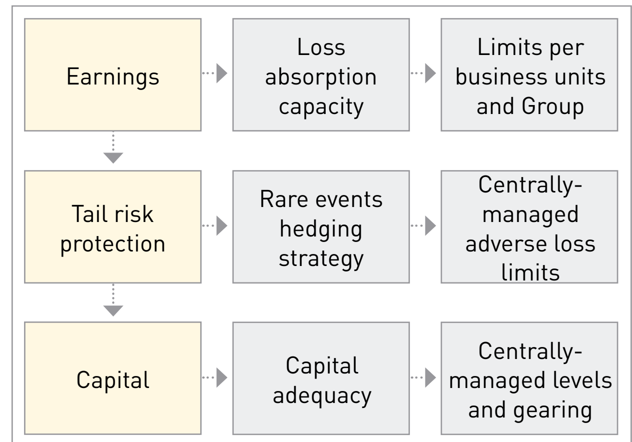
FirstRand's overall objective is to be the African financial services group of choice. To execute on these strategies, the Group will actively assume certain risks – including credit, market and investment risk. As a consequence of its banking activities it also incurs funding and liquidity, operational, interest rate and reputational risk. These risks are predominantly within South Africa and other select African markets.

In addition to the above risks, the Group's strategy can also be affected by external risks such as regulatory changes, political shifts and macroeconomic conditions.

The collective leadership of FirstRand, including the FirstRand CEO, COO and the franchise CEOs, determines the Group's strategy and is accountable for the overall performance of the Group. The strategy is approved by the Board. The determination of the Group's strategy is a dynamic process as illustrated by the diagram on page 3. It is designed to achieve superior, sustainable economic returns to shareholders, within acceptable levels of earnings volatility. The Group's strategy is executed through its portfolio of leading franchises. The Group seeks to be represented in all significant earnings pools across all chosen market segments playing across the full value chain (lending, transactional, savings and risk taking), therefore, this portfolio must represent the appropriate business mix and risk profile to deliver on this strategy.

On a regular basis, depending on certain macro dynamics or specific internal issues, the Group assesses whether the risk profile or business mix within its portfolio is optimal to deliver on its strategy; if not, it will take actions to adjust accordingly.

As illustrated in the diagram below, the Group views earnings as its first defence against adverse outcomes.



Beyond targeting suitable earnings streams, the Group can also enhance value by understanding, managing and mitigating tail risks to earnings stability. As part of its forecasting process, the Group considers outcomes beyond its core and risk scenarios which might have large adverse effects. As an additional layer of defence against tail risk, the Group also implements certain hedges.

In addition to earnings, capital provides a further buffer against unexpected losses. The Group is appropriately capitalised under a range of normal and severe scenarios, as well as under a range of stress events. The Group aims to back all economic risk with Tier 1 capital, as it offers the only real capacity to absorb losses. Currently, at least 90% of the Tier 1 ratio is equity capital.

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	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. **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 capital base is negatively impacted by a downturn in revenue due to market factors (e.g. margin compression), combined with the risk that the cost base is inflexible.	14
		Reputational risk is the risk of reputational damage due to compliance failures, pending litigations or 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. The overall objective of capital management is to maintain sound capital ratios, a strong credit rating, and to ensure confidence in the solvency of the Group during calm and turbulent periods in the economy and financial markets.	17
	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.	26
	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.	62
	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.	65

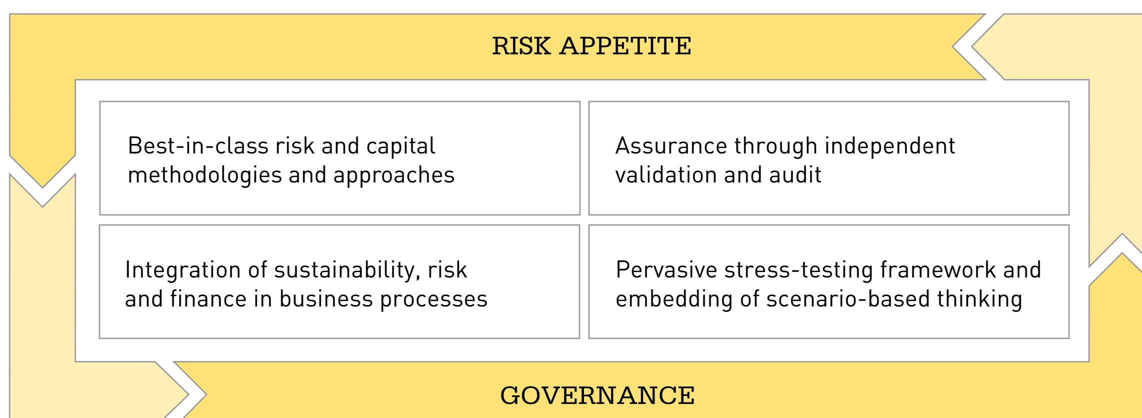
Risk category	Risk components	Definition	Page reference
Financial risks	Foreign exchange and translation risk in the banking book	**Foreign exchange risk** is the risk of losses occurring or a foreign investment's value changing from movements in foreign exchange rates. A bank is exposed to currency risk in its 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.	68
	Liquidity risk	Liquidity risk is the risk that a bank will not be able to meet all payment obligations as liabilities fall due. It is also the risk of not being able to realise assets when required to do so to meet repayment obligations in a stress scenario. The definition of liquidity risk is expanded in the *Liquidity risk* section on page 69.	69
	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.	72
Operational risk	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.	76
	Regulatory risk	Regulatory risk is the risk of statutory or regulatory sanction and material financial loss or reputational damage as a result of a failure to comply with any applicable laws, regulations or supervisory requirements.	79

FirstRand's approach to risk and capital management

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).
- Best practice risk and capital 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).
- 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 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 11).

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 12.

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. 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.

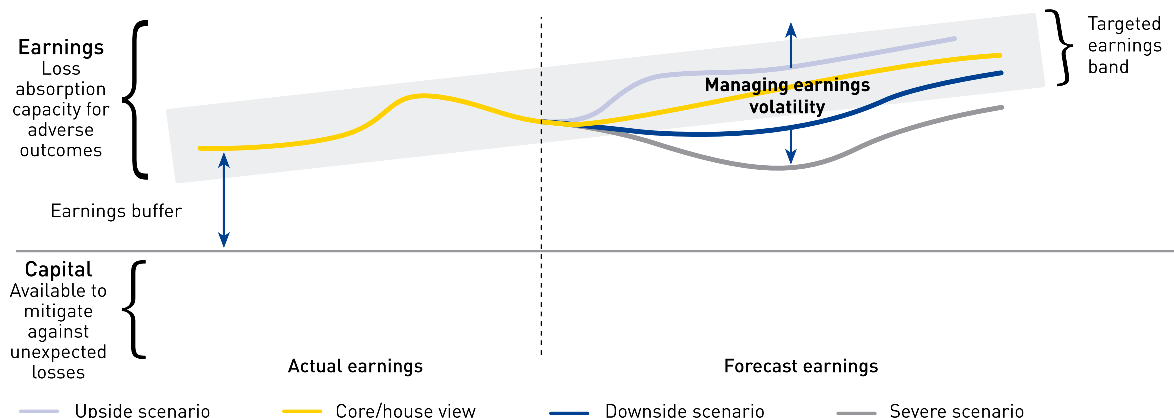
In setting the risk appetite, the executive committee (Exco) and the Board balance the organisation's overall risk capacity with a bottom-up view of the planned risk profile for each business. It is in this process that the Group ultimately seeks to achieve an optimal trade-off between its ability to take on risk and the sustainability of the returns it delivers to its 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 14 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 it adopts a management approach 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 and forecasting processes, informs credit origination strategies and capital stress testing, directs the interest rate positioning of the banking book and is used for tail risk strategies.

The Balance Sheet Management (BSM) unit within the Corporate Centre is the custodian of the macroeconomic house view. It provides the business units with a forecast of key variables that impact the balance sheet and that spans a three-year forecast horizon. Given the volatility of the macroeconomic environment, a core forecast and two risk scenarios are presented to the business units for each key variable. A severe scenario is also included for stress testing purposes. These scenarios and forecasts are debated and then communicated to the business units. The outlook is monitored on a daily basis and updated quarterly, or more frequently if required.

The Capital Management and Group Treasury functions within the Corporate Centre are responsible for the management of the Group's capital and liquidity, respectively. The capital position provides the final buffer against adverse business performance under extremely severe economic conditions.

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

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

INTERNAL CAPITAL ADEQUACY ASSESSMENT PROCESS

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 South African Reserve Bank (SARB) to allow the Group to conduct business;
- hold sufficient capital that will instil confidence in all stakeholders in the Group's ongoing solvency and status as a creditworthy counterparty;

- 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 the 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;
- to 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.

The internal capital adequacy assessment process (ICAAP) is an integral tool in meeting the above capital management objectives and 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.

STRESS TESTING AND SCENARIO-BASED ANALYSES

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 may 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.

As discussed earlier, the core macro scenario reflects the Group's view on the risks that are central to its business and which it assumes and manages accordingly. In addition, several stress scenarios are prepared to supplement the core view and inform management action at a business and Group level with respect to potential deviations from budget and the potential implications for earnings volatility. Furthermore, reverse stress test scenarios provide management and regulators with a structured view on potential developments that may threaten the stability of the institution.

The Group also recognises the fact that it is exposed to a number of risks that are difficult to anticipate and model and that 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 stress-testing framework provides for proactive and continuous identification of such potential events and establishes a process in which these are evaluated, discussed and escalated across the businesses.

Stress testing and scenario analyses have been integrated across the traditionally separate domains of risk and finance.

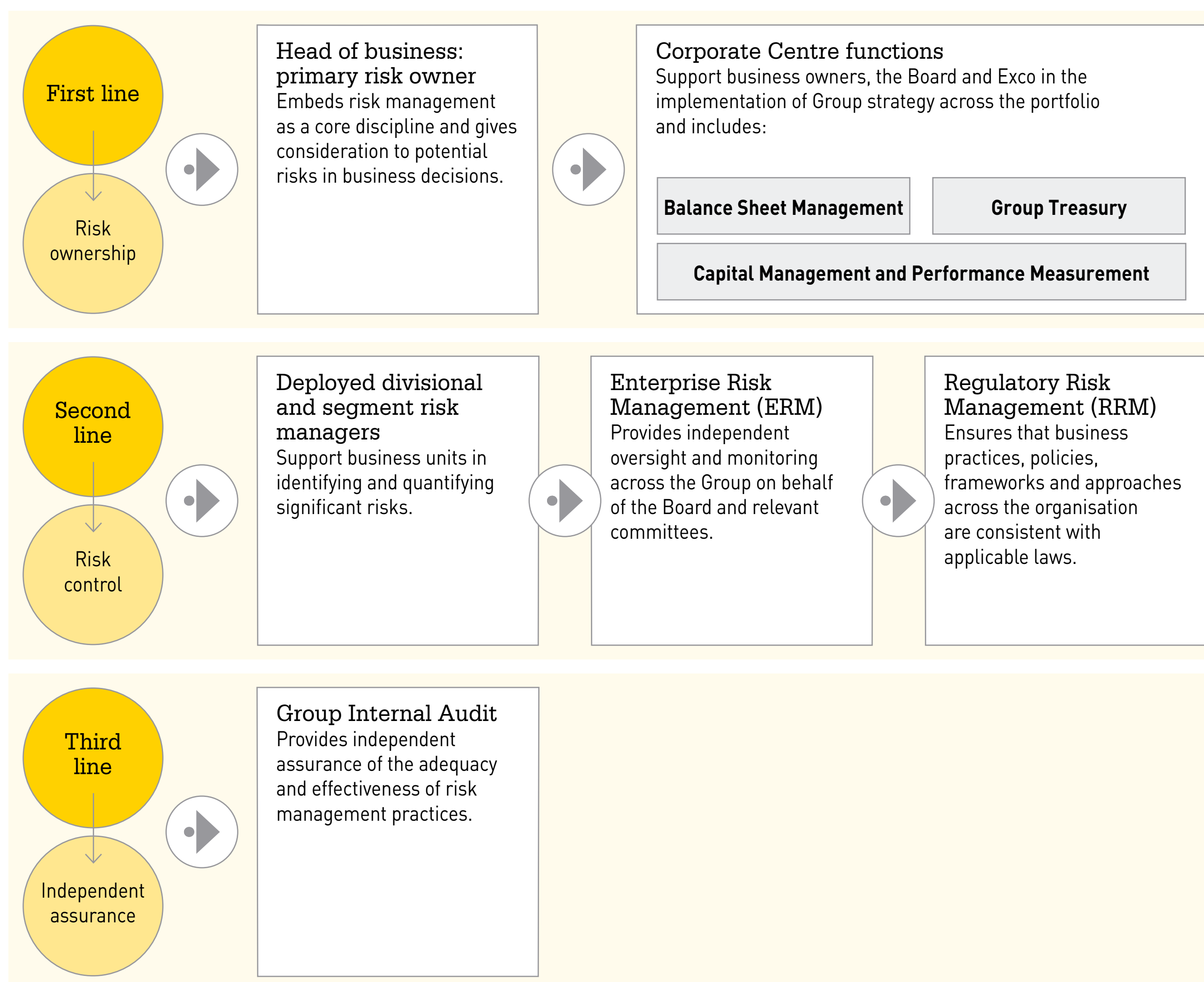
RISK MANAGEMENT FRAMEWORKS AND GOVERNANCE STRUCTURE

Risk governance framework

The Group's Board retains ultimate responsibility for ensuring that risks are adequately identified, measured, monitored and managed. The Group believes that effective risk management is predicated 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 chart overleaf.

Lines of risk control in the Group



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;
- 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 as appropriate 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 the Corporate Centre functions including BSM, Group Treasury, and Capital Management and Performance Measurement. The responsibilities of these functions 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;
- ensure that performance, risk exposures and corrective actions are reported in an appropriate format and frequency;
- monitor appropriate implementation of corrective action;
- identify process flaws and risk management issues and initiate corrective action;
- compile, analyse and escalate risk reports through appropriate governance structures; and
- ensure all risk management and loss containment activities are performed in a timely manner as agreed with ERM.

Divisional and segment risk management activities are overseen by the independent, central risk control functions, ERM and 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 the risk management strategy plan 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 management of risk exposures to 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 79.

Third line – independent assurance

The third major line of control involves functions providing independent assurance on the adequacy and effectiveness of risk management practices across the Group. These are the internal audit functions at a business and at a Group level.

Group Internal Audit (GIA) is headed by the chief audit executive and reports to the Board through the Audit committee chairman. The chief audit executive has direct, unrestricted access to the Group CEO, the executives in the respective businesses as well as all FirstRand functions, records, property and personnel.

With respect to risk and control environment, GIA is responsible for providing independent assurance that:

- risks are appropriately identified and managed;
- significant financial, managerial and operational information is accurate, reliable and timely;
- resources and assets are effective and efficiently utilised and adequately protected;
- employees actions are in compliance with policies, standards, procedures and applicable laws and regulations;
- significant legislative or regulatory issues impacting the organisation are recognised and addressed appropriately;
- the adequacy and effectiveness of the organisation's corporate governance, risk and control frameworks are rigorously assessed; and
- processes for controlling and managing its activities and associated risks are adequate.

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

Combined assurance

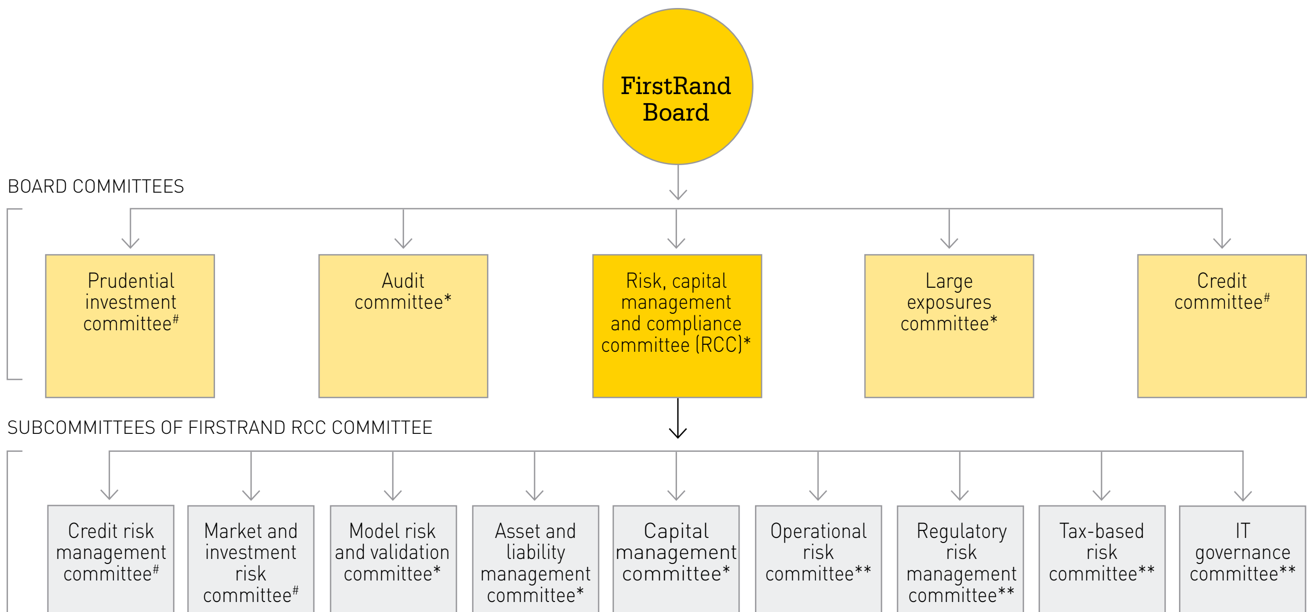
The Audit committee has overseen the establishment of formal enterprise-wide governance structures for enhancing the practice of combined assurance, involving the establishment of combined assurance forums at Group and subsidiary level. Through the combined assurance framework, GIA coordinates its efforts with the other control and monitoring functions namely ERM, RRM and external audit. The combined assurance forum is specifically mandated to achieve coordination, alignment and integration of risk management and assurance processes within the Group to optimise and maximise the level of risk, governance and control oversight over the organisation's risk landscape. This work has involved establishing common end-to-end business process and transaction life cycle frameworks against which different assurance processes are leveraged.

The initial outcomes of the combined assurance work completed indicate greater efficiency of assurance processes through the elimination of duplication, more focused risk-based assurance against key control areas and the emergence of a more accurate multidimensional picture of the Group's risk and control universe.

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 a non-executive board member.*
 # Chairperson is a member of senior executive management. The Credit and Credit risk management committees have 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.

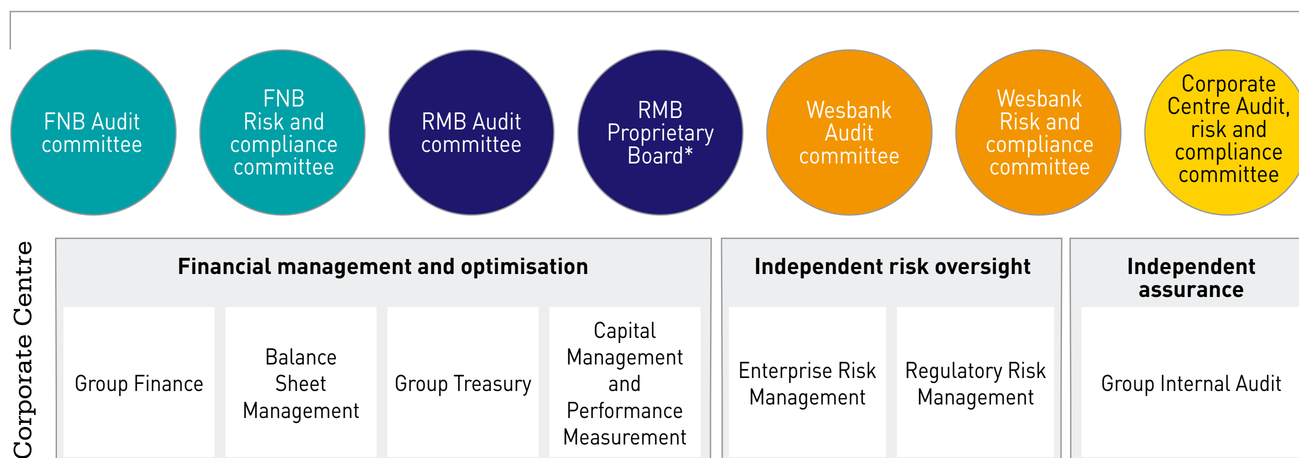
Responsibilities of the committees in the risk governance structure

	Committee	Responsibility
Board committees	Prudential investment committee	• ensures investment exposures comply with FirstRand's prudential investment guidelines.
	Audit committee	• considers the annual financial statements for approval by the Board; and • monitors the quality of the internal financial controls and processes of FirstRand and the implementation of corrective actions.
	Risk, capital management and compliance 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; and • approves risk and capital targets, limits and thresholds.
	Large exposures committee	• approves credit exposures in excess of 10% of the Group's capital.
	Credit committee	• credit approvals of group or individual credit facilities in excess of subcommittee mandates and limits; and • approves all wholesale credit policies.

	Committee	Responsibility
Subcommittees of the RCC committee	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 scenario and sensitivity analysis, stress tests, credit economic capital and credit concentrations; and • approves all retail and commercial credit policies.
	Market and investment risk committee	• approves market and investment risk management policy, 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	• considers and approves 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 and liability committee	• approves and monitors effectiveness of management policies and processes for interest rate risk in the banking book and liquidity risk.
	Capital management committee	• approves policies and principles relating to the management process of accounting, regulatory and economic capital; and • approves buffers over regulatory capital and monitors capital adequacy ratios.
	Operational risk committee	• provides governance, oversight and coordination of relevant operational risk management processes.
	Regulatory risk management 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-based 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

Franchise committees support FirstRand in the third line of control across the Group



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

The roles of the RCC committee and its subcommittees are further 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

KEY DEVELOPMENTS AND FOCUS

Strategic and business risks	Global risk sentiment remains challenging and the European sovereign debt crisis is likely to continue for some time. The short- and medium-term outlook will be characterised by periods of low growth and tough operating conditions. The Group will continue to monitor the macroeconomic and business conditions to ensure efficiency in a challenging operating environment.
ESG risks	As the Group is in the second year of detailed performance reporting against Equator Principles (EP) 13 projects were screened for the six months ended 31 December 2011. Of these seven were executed of which only one is 'Category A' or high risk. The Group continues to manage its ESG risks in line with the Group's predefined tolerances.

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.

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 Corporate Centre, review the external environment, industry trends, potential emerging risk factors, competitor actions and regulatory changes as part of the strategic planning process. 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 appetite and ICAAP processes.

Business risk is assessed regularly as part of ICAAP. It is managed strategically at a Group level through the development, review and updating of the strategy in light of the organisation's evolving view of the business environment.

For capital purposes the past history of revenues and costs (on a suitably-adjusted basis) are reviewed to determine whether it is likely that revenues would be insufficient to cover costs in a severe scenario. At present, projections indicate an adequate coverage of the projected cost base and no buffer or additional economic capital is therefore held against this risk type.

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. The manifestation of 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.

The analysis of volume and margin risk is a process to determine the relationship between a fixed cost base and a variable income stream and what the impact might be if market developments lead to sudden decreases in income while costs cannot be reduced as quickly or sufficiently to offset the loss of revenue.

For capital purposes, a stress estimate is applied to the calculated cost-to-income variability of the Group (based on a historical analysis). The stressed ratio is then compared to operating income to determine whether volume and margin risk pose a significant threat to the Group's income.

Reputational risk

As a financial services provider, the Group's business is one that is 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 both 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 finance institution in July 2009. The Equator Principles (EP) are included to form a risk management framework for determining, assessing and managing environmental and social risks 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.

During the 2010 financial year FirstRand extended the ESRA practices beyond EP transactions to commercial, corporate and working capital lending activities where material environmental and social risks may exist.

2011 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	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	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-compliances and reputational damage. Examples could include increased use of energy or increased atmospheric emissions.
Category C	Projects with minimal or no social or environmental impacts.

EP transactions

	Six months ended December 2011		Year to June 2011	
EP category	Projects reviewed	Projects funded	Projects reviewed	Projects funded
A (high risk)	3	1	5	3
B (medium risk)	3	2	2	0
C (low risk)	7	4	3	2
Total	13	7	10	5

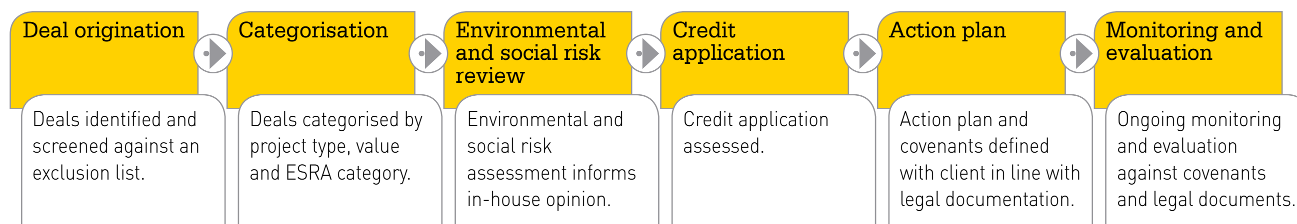
The Group is confident that deals disclosed in the table above have been subjected to appropriate due diligence for environmental and social risks and that, where appropriate, mitigating action plans are in place.

EP transactions during the period under review were categorised as falling into the mining and infrastructure sectors, renewable energy projects or "other" – which typically comprise deals related to large commercial property developments. This is not an unusual grouping of sectors in relation to EP due to the financial threshold associated with the EP projects, and the nature of project finance deals within these sectors.

ESRA process going forward

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 committees, as well as affected credit committees. At a Group level oversight is provided by the RCC committee.

ESRA implementation process



Although the evaluation and monitoring of EP transactions is embedded across the Group, continued focus will be given to both awareness training and the effective implementation of the ESRA process. The Waste Management Act is an area of integration into the ESRA processes which will be a focus going forward, particularly as it relates to the review of contamination risk in property financed or taken as security.

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

Capital management

KEY DEVELOPMENTS AND FOCUS

Capital management continues to focus on maintaining strong capital levels, with a particular focus on the quality of capital. This is reflected in the Core Tier 1 ratios of the Bank and the Group, which remained above targeted levels throughout the period.

The Group currently finds itself in an environment of significant regulatory uncertainty. The final Basel III framework released in December 2010 will be phased in from 1 January 2013 with full compliance of capital levels (including buffers) required by 1 January 2019. These guidelines have not yet been incorporated into the SARB regulations. The first draft of the Bank regulations incorporating the Basel III rules is expected by the end of March 2012.

The SARB has, however, commenced giving industry guidance on certain items that will be changed once Basel III is implemented. A guidance note was issued on the 8 February 2012 clarifying its Basel III treatment of disclosed reserves and the phasing out arrangement of existing Other Tier 1 and Tier 2 instruments that no longer qualify as regulatory capital. In terms of this guidance note, disclosed reserves will be included in Core Tier 1 capital and capital instruments no longer qualifying as regulatory capital will be phased out over a ten-year period from 1 January 2013. This guidance note is in line with the Basel III framework. Optimising the impact of Basel III continues to be an area of focus for the Group.

The Basel Committee on Banking Supervision (BCBS) has proposed a simple transparent non-risk based capital leverage ratio, with a minimum requirement of 3%. The Group is well in excess of this minimum requirement and this requirement, therefore, does not introduce any constraint for the Group.

Performance measurement is on a risk-adjusted basis and is continually enhanced to drive the desired behaviour. Economic profit or net income after capital charge (NIACC) is embedded in the management of the business. The Group achieved positive NIACC and generated value for shareholders for the period under review.

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. In addition, targeted capital ratios, future business plans, issuance of additional capital instruments, the need for appropriate buffers in excess of minimum requirements, rating agencies' considerations, investor expectations and proposed regulatory changes are all factors taken into consideration.

Allocating resources, including capital and risk capacity effectively in terms of the risk appetite targets and in a manner that maximises value for shareholders is a core competence and a key focus area. Sound capital management practices, therefore, form an important component of its overall business strategy. Moreover, performance measurement is aligned with the allocation of risk and continually enhanced to drive the desired behaviour.

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 in order 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 a range of 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. These processes are under continuous review and refinement and continue to inform the targeted buffer.

The Group currently finds itself in an environment of significant regulatory uncertainty. Although many of the Basel III changes have been finalised, these proposals are yet to be outlined in the domestic regulations. Targeted ranges were increased in the prior year in anticipation of the implementation of Basel III, even though the levels for South Africa are not yet finalised. For this reason the Group follows a conservative approach to capital levels and prefers to maintain capital ratios at the upper end of its targeted capitalisation range.

Over the period the Group operated above its targeted capitalisation range, reporting a total capital adequacy of 15.4% and a solid Core Tier 1 ratio of 12.9% at 31 December 2011. The Core Tier 1 ratio for the Group decreased due to the payment of the special dividend. Similarly the Bank, excluding subsidiaries and branches, operated comfortably above its targets with a total capital adequacy of 14.7% and Core Tier 1 ratio of 12.0%.

The targeted capital levels as well as the ratios at 31 December 2011 are summarised in the table below.

Capital adequacy position

	FirstRand		FRB*		Regulatory minimum
%	Actual	Target	Actual	Target	
Capital adequacy ratio	15.4	12.0 – 13.5	14.7	11.5 – 13.0	9.5#
Tier 1 ratio	14.0	11.0	13.0	10.5	7.0
Core Tier 1 ratio	12.9	9.5 – 11.0	12.0	9.0 – 10.5	5.25

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

Regulatory developments

Enhancements to the Basel II framework (Basel 2.5)

The SARB issued the final set of regulations covering the revised market risk and securitisation proposals as per Basel 2.5, as well as introducing a 6% scalar for credit risk. These regulations came into effect 1 January 2012 and currently do not make provision for the proposed Basel III framework discussed below.

It is estimated that the change to market risk will increase risk weighted assets (RWA) by R6.2 billion, whilst the 6% scalar will add another R15.2 billion to RWA. This will reduce the Group's Core Tier 1 ratio reported at the end of December 2011 by 63 basis points (bps), however, the Group will remain above the targeted capitalisation range.

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.

Bi-annual quantitative impact studies are currently being completed to assess the impact of the Basel III rules. The Group continues to be involved in this impact study and current calculations show a decline in the Core Tier 1 ratio. However, both the Group and the Bank will remain above the current regulatory minimum and internal minimum requirements. The targeted levels may be further revisited once the Basel III proposals are incorporated into the SARB regulations. The Group expects a first draft of the Bank regulations incorporating Basel III by the end of March 2012.

The BCBS introduced a simple, transparent non-risk based leverage ratio that is calibrated to act as a credible supplementary measure to the risk-based capital requirements. The BCBS has proposed a minimum Tier 1 capital leverage ratio of 3%. The Group's current leverage ratio is well in excess of this requirement and therefore this does not introduce any constraint for the Group.

The SARB issued a guidance note on 8 February 2012 clarifying its Basel III treatment of disclosed reserves and the phasing-out arrangement of existing Other Tier 1 and Tier 2 instruments that no longer qualify as regulatory capital. In terms of the guidance note issued the following treatment will be applied:

- disclosed reserves (including the share-based payment reserve, available-for-sale and foreign currency translation reserves) will be included in Core Tier 1 capital from 1 January 2013. This adds approximately R4.5 billion or 100 bps to the Group's Core Tier 1 capital if applied to the December regulatory balance sheet; and
- any capital instruments no longer qualifying as additional Tier 1 and Tier 2 under Basel III will be phased out from 1 January 2013 over a ten-year period.

This guidance note is in line with the Basel III framework. Optimising the impact of Basel III continues to be an area of focus for the Group.

Supply of capital – Tier 1

The Group aims to back all economic risks with Tier 1 capital, which offers the greatest capacity to absorb losses. Consequently, required Tier 1 capitalisation levels are used as the primary driver of performance measurement across the various businesses. Tier 1 capitalisation ratios benefited from stronger internal capital generation through earnings, offset by the special dividend paid in October 2011.

Supply of capital – Tier 2

The Group continues to investigate ways of optimising its capital base given the recent guidance note issued by the SARB.

For example, on 1 December 2011, FNB Botswana called its subordinated debt and replaced it with subordinated debt that meets the Basel III entry criteria.

Demand for capital

Capital requirements expressed as a percentage of RWA remain risk sensitive and cyclical under Basel II. This cyclicality, particularly for credit risk, is less evident at this point in the cycle. RWA movement for the Group was driven mainly by the following:

- equity investment risk – effective 1 July 2011, the SARB requested that all equity investment risk exposures be risk weighted under the simple risk weighted method (previously risk weighted under the standardised approach). This is only applicable to the non-bank entities and has increased the RWA movement for the Group;
- credit and market risk – the increase in credit RWA was mainly due to credit risk recalibrations and volume growth, and was partly offset by decreased market risk positions in the Bank.

Composition of capital

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

Composition of qualifying capital and capital ratios for FirstRand

	FirstRand		
R million	**December 2011**	December 2010	June 2011
Ordinary shareholders equity as per IFRS	**57 506**	50 360	56 631
Less: non-qualifying reserves	**(3 577)**	(3 075)	(2 954)
Cash flow reserve	**649**	561	451
Available-for-sale reserve	**(412)**	(612)	(225)
Share-based payment reserve	**(3 054)**	(2 703)	(2 739)
Foreign currency translation reserve	**(1 080)**	(348)	(474)
Other reserves	**320**	27	33
Ordinary shareholders equity qualifying as capital	**53 929**	47 285	53 677
Ordinary share capital and share premium	**5 222**	5 248	4 998
Reserves	**48 707**	42 037	48 679
Non-controlling interests	**3 074**	2 869	3 069
Less: total impairments	**(3 492)**	(3 118)	(3 521)
Excess of expected loss over eligible provisions (50%)	**(844)**	(542)	(907)
First loss credit enhancements in respect of securitisation structures (50%)	**(284)**	(78)	(247)
Goodwill and intangibles	**(1 650)**	(1 510)	(1 691)
Other impairments	**(714)**	(988)	(676)
Total Core Tier 1 capital	**53 511**	47 036	53 225
Non-cumulative non-redeemable (NCNR) preference shares	**4 519**	4 519	4 519
Total Tier 1 capital	**58 030**	51 555	57 744
Upper Tier 2 instruments	**1 044**	1 068	1 042
Tier 2 subordinated debt instruments	**5 784**	5 692	5 712
Other reserves	**208**	199	202
Less: total impairments	**(1 128)**	(620)	(1 154)
Excess of expected loss over eligible provisions (50%)	**(844)**	(542)	(907)
First loss credit enhancements in respect of securitisation structures (50%)	**(284)**	(78)	(247)
Total Tier 2 capital	**5 908**	6 339	5 802
Total qualifying capital and reserves	**63 938**	57 894	63 546

The table below provides more detail on the Group's capital instruments at 31 December 2011.

Characteristics of capital instruments of FirstRand

Capital type	Instrument	Nominal (R million)	Actual (R million)	Rate type	Maturity date*
Other Tier 1	NCNR preference share capital	4 519	4 519	Floating	Perpetual
Upper Tier 2	FRBC21	628	603	Fixed	21 Dec 2018
	FRBC22	440	441	Floating	21 Dec 2018
Lower Tier 2 (Subordinated debt)	FRB03	1 740	1 815	Fixed	15 Sept 2014
	FRB05	2 110	2 037	Fixed	21 Dec 2018
	FRB06	1 000	1 004	Floating	5 Nov 2012
	FRB07	300	304	Floating	6 Dec 2012
	FRB08	100	102	Floating	10 Jun 2016
	FRB09	100	102	Floating	10 Jun 2017
	FNBB002	122	133	Floating	1 Dec 2016
	FNBB003	27	27	Fixed	1 Dec 2016
	FNB17	260	268	Fixed	29 Mar 2012

* *Represents the call date of the instrument.*

The table below provides a detailed breakdown of the RWA numbers and capital requirement per Basel II approach for each risk type of FirstRand.

RWA and capital requirements per Basel II approach of FirstRand

	FirstRand					
	December 2011				December 2010	June 2011
	RWA†					
R million	Advanced approach	Standardised approach	Total	Capital requirement#	RWA†	
Credit risk						
Corporate, banks and sovereigns	96 663	8 205	104 868	9 962	85 581	92 642
Small and medium enterprise (SME)	39 648	9 786	49 434	4 696	41 095	37 584
Residential mortgages	43 464	3 701	47 165	4 481	44 747	42 388
Qualifying revolving retail	9 611	–	9 611	913	9 123	9 003
Other retail	45 186	8 628	53 814	5 112	31 962	40 481
Securitisation exposure	8 673	340	9 013	856	5 404	4 580
Other	–	8 443	8 443	802	36 797	31 911
Total credit risk	243 245	39 103	282 348	26 822	254 709	258 589
Operational risk*	51 626	12 119	63 745	6 056	63 163	63 649
Market risk	5 125	7 496	12 621	1 199	14 216	17 311
Equity investment risk**	30 236	–	30 236	2 872	27 087	20 605
Other assets	–	26 171	26 171	2 486	19 315	25 036
Total RWA	330 232	84 889	415 121	39 435	378 490	385 190

* *Exposures subject to basic indicator approach included under the standardised approach.*

** *Effective 1 July 2011, all exposures subject to the simple risk weighted method (previously non-bank entities were on the standardised approach).*

Capital requirement calculated at 9.5% (Pillar 1 of 8% and Pillar 2a of 1.5%) of RWA.

† *All risk types, except other assets are subject to the advanced approach in FRB.*

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

Composition of qualifying capital of the Bank

	FRB*		
R million	**December 2011**	December 2010	June 2011
Ordinary shareholders equity as per IFRS	**42 187**	36 303	37 965
Less: non-qualifying reserves	**(1 406)**	(1 690)	(333)
Cash flow reserve	**649**	561	452
Available-for-sale reserve	**(518)**	(619)	(443)
Share-based payment reserve	**(369)**	(355)	(342)
Unappropriated profits	**(1 168)**	(1 277)	
Ordinary shareholders equity qualifying as capital	**40 781**	34 613	37 632
Ordinary share capital and share premium	**14 608**	11 308	11 459
Reserves	**26 173**	23 305	26 173
Less: total impairments	**(2 859)**	(2 823)	(3 295)
Excess of expected loss over eligible provisions (50%)	**(844)**	(542)	(907)
First loss credit enhancements in respect of securitisation structures (50%)	**(45)**	(71)	(71)
Qualifying capital in branches	**(1 732)**	(1 732)	(1 732)
Intangibles	**(224)**	(189)	(268)
Other impairments	**(14)**	(289)	(317)
Total Core Tier 1 capital	**37 922**	31 790	34 337
NCNR preference shares	**3 000**	3 000	3 000
Total Tier 1 capital	**40 922**	34 790	37 337
Upper Tier 2 instruments	**1 044**	1 068	1 042
Tier 2 subordinated debt instruments	**5 364**	4 975	5 349
Less: total impairments	**(889)**	(613)	(978)
Excess of expected loss over eligible provisions (50%)	**(844)**	(542)	(907)
First loss credit enhancements in respect of securitisation structures (50%)	**(45)**	(71)	(71)
Total Tier 2 capital	**5 519**	5 430	5 413
Total qualifying capital and reserves	**46 441**	40 220	42 750

* *Reflects solo supervision, i.e. the Bank excluding branches and subsidiaries.*

RWA and capital requirements per Basel II approach of the Bank

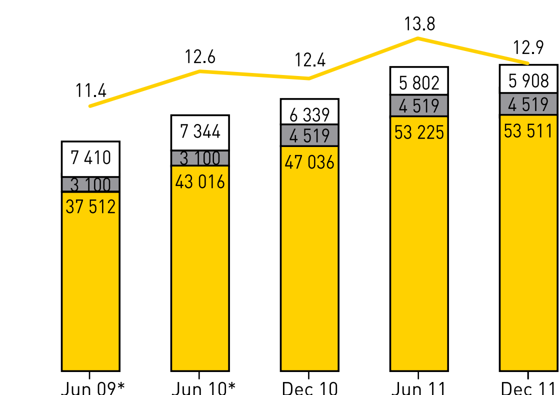
	FRB					
	December 2011				December 2010	June 2011
	RWA					
R million	Advanced approach	Standardised approach	Total	Capital requirement*	RWA	
Credit risk						
Corporate, banks and sovereigns	96 663	–	96 663	9 183	85 581	92 642
Small and medium enterprise (SME)	39 648	–	39 648	3 767	41 095	37 584
Residential mortgages	43 464	–	43 464	4 129	44 747	42 388
Qualifying revolving retail	9 611	–	9 611	913	9 123	9 003
Other retail	45 186	–	45 186	4 293	31 962	40 481
Securitisation exposure	8 673	–	8 673	824	5 404	4 580
Other	–	–	–	–	–	–
Total credit risk	**243 245**	**–**	**243 245**	**23 109**	217 912	226 678
Operational risk	42 268	–	42 268	4 015	42 992	42 659
Market risk	5 125	–	5 125	487	7 702	7 016
Equity investment risk	10 570	–	10 570	1 004	9 599	10 460
Other assets	–	14 545	14 545	1 382	14 401	14 027
Total RWA	**301 208**	**14 545**	**315 753**	**29 997**	292 606	300 840

* *Capital requirement calculated at 9.5% (Pillar 1 of 8% and Pillar 2a of 1.5%) of RWA.*

Historical overview of capital adequacy

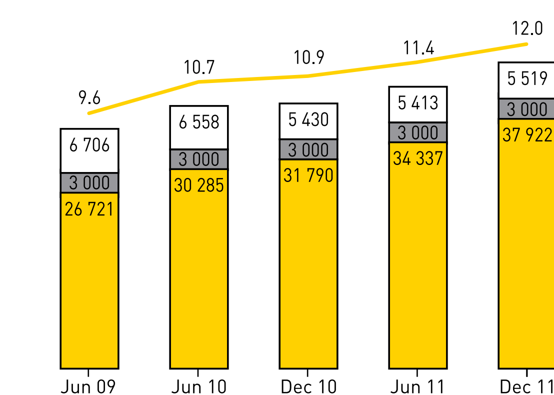
The graphs below provide a historical overview of the capital adequacy for FirstRand and the Bank.

FirstRand regulatory capital position



* *Comparative information prior to July 2010 relates to previously regulated entity FirstRand Bank Holdings Limited.*

FRB regulatory capital position



Capital adequacy position for FirstRand and its subsidiaries

The registered banks in FirstRand must comply with SARB regulations and those of their home 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. Appropriate 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 the Group, 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 is set out below.

RWA and capital adequacy position for FirstRand and its subsidiaries

	December 2011		December 2010	June 2010
	RWA R million	**Total capital adequacy %**	Total capital adequacy %	Total capital adequacy %
Basel II				
Bank controlling company	**415 121**	**15.4**	15.3	16.5
FirstRand Bank South Africa	**315 753**	**14.7**	13.7	14.2
FirstRand Bank London	**6 893**	**11.7**	11.6	12.5
FirstRand Bank India	**1 667**	**33.9**	69.3	43.0
FirstRand Ireland**	**–**	**–**	47.5	24.9
RMB Australia	**8 722**	**15.1**	25.1	24.0
FNB Namibia*	**12 159**	**16.7**	19.4	16.6
Basel I*				
FNB Botswana	**9 077**	**18.0**	17.4	15.7
FNB Lesotho	**285**	**19.5**	22.5	20.0
FNB Mozambique	**1 117**	**10.7**	10.6	16.6
FNB Swaziland	**1 449**	**28.8**	21.1	24.2
FNB Zambia	**720**	**14.6**	27.7	33.0
FNB Tanzania#	**86**	**107.2**	–	–

* *Ratios based on local rules.*
** *In the process of liquidation.*
# *Opened offices in July 2011.*

Performance measurement

To ensure that the Group delivers sustainable returns to its shareholders, the performance of each business unit is evaluated using both ROE and NIACC. These measures are steered by the allocation of risk capacity and aligned to the new regulatory requirements.

Economic capital

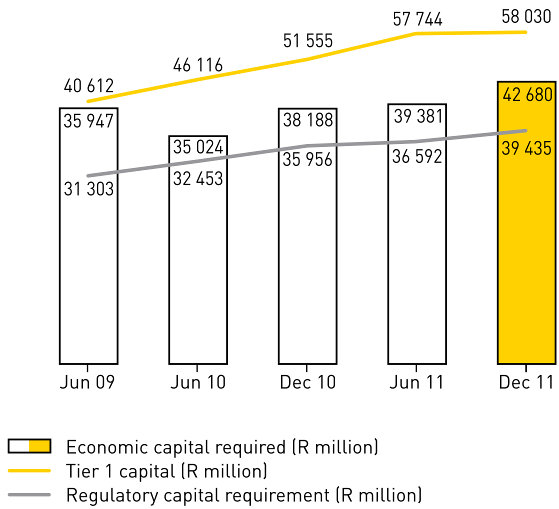
In addition to the regulatory capital requirements disclosed in the previous section, economic capital requirements are also calculated based on internally developed models. Economic capital is defined as the level of capital held that is commensurate with the Group's risk profile under severe stress conditions. This provides comfort to a range of stakeholders that the Group will be able to satisfy all its obligations to third parties with a desired degree of certainty and will continue to operate as a going concern.

Regular reviews of the economic capital position 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. The Group aims to back all economic risks with Tier 1 capital. Furthermore, it uses the allocation of capital based on risk capacity as a steering tool and for performance measurement of business units.

ICAAP assists in the attribution of capital in proportion to the risks inherent in the respective business units with reference to both normal economic circumstances and times of potential stress, which may lead to the realisation of risks not previously considered. This process is also supported by the stress testing and scenario-based analysis described on page 9.

The graph below provides an overview of the evolution of economic and regulatory capital requirements, as well as Tier 1 capital for the Group.

Economic capital and regulatory capital



Credit risk

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KEY DEVELOPMENTS AND FOCUS

In spite of the negativity and risks permeating the macro-economic environment, the credit portfolios performed very well. The pace of advances growth increased compared to prior periods and the Group's credit portfolios continued the positive momentum experienced during the prior period. The advances book grew substantially over the period under review while non-performing loans (NPLs) and income statement impairments continued to improve.

The economic environment remained uncertain during the six months to December 2011. The currency weakened exerting upward pressure on the cost of imports and consequentially pushing inflation above the SARB's target levels. Interest rates remained at very low levels and house price growth was subdued. There was no material improvement in unemployment levels.

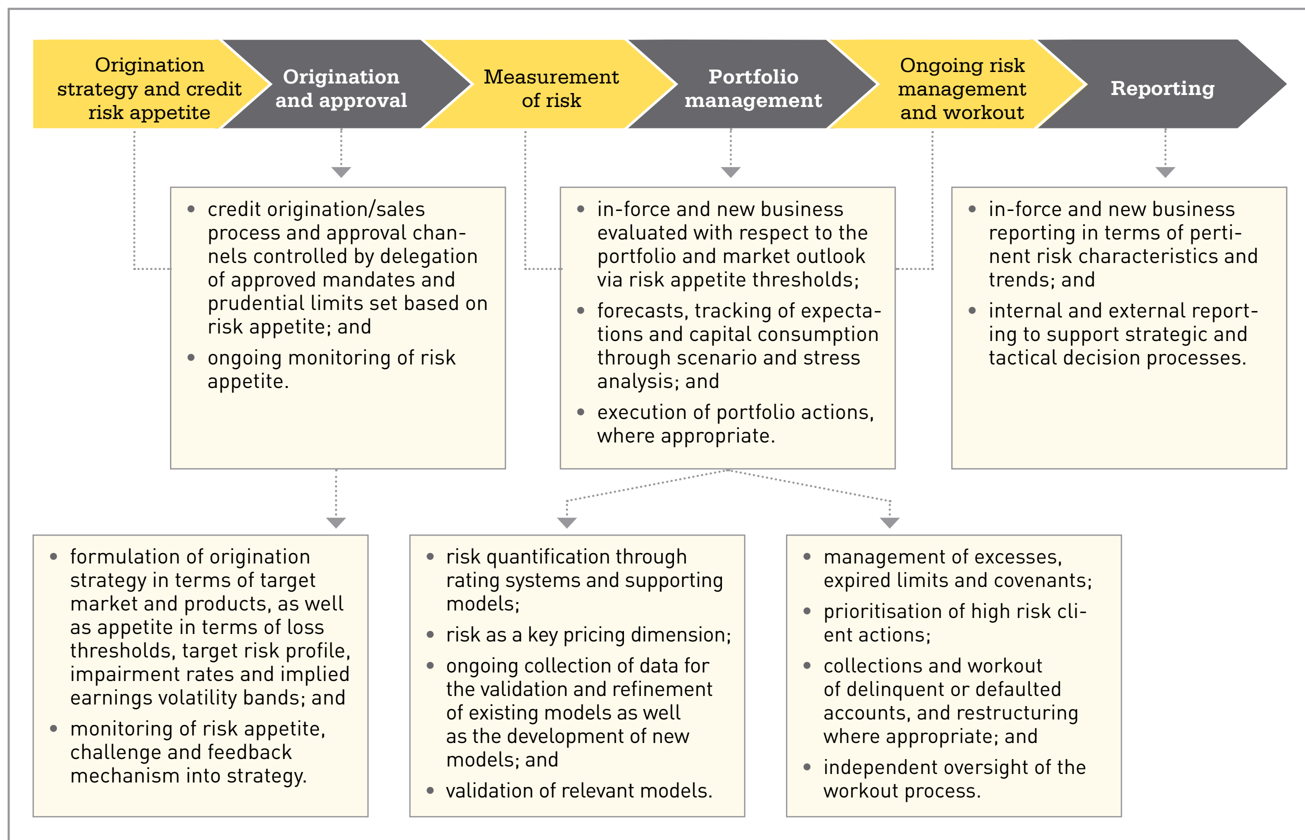
INTRODUCTION AND OBJECTIVES

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 (GCRM) function within ERM and relevant board committees, as well as BSM and the Performance Measurement function within the Corporate Centre, 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, the CRMF is a policy of the Board and a subframework of the BPRMF (see page 10).

The credit-focused board committees, namely the Credit committee, the Large exposures credit committee and the Model risk and validation committee (MRVC), as well as the Credit risk management committee (a subcommittee of the RCC committee), support the RCC committee in its task. For a description of the role and responsibilities of these committees refer to the governance structure on page 12.

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;
- 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 default experience;

- 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; and
- consolidated regulatory reporting.

The GCRM function is supported by deployed, segment 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 BSM and Performance Measurement and within the constraints of the overall credit risk appetite, see below);
- 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 provisioning models;
- ownership of the credit regulatory reporting process;
- maintaining the credit governance structure; and
- monitoring of corrective actions.

To support GCRM in the oversight of credit risk management, the Performance Measurement function in the Corporate Centre performs certain functions with respect to credit risk. Its tasks include the assessment, analysis, forecasting and reporting of impairments and credit risk reporting to stakeholders such as the Credit risk management committee.

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 advanced internal rating based (AIRB) approach requirements and the Bank's model building framework. The Group was granted regulatory approval under Basel II for the approaches as shown in the table below.

Basel approach	FirstRand Bank	Remaining FirstRand subsidiaries
AIRB	√	
Standardised Approach		√

Even though only the Bank has regulatory approval to use the AIRB approach, the same or similar models are applied for the internal assessment of credit risk in the remaining Group 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 includes the forfeiting of principal or interest, as well as a restructuring of facilities resulting in an economic loss).

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 – 12	0.04%	AAA, AA, A
FR 13 – 25	0.27%	BBB
FR 26 – 32	0.77%	BB+, BB
FR 33 – 37	1.34%	BB-
FR 38 – 48	2.15%	B+
FR 49 – 60	3.53%	B+
FR 61 – 83	6.74%	B
FR 84 – 91	15.02%	B-
FR 92 – 94		Below B-
FR 95 – 100	100%	D (defaulted)

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

An 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 the calculation of impairments for accounting purposes.

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 time 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.

Specialised lending

Specialised lending 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.

Where the Group finances an entity created to finance and/or operate physical assets, the slotting approach is applied where:

- the primary source of repayment of the obligations is the income generated by the assets (i.e. specialised lending); and
- the PD and LGD cannot be determined.

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: FNB Corporate, WesBank Corporate, Corporate Centre and RMB) 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 II requirements. **Rating process:** • Rating assignment to corporate credit counterparties is based on a detailed individual assessment of the counterparty's creditworthiness. The default definitions applied in the rating systems are aligned to Basel II requirements. • 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 Credit committee and the rating (and associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee. • 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: FNB Corporate, Corporate Centre and RMB) Exposures to sovereign and bank counterparties.	The default definitions applied in the rating systems are aligned to Basel II 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 Credit committee and the rating (as well as the associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee.
Specialised lending portfolios (Wholesale: FNB Corporate, RMB and FNB Commercial) 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 II requirements. **Rating process:** • The 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 Credit committee and the rating (as well as the associated PD) is approved by this committee. • No overrides of the ratings or the PDs are possible after approval by this committee.

<table>
<tr><th>Portfolio and type of exposures</th><th>Description of rating system</th></tr>
<tr><td>Commercial portfolio (SME corporate and SME 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 II 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.
• 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™, 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.
• 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, RMB Private Bank exposures and mortgage exposures in the Mass 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 II.
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.
• 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.
• 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 vs. budget in the case of credit cards).</td></tr>
<tr><td>Qualifying revolving retail exposures (Retail portfolios in FNB Card, FNB Consumer overdrafts and RMB Private Bank)
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 Personal loans, Smart products and WesBank Retail auto finance and personal 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 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 additional reviews of the rating systems, as well as sample revalidations. The results of these analyses are reported to MRVC. 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. GCRM is the custodian of these documents, which 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 SME counterparties, and commercial property transactions are supported by the financed property and associated cash flows;
- working capital facilities in FNB Corporate 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 Fixed Income, Currency and Commodities (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, valuations are 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 and the Performance Measurement function. Concentration risk is managed in the respective credit portfolios as outlined below. In the wholesale credit portfolio, through:

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

In the commercial portfolios through:

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

In retail credit portfolios:

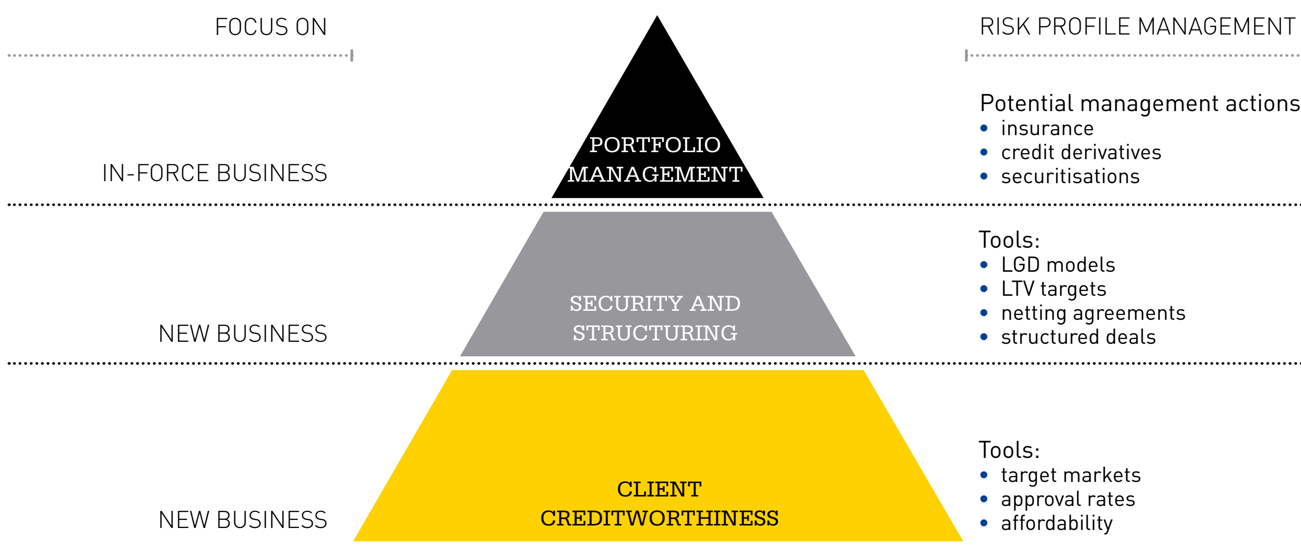
- monitoring on a (homogeneous) portfolio basis;
- restructuring of weak exposures to increase the projected realised value;
- reduction or removal of undrawn facilities in areas such as HomeLoans and Card; and
- revaluation of properties before approval of additional facilities.

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

Area	Wholesale	Retail
Credit approval	Ratings form an explicit and integral component of the approval decision, both with respect to the targeted portfolio composition in terms of applicable risk appetite limits (e.g. ratings profile) and with respect to the value proposition based on the projected risk adjusted return on economic capital (for which PD, EAD and LGD are key inputs).	Credit approvals are largely automated on the basis of application scorecards and applicable policy. These are reflective of PD, EAD and LGD.
Determination of individual and portfolio limits	The setting of limits at a client level and the ongoing evaluation of industry and geographical concentrations are key aspects of the determination of the overall credit strategy (see below). Ratings are an important consideration in this process and risk-related limits on the composition of the portfolio are used to ensure compliance with the Group's credit risk appetite.	See Wholesale. In addition, retail portfolios are regularly evaluated with respect to modelled vs. actual experience in the setting of credit risk appetite.
Reporting to senior management and the Board	Portfolio reports are collated on an ongoing basis and these are presented to and discussed regularly at relevant business and deployed risk committees. Quarterly portfolio reports are also submitted to the Credit risk committee, the Wholesale credit technical committee and the RCC committee.	See Wholesale. Reports are also submitted to the Retail and SME credit risk technical committee and the RCC committee.
Provisioning	PD and LGD estimates are used extensively in the assessment of impairments and thus in the calculation of provisions.	Loss identification period (LIP) PD, long-run LGD and roll rates are used in the derivation of specific, portfolio and incurred but not reported (IBNR) provisions.

Area	Wholesale	Retail
Regulatory and economic capital allocation	As the primary credit risk measures, PD, EAD and LGD are the most important inputs for both regulatory and economic capital models.	See Wholesale.
Profitability analysis and pricing decisions	The primary risk measures are the core parameters of the pricing calculator used for each transaction. For each application a value proposition section has to be completed that provides a cogent rationale for the transaction on a risk-adjusted basis.	PIT PDs, downturn LGDs and EADs are used in assigning appropriate price points to each risk rating. Profitability is assessed in terms of economic profit.
Credit monitoring and risk management	The monitoring of exposures is dependent on the risk assessment as given by PD, EAD and LGD. FR grades are updated on a regular basis to reflect the organisation's assessment of obligor risk. The risk parameters are also used in the Group's portfolio model as well as other tools which attribute additional capital to large transactions or to deals that further increase the concentration of risk in the portfolio.	See Wholesale. Extensive analysis of portfolio and risk movements is carried out on a monthly basis. These are used in portfolio management and credit strategy decisions.
Determination of portfolio and client acquisition strategy	Credit portfolio strategy is driven by the assessment of overall portfolio credit risk, which is based on a portfolio model driven by the primary risk measures. In this context, acquisition and overall strategies are set in terms of appropriate limits so as to ensure that the credit portfolios remain within the overall risk appetite prescribed by the Board.	See Wholesale. Credit models are also used to determine loss thresholds across retail portfolios, which are a direct consideration in the setting of credit risk appetite.
Performance measurement and compensation	The primary risk measures are key parameters for the calculation of deal pricing and are also used in the assessment of economic value added by a transaction or a business unit. From an operational perspective, each deal is evaluated with respect to the value added and compensation structures are tied to the measures.	See Wholesale. By necessity, analyses tend to be carried out at a portfolio level but performance is consistently measured on the basis of capital consumption and economic value added in the form of economic profit.

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 pages 52).

The Group's credit origination strategies, combined with the series of interest rate reductions from 2008 into 2010, have facilitated a reduction in new NPL inflows and credit impairment charges in most retail portfolios. These portfolios were also positively impacted by positive income growth and increased wages.

Although investment spending by business remains subdued, advances growth in the wholesale portfolios remained resilient over the reporting period mainly due to the approval of new investment-grade deals.

Retail credit portfolios

The Group's strategies to reduce NPLs continued to yield favourable results. The retail NPL% is 5.02% and is down from the 6.58% reported at December 2010. NPLs in the retail portfolios have declined by 17% since December 2010. The reduction in NPLs is driven by the slower inflow into NPLs in the FNB HomeLoans and WesBank vehicle and asset finance (VAF) portfolios. Accounts under debt review still prolong recovery periods and keep NPLs at higher levels. However, as at December 2011 the proportion of debt review accounts present in the WesBank and FNB HomeLoans portfolios showed signs of improvement. Increases in NPLs in some unsecured portfolios have been recorded, however, this increase is in line with expectations and risk appetite.

The reducing impairment charges in the retail secured portfolios were supported by the sustained low interest rates, reductions in NPL inflows and by post write-off recoveries. The retail unsecured portfolio showed increased impairments compared to December 2010 with the exception of FNB Card where the charge was substantially reduced by post write-off recoveries.

Corporate credit portfolios

The RMB core advances book grew by 16% due to investment banking related lending. The FNB Commercial portfolio achieved growth of 11% year-on-year. This growth is attributed mainly to the property term loans portfolio. Global Transactional Services (GTS) saw increased utilisation of facilities by clients which resulted in growth of 26% on advances of the prior period.

NPLs in the Corporate portfolio declined modestly over the period under review. This change is impacted by a reduction in NPLs in the FNB Commercial portfolio and an increase in the RMB NPLs. The Corporate NPLs % at December 2011 was 2.36% (December 2010: 2.63% and June 2011: 2.62%). Impairment charges also showed signs of improvement. The charge at December 2011 is 0.45% (December 2010: 0.61% and June 2011: 0.66%). Significant reductions in impairment charges were experienced in FNB Commercial and RMB compared to the previous December and June.

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 2011	December 2010	June 2011
Cash and short-term funds	30 213	25 576	29 239
Money at call and short notice	2 772	1 700	1 371
Balances with central banks and guaranteed by central banks	14 835	12 142	15 660
Balances with other banks	12 606	11 734	12 208
Gross advances	506 165	461 503	472 615
FNB*	211 058	199 127	206 183
FNB Retail	179 139	170 435	175 386
FNB Commercial	31 919	28 692	30 797
WesBank	110 713	95 359	102 125
RMB*	145 447	137 665	130 862
GTS*	3 600	2 849	2 593
FNB Africa	25 121	21 061	22 639
Other	10 226	5 442	8 213
Derivatives	57 721	51 052	37 206
Debt investment securities (excluding non-recourse investments)	88 749	96 289	89 280
Accounts receivable	7 894	5 598	7 289
Reinsurance assets	855	527	484
Credit risk not recognised on the balance sheet	97 495	83 485	95 852
Guarantees	21 747	21 168	24 727
Acceptances	267	291	289
Letters of credit	7 020	5 352	6 331
Irrevocable commitments	65 180	55 313	63 298
Credit derivatives	3 281	1 361	1 207
Total	**789 092**	724 030	731 965

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

Credit quality

Advances are considered past due where a specific payment date was not met, or where regular instalments are required and such payments were not received. A loan payable on demand is classified as overdue where a demand for repayment was served but repayment was not made in accordance with the stipulated requirements.

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

Age analysis of advances

	FirstRand						
	December 2011						
			Past due but not impaired				
R million	**Neither past due nor impaired**	**Renegotiated but current**	**1 – 30 days**	**31 – 60 days**	**61 – 90 days**	**Impaired**	**Total**
FNB Retail*	160 187	215	4 760	2 332	1 364	10 281	179 139
FNB Commercial	30 033	–	118	75	50	1 643	31 919
FNB	190 220	215	4 878	2 407	1 414	11 924	211 058
WesBank	102 873	–	2 811	823	84	4 122	110 713
FNB Africa	23 725	9	846	61	98	382	25 121
RMB**	144 174	–	53	6	73	1 141	145 447
GTS*	3 585	–	–	–	–	15	3 600
Other	10 248	–	–	–	–	(22)	10 226
Total	**474 825**	**224**	**8 588**	**3 297**	**1 669**	**17 562**	**506 165**

* *The comparative information for certain portfolios has been restated to reflect the current segmentation of the business.*
** *Impaired advances for RMB are net of cumulative credit fair value adjustments.*

	December 2010						
			Past due but not impaired				
R million	Neither past due nor impaired	Renegotiated but current	1 – 30 days	31 – 60 days	61 – 90 days	Impaired	Total
FNB Retail*	148 497	634	5 370	2 537	1 156	12 241	170 435
FNB Commercial	26 509	–	188	35	33	1 927	28 692
FNB	175 006	634	5 558	2 572	1 189	14 168	199 127
WesBank	88 399	–	1 507	493	73	4 887	95 359
FNB Africa	19 558	–	675	258	204	366	21 061
RMB**	136 293	–	129	32	32	1 179	137 665
GTS*	2 844	–	–	–	–	5	2 849
Other	5 443	–	(1)	(1)	–	1	5 442
Total	427 543	634	7 868	3 354	1 498	20 606	461 503

* *The comparative information for certain portfolios has been restated to reflect the current segmentation of the business.*
** *Impaired advances for RMB are net of cumulative credit fair value adjustments.*

	June 2011						
	Neither past due nor impaired	Renegotiated but current	Past due but not impaired				
R million			1 – 30 days	31 – 60 days	61 – 90 days	Impaired	Total
FNB Retail*	154 110	474	5 439	2 633	1 359	11 371	175 386
FNB Commercial	28 630	–	165	106	31	1 865	30 797
FNB	182 740	474	5 604	2 739	1 390	13 236	206 183
WesBank	93 879	–	2 812	978	89	4 367	102 125
FNB Africa	21 824	7	326	48	64	370	22 639
RMB**	126 656	3 094	12	7	–	1 093	130 862
GTS*	2 573	–	–	–	–	20	2 593
Other	8 213	–	–	–	–	–	8 213
Total	435 885	3 575	8 754	3 772	1 543	19 086	472 615

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

*** Impaired advances for RMB are net of cumulative credit fair value adjustments.*

Renegotiated advances

Renegotiated advances are advances where, due to the deterioration in a counterparty's financial condition, the Group granted a concession where the original terms and conditions of the facility were amended. The objective of such an amendment is to mitigate the risks where the current situation could result in the counterparty no longer being able to meet the terms and conditions originally agreed upon. As part of the risk management and workout approach, the Group enters into arrangements with clients where concessions are made on payment terms (e.g. a reduction in payments for a specified period of time, 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. The Group does not reclassify NPLs into the renegotiated advances category.

Renegotiated advances disclosed above include all loans renegotiated to date and for which the renegotiated terms have not yet expired. All of these advances comply with the revised terms and conditions. These advances are considered as a separate category for purposes of impairments and are not considered with the neither past due nor impaired category.

Renegotiated advances exclude any advances where the facility terms were extended or renewed as part of the ordinary course of business on terms and conditions equivalent to the current terms or conditions for new debt with similar risk.

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 two types of arrear accounts. These are normal arrears (i.e. accounts in arrears by one up to three full repayments) and technical arrears (e.g. accounts in arrears due to partial payment of the instalment due). Normal arrears are split into the three time buckets provided in the tables above, whereas the majority of technical arrears are in the 1-30 days bucket. Exposure to technical arrears of R3.5 billion (December 2010: R4.3 billion, June 2011: R3.7 billion) was included in the advances past due but not impaired total and was 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 we elect to foreclose or not.

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 impairment in the income statement.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively 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

	FirstRand		
R million	**December 2011**	December 2010	June 2011
Opening balance	**5 812**	6 888	6 888
Exchange rate difference	**13**	(2)	11
Amounts written off	**(2 501)**	(3 167)	(5 518)
Unwinding of discounted present value on NPLs	**(71)**	(124)	(213)
Reclassifications, transfers and acquisitions	**(34)**	70	(140)
Net new impairment created	**2 193**	2 551	4 784
Specific impairment	**5 412**	6 216	5 812
Portfolio impairment	**2 495**	1 997	2 210
Total impairments	**7 907**	8 213	8 022

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.

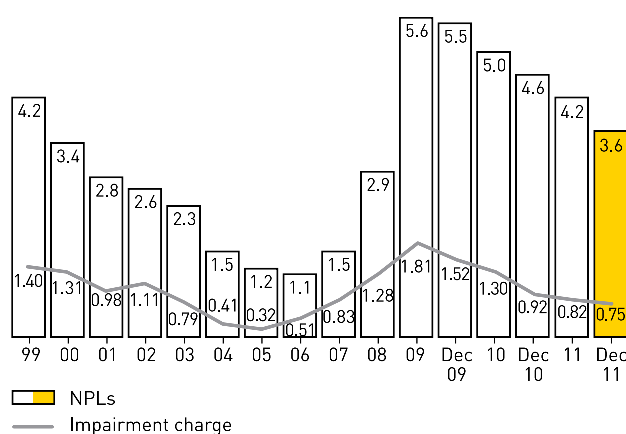
For amortised cost advances, impairments are recognised through the creation of an impairment reserve and an impairment charge in the income statement. For fair value advances, the credit valuation adjustment is charged to the income statement through trading income and recognised as a change to the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

Specific impairments are created for non-performing advances for which objective evidence that an incurred loss event will have an adverse impact on the estimated future cash flows from the asset was identified. 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 are 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
(%)



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

NPLs by class

	FirstRand					
	NPLs as a % of advances			NPLs		
%/R million	**December 2011**	December 2010	June 2011	**December 2011**	December 2010	June 2011
FNB*	**5.65**	7.12	6.42	11 924	14 168	13 238
FNB Retail	**5.74**	7.18	6.48	10 281	12 241	11 373
FNB Commercial	**5.15**	6.72	6.06	1 643	1 927	1 865
WesBank	**3.72**	5.12	4.28	4 122	4 887	4 367
RMB	**1.34**	1.23	1.37	1 945	1 690	1 798
GTS	**0.42**	0.18	0.69	15	5	18
FNB Africa	**1.52**	1.74	1.63	382	366	370
Other	**(0.22)**	0.02	(0.01)	(22)	1	(1)
Total NPLs	3.63	4.58	4.19	18 366	21 117	19 790

* *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 2011**	December 2010	June 2011	**December 2011**	December 2010	June 2011
Agriculture	**4.36**	2.90	3.28	**533**	390	453
Banks and financial services	**0.09**	0.04	0.93	**56**	28	519
Building and property development	**9.60**	9.57	7.24	**2 308**	2 056	1 771
Government, Land Bank and public authorities	**0.27**	0.42	0.48	**42**	73	74
Individuals	**4.46**	5.87	5.18	**12 748**	15 333	14 161
Manufacturing and commerce	**1.37**	2.30	1.80	**585**	752	635
Mining	**0.61**	0.56	0.49	**78**	61	55
Transport and communication	**1.61**	2.15	2.14	**240**	305	276
Other	**5.27**	8.71	6.12	**1 777**	2 119	1 846
Total NPLs	3.63	4.58	4.19	**18 366**	21 117	19 790

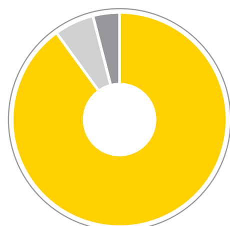
NPLs by geographical area

	NPLs as a % of advances			NPLs		
%/R million	**December 2011**	December 2010	June 2011	**December 2011**	December 2010	June 2011
South Africa	**3.87**	4.81	4.43	**17 540**	20 360	19 057
Other Africa	**1.36**	1.89	1.57	**418**	456	406
UK	**0.11**	0.17	0.14	**13**	15	16
South America	>**100**	60.17	>100	**342**	210	248
Australasia	**3.88**	12.82	2.66	**53**	76	63
Total NPLs	3.63	4.58	4.19	**18 366**	21 117	19 790

Geographic and industry concentration risk

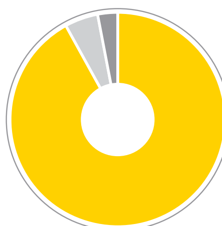
Geographically, most of the Group's exposure originates in South Africa. The following charts provide the geographical and industry split of gross advances after deduction of interest in suspense.

Geographic split by exposure 2011



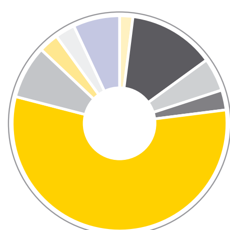
South Africa / 90%
Other Africa / 6%
Rest of the world / 4%

Geographic split by exposure 2010



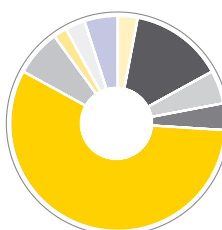
South Africa / 92%
Other Africa / 5%
Rest of the world / 3%

Industry split by exposure 2011



Individuals / 56%
Bank and financial services / 13%
Manufacturing and commerce / 8%
Other services / 7%
Building and property development / 5%
Government, Land Bank and public authorities / 3%
Mining / 3%
Transport and communication / 3%
Agriculture / 2%

Industry split by exposure 2010



Individuals / 57%
Bank and financial services / 14%
Manufacturing and commerce / 7%
Building and property development / 5%
Other services / 5%
Government, Land Bank and public authorities / 4%
Agriculture / 3%
Transport and communication / 3%
Mining / 2%

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

Concentration of significant credit exposure

R million	December 2011								
	South Africa	Other Africa	United Kingdom	Ireland	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

* *Significant off-balance sheet exposures.*

R million	December 2010								
	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	423 561	24 114	8 669	15	2 076	1 216	349	1 503	461 503
Derivatives	33 393	200	7 823	–	7 987	1 477	–	172	51 052
Debt investment securities	82 029	9 762	567	–	1 905	904	–	1 122	96 289
Guarantees, acceptances and letters of credit*	22 723	2 912	311	–	25	13	59	768	26 811
Irrevocable commitments*	50 791	3 446	793	–	187	22	–	74	55 313

* *Significant off-balance sheet exposures.*

R million	June 2011								
	South Africa	Other Africa	United Kingdom	Ireland	Other Europe	North America	South America	Other	Total
Advances	430 377	25 817	11 474	–	2 032	375	171	2 369	472 615
Derivatives	23 198	157	5 611	–	6 215	1 874	40	111	37 206
Debt investment securities	76 223	5 631	468	–	4 538	1 356	–	1 064	89 280
Guarantees, acceptances and letters of credit*	26 913	3 204	–	–	546	–	16	668	31 347
Irrevocable commitments*	56 901	5 192	363	–	794	9	–	39	63 298

* *Significant off-balance sheet exposures.*

Average advances per major risk type

R million	December 2011	December 2010	June 2011
Retail credit	301 941	282 024	289 963
Africa	22 861	19 636	21 096
Wholesale credit	136 778	128 149	132 274
Commercial credit	30 660	28 290	29 263

BASEL II DISCLOSURE

Credit rating systems and processes used for Basel II

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 approaches

		AIRB	Standardised approach subsidiaries and branches	
R million	2011	FRB (SA)	Regulated bank entities within FNB Africa	Branches and other subsidiaries
Cash and short-term funds	**30 213**	23 864	4 454	1 895
Money at call and short notice	**2 772**	2 405	95	272
Balances with central banks and guaranteed by central banks	**14 835**	11 704	3 071	60
Balances with other banks	**12 606**	9 755	1 288	1 563
Gross advances	**506 165**	459 208	25 121	21 836
FNB	**211 058**	209 503	–	1 555
FNB Retail	**179 139**	177 633	–	1 506
FNB Commercial	**31 919**	31 870	–	49
WesBank	**110 713**	98 295	–	12 418
RMB	**145 447**	138 932	–	6 515
GTS	**3 600**	3 600	–	–
FNB Africa	**25 121**	–	25 121	–
Other	**10 226**	8 878	–	1 348
Derivatives	**57 721**	57 191	–	530
Debt investment securities	**88 749**	78 501	4 806	5 442
Accounts receivable	**7 894**	2 753	522	4 619
Loans due by holding company and fellow subsidiaries	**–**	20 378	2 176	(22 554)
Reinsurance assets	**855**	–	1	854
Credit risk not recognised on the balance sheet	**97 495**	88 184	7 237	2 074
Guarantees	**21 747**	19 129	2 034	584
Acceptances	**267**	267	–	–
Letters of credit	**7 020**	6 349	670	1
Irrevocable commitments	**65 180**	59 158	4 533	1 489
Credit derivatives	**3 281**	3 281	–	–
Total	**789 092**	730 079	44 317	14 696

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 grade.

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%	95
10%	
20%	4 505
35%	9 178
50%	3 769
75%	3 600
100%	22 985
Specific impairments	185
Total	**44 317**

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 29) which are then mapped to Basel rating buckets (1-25) for regulatory reporting purposes.

The graphs 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.

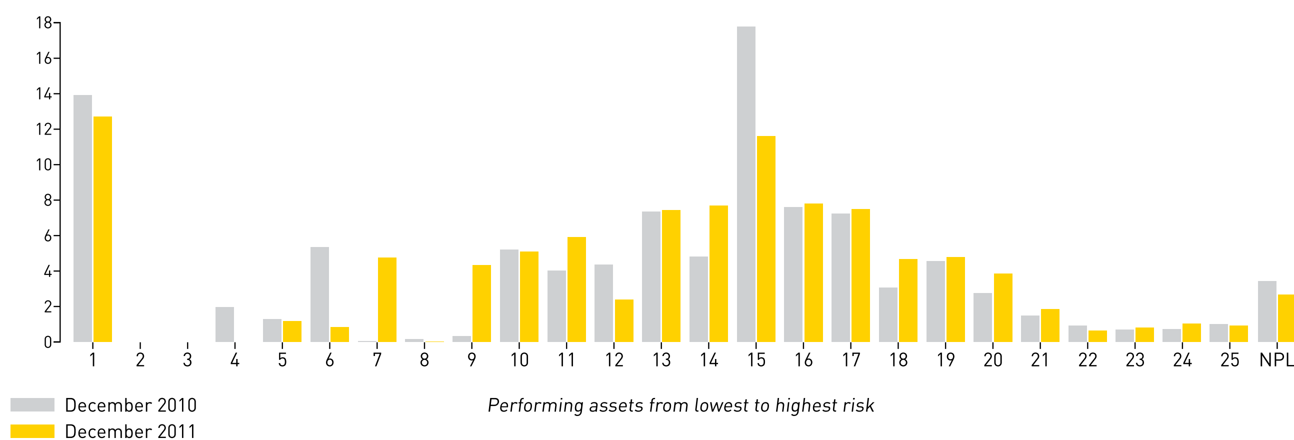
Year-on-year trends will be impacted by the risk migration in the existing book (reflecting changes in the economic environment), quality of new business originated and any model recalibrations implemented during the course of the year.

The majority of the retail portfolios exhibited significant positive risk migration for the period under review. This was, however, negated by model recalibrations implemented during the financial year, incorporating further defaults after the peak of the economic downturn.

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

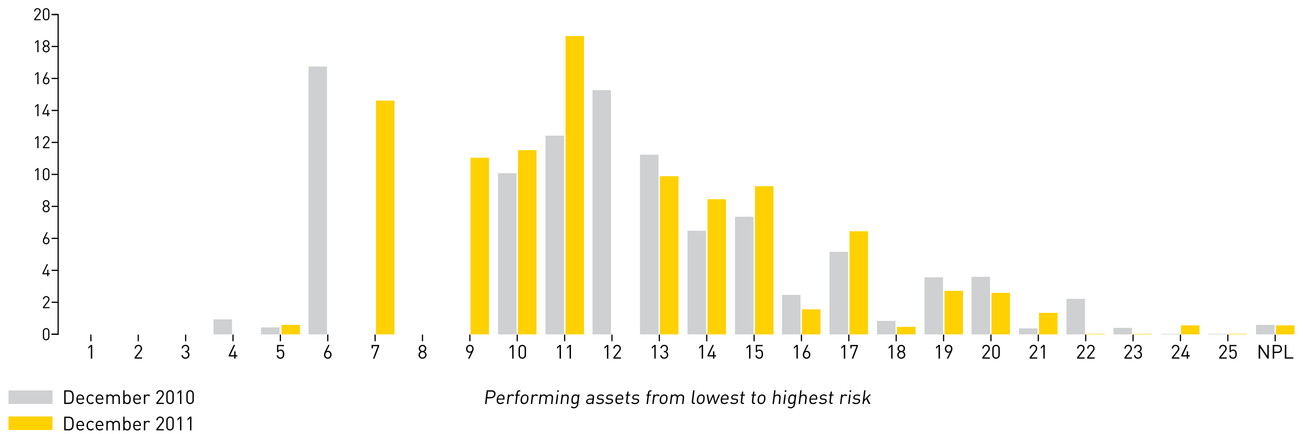
The risk profile reflects the revised credit origination strategy that selectively targets segments providing an appropriate risk/return profile in the current economic environment.

Risk profile for FRB: EAD % distribution per Basel risk buckets
(EAD %)



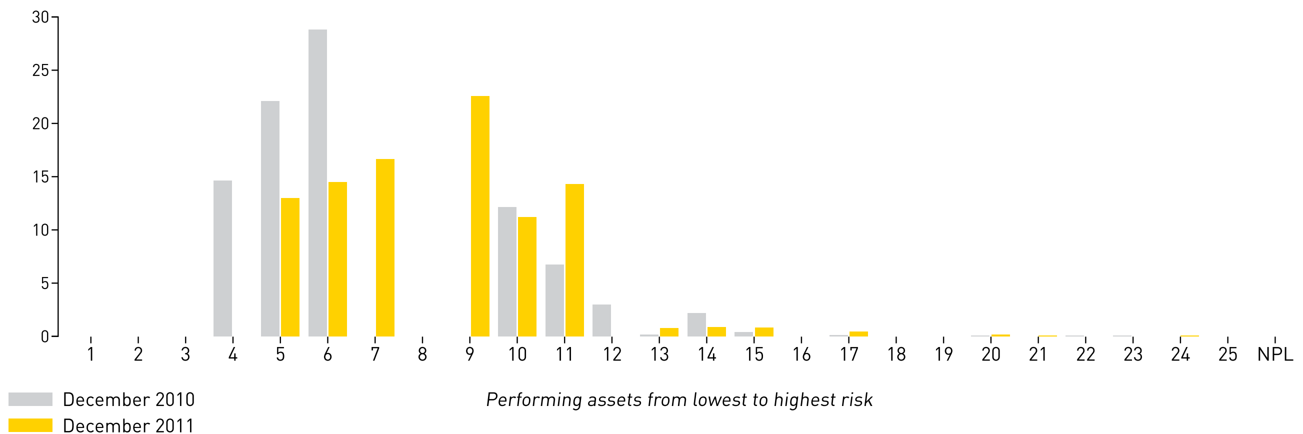
Average performing PD%	3.03%	Average total book PD%	6.03%
Average performing LGD%	28.01%	Average total book LGD%	28.4%
Performing book EL/EAD	0.85%	Total book EL/EAD	1.70%

Risk profile for corporate exposures: EAD % distribution per Basel risk buckets
(EAD %)



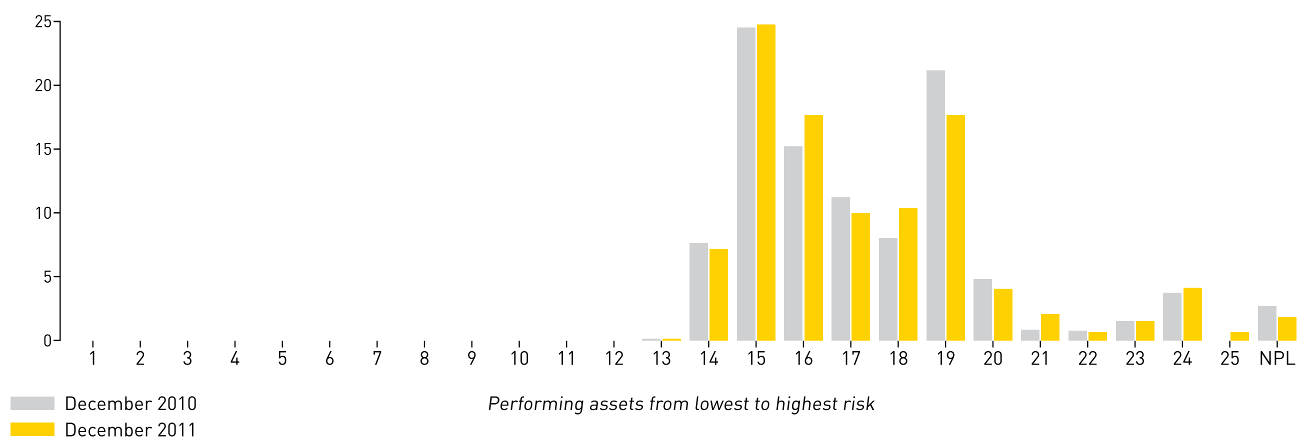
Average performing PD%	1.45%	Average total book PD%	2.33%
Average performing LGD%	36.03%	Average total book LGD%	36.15%
Performing book EL/EAD	0.52%	Total book EL/EAD	0.84%

Risk profile for banks exposures: EAD % distribution per Basel risk buckets
(EAD %)



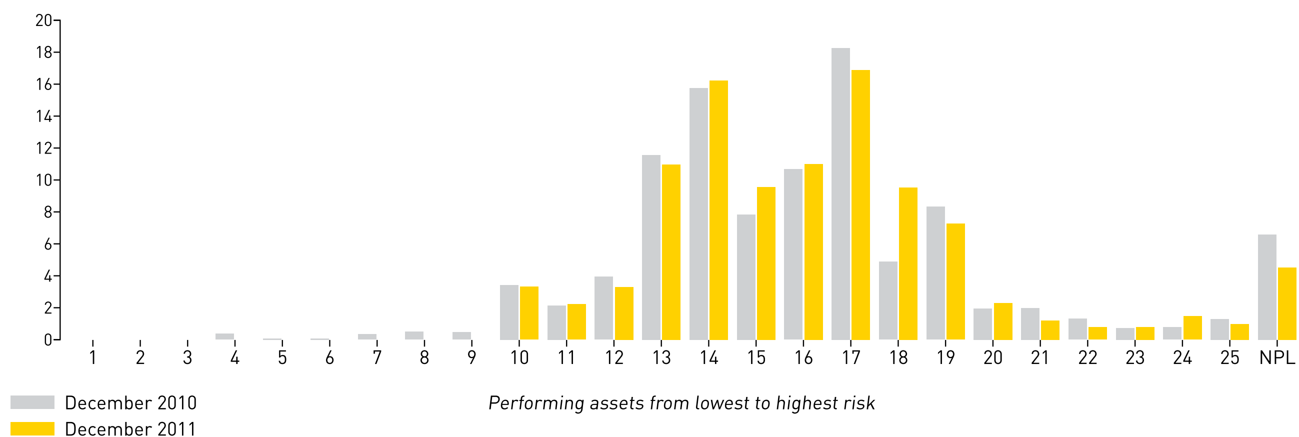
Average performing PD%	0.20%	Average total book PD%	0.20%
Average performing LGD%	32.94%	Average total book LGD%	32.94%
Performing book EL/EAD	0.07%	Total book EL/EAD	0.07%

Risk profile for SME corporate exposures: EAD % distribution per Basel risk buckets
(EAD %)



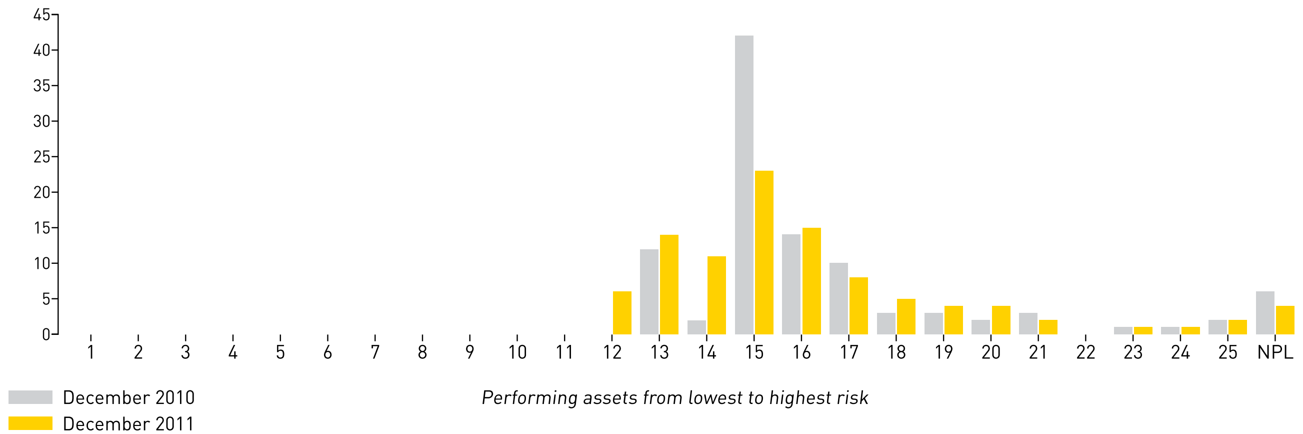
Average performing PD%	4.70%	Average total book PD%	6.90%
Average performing LGD%	30.69%	Average total book LGD%	30.82%
Performing book EL/EAD	1.44%	Total book EL/EAD	2.13%

Risk profile for SME retail exposures: EAD % distribution per Basel risk buckets
(EAD %)



Average performing PD%	2.63%	Average total book PD%	8.69%
Average performing LGD%	32.18%	Average total book LGD%	33.23%
Performing book EL/EAD	0.85%	Total book EL/EAD	2.89%

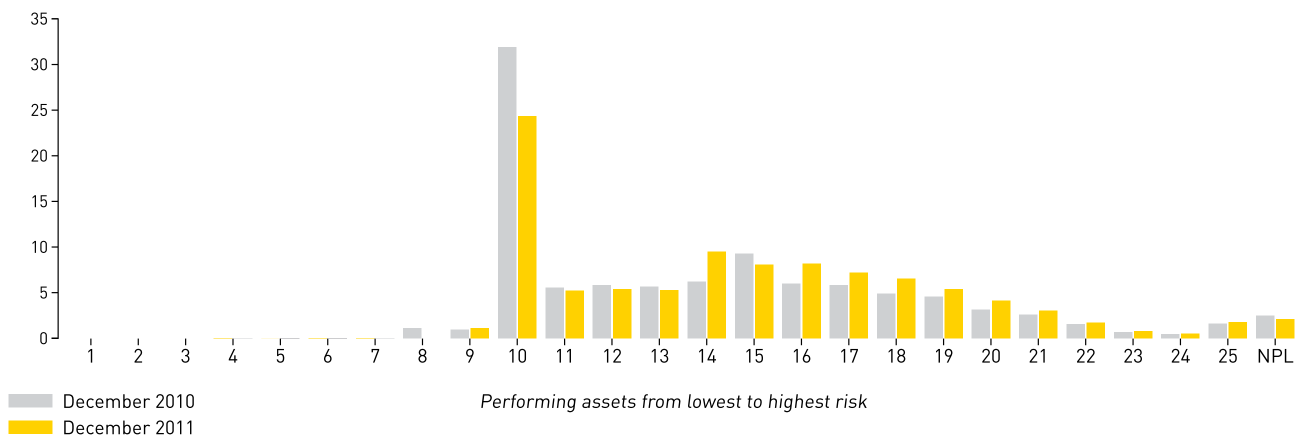
Risk profile for retail mortgage exposures: EAD % distribution per Basel risk buckets
(EAD %)



Average performing PD%	3.67%	Average total book PD%	10.31%
Average performing LGD%	13.38%	Average total book LGD%	13.67%
Performing book EL/EAD	0.49%	Total book EL/EAD	1.41%

The risk profile improved and PDs decreased consistently due to positive risk migration, with the low interest rate environment positively impacting the existing portfolio. In addition, stricter lending criteria resulted in higher quality new business being written. Monthly trend analyses from January 2011 to December 2011 show this consistently throughout the calendar year.

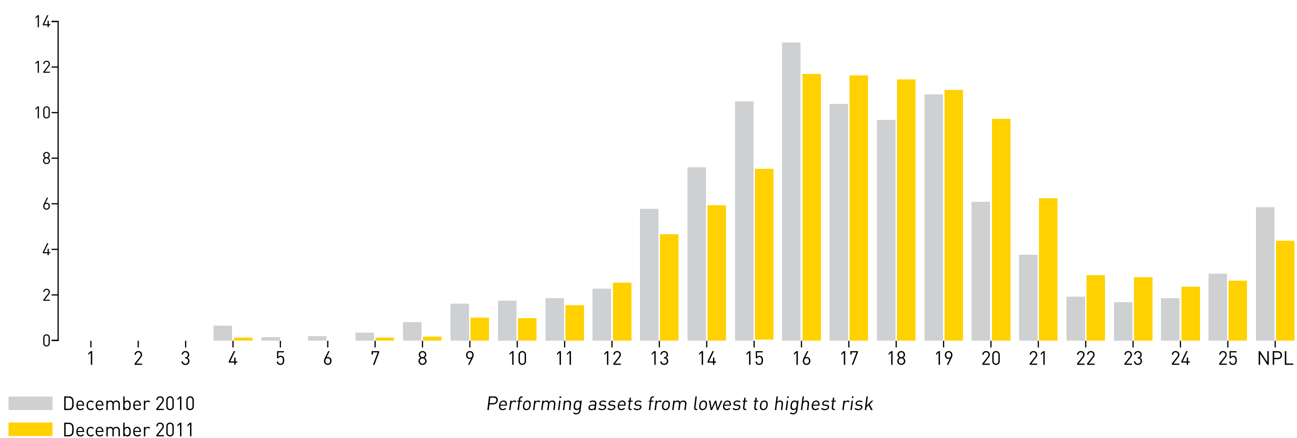
Risk profile for retail revolving credit exposures: EAD % distribution per Basel risk buckets
(EAD %)



Average performing PD%	3.63%	Average total book PD%	5.94%
Average performing LGD%	66.46%	Average total book LGD%	66.67%
Performing book EL/EAD	2.41%	Total book EL/EAD	3.96%

Once again, the improvement in the risk profile in the chart above is attributed to the low interest rate environment positively impacting the existing portfolio. Monthly trend analysis over January 2011 to December 2011 shows this consistently throughout the calendar year.

Risk profile for other retail exposures: EAD % distribution per Basel risk buckets
(EAD %)



Average performing PD%	8.56%	Average total book PD%	13.21%
Average performing LGD%	32.93%	Average total book LGD%	34.05%
Performing book EL/EAD	2.82%	Total book EL/EAD	4.50%

A significant proportion of the other retail asset class is made up of vehicle and asset finance, which is secured by the underlying asset. As such, the LGD is lower than what would be expected in unsecured other retail portfolios. This can be attributed to recalibrations implemented during the calendar year. With the exception of this, PDs decreased consistently from January 2011 to December 2011 reflecting the impact of low interest rates.

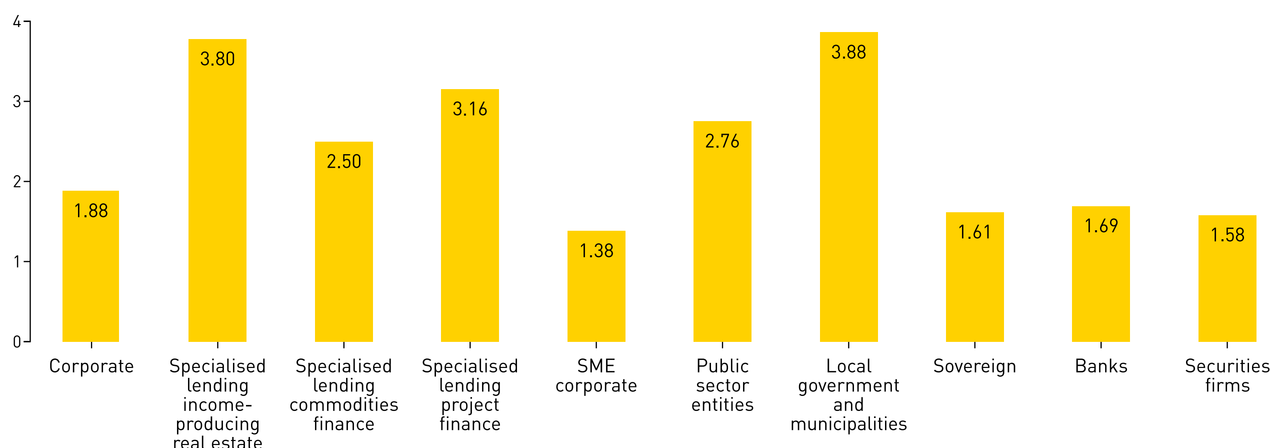
Maturity breakdown

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 as at 31 December 2011
(Maturity in years)



Actual vs. expected loss analysis

To provide a meaningful assessment of the effectiveness of internal ratings-based models, expected loss is compared against losses actually experienced during the 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.

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 experienced during the period consist of both the level of specific impairments at the start of the period (1 January 2011), and the net specific impairment charge recorded through the income statement for the period as determined by IFRS. 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 2010. These exposures are not reflected in the expected loss value described below.

The table below 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 would be anticipated to underestimate actual defaults at the top of the credit cycle and overestimate actual defaults at the bottom of the credit cycle, as is evident from the following table.

Actual vs. expected loss per portfolio segment for the Bank

	December 2011	
R million	**Expected loss**	**Actual loss**
Corporate (corporate, banks and sovereigns)	**1 488**	**16**
SME (SME corporate and SME retail)	**1 345**	**1 189**
Residential mortgages	**2 628**	**3 773**
Qualifying revolving retail	**1 021**	**1 122**
Other retail	**1 177**	**1 013**
WesBank	**3 059**	**3 663**
Total	**10 718**	**10 776**

The composition used above differs slightly from that used in the remainder of this section, due to impairment charges being available on business unit level as opposed to AIRB asset class level.

	December 2010	
R million	Expected loss	Actual loss
Corporate (corporate, banks and sovereigns)	785	135
SME (SME corporate and SME retail)	1 267	1 134
Residential mortgages	3 230	3 956
Qualifying revolving retail	1 559	1 489
Other retail	826	1 454
WesBank	2 763	3 434
Total	10 430	11 602

	June 2011	
R million	Expected loss	Actual loss
Corporate (corporate, banks and sovereigns)	847	16
SME (SME corporate and SME retail)	1 354	1 189
Residential mortgages	3 102	3 773
Qualifying revolving retail	1 168	1 122
Other retail	790	1 013
WesBank	3 142	3 663
Total	10 403	10 776

It should also be noted that the regulatory expected loss shown above is based on the expected loss derived from the regulatory capital models that were applied as at 31 December 2010.

This comparison is supplemented with more detailed analyses below, 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 2010. For PDs, this is applied to the total performing book as at 31 December 2010. 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 2011 to December 2011. It should be noted that 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 1 and 12 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 2011 calendar year) to the actual nominal exposure at default for the same accounts. A ratio above 100% indicates an overestimation.

Risk parameters used to determine reglatory expected loss for the Bank

	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**
SME corporate	**4.28**	**2.42**	**33.59**	**22.93**	**136.04**
SME 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 shown as one asset class to align with the respective asset class in the actual vs. expected loss table.*

	December 2010				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate	1.63	1.75	34.20	0.01	100.00
Banks*	0.15	–	n/a	n/a	n/a
SME corporate	3.99	3.81	35.90	23.86	104.33
SME retail	3.31	4.05	43.11	13.82	108.33
Residential mortgages	3.36	3.72	16.04	11.20	103.13
Qualifying revolving retail	2.64	2.74	65.68	67.32	124.78
Other retail	6.26	6.60	33.72	35.69	105.36
Total	2.98	3.21	30.41	16.24	104.52

** As no defualts were experienced within the banks asset class, actual LGDs and EADs could not be calculated for this asset class.*

	June 2011				
	PD		LGD		EAD estimated to actual ratio
Asset class	Estimated %	Actual %	Estimated %	Actual %	%
Corporate, banks and sovereigns*	0.88	0.19	24.94	28.28	122.96
SME corporate	4.54	2.15	35.81	14.04	108.56
SME retail	3.40	3.27	36.93	26.98	114.82
Residential mortgages	3.06	3.13	15.46	14.44	104.82
Qualifying revolving retail	2.58	2.64	64.78	66.63	127.53
Other retail	5.89	5.92	33.61	31.73	106.00
Total	2.57	2.18	26.32	24.27	108.08

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

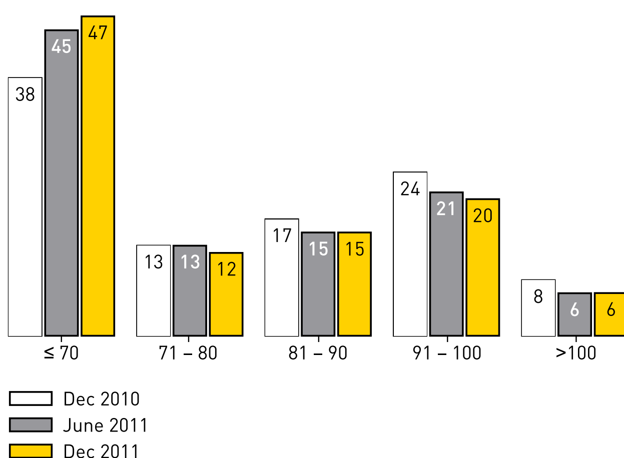
PDs used for regulatory capital purposes are based on long-run experience and would be anticipated to underpredict actual defaults at the top of the credit cycle and overestimate actual defaults at the bottom of the credit cycle. The analysis is based on regulatory capital models that were applied at 31 December 2010.

SELECTED RISK ANALYSES

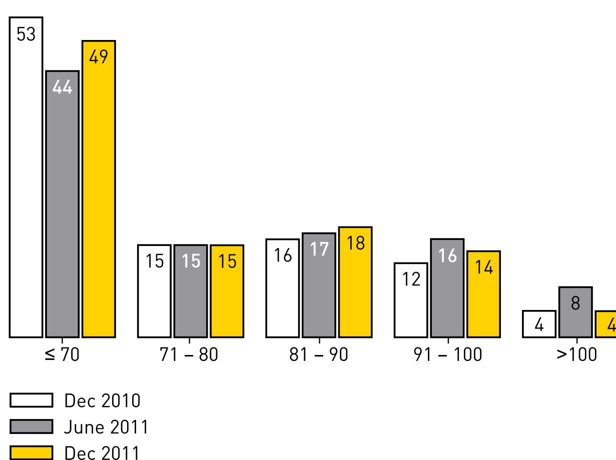
This section provides further information on selected risk analyses of the credit portfolios of the Bank.

The graphs below provide the balance-to-value distributions and the ageing of the residential mortgages portfolios. The 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 on the underlying security.

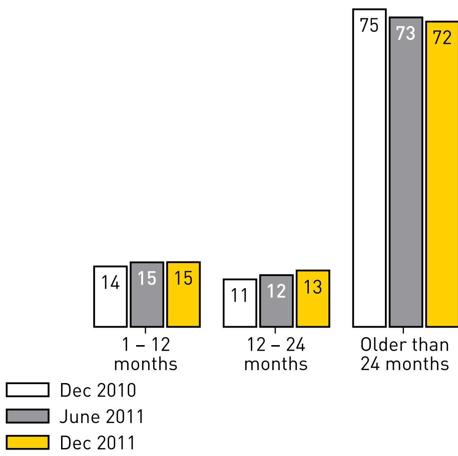
Residential mortgages balance-to-value – original value
(%)



Residential mortgages balance-to-value – market value
(%)

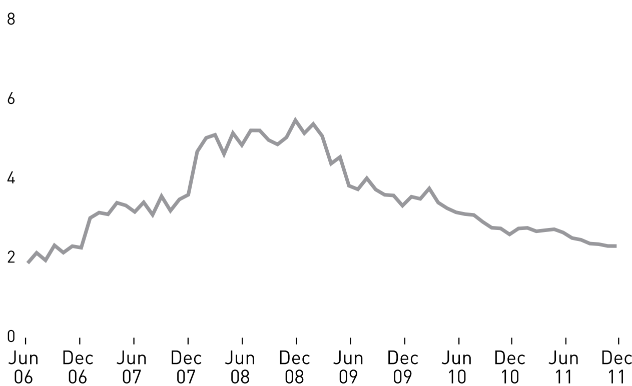


Residential mortgages age distribution
(%)



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

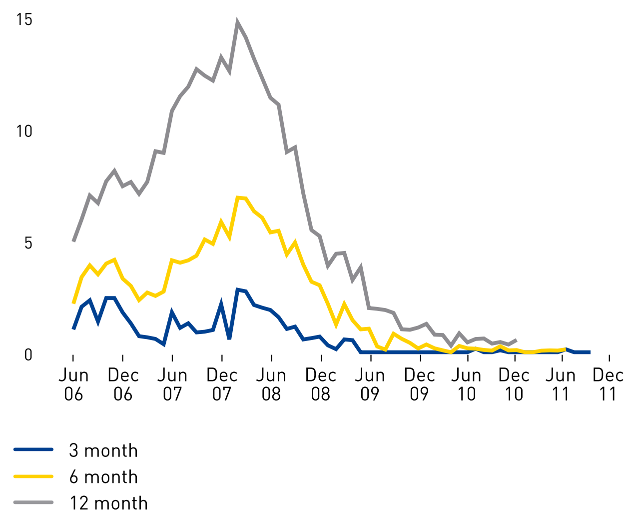
FNB HomeLoans arrears
(%)



The following graphs provide the vintage analyses for key retail portfolios. Vintage graphs provide the default experience three, six and twelve months after each origination date. It indicates the impact of origination strategies and the macroeconomic environment.

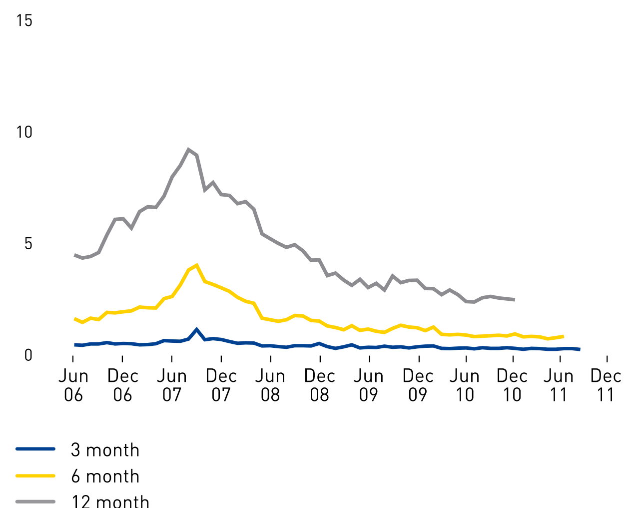
For FNB HomeLoans, the three, six and twelve month cumulative vintage analyses illustrate a marked improvement in the quality of business written since mid-2008 despite further deterioration in macro conditions in the succeeding period. The more recent decreases in the default experience reflect a combination of the credit origination strategies and the improvement in macro conditions.

FNB HomeLoans 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 and the more benign macro environment.

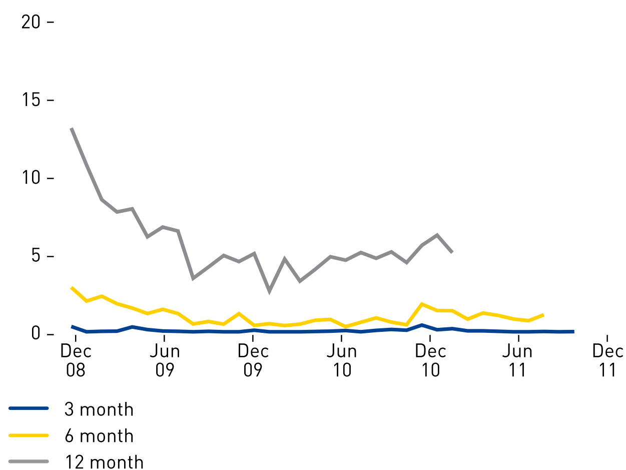
WesBank retail vintage analysis
(%)



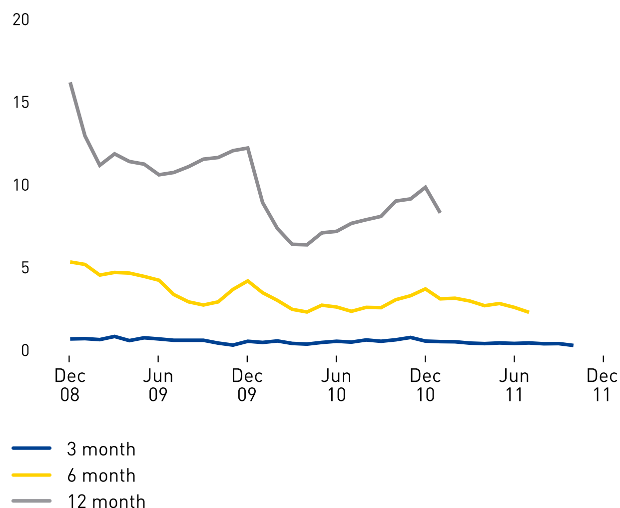
The default experience of the FNB and WesBank unsecured portfolios are within risk appetite.

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

FNB Card vintage analysis
(%)



Unsecured (excluding Card) vintage analysis
(%)



The Group's South African repossessed properties are shown below.

	Properties in possession			
	As at 31 December		% change	As at 30 June
	2011	2010		2011
Number of properties	**920**	1 387	(34)	1 117
Value (R million)	**189**	450	(58)	282

Securitisations and conduits

KEY DEVELOPMENTS AND FOCUS

In August 2011, the Group closed its fourth domestic traditional auto loan securitisation, Nitro 4 Issuer Trust (Nitro 4). Nitro 4 is a cash securitisation of auto loans extended to obligors by WesBank. The note issuance of R4 billion was divided into five tranches. Nitro 4 is rated by Moody's Investor Services. Further detail is provided on page 56.

In August 2011, Fitch concluded their rating review of Fresco 2. The rating actions resulted in downgrades for Class A1 and A2 with rating affirmations for Classes B1 to G. Further information on this is provided on page 57.

In November 2011, the Bank sought and received approval from the SARB to repurchase all outstanding residential mortgage assets of iKhaya 1 RMBS Limited (iKhaya 1). The proceeds allowed iKhaya 1 to redeem all outstanding notes on the target maturity date. Further information is provided on page 57.

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.

This enables the Group to access the funding markets at debt ratings higher than its overall corporate ratings, 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.

Securitisation transactions

R million	Asset type	Year initiated	Expected close	Rating agency	Assets securitised
Traditional securitisations					12 386
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	Retail: Auto loans	2011	2013	Moody's and Fitch	3 620
Synthetic securitisations					20 000
Fresco II	Corporate receivables	2007	2013	Fitch	20 000
Total					32 386

** Does not include cash reserves.*

Rating distribution of retained securitisation exposures

R million	AAA (zaf)	AA (zaf)	AA- (zaf)	A+ (zaf)
Traditional				
At 31 Dec 2011	**1 953**	**–**	**–**	**81**
At 31 Dec 2010	6	5	–	–
At 30 Jun 2011	596	5	–	–
Synthetic				
At 31 Dec 2011	**–**	**–**	**17 840**	**–**
At 31 Dec 2010	17 840	–	–	–
At 30 Jun 2011	17 839	–	–	–

While national scale ratings have been used in this table, global-scale equivalent ratings are used for internal risk management purposes.

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.

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. 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. 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.

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.

	Assets outstanding*			Notes outstanding			Retained exposure		
	December 2011	December 2010	June 2011	**December 2011**	December 2010	June 2011	**December 2011**	December 2010	June 2011
	6 935	2 963	5 476	**7 354**	2 919	5 474	**3 213**	262	1 260
	3 227	–	–	**3 687**	–	–	**1 824**	–	–
	–	1 232	1 164	**–**	1 232	1 131	**55**	79	84
	1 498	1 731	1 625	**1 439**	1 687	1 580	**159**	183	148
	2 210	–	2 687	**2 228**	–	2 763	**1 175**	–	1 028
	20 000	20 000	20 000	**20 000**	20 000	20 000	**18 263**	18 263	18 262
	20 000	20 000	20 000	**20 000**	20 000	20 000	**18 263**	18 263	18 262
	26 935	22 962	25 476	**27 354**	22 918	25 474	**21 476**	18 525	19 522

	A(zaf)	BBB+ (zaf)	BBB (zaf)	BB (zaf)	B+ (zaf)	Not rated	Total
	–	**59**	**–**	**–**	**–**	**1 121**	**3 213**
	4	–	45	–	–	202	262
	4	–	373	–	–	282	1 260
	–	**–**	**–**	**180**	**53**	**190**	**18 263**
	–	–	–	180	53	190	18 263
	–	–	–	180	53	190	18 262

The Group's role in securitisation transactions

Transaction	Originator	Sponsor	Investor	Servicer	Liquidity provider	Credit enhancement provider	Swap counter party
Nitro 4	√	√	√	√			√
Turbo Finance	√	√	√	√			
iKhaya 2	√	√	√	√			√
Fresco 2	√	√	√	√		√	

Third-party securitisation exposure

As at 31 December 2011 the Group held R676 million of notes in third party securitisations of which 92% was AAA(zaf) and 8% was rated A(zaf).

Nitro 4

In August 2011, the Group closed its fourth domestic traditional auto loan securitisation, Nitro 4. Nitro 4 is a cash securitisation of auto loans extended to obligors by WesBank. Nitro 4 was set up as an insolvency remote trust and issued R4 billion of notes rated by Moody's to acquire the asset pool.

The Bank, acting through its RMB division, was the arranger, manager and sponsor for the transaction. The interest rate swap is provided by the Bank with deal administration by RMB. The assets will continue to be serviced by WesBank. The following table provides further detail regarding the notes issued.

Nitro 4 Notes issued

Tranche	Rating (Moody's)*	Amount (R million)	Credit enhancement (%)	Coupon (bps over 3M JIBAR)
A1	Aa2(sf)/Aaa.za(sf)	345	20.78	12
A2	Aa2(sf)/Aaa.za(sf)	345	20.78	30
A3	Aa2(sf)/Aaa.za(sf)	330	20.78	37
A4	Aa2(sf)/Aaa.za(sf)	320	20.78	44.5
A5	Aa2(sf)/Aaa.za(sf)	314	20.78	52
A6	Aa2(sf)/Aaa.za(sf)	320	20.78	58
A7	Aa2(sf)/Aaa.za(sf)	295	20.78	68
A8	Aa2(sf)/Aaa.za(sf)	150	20.78	73
A9	Aa2(sf)/Aaa.za(sf)	140	20.78	79
A10	Aa2(sf)/Aaa.za(sf)	130	20.78	94
A11	Aa2(sf)/Aaa.za(sf)	115	20.78	104
A12	Aa2(sf)/Aaa.za(sf)	100	20.78	115
A13	Aa2(sf)/Aaa.za(sf)	85	20.78	125
A14	Aa2(sf)/Aaa.za(sf)	180	20.78	130
B	Baa2(sf)/A1(sf)	286	13.63	190
C	Ba2(sf)/Baa1.za(sf)	140	10.13	260
D	NR	281	3.10	425
	NR	124	0.00	500
Total		4 000		

* *International and national scale ratings provided.*

Structural highlights include:

- a sequential pay waterfall where senior notes are paid down first in order of priority;
- as and when the subordination is double that at closing, the transaction will redeem capital on all then outstanding notes proportionally;
- unexpected prepayments will fund the purchase of additional eligible assets;
- first of the Group's transactions to be managed using the Deloitte securitisation administration system, ABSSuite™; and
- the transaction is compliant with South African securitisation regulations.

The transaction was structured to obtain matched term funding for the Bank and is currently performing in line with expectations.

Rating actions by Fitch Ratings (Fitch)

Fresco 2, which is incorporated under South African law, is a partially-funded synthetic securitisation of a portfolio of South African and international wholesale credit exposures originated by the Bank. At closing on 17 July 2007, Fresco 2 entered into a credit default swap (CDS) with the Bank, whereby Fresco 2, as the protection seller, purchased the credit risk portfolio from the Bank.

Following rating actions on Fresco 2 in November 2010, Fitch placed the Class A1 and A2 tranches on Rating Watch Negative (RWN). On 9 August 2011, Fitch concluded the rating review of Fresco 2 and downgraded the Class A1 and A2 tranches, assigning a Stable outlook. The ratings on tranches B1 to G have been affirmed, while the outlook on tranches C to G has been changed to negative.

These downgrades were a result of Fitch's revision of their rating criteria/methodology and were not a reflection of any deterioration in the credit quality of the underlying corporate assets of Fresco 2 or the Bank.

The rating actions were as follows:

- Class A1: downgraded to 'BBB (zaf)' from 'AA- (zaf)'; RWN removed; assigned outlook stable.
- Class A2: downgraded to 'BBB (zaf)' from 'AA- (zaf)'; RWN removed; assigned outlook stable.
- Class B1: affirmed at 'BB (zaf)'; outlook stable.
- Class B2: affirmed at 'BB (zaf)'; outlook stable.
- Class C: affirmed at 'B+ (zaf)'; outlook negative.
- Class D: affirmed at 'B (zaf)'; outlook negative.
- Class E: affirmed at 'B (zaf)'; outlook negative.
- Class F: affirmed at 'B (zaf)'; outlook negative.
- Class G: affirmed at 'B- (zaf)'; outlook negative.

Since closing, the transaction's performance has been in line with expectations.

iKhaya 1 maturity

iKhaya 1 was launched on 9 March 2007 with a total note issuance of R1.9 billion. The Class A notes were rated AAA(zaf) with 12.4% subordination and the Bank retained the subordinated loan of R56 million.

By September 2011, notes to the value of R1.09 million were outstanding, representing some 57% of the outstanding principal amount of the notes on issue date. From a loss perspective, the transaction had by this time suffered a cumulative loss of 1.2%, all of which was covered by excess spread.

A muted housing market and lower than expected levels of prepayments leading to lower levels of principal payments meant that although being solvent, the transaction would be unable to meet its targeted maturity date. Structuring features of the vehicle precluded the raising of additional funding and limited the use of liquidity facilities to only covering interest payments and not redemptions.

Consequently, in November 2011, the Bank sought and obtained approval from the SARB and note holders to repurchase the underlying iKhaya 1 assets, on market-related terms. The repurchase took place on 9 December 2011 and the proceeds were utilised for the redemption of the outstanding iKhaya 1 notes.

Investors in iKhaya 1 were able to realise their investments at the targeted maturity date, without suffering any losses.

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 assessing 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.

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 provided		
					December 2011	December 2010	June 2011	**December 2011**	December 2010	June 2011
Conduits										
iNdwa	Corporate and structured finance term loans	2003	Fitch	15 000	**7 806**	7 160	8 779	**–**	–	–
iVuzi	Corporate and structured finance term loans	2007	Fitch	15 000	**6 277**	5 413	6 741	**740**	638	753
Total				30 000	**14 083**	12 573	15 520	**740**	638	753
Fixed income fund										
iNkotha	Overnight corporate loans	2006	GCR	10 000	**3 571**	2 233	2 948	**–**	–	–
Total				10 000	**3 571**	2 233	2 948	**–**	–	–

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 Dec 2011	**–**	**492**	**201**	**4 596**	**4 474**	**1 483**	**1 775**	**1 062**	**14 083**
At 31 Dec 2010	–	1 096	338	2 448	4 361	1 680	1 945	705	12 573
At 30 Jun 2011	–	853	248	4 438	5 074	1 449	2 025	1 433	15 520
Fixed income fund									
At 31 Dec 2011	**–**	**–**	**–**	**1 277**	**823**	**97**	**1 302**	**72**	**3 571**
At 31 Dec 2010	–	–	–	878	413	244	409	289	2 233
At 30 Jun 2011	–	–	–	969	652	548	453	326	2 948

The Bank's role in securitisation transactions

Transaction	Originator	Sponsor	Investor	Servicer	Liquidity provider	Credit enhancement provider	Swap counter party
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	December 2011	December 2010	June 2011
Own transactions		**10 548**	9 800	12 671
iNdwa	Conduit	**5 863**	5 611	7 159
iVuzi	Conduit	**4 685**	4 189	5 512
Third party transactions	Securitisations	**860**	1 674	1 372
Total		**11 408**	11 474	14 043

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 2011	December 2010	June 2011	December 2011	December 2010	June 2011	December 2011	December 2010	June 2011
Risk weighted bands									
= <10%	**7 511**	17 840	24 322	**53**	139	183	**–**	–	–
<10% = <20%	**1 111**	11 474	1 378	**14**	85	16	**–**	–	–
<20% = <50%	**729**	11	5 517	**36**	–	133	**–**	–	–
<50% = <100%	**81**	4	4	**6**	–	–	**–**	–	–
<100% = <650%	**59**	863	180	**24**	302	114	**–**	–	–
1250%/deduction	**1 311**	445	415	**–**	–	–	**1 311**	445	415
Look Through	**23 497**	–	–	**741**	–	–	**–**	–	–
Total	**34 299**	30 637	31 816	**874**	526	446	**1 311**	445	415

* *Capital is calculated at the Basel II 9.75% requirement.*

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

Deductions arising from securitisation exposures

R million	Corporate receivables	Retail mortgages	Retail: instalment sales and leasing	Total
Traditional	–	214	907	1 121
Synthetic	190	–	–	190
Total	190	214	907	1 311

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

KEY DEVELOPMENTS AND FOCUS

The focus during the period under review has been on further enhancing the governance, management and reporting structures for counterparty credit risk, as well as a focus on the requirements of Basel III.

Existing credit governance structures were strengthened through the establishment of the Traded products counterparty risk committee. The committee consists of credit and market risk specialists and supports the Credit committee and its subcommittees in the quantification and analysis of traded product counterparty exposures on a dynamic and granular basis.

The implementation of a counterparty credit risk-specific framework continues with attention focused on addressing the Basel III counterparty credit risk requirements. Heightened focus has been placed on the impact of credit valuation adjustment (CVA) capital. A Basel III capital impact assessment and optimisation initiative have been launched to ensure the Group meets these requirements. This initiative is focusing on the existing capital base as well as the envisaged capital changes.

INTRODUCTION AND OBJECTIVES

Counterparty credit risk is concerned with 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.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

RMB's credit department is responsible for the overall management of counterparty credit risk. It is supported by RMB's portfolio and crossover 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 9), and the *Credit risk governance* section (page 27) for more details.

The Traded products counterparty risk committee supports the Credit committee and its subcommittees with granular 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. The two-way credit (and debit) valuation adjustment is calculated and priced on bespoke transactions.

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 RMB Risk and compliance 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 over-the-counter 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 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

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.

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.

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 2011**	December 2010	June 2011
Gross positive fair value	**130 160**	120 741	114 070
Netting benefits	**(57 376)**	(58 066)	(38 462)
Netted current credit exposure before mitigation	**72 784**	62 675	75 608
Collateral value	**(60 873)**	(52 220)	(63 772)
Netted potential future exposure	**11 496**	14 613	12 293
Exposure at default	**23 407**	25 068	24 129

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

R million	December 2011 Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	**15**	**–**	**–**	15
– protection sold	**3 454**	**–**	**–**	3 454
Intermediation activities				
– protection bought	**665**	**–**	**–**	665
– protection sold	**3 259**	**–**	**–**	3 259

R million	December 2010 Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	922	–	–	922
– protection sold	2 253	–	–	2 253
Intermediation activities				
– protection bought	–	–	–	–
– protection sold	–	–	–	–

R million	June 2011 Credit default swaps	Total return swaps	Other	Total
Own credit portfolio				
– protection bought	18	–	–	18
– protection sold	3 259	–	–	3 259
Intermediation activities				
– protection bought	46	–	–	46
– protection sold	1 091	–	–	1 091

Market risk in the trading book

KEY DEVELOPMENTS AND FOCUS

The Bank implemented the regulatory changes associated with Basel 2.5 in the local trading book, namely the combined incorporation of Value-at-Risk (VaR) plus stressed VaR on 1 January 2012. Performance of market risk-taking activities will consequently be measured from 1 January 2012 as the higher of the Bank's internal expected tail loss (ETL) measure (as a proxy for economic capital) or regulatory capital based on VaR pus stressed VaR. A number of additional concentration measures were implemented as a key area of focus across all asset classes.

INTRODUCTION AND OBJECTIVES

Market risk exists in all trading, banking and investment portfolios, but for the purpose of this report, it is considered as a risk specific to trading portfolios. Substantially all market risk in the Group is taken and managed by RMB. The relevant businesses within RMB function as the centre of expertise with respect to 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 risk appetite.

Non-trading interest rate risk in the banking book is managed by Group Treasury and is 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. During the year, holding periods used in the calculation were increased and are now based on an assessment of distressed liquidity of portfolios. As a consequence, holding periods ranging between 10 to 90 days are used. Historical data sets are chosen to incorporate periods of market stress with the recent 2008/2009 stress period incorporated into the historical data set 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.

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 historical, hypothetical and Monte Carlo-type simulations. The calibrations of the stress tests are reviewed from time to time to ensure that the results are indicative of possible market moves under distressed market conditions. Stress and scenario analyses are reported to and considered regularly by the business unit executive committees and the boards.

Back testing

Back testing is performed in order to verify the predictive ability of the VaR calculations and ensure ongoing appropriateness of the model. 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 will be reassessed for appropriateness.

Regulatory and economic capital for market risk

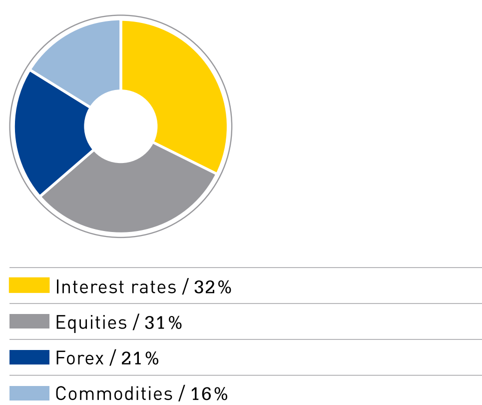
The internal VaR model for general market risk was approved by the SARB for local trading units and is consistent with the methodologies as stipulated under the Basel II framework. For all international legal entities, the standardised approach is used for regulatory market risk capital purposes.

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

TRADING BOOK MARKET RISK PROFILE

The following chart shows the distribution of exposures per asset class across the Group's trading activities at 31 December 2011 based on the VaR methodology.

Composition of VaR exposure per asset class



VaR analysis by risk type

The table below reflects the regulatory VaR over a 1-day holding period at a 99% confidence level. Interim results for the half year to 31 December 2011 reflect overall lower levels of risk when compared to prior periods.

1-day 99% VaR analysis by instrument

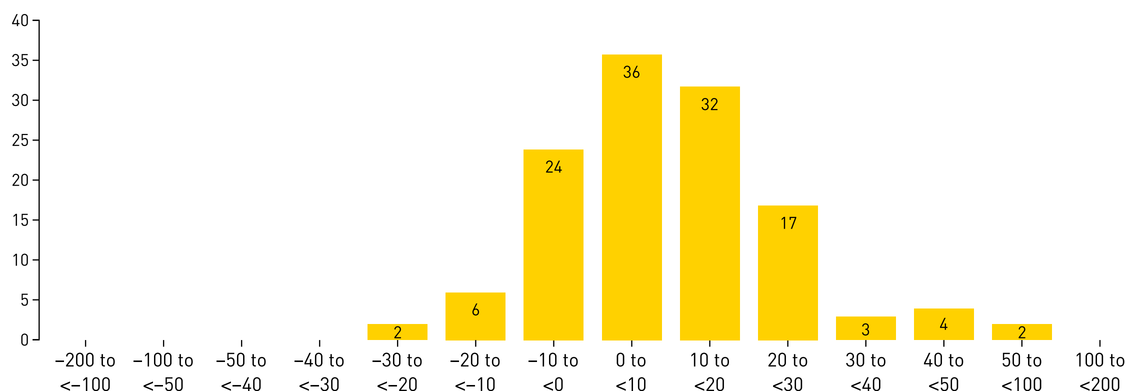
	December 2011				December 2010	June 2011
R million	Min*	Max*	Average	Period end	Period end	Period end
Risk type						
Equities	5.2	34.9	12.2	17.4	14.7	11.7
Interest rates	13.5	33.8	23.3	17.9	29.1	21.6
Foreign exchange	6.2	37.7	17.2	11.4	6.0	7.9
Commodities	8.9	45.1	28.3	8.9	21.6	32.4
Diversification effect				(35.7)	(29.7)	(31.3)
Diversified total	19.9	53.0	38.0	19.9	41.8	42.4

* *The maxima and minima VaR figures for each asset class did not necessarily occur on the same day. Consequently, a diversification effect was omitted from the above table. The distressed liquidity adjusted ETL for trading, banking and investing activities subject to market price risk across the Group at 31 December 2011 is R1 290 million. 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.

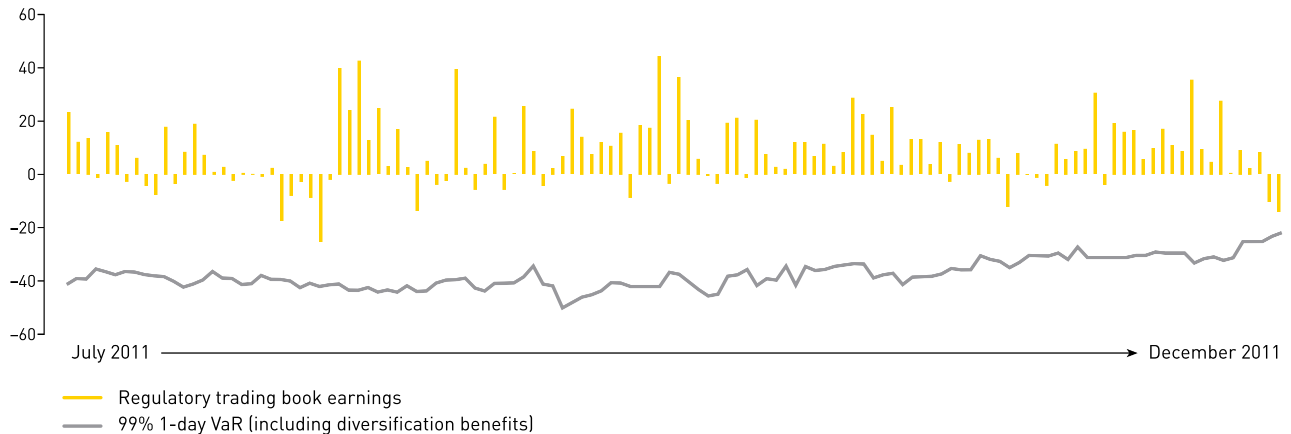
Distribution of daily earnings of FirstRand
(Frequency: days in a period – number of observations)



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)



Over the period under review there were no instances of actual trading losses exceeding the corresponding VaR estimate. This implies that the Group's model provided a reasonably accurate quantification of market risk.

International

RMB Australia Holdings and FirstRand Bank India Branch hold the most material 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.

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.

Equity investment risk

KEY DEVELOPMENTS AND FOCUS

The overall quality of the investment portfolio remains acceptable and within risk appetite. During the period under review the Group divested of its WesBank interests in Tracker and Ronald Sewalles. The Private Equity division continued to build its portfolio through new investments.

The Group actively monitors regulatory developments; including amendments to current Basel II capital requirements and the anticipated impact of Basel III. Regulatory developments expected to impact the Group's principal investment portfolio include:

The introduction of a South African specific 6% scaling factor (effective 1 January 2012). This scaling factor will be applied to risk-weighted credit and investment risk exposures held by entities applying the internal ratings model approach.

Basel III amendments (effective 1 January 2013) are expected to result in the minority interests, intangibles and goodwill of the Group's fully consolidated subsidiaries no longer qualifying as Core Tier 1 Capital.

INTRODUCTION AND OBJECTIVES

Portfolio investments in equity instruments are primarily undertaken in RMB, but certain equity investments have been made by WesBank, FNB and 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 Equities division.

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 also 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 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. WesBank's executive management monitors and manages its 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 the company's operations.

The investment thesis, results of the due diligence process and investment structure are challenged 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 which 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 (300% or 400%) approach or the standardised approach is used for the quantification of regulatory capital.

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

Attractive market prices in selected industries continue to present the Group with opportunities to build its private equity portfolio. Although some segments of the portfolio exposed to specific industries and/or geographies have come under cyclical pressure, overall unrealised profits for the portfolio have remained resilient.

Investment risk exposure and sensitivity of investment risk exposure

R million	December 2011	December 2010	June 2011
Listed investment risk exposure included in the equity investment risk ETL process*	1 493	1 825	3 333
ETL on above equity investment risk exposures*	696	695	1 297
Estimated sensitivity of remaining investment balances**			
Sensitivity to 10% movement in market value on investment fair value	364	943	169
Cumulative gains/(losses) realised from sale of positions in the banking book during the period	831	129	972

* *The decline in both exposure and ETL for listed investments from June 2011 to December 2011 was largely due to the allocation of certain exposures from equity investment risk portfolio to the market risk portfolio.*

** *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 economic capital requirements

	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	227
Latent revaluation gains not recognised in the balance sheet**	–	2 905	2 905
Capital requirement#	649	2 299	2 948

* *Fair values of listed private equity associates based on their value in use exceeded the quoted market prices by R12 million.*

** *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.*

	December 2010		
R million	Publicly quoted investments	Privately held	Total
Carrying value disclosed in the balance sheet	2 237	9 792	12 029
Fair value*	2 263	12 226	14 489
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement**	296	62	358
Latent revaluation gains not recognised in the balance sheet**	26	2 434	2 460
Capital requirement#	356	1 308	1 664

* *The fair values of publically quoted 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.*

\# *The capital requirement calculated at 8%.*

R million	June 2011		
	Publicly quoted investments	Privately held	Total
Carrying value disclosed in the balance sheet	3 236	8 068	11 303
Fair value*	3 236	10 973	14 209
Total unrealised gains recognised directly in balance sheet through equity instead of the income statement**	49	134	183
Latent revaluation gains not recognised in the balance sheet**	–	2 905	2 905
Capital requirement#	493	1 459	1 952

* *Fair values of listed private equity associates based on their value in use exceeded the quoted market prices by R23 million.*

** *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

KEY DEVELOPMENTS AND FOCUS

As an authorised dealer in foreign exchange, the Group has a restriction on the gross amount of foreign currency holdings and other foreign exposure it may hold, capped at 25% of its local liabilities. Furthermore, banking regulations regarding the net open forward position in foreign exchange (NOFP) limits the net open overnight position to no more than 10% of net qualifying capital. The two aspects (gross macro foreign exposure limit and the NOFP) overlay each other and ensure a complementary prudential approach to foreign currency risk management.

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 the 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 FICC. Foreign currency funding, foreign exposure and liquidity 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 NOFP are overseen by MIRC, a subcommittee of the RCC committee and mismatch risk is governed through the FirstRand ALCO and international ALCO 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 exposure, 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 are reviewed when necessary.

The Group's NOFP position is within the regulatory limit of approximately US$600 million. Senior management implemented various levels of internal prudential limits, 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 remediation 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 contained well 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. The macro foreign exposure of the Group remained far below both regulatory and board limits and there is significant headroom for expansion into foreign assets.

Liquidity risk

KEY DEVELOPMENTS AND FOCUS

The Basel III guidelines propose two new liquidity metrics: the Liquidity Coverage Ratio (LCR), effective 1 January 2015, which measures short-term liquidity stress, and the Net Stable Funding Ratio (NSFR), effective 1 January 2018, which measures the stability of long-term structural funding.

The BCBS has put processes in place to ensure the rigorous and consistent global implementation of the Basel III Framework. The standards will be phased in gradually so that the banking sector can move to the higher liquidity standards while supporting lending to the economy. Both the LCR and the NSFR will be subject to an observation period and will include a review clause to address any unintended consequences.

When applying the metrics to the Group's balance sheet at 31 December 2011, both the Group and most of the South African banking industry do not meet the minimum quantitative requirements. This is due to the specific structure of funding in the domestic financial services industry, particularly the issue of low discretionary savings, the closed Rand domestic market and the fact that South Africa is an emerging economy.

These structural issues have been recognised by the South African regulators, banking industry and National Treasury. In response, and under the guidance of National Treasury, a Structural funding and liquidity task team has been established and mandated to assess the impact and subsequently make recommendations to the Finance Ministry on how the banking industry will effectively deal with the proposed regulations.

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 affecting market prices significantly; and
- mitigation of market and funding liquidity risks is achieved via *contingent liquidity risk* management. Buffer stocks of highly liquid assets are held to either 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.

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 Grouop 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 ALCO. FirstRand ALCO'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 ALM functions and ALCOs in these subsidiaries and branches.

FirstRand Bank

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

The Group's liquidity position, exposures and auxiliary information are reported bimonthly to the Funding executive committee. In addition, management aspects of the liquidity position are reported to and debated by Group Treasury. The liquidity risk management and risk control teams in Group Treasury and ERM also provide regular reports to FirstRand ALCO.

FNB Africa

Individual ALCOs have been established in each of the FREMA businesses that 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 ALCO 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 ALCO.

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 ALCO, which is a subcommittee of FirstRand ALCO and meets quarterly to review and discuss region specific issues and challenges for liquidity and interest rate risk.

Dispensation was granted by the Financial Services Authority (FSA) for a waiver on a "Wholefirm Liquidity Modification application" basis where the FSA considers local risk reporting and compliance of the parent bank sufficient to waive FSA requirements for FRB (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.

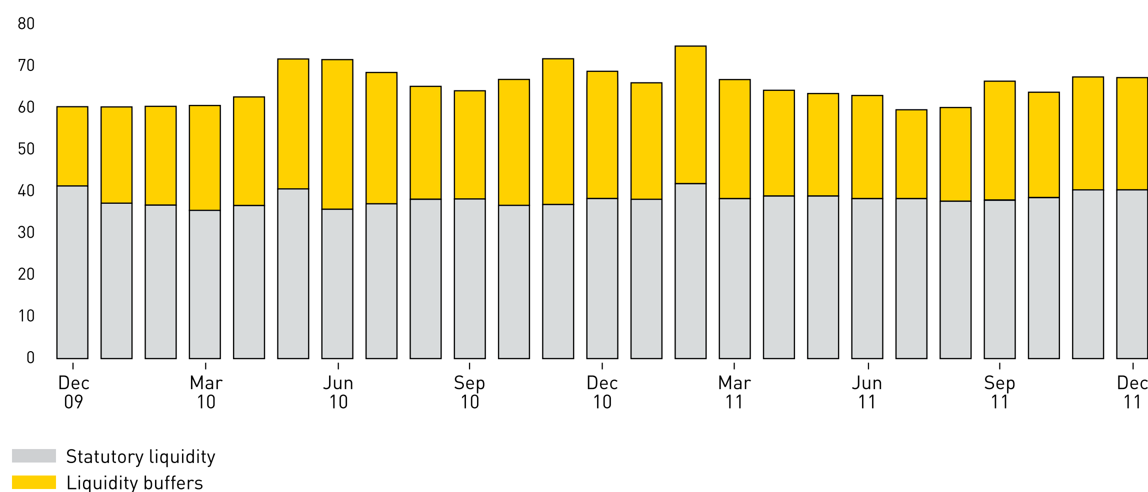
Aspects of liquidity risk management

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.

FRB 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 ALCO 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

The formal liquidity contingency plan sets out policies and procedures as a blueprint for handling a potential liquidity crisis. Addressing both temporary and long-term liquidity disruptions, it is a comprehensive framework that is tightly integrated with ongoing analyses, stress tests, key risk indicators and early warning systems, as described above. It is reviewed, updated and debated on a regular basis and structured to provide for reliable but flexible administrative structures, realistic action plans and ongoing communication with key external stakeholders and across all levels of the Group.

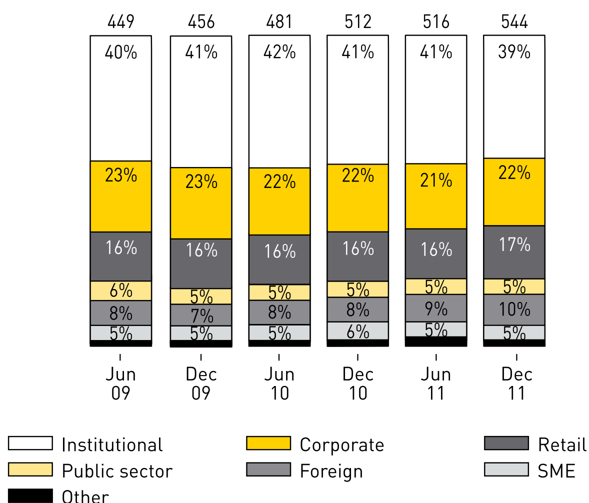
FUNDING STRATEGY

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.

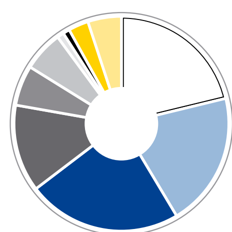
The table below illustrates the Group's sources of funding by counterparty.

FRB's total deposit base
(R billion)



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

FRB's funding instruments by instrument type



- Current and savings accounts / 22%
- Call deposits / 20%
- Fixed and notice deposits / 23%
- NCDs / 13%
- Other deposits and loan accounts / 6%
- Repos / 6%
- Subordinated debt / 1%
- Securitisations / 1%
- Conduits / 3%
- Senior debt / 5%

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 their liquidity risk, liabilities in accordance with their funding maturity and contingents in respect of the potential funding draws on the Group.

Interest rate risk in the banking book

KEY DEVELOPMENTS AND FOCUS

The average repo rate for the six months ending Decemeber 2011 decreased by 0.58% in relation to the six months to December 2010. The margin was therefore exposed to a negative endowment impact which resulted in a 9 bps net interest income (NII) margin squeeze in the period under review.

As at December 2011, a 50 bps decrease in rates is expected to impact the Groups margin by R360 million after management notion.

As at the end of the period under review interest rates were at historically low levels, however, given the continued threat of a European crisis and global growth concerns, management will continue to focus on protecting and enhancing the earnings of the Group in line with the macroeconomic view and within approved risk limits.

INTRODUCTION AND OBJECTIVES

The Group's interest rate risk is managed in two distinct categories:

- interest rate risk from trading activities, which is managed on an ETL/VaR basis (refer to the *Market risk in the trading book* section on page 62); and
- interest rate risk in the banking book (IRRBB), which is covered here.

IRRBB is defined as the sensitivity of the balance sheet and income statement to unexpected, adverse movements of interest rates. This originates from the repricing characteristics of the balance sheet, yield curve risk, basis risk and client optionality.

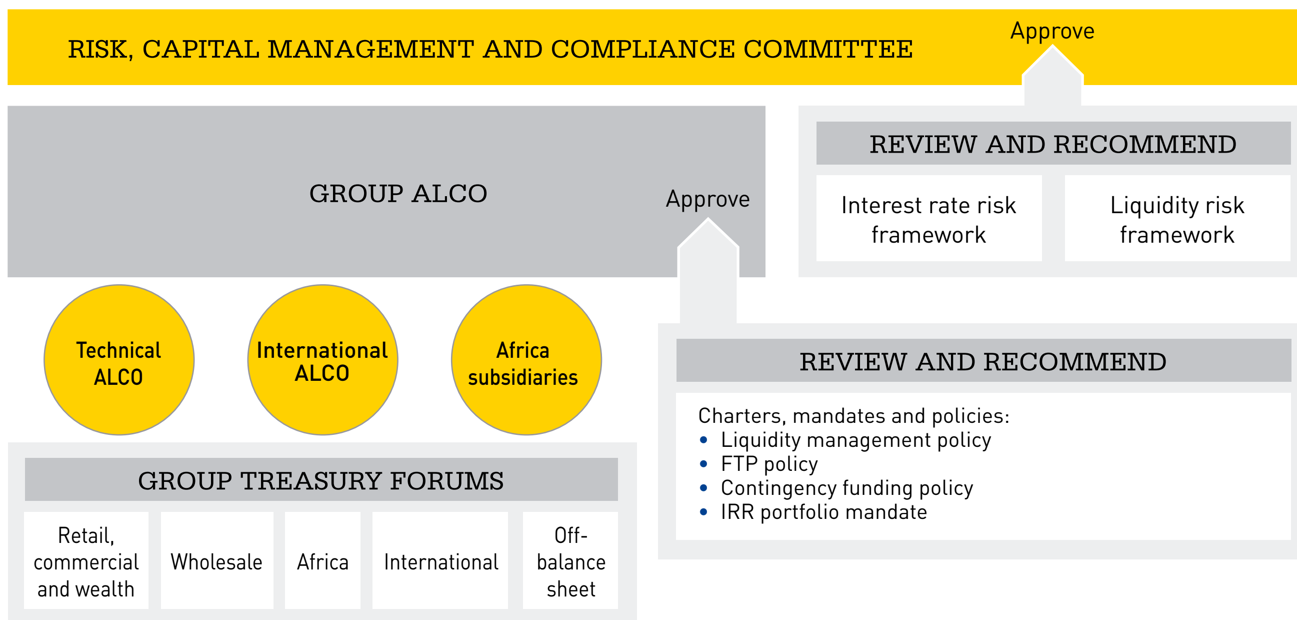
This risk is a normal part of banking and can be an important source of profitability and shareholder value. Interest rate risk at the Bank continues to be managed from an earnings approach, with the aim to protect and enhance NII, within the Group's appetite and approved limits.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

The management and governance of IRRBB is delegated by the Board to the RCC committee, which in turn delegates the responsibility to ALCO. The control and management of interest rate risk is governed by the framework for the management of IRRBB, which is an ancillary framework to the BPRMF.

All IRRBB is reported through to the FirstRand ALCO. The FirstRand ALCO which is also responsible for the allocation of sublimits and approves proposed remedial action for any limit breaches.

Interest rate risk management and governance structure



Individual ALCOs exist in the African subsidiaries and international branches which monitor and manage IRRBB. Relevant reports are submitted by the subsidiaries to FirstRand ALCO on a quarterly basis.

Management of the domestic banking book is split between the RMB banking book and the remaining banking book. RMB has the mandate to manage the interest rate risk in its banking book under the market risk framework in line with the SARB dispensation. The RMB banking book interest rate risk exposure was R27.0 million on a 10-day ETL basis at 31 December 2011 (June 2011: R45.9 million). The *market risk* section of this report provides a description of the ETL methodology. The remaining domestic banking book is managed centrally by Group Treasury.

ASSESSMENT AND MANAGEMENT

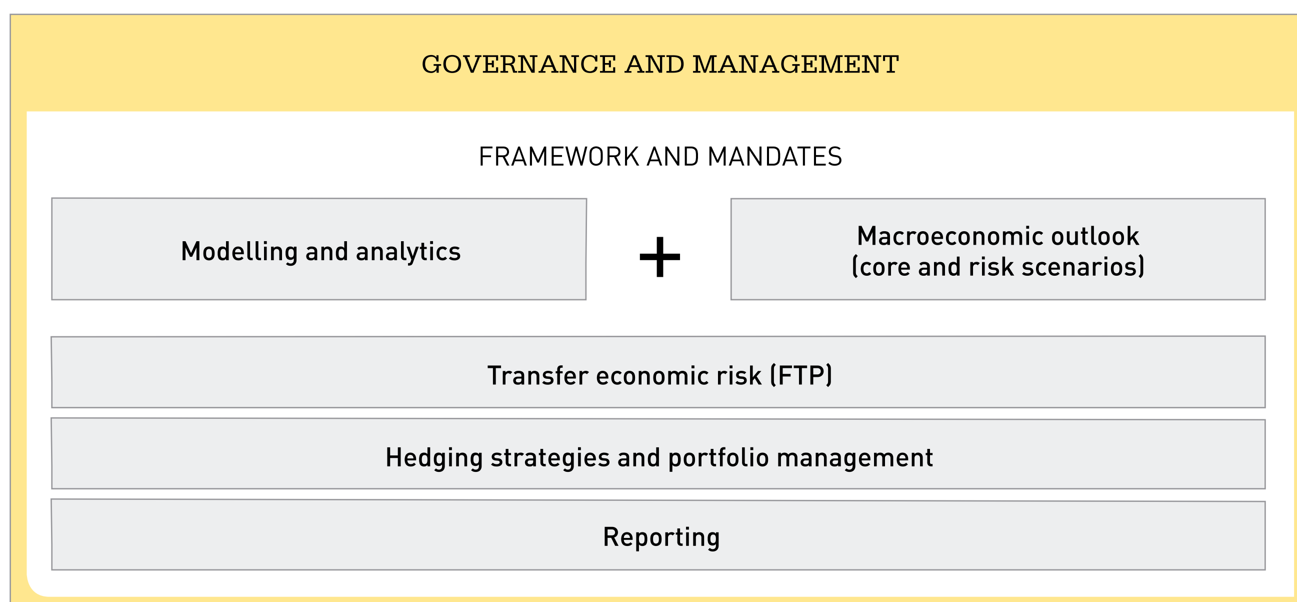
A number of measurement techniques are utilised to quantify IRRBB, these focus both on the earnings risk and the overall impact on economic value.

The resultant risk profile is managed holistically in line with the Groups macroeconomic view. This is achieved by changing the composition of the balance sheet through balance sheet restructuring or by the use of off-balance sheet derivatives.

The FTP process is used to transfer the risk from the various brands through to Group Treasury. Cash flow hedge accounting is applied for external derivatives used as part of these hedging strategies.

All management actions need to take place within the various risk limits set by ALCO. The Group Treasury investment committee meets regularly to discuss proposed strategies, to ensure that management action is within these limits, and within the Group's appetite.

Interest rate risk management and assessment



CURRENT REPRICING PROFILE

The natural position of the banking book continues to be asset sensitive, with interest-earning assets repricing faster than interest-paying liabilities. As a result, the primary driver of IRRBB relates to the sensitivity arising from the non- and low-rate products in the balance sheet, the 'endowment book'. This has an adverse impact on the Group's margin in a cutting cycle as the impact of assets repricing at lower rates is not offset by a corresponding saving from interest paid on liabilities.

Repricing schedule for the FirstRand banking book

	December 2011				
	Term to repricing				
R million	< 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	–

	December 2010				
	Term to repricing				
R million	< 3 months	> 3 but ≤ 6 months	> 6 but ≤ 12 months	> 12 months	Non-rate sensitive
FirstRand Bank					
Net repricing gap	26 398	(13 065)	(7 646)	9 968	(15 655)
Cumulative repricing gap	26 398	13 333	5 687	15 655	–
FNB Africa					
Net repricing gap	5 506	(869)	(708)	567	(4 496)
Cumulative repricing gap	5 506	4 637	3 929	4 496	–
Total cumulative repricing gap	31 904	17 970	9 616	20 151	–

R million	June 2011 Term to repricing < 3 months	> 3 but ≤ 6 months	> 6 but ≤ 12 months	> 12 months	Non-rate sensitive
FirstRand Bank					
Net repricing gap	52 582	(2 746)	(12 145)	(8 061)	(29 630)
Cumulative repricing gap	52 582	49 836	37 691	29 630	–
FNB Africa					
Net repricing gap	5 263	(715)	(562)	642	(4 628)
Cumulative repricing gap	5 263	4 548	3 986	4 628	–
Total cumulative repricing gap	57 845	54 384	41 677	34 258	–

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

Sensitivity analysis

The tables below show the 12-month NII sensitivity for a 200 bps instantaneous and sustained downward parallel shock to interest rates. The increased sensitivity from December 2010 stems from growth in the underlying non-rate book. The decrease in sensitivity from June 2011 is attributable to an increase in the hedge position as a result of uncertainty in the macroeconomic environment.

Assuming no management action in response to interest rate movements, an instantaneous and sustained decrease in interest rates of 200 bps would result in a reduction in projected 12-month NII by R 1 550 million, a similar increase in interest rates would result in an increase in projected 12-month NII of R 1 662 million.

Sensitivity of FirstRand projected NII

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

R million	December 2010 Change in projected 12-month NII FRB	FNB Africa	FirstRand
Downward 200 bps	(1 004)	(138)	(1 142)
Upward 200 bps	1 073	138	1 211

R million	June 2011 Change in projected 12-month NII FRB	FNB Africa	FirstRand
Downward 200 bps	(2 013)	(173)	(2 186)
Upward 200 bps	2 027	173	2 200

Modelling assumptions

Modelling assumptions are made that affect both the determination of interest rate risk in the banking book and the hedging activity that takes place:

- all banking book assets, liabilities and derivative instruments are placed in gap intervals based on their repricing characteristics;
- instruments which have no explicit contractual repricing or maturity dates are placed in gap intervals according to management's judgement and analysis, based on the most likely repricing behaviour;
- new volume points are assigned to balances as and when they mature in order to maintain balance sheet size and mix;
- derivatives hedges that mature are not replaced;
- pre-settlement expectations are factored into the volume and term of hedges for fixed rate lending activities; and
- interest rate risk modelling extends over a five year time horizon, of which the first 12 month period is disclosed. Several interest rate shocks and scenarios are modelled

Assumptions are made with respect to the repricing characteristics of instruments that have no explicit contractual repricing or maturity dates:

- non-maturity deposits and transmission account balances (NMDs) do not have specific maturities as individual depositors can freely withdraw or place funds. Interest rates associated

with these products are administered by the Group, but are not indexed to market rates. NMDs are assumed to reprice overnight since the administered rate can change at any time at the Group's discretion; and
- prime-linked products are assumed to reprice immediately whenever the repo rate changes.

Operational risk

KEY DEVELOPMENTS AND FOCUS

The Group's focus remains on implementing the process-based risk and control identification and assessment tool across its various businesses and automating all its operational risk management tools onto a single platform to enhance operational risk management and process efficiencies. In order to ensure that the Group's operational risk practices remain in line with global and emerging operational risk management standards, its practices were benchmarked against the recently issued BCBS's Principles for the Sound Management of Operational Risk and Operational Risk – Supervisory Guidelines for the advanced measurement approach (AMA).

INTRODUCTION AND OBJECTIVES

Operational risk vs. reward is seldom proportional, yet it is an inherent and unavoidable part of doing business and exists, to a varying degree, in all organisational activities.

The Group recognises that operational risk exposure is incurred in generating sustainable profits, but advocates that it only does so within the Group-defined risk tolerance levels.

The objective of operational risk management is thus not to eliminate all operational risk exposure but to set a framework for effectively managing and mitigating operational risk within acceptable and approved risk appetite levels. Management's continued focus on improving process efficiencies is yielding positive business benefits.

The Group reviews and advances its operational risk management methodologies, practices and capabilities on a regular basis in line with regulatory developments and emerging best practices.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

The management of operational risk is governed by the board-approved operational risk management framework (ORMF) a subframework of the BPRMF. 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.

The Board has delegated its responsibility for the adequate identification and management of operational risk to the RCC committee, which in turn delegated this task 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 ORMF. To ensure appropriate visibility at board level, the ORC includes two non-Exco members, one of whom is a board member. Other members include franchise heads of operational risk and senior personnel of the central ERM function.

In addition, there are governance committees at all levels of the Group (business unit, segment and franchise) that have been designed and established to support the ORC and the RCC committee in executing their risk management duties and responsibilities.

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

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 processes. GIA in the third line of control provides independent assurance of the adequacy and effectiveness of operational risk management practices.

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

Operational risk tools and approaches

OPERATIONAL RISK TOOLS AND APPROACHES		
Risk control self assessments (RCSA)	**Key risk indicators (KRI)**	**Audit findings**
• integrated in the day-to-day business and risk management processes; and • used by business and risk managers to identify and monitor key risk areas and assess the effectiveness of existing controls.	• used across the Group in all businesses as an early warning measure; • highlight areas of changing trends in exposures to specific operational risks; and • KRI's inform operational risk profiles which are reported periodically to the appropriate management and risk committees and monitored on a continuous basis.	• GIA acts as the third line of risk control across the Group; • GIA provides an independent view on the adequacy of existing controls and their effectiveness in mitigating risks associated with key and supporting processes; and • audit findings are tracked, monitored and reported on through the risk committee structures.
Internal/external loss data	**Internal validation**	**Risk scenarios**
• the capturing of loss data is well entrenched within the Group; • internal loss data reporting and analyses occurs at all levels with specific focus on the root cause analysis and corrective action; and • external loss data bases are used to learn from other organisations and as an input to the risk scenario process.	• a Group wide internal validation is undertaken annually to ensure consistency in the application and output of the various tools; • this process involves a robust challenge of all the risk tools at all levels within the Group; and • a report is issued on the final result to the business.	• 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.

In addition to these operational risk tools and approaches, other specialised operational risk tools are used for specific risks, such as business resilience and IT risks. FirstRand also uses an integrated and internationally renowned operational risk system which provides the technology for the automation of certain operational risk tools. This system is well positioned as the core operational risk system and provides a solid platform for further automation, which is currently a key focus area for operational risk management. Other key objectives include the development, deployment and integration of an integrated risk and performance management solution which includes the implementation of an enhanced RCSA process which has been expanded to include process based risk and control identification and assessment.

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. fraud) and are budgeted for appropriately. Business areas seek to 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 seeks to minimise these incidences and contain severity within its risk appetite limits.

Given the ever changing and complex nature of its business and processes, the Group employs a dynamic approach to managing operational risk and this approach results in continuous change or renewal. It is common practice, when implementing change of this nature, to address less than optimal operational procedures with meaningful adjustments to risk management. The Board and management continue to refine the consistent and disciplined approach of linking business processes to the operational risk and control environment.

Basel II – AMA

FirstRand began applying AMA under Basel II 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 FRIHL 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 granular and accurate risk-based measures of capital for all business units on AMA.

A number of 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 units. 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 II event types across various internal business lines. Data collection is the responsibility of the respective business units and is overseen by the central operational risk function 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. Regulatory capital requirements are then calculated (for the Group and each franchise) as the operational VaR at the 99.9^{th} percentile of the aggregate loss distribution, excluding the effects of insurance, expected losses and potential diversification effects.

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 exposure and associated capital requirements take the following into account:

- changes in the risk profile, as measured by the various risk measurement 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.

Management processes

A comprehensive and integrated approach to managing operational risk includes the monitoring of some specialist operational risk processes. These are described below.

Business resilience management

Business resilience management (BRM) is focused 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 business resilience management.

The business continuity practices of the Group are documented in the business resilience, emergency response and incident management policy and supporting standards, which are approved at the ORC. The policy 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.

The Group carries out regular reviews of BRM practices, and any disruptions or incidents are regularly reported to the relevant risk committees. Over the reporting period, all material areas remained at an acceptable status of readiness.

Legal risk

The legal risk management framework 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.

The legal risk management programme which flows from this is subject to continual review and refinement to ensure that sound operational risk governance practices and solutions are adopted and that it aligns with the Group's overall risk management programme. The legal risk committee, a subcommittee of the ORC, has oversight of legal risk management. During the period under review there were no significant legal risk-related incidents.

Information risk

Information risk is the risk of adverse business impacts, including reputational damage caused by a failure of data confidentiality, integrity and availability controls and is therefore a key area of ongoing focus.

The IT risk committee, a subcommittee of the ORC, has oversight of IT risk management.

The Group's information and technology risk management framework (IT risk management framework) requires the application of the operational risk tools as discussed above. The tools have been adapted to align with IT standards and best practice. The IT risk management framework is approved by the ORC and applies to all operations across the Group.

The IT framework clearly defines the objectives for managing information and technology risk, and outlines the processes that need to be embedded, managed and monitored across the Group.

Like many other large organisations, the Group constantly faces a number of new and changing threats across the evolving IT landscape. The risk monitoring and management structures are designed to enable it to adapt and evolve its risk management strategy with the continuously changing IT environment.

Fraud and security risks

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.

Oversight and governance of fraud and security risk is ensured via specific frameworks and policies that are applicable across the Group.

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 centrally by ERM.

Regulatory risk

KEY DEVELOPMENTS AND FOCUS

The regulatory landscape remained dynamic with many regulatory reforms being implemented and proposed at a national and international level.

Regulatory risk managers proactively identify any emerging risks and related implications emanating from these changes. This requires, inter alia, constructive working relationships with regulators and all other key stakeholders, built on mutual trust and ethical behaviour.

The new regulations relating to banks (the Regulations) became effective on 1 January 2012 and incorporates changes agreed to by international standard-setting bodies and regulators responding to lessons learned from the global banking crisis.

FirstRand is supportive of the banking regulator's objectives and endorses improvements in risk management and governance practices as an active participant in the changing regulatory landscape. The same approach is also applied in respect of cooperation with other regulatory authorities in order to derive maximum benefits from the implementation of best practice and the resultant enablement of our business activities.

INTRODUCTION AND OBJECTIVES

The Group's RRM function plays an integral part in managing the risks inherent in the business of 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 Group embeds and endorses a culture that emphasises standards of honesty and integrity in which the Board and senior management lead by example. The compliance culture also embraces broader standards of integrity and ethical conduct and 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.

It is of paramount importance to ensure compliance with, among others, the provisions of the Banks Act, 1990 (Act No. 94 of 1990 – the Act and the Regulations), and to ensure that all compliance issues identified in this context are effectively and expeditiously resolved by senior management with the assistance of RRM.

In order to achieve this, all staff members are continually made aware of compliance requirements in order to ensure a high level of understanding and awareness of the regulatory framework applicable to the Group and the potential regulatory risks to which the Group is exposed.

Furthermore, ethical behaviour is both a keystone and an important contributor to the success of the entire compliance process. In view thereof, the Group expects all staff to maintain standards of honesty, integrity and fair dealing and to act with due skill, care and diligence.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

Responsibility for ensuring compliance with all relevant laws, 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.

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

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.

ASSESSMENT AND MANAGEMENT

The high-level activities of RRM are described in the chart below.

Regulatory risk management activities

<table>
<tr><th>Regulatory risk and ethics strategy development</th><th>Regulatory risk and ethics management</th><th>Centre of excellence</th><th>Relationship management</th></tr>
<tr><td rowspan="2">Defines overall strategy for FirstRand – and ensures alignment of brand strategy</td><td>Performs strategic risk identification, assessment, mitigation and provides assurance</td><td rowspan="2">Provides expertise, advice and guidance</td><td rowspan="3">Provides regulatory liaison and relationship management</td></tr>
<tr><td>Monitors, analyses and reports on ethics and regulatory risks</td></tr>
<tr><td rowspan="2">Sets framework, policies, standards and ethics</td><td>Gathers and manages ethics and regulatory risk data/information</td><td rowspan="2">Facilitates knowledge management, training and awareness</td></tr>
<tr><td>Sets core control functions at FirstRand level for standards/ policy setting</td><td rowspan="3">Stakeholder relationship management (internal and external)</td></tr>
<tr><td rowspan="2">Fosters a culture of ethical conduct and compliance</td><td>Challenges, tests and makes final trade-off decisions at divisional level (dependent on decision rights)</td><td rowspan="2">Runs selected core activities</td></tr>
<tr><td>Ensures sustainability through regulatory risk and ethics strategy</td></tr>
</table>

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.

Remuneration and compensation

KEY DEVELOPMENTS AND FOCUS

During the year the Remuneration committee (Remco) ensured alignment between FirstRand's remuneration practices and those recommended by the International Financial Stability Board's Principles for Sound Compensation Practices and the International Financial Service Authority's remuneration code of practice.

INTRODUCTION AND OBJECTIVES

As a financial services group, FirstRand's most critical asset, required for delivering on its proposition to customers, is its human resources. Given the war for talent in the financial services arena, rewarding these resources appropriately is key to the sustainability of its business. Its remuneration strategy is accordingly tailored towards:

- attracting, retaining and motivating people with the ability, experience and skill to successfully implement business strategy;
- creating recognisable alignment between rewards for employees, particularly executive directors and senior management and the risk exposure of shareholders and other stakeholders;
- incentivising employees to deliver consistent performance in line with strategic goals and risk tolerances and rewarding success appropriately;
- delivering compensation that is affordable and reasonable in terms of the value created for shareholders; and
- encouraging behaviour consistent with FirstRand's code of ethics, business philosophy and corporate culture.

Remco has access to local and international consultants to ensure that it obtains independent advice on both general and specific remuneration practices.

Subsequent to local regulatory events in South Africa, the Group has included additional remuneration disclosure relating to those individuals that are defined by the new Companies Act as "prescribed officers". Members of Group Strategic committee (Stratco), namely the Group CEO, Group CFO/COO and the CEO's of the Group's operating franchises, FNB, RMB and WesBank, are so defined and their remuneration is included in the Group's annual disclosure.

ORGANISATIONAL STRUCTURE AND GOVERNANCE

Remco exists as a subcommittee of the Board to assist the Board in discharging its duties relative to remuneration practices. The Board approves the mandate and terms of reference for Remco which is ultimately accountable to the Board for the effective functioning of the Group's remuneration practices.

Remco is chaired by an independent non-executive director and is composed of non-executive directors, the majority of whom are independent directors. Executives attending Remco meetings do so in an ex officio capacity.

The chairman of the RCC committee is a member of Remco and provides formal confirmation that the risk element of FirstRand's remuneration practices has been duly considered and does not encourage risky behavior or pose a threat to the robustness of the Group's capital management programme.

Remco ensures that the Group's remuneration practices appropriately reflect company performance and are aligned with the interests of shareholders and other stakeholders. Remco provides oversight of all forms of remuneration and reward to executive directors and senior management including fees, basic and variable pay, other benefits and share awards. The committee is also responsible for reviewing proposals to the Board and shareholders on non-executive director remuneration.

In discharging its duties Remco aligns remuneration with stakeholder interests through overseeing appropriate adjustments to fixed, variable and long-term remuneration arrangements relative to company performance and industry specific remuneration practices.

ASSESSMENT AND MANAGEMENT

Remuneration design

FirstRand is acutely aware of the need to align employee remuneration with shareholder returns and the Group's remuneration policy specifically addresses the following factors to ensure this alignment:

- incentive pools shaped by Group profitability and performance metrics, divisional profitability, risk taken within risk appetite versus reward realised and sustainable future profitability;
- individual performance measured against specific quantitative financial and non-financial performance criteria, individual behaviour and competitive performance;
- incentives which diminish or disappear in the event of poor Group, divisional or business unit performance;
- no multi-year guaranteed incentives, substantial severance arrangements or remuneration linked to revenue generation by formula;
- significant deferral of senior management's variable remuneration into FirstRand shares for a period of two years; and
- transparency to enable stakeholders to make reasonable assessments of reward practices and underlying governance processes.

Performance measurement and risk adjustment

The chairman of the RCC committee provides formal confirmation that the risk element of FirstRand's remuneration policy has been duly considered and will not encourage risky behaviour.

Remco ensures that total variable compensation does not limit its ability to strengthen its capital base and compensation has been structured to account for all types of risk including credit and liquidity risk.

The size of the variable compensation pool and its allocation within the Group takes current and potential future risks into account. These include:

- the cost and quantum of capital required to support the risks taken;
- the liquidity risk assumed in the conduct of business; and
- consideration of the timing and certainty of the realisation of accrued, but as yet unrealised, accounting profits included in current earnings.

As part of the Group's ICAAP, three year forecasts are used taking into account the Basel Pillar 1 and 2 stresses, and future regulatory changes. ICAAP includes an assessment of the Pillar 1 risk types (i.e. credit, operational, market, equity investment and other risks) and Pillar 2 risk types (liquidity risk, interest rate risk in the banking book, business and strategic risk and reputational risk). These assessments inform the target capitalisation levels and buffers for the Group. The targeted capitalisation levels inform the capital allocation percentages to the business units. These derive the economic capital requirements for each business unit. All risks within the organisation are taken into account when capital is allocated for performance measurement purposes since outputs from ICAAP are key inputs into pricing and performance measurement.

A derivative of the above calculation is NIACC, which measures the value added by each business unit after taking into account the cost of capital (i.e. NIACC = earnings less cost of capital). The capital levels used in the cost of capital calculations are based on the higher of net asset value (existing capital), regulatory and economic capital (required capital). Therefore the variable compensation pool allocation incorporates both the earnings generated and risk introduced by the business unit on a current and forward-looking basis.

Reputational and legal risk is dealt with in product acceptance and deal conclusion forums. These are overseen via the governance structure of risk committees, audit committees and review committees. These controls have a bearing on the size of the variable compensation pool through impacting the quality of business written and therefore the income earned. To the extent that reputational or legal risks result in a financial loss for the bank, these costs would impact the income of the affected business units and would therefore have a direct bearing on the size of the variable compensation pool for the period under review.

In addition to the above measures, remuneration practices for employees in the risk functions have recently been reviewed and steps taken to ensure that their remuneration is market related and adequate to attract and retain qualified and skilled staff. The heads of ERM and RRM monitor the compensation levels of risk managers across the Group with ultimate oversight provided by the Board via Remco.

Deferral policy

Profits and losses of different activities of the Group are deferred over different periods of time. Variable compensation payments are deferred accordingly and payments are not finalised over short periods where risks can manifest over longer periods. For senior executives and all other employees whose actions have a material impact on the risk exposure of the Group, a substantial proportion of compensation is variable and paid on the basis of individual business unit and Group-wide performance indicators.

The Group's new deferral policy requires that all employees earning variable compensation above a pre-determined threshold will have between 20%-40% of the variable compensation deferred over a period of two to three years. Of the portion deferred 100% will be deferred in FirstRand ordinary shares using the existing conditional share plan. All senior participants already have a portion of variable pay remitted under the Group's long term incentive plans which are share-based payments vesting over a period of three years.

2011 deferral structure

Performance payment	Deferred in shares	Payment date			
		August 2011	December 2011	June 2012	September 2013
≤ R500k	No	100%	–	–	–
≤ R1.5 million	No	R500k + 33% of balance of cash portion	33% of balance of cash portion	33% of balance of cash portion	–
> R1.5 million	20-40% of amount above R1.5 million	R500k + 33% of balance of cash portion	33% of balance of cash portion	33% of balance of cash portion	Shares vest
> R1.5 million (All employees earning variable pay above R5 million)	30% of amount above R1.5 million	R500k + 33% of balance of cash portion	33% of balance of cash portion	33% of balance of cash portion	Shares vest
> R1.5 million (FirstRand and franchise Exco members only)	40% of amount above R1.5 million	R500k + 33% of balance of cash portion	33% of balance of cash portion	33% of balance of cash portion	Shares vest

There is no guaranteed variable compensation for senior positions. Should an employee resign or be dismissed from the Group's employment, unpaid variable compensation tranches are forfeited. In terms of FirstRand's current policy any unpaid portion of deferred variable compensation is withheld in the case of the applicable business unit making a loss during the year in question.

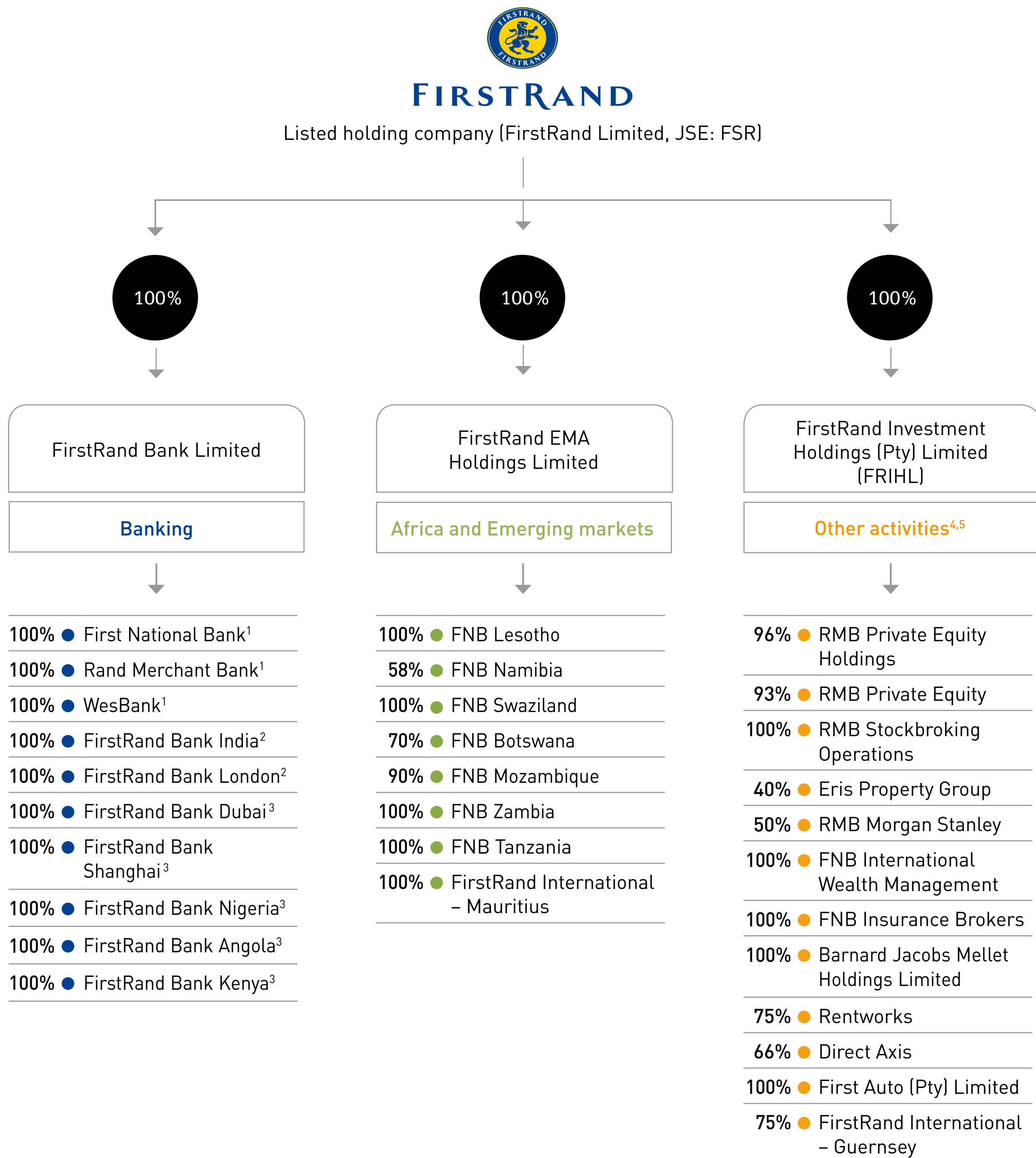
Remuneration mix

Remuneration mix varies depending on the employee's position and role and the risk and opportunities that these bring to the Group.

An analysis of the mix of cash, equity and other forms of compensation, after the implementation of the new variable compensation deferral policy, has been conducted. Remco is of the opinion that the balance between cash, short-term incentives and equity based long-term and deferred incentives represents a healthy mix which will encourage focus on sustainability of profits and share price performance.

The Group has an annual remuneration cycle in respect of which the quantitative disclosure with regards to remuneration and compensation will be provided on an annual basis.

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 securitisation vehicles and conduits are in FRIHL.

Abbreviations

AIRB	Advanced internal ratings based approach
ALCO	Asset and liability management committtee
ALM	Asset and liability management
AMA	Advanced measurement approach
BCBS	The Basel Committee on Banking Supervision
BPRMF	Business performance and risk management framework
BRM	Business resilience management
BSM	Balance Sheet Management
CDS	Credit default swaps
CEO	Chief executive officer
COO	Chief operating officer
CRMF	Credit risk management framework
CRO	Chief risk officer
CSA	Credit support annexes
CVA	Credit valuation adjustment
EAD	Exposure at default
EL	Expected loss
EP	Equator principles
ERM	Enterprise Risk Management
ESG	Environmental, social and governance risks
ESRA	Environmental and social risk analysis
ETL	Expected tail loss
Exco	Executive committee
FICC	Fixed income, currency and commodities division
FNB	First National Bank
FSA	Financial Services Authority
FRB	FirstRand Bank Limited
FREMA	FirstRand EMA Holdings Limited
FRIHL	FirstRand Investment Holdings (Pty) Limited
FTP	Funds transfer pricing
GCRM	Group Credit Risk Management
GIA	Group Internal Audit
GTS	Global Transational Services
IBNR	Incurred but not reported
ICAAP	Interal capital adequacy assessment process
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
IRRBB	Interest Rate Risk in the banking book
LCR	Liquidity coverage ratio
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
NIACC	Net income after capital charge
NII	Net interest income
NMDs	Non-maturity deposits and transmission account balances
NOFP	Net open foreign positions
NPLs	Non-performing loans
NSFR	Net stable funding ratio
ORC	Operational committee
ORMF	Operational risk management framework
PD	Probability of defualt
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
ROE	Return on equity
RRM	Regulatory Risk Management
RWA	Risk weighted assets
RWN	Rating watch negative
SARB	South African Reserve Bank
SME	Small and medium enterprise
Stratco	Strategic executive committee
TTC	Through-the-cycle
VaR	Value-at-Risk